Incentives for the Introduction of Agents by Banca de las Oportunidades in Colombia

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Executive Summary

From a public policy standpoint, there may be benefits to subsidizing or co-financing an extensive network of nonbanking correspondents[1] (referred to hereafter as "agents"). Doing so has the potential to facilitate cash transfer payments integrated into a country's payment infrastructure and to become a channel that promotes financial inclusion. Examples of such interventions include the incentives offered by Banca de las Oportunidades (BdO)[2] in Colombia to extend agent networks to municipalities in rural areas and marginal neighborhoods in major cities that previously had no financial coverage.

In August 2006, 309 out of 1,100 municipalities in Colombia had no banks, highlighting the need to help smaller municipalities gain access to financial services. At the same time, the government was planning to expand the conditional cash transfers program known as Familias en Acción to all municipalities in the country—an endeavor that would require a payments channel. Regulators had already authorized the use of agents to provide financial services. However, to help quicken the pace of developments, BdO provided direct incentives to achieve greater coverage in a short amount of time. This led to three invitations to tender between 2007 and 2010:

- Invitation to Tender I—**128 agents in 128 municipalities with fewer than 50,000 inhabitants.** The incentive guaranteed a minimum number of transactions over a specific period at a set price so that the bank would break-even. This was a decreasing incentive whereby, in the first year, BdO paid the difference between the transactions made and those guaranteed at 100% of the price, at 50% the second year, and at 0% the third year. The bank was committed to keeping the agent open until the end of the third year.

- Invitation to Tender II—**Remaining 67 municipalities after the first tender process.** The same system of guaranteeing transactions was used, but given that the municipalities were smaller and more remote, the minimum number of guaranteed transactions was increased. This incentive was also designed to decrease progressively, but at a slower rate and within a longer period—over four years, instead of three.

- Invitation to Tender III—**Expanded coverage to marginal neighborhoods in five major cities.** This incentive co-financed the cost of establishing agents, including costs of installations, operations, and staff. The types of transactions permitted by the bank were also defined. Co-financing would gradually decrease throughout a period of three years: 50% the first year, 25% the second, and 0% the third.

The investment of public resources, which currently stands at $2.5 million, extended bank agent coverage to 187 rural municipalities, where more than 1 million people live. An additional $84,000

[1] Nonbanking correspondents, or *corresponsales no bancarios* in Spanish, is the term used in Colombia to refer to what is more commonly known as "agents."

[2] BdO was established in 2006 as a policy of the Colombian government to promote access to financial services for low-income populations of the country. It acts through three intervention instruments: the promotion of regulatory reforms that facilitate an appropriate framework in which to promote access to financial services for sectors that so far have not been serviced by the formal financial system; the development of projects that facilitate a closer relationship between those who offer financial services and potential clients; and lastly, the offering of different types of direct incentives to improve coverage, quality and methodologies for servicing the target population, all of them assigned under open and competitive tender processes. The tenders described in this report are part of this last group.

provided agent access to 22 marginal neighborhoods in the country's five biggest cities. This reflects a cost of $13,000 per municipality, or $2,400 per inhabitant, in the first two tenders, and $3,800 per agent in the case of marginal neighborhoods. Increased coverage was achieved; today 99% of all municipalities have access to financial services. The intervention ensured a more prominent presence of formal financial entities in remote areas and promoted the establishment of other banks to the same areas. Withdrawals from savings accounts increased, mostly tied to the payment of Familias en Acción subsidies, which account for almost 40% of all transactions over this channel.

Lessons Learned

- A favorable regulatory framework that allows financial institutions to use a low-cost channel such as agents is necessary, but it is not enough to achieve coverage in rural and less inhabited areas of the country.
- The use of incentives cannot go against the very dynamic of the market. It may accelerate the process and reduce the time needed to learn, but it cannot skip any steps in the learning curve.
- The lack of participation by private banks indicated an insufficient capacity to roll out the model to rural areas.
- Basic difficulties inherent in an agent model cannot be solved with incentives, at least not the ones focused on reducing risks or co-financing investments.
- Subsidies that decreased over time were not enough to help the bank develop an interesting value proposition for customers, even though this would have resulted in a greater use of the channel.
- Even though agents are a low-cost channel, agents do not offer a sustainable solution in very small communities under the model developed in Colombia.
- The type of incentives used may vary and must be adapted to the circumstances of each case.
- The subsidy auction is an ideal mechanism to assign fiscal resources to financial intermediaries as long as a minimum degree of competition is ensured; otherwise, it is important to set limits to prevent paying for inefficiencies.
- Reaching the poorest populations, who usually live in rural areas, and reducing transaction costs of delivering payments to beneficiaries are crucial elements for conditional cash transfer programs.

1. Introduction

This report builds on the CGAP Focus Note "Social Cash Transfers and Financial Inclusion: Evidence from Four Countries" (Bold, Porteous, and Rotman 2012). The Focus Note sought to answer questions on the relationship between cash transfer programs and financial inclusion; it looked specifically at Brazil, Colombia, Mexico, and South Africa. According to these findings and other research, from a public policy standpoint, there may be benefits to subsidizing or co-financing agent networks to facilitate payment transfers where financial infrastructure is lacking.

The program of incentives offered by Banca de las Oportunidades (BdO) in Colombia to extend nonbank correspondents (referred to hereafter as "agents") to municipalities not included in the financial sector presents a compelling case study. The goal of this report is to identify lessons learned that may be useful to other governments interested in this kind of initiative. This report first describes the essential elements that characterize each of three tenders. It then presents the results of the tenders. Finally, it shares the lessons learned from this effort, which began in 2007 and continues to date, including lessons learned from the last phase of network extension into marginal urban areas.[3]

2. Background

When the BdO program began in August 2006, there were no banks in 309 municipalities out of 1,100 municipalities in the country; 872 municipalities did not have a cooperative; and 755 municipalities were not served by a microfinance nongovernment organization (NGO). The government set a priority to promote increased coverage of each type of financial intermediary in smaller municipalities, with the understanding that a network of service points for the low-income population was necessary to ensure access to financial services. Within this context, three invitations to tender were launched in 2007 to co-finance the expansion of microfinance NGOs, financial companies, and cooperatives. Each tender used an independent process that favored municipalities with a population of fewer than 50,000.[4]

During this time, banks started to strategize to gain greater coverage through branchless banking and the use of agents. As part of the BdO program, the Ministry of Finance and the Finance Superintendence promoted regulations that authorized banks to use agents. These regulations were issued in July and August 2006.[5]

A year after these regulations were issued, it was evident that achieving the government's goal of having a financial presence in all of the country's municipalities by 2010 was going to require a lot more than just regulatory reform authorizing the use of agents. By June 2007, there were approximately 1,500 agents in the country, but most had been created in urban centers and had very high inactive rates.[6] In

[3] This study received the crucial support of BdO staff and benefited from the comments and help throughout the editing process from Sarah Rotman at CGAP.

[4] With the tenders that co-financed the expansion of these types of financial entities, three processes were organized for microfinance NGOs, two for cooperatives, and one for financial companies from 2007 to 2009. BdO invested approximately $844,000 in resources, with leverage nearly 1.8 times the resources of the institutions themselves. The NGOs were able to reach 92 municipalities for the first time, cooperatives reached 16 municipalities, and finance companies reached 15 municipalities.

[5] Decree 2233 of the Ministry of Finance, July 2006, and External Circular 26 of the Financial Superintendence, August 2006.

[6] The inactivity is explained by the agent network created by Citibank, only 33% of which conducted transactions in 2007.

terms of coverage, banks at the time had used this channel to reach just 25 of the 309 municipalities that had no previous financial institution presence.

This slow expansion of agents into the municipalities raised concerns given the difficulties involved in expanding the Colombian Government's conditional cash transfer program Familias en Acción (FA).[7] By 2007, FA had 650,000 beneficiaries in 878 municipalities. However, 121 of those municipalities had no Banco Agrario branches, which required beneficiaries to spend time and money to travel to the closest municipality that did have a branch. FA planned an ambitious expansion over subsequent years to service 1.5 million beneficiaries in all of the country's municipalities.

To hasten the implementation of agents in unserved areas, BdO designed an incentive program. After reviewing and evaluating the existing co-financing strategy used in the tender processes with microfinance NGOs, financial companies, and cooperatives, it was clear to BdO that it had to try something new.

3. Designing and Implementing Incentives[8]

As banks began developing their agent models, they faced various challenges, which were monitored by BdO. Periodic meetings were held with the Banking Association, which established a Banking Committee. The committee facilitated dialogue with the government to discuss the challenges encountered and the solutions found in developing this new channel. The committee–government interface also presented an opportunity to discuss other issues arising from the strategies promoted by BdO and the sector itself. The objective of these meetings was to promote access to financial services among the population that was currently unserved. An initial effort was made to promote the model through the use of network extension alternatives based on other government initiatives that could support the development of this channel.[9] Monitoring revealed that the development of the channel faced numerous difficulties that were delaying the roll out of the model: (*i*) selecting each agent required performing a risk assessment, which proved difficult for the banks that had not interacted with these types of businesses before[10]; (*ii*) profitability of the channel was not easy to achieve, except in

[7] The purpose of FA is to pay a bimonthly education and nutrition subsidy to the poorest families with children. Beneficiary mothers must comply with specific requirements to receive payment. An average bimonthly payment is COP 80,000 ($55). Banco Agrario currently pays these subsidies nationally by depositing the money into savings accounts opened by the beneficiaries.

[8] The descriptions of the design and the tender process are based on interviews with BdO directors and on the authors' own experiences as advisers of the program. The authors also had access to the history of each tender process, which is kept updated by BdO.

[9] The public post office company at that time, ADPOSTAL, was initially contacted to discuss the possibility of an agreement between the company and a bank. This was not possible because ADPOSTAL went through a deep restructuring process that led to its liquidation and the creation of a new company, 472, in 2009. However, in 2011 an agreement with a bank became possible, with 472 acting as an agent. In another effort, the Computing Centers Program of the Ministry of Telecommunications, which worked in low-income communities, was contacted to discuss its possible role in supplying the communications systems that would allow the financial sector to have an online and real-time connection between the agent and the bank, a prerequisite stipulated by regulation. It was later determined that the bandwidth that these centers used was unstable and did not offer the necessary capacity to be able to perform financial transactions.

[10] In the Colombia agent model, the bank gives the agent a credit line. The agent "uses" this credit line up to the risk limit set by the bank as the maximum amount of cash that can be left in the hands of the agent at any given time. When the agent carries out cash withdrawals or pays out remittances, "space" is freed up. When the agent

those cases where agents were used to decongest nearby branches; and (*iii*) lack of market knowledge in previously unserved communities regarding the potential size and type of products. Moreover, delegating the bank's brand and the quality of customer service to third parties and managing liquidity were additional challenges for each bank.

These challenges motivated BdO to consider an incentive plan that could resolve or partly control for some of these difficulties. BdO issued three invitations to tender between 2007 and 2010 to encourage the expansion of the network.

3.1 Challenges and Complexities in the Design of the Tenders

3.1.1 First Invitation to Tender: 128 agents in municipalities with fewer than 50,000 inhabitants

A year after new regulations allowed banks to use agents, the channel was still being piloted. But the political reality and the circumstances around broadening FA required the agent network to rapidly expand.

The municipalities with no agent coverage had small populations and low-income levels, and they were far away from existing branches.

The BdO incentive was designed based on several considerations:

- The tool for incentivizing banks to set up an agent in these municipalities had to lower the risk and the perception of low profitability; this perception came from a lack of knowledge of and ability to estimate the economic activity of each new municipality.
- The agent model being used at the time did not allow for an accurate estimate of the cost structure because different technological options were being tested.
- There was a lack of clarity regarding the business models and commission models that could be implemented.

A co-financing plan like the one used for the other types of financial intermediaries risked subsidizing very expensive plans and also risked subsidizing agent operations in areas where there was a significant market that could make the operation profitable much sooner than expected.

The decision was made to guarantee a specific number of transactions for a specific period of time at a specific price—a model based on incentive plans frequently used in road concessions. The guaranteed transactions would allow the intermediary to cover its break-even point if actual transactions were less than the guaranteed level, and in the event where the transactions were higher than the guaranteed level, the government would not have to pay. The risk perceived by the institutions of operating in smaller municipalities would thereby be covered, and this would also avoid the possibility of paying a subsidy when an agent or a group of agents was successful or profitable at any point in time.

The difference between the actual versus guaranteed transaction amounts would be paid at a rate defined in the Terms of Reference. This rate would be 100% the first year, 50% the second year, and 0% in the third year. The bank would be required to keep the agent operating until the end of the third year

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reaches the maximum cash limit, the system does not allow for any more transactions until the accumulated cash is taken to the nearest bank branch, at which point the limit is reset and the agent is authorized to perform transactions again.

after which the bank may choose to continue operating the agent location or close it down if it is still unprofitable. The purpose of gradually eliminating the subsidy was to provide a clear message to the bank that although the risk was covered at 100% in the first year, the bank must find ways to make each agent profitable as it plans ahead to the third year operating without any support.

A simple auction system was used, where the incentive was awarded to the bank that requested the least number of guaranteed transactions. In retrospect, this may not have been the best system due to the lower-than-expected level of competition among the banks. The incentive as designed did not account for inefficiencies, so it became necessary to set a limit on the number of guaranteed transactions that could be requested. To define this limit, as well as the price per transaction, a consultant was brought in with the support of the MIDAS-USAID program to develop a financial model that would reasonably simulate the operation of an agent in Colombia at the time. Information obtained from all of the financial institutions that had agents operating in the country, as well as information obtained from different providers of technology platforms, was used to develop the model. Based on this model, an average cost of $0.50 per transaction was defined (which was established as a reference price taking into account the fact that it was already being charged to clients by a few banks). The maximum number of transactions an agent was guaranteed per month was set at 1,400. This implied that if no transactions were done by any agent during the two-year period in which the guarantee was in effect, an incentive totaling $1.6 million for the 128 agents would be paid, breaking down to a cost of $12,600 per agent over a two-year period. In actuality, a total of $850,000 was paid, or $6,500 per agent. These numbers reflect the activity level of the agents and are presented in the following section.

The criteria of the municipalities to be included were based on the priorities of the FA Program's expansion plan. Out of the 248 unserved municipalities, the largest ones where the FA Program had the highest number of beneficiaries were initially chosen to be in the program—a total of 148 municipalities with 115,000 FA beneficiaries and a population of a little over 1 million. Recognizing the new experience of banks using agents and the banks' possible lack of enthusiasm to extend their range of operations, the first incentive was designed to cover only 50% of the 148 municipalities, leaving the rest for 2008 to allow for time to generate more interest from the banks. However, the BdO's Directing Body, the Inter-sectorial Commission, considered it a priority to accelerate and ensure coverage in all municipalities. So in the end, the process included all 148 municipalities. The municipalities were organized into 15 groups given their heterogeneity. Each group had between five to 12 municipalities of different sizes within a certain geographic proximity. Interested banks could bid on all groups, but they had to make a proposal for the number of minimum transactions per group. In terms of population size, the selected municipalities were sorted as indicated in Table 1.

Table 1: Invitation to Tender: Municipality Distribution, by Population Size

Population Range	No. of Municipalities	Total Population
0 - 2,000	4	7,157
2,001 - 4,000	27	75,627
4,001 - 6,000	28	134,000
6,001 - 10,000	36	279,550
10,001 - 20,000	26	343,458
20,001 - 30,000	6	141,631
30,001 - 50,000	1	31,596
Total	128	1,013,019

Therefore, the bank that asked for the lowest number of guaranteed transactions on average for each group of agents without exceeding an average of 1,400 transactions per month was assigned a specific group. The selected bank would then receive on a quarterly basis an amount equivalent to the monthly transaction deficit per group of agents (total number of transactions conducted compared with the total number of transactions guaranteed), multiplied by the number of agents in each group, and multiplied by the price applicable to the corresponding year. This implied that if some groups had agents with high transaction levels and others with low levels, the former would compensate for the latter, and this would decrease the average differential between the actual transactions conducted and the transactions guaranteed for the group as a whole. As such, the agent network did not have to be profitable at each point, but instead an ecosystem could be developed where the overall network was profitable.

The invitation to tender was published in November 2007; proposals were to be submitted within two months after the invitation was issued. This original submission deadline was extended twice on the request of the banks. Within the six months between the design of the tender and the final submission date, agents were installed by some of the banks in 20 of the selected municipalities. This reduced the total number of agents needed to 128 (one in each municipality). By the closing date in February 2008, only one bank—Colombia's public sector bank Banco Agrario, which was already the bank with the best coverage in the country—had presented a proposal for all 15 groups. The requested transaction guarantee was different for each group and was lower than the maximum set, as seen in Table 2.

Table 2: Banco Agrario's Offer of the Number of Guaranteed Transactions per Municipality Group, with Average Population per Municipality in Each Group

Group	No. of Agents	Total Population	Average Population per Municipality	No. of Transactions Guaranteed per Group
1	9	54,044	6,005	1,133
2	6	52,784	8,797	1,000
3	7	93,312	13,330	1,114
4	12	147,050	12,254	1,133
5	6	71,225	11,871	1,067
6	11	55,206	5,019	1,291
7	10	33,590	3,359	1,360
8	9	33,035	3,671	1,400
9	11	49,172	4,470	1,327
10	9	37,080	4,120	1,311
11	9	30,639	3,404	1,400
12	8	77,325	9,666	1,050
13	7	96,142	13,735	1,171
14	5	43,929	8,786	1,160
15	9	138,486	15,387	1,133
Total	128	1,013,019	7,914	1,203

Source: Created with information from BdO

The bank required the maximum level of guaranteed transactions in only two of the groups—namely, in groups 8 and 11, where the average size of the population was the lowest. In groups 3 and 13, where the average population size was among the highest, the guaranteed transaction levels required were among the lowest. The number of transactions was calculated taking into account several variables, including size and location of the adult population, the socioeconomic characteristics of the municipality, the ease of performing banking transactions based on the proximity of another bank branch, and cash management and monitoring.

It took six months to establish these agents; by September 2008 they were all operating.

3.1.2 Second Invitation to Tender: Remaining 67 rural municipalities

In mid-2009, immediately after establishing the first round of agents, there were still 67 municipalities without agent coverage. These were the very small municipalities—71% had fewer than 6,000 inhabitants. To provide agents to these remaining municipalities, BdO launched a new invitation to tender (see Table 3).

Table 3: Distribution of the Municipalities in the Second Process, by Size of Population

Population	No. of Municipalities
0- 3,000	30
3,000 - 6,000	18
6,000 - 10,000	8
10,000 - 30,000	8
30,000 - 50,000	1
More than 50,000	2
TOTAL	67

In response to some of the difficulties that Banco Agrario faced in establishing and operating the agents from the first tender, BdO modified the design of the second tender.

First, the cost model was adjusted using new investment costs based on the most expensive technology in the market. The new technology consisted of a communications system with a satellite antenna at the agent site to comply with the requirement that the agent be connected to the bank via the Internet in real time. This not only increased the initial investment, but it also implied some fixed costs for monthly operations of around $250 per agent. In addition, other costs associated with the increased risk of these agent locations were considered at the request of the banks, especially Banco Agrario. A life insurance policy for the agent and insurance to cover theft were included. The cost of a marketing adviser was also included to help five agents in marketing their services (offering bank products, signing up new clients, etc.) and in promoting the use of the agent among the population. The assumption was that everyone would be new clients of the financial institution and would need some hand-holding. All of these changes led to a significant adjustment to the cost structure, increasing the maximum number of guaranteed transactions to 2,200. Not only was the agent's installation subsidized, but also the work that would need to be carried out by the bank.

Second, banks argued that they would need more time to make their operations viable in these municipalities. The agent would have to remain open for four years. During the first year, transactions were guaranteed at 100% of the price, at 75% in the second year, and at 50% in the third year. In the fourth year, the agent would have to remain open without any subsidy. Finally, the guarantee was offered per municipality, not per group as was the case in the first tender. This change was made to offer greater coverage to the bank.

In the end, 59 of the previously planned 67 municipalities were included in the tender (agents had already been set up in eight of the rural municipalities). Taking all of these changes into account, the maximum investment that BdO would have to make in the case that no transactions were made by the 59 agents throughout the three-year period would be $1.75 million, radically increasing the value per agent to $29,700. BdO justified this amount as an investment of fiscal resources in favor of very poor and isolated communities in the country.

The invitation to tender was presented in October 2009. Once again only Banco Agrario submitted an offer, requesting in every case the maximum monthly transaction guarantee of 2,200 transactions.

With this invitation to tender, the process to reach all municipalities was finalized. In December 2010, six municipalities were still without service due to difficulties in establishing agents in them during the first tender.

3.1.3 Third Invitation to Tender: Marginal urban neighborhoods

Just as lack of coverage at the rural level generated some concern, the fact that agents were not able to extend their presence to marginal neighborhoods in major cities also concerned authorities. In the second half of 2008, BdO conducted a study on the establishment of financial institutions through branches, automatic teller machines (ATMs), and agents in neighborhoods in the outskirts of major cities. The study was meant to determine whether there were neighborhoods in strata 1 and 2 (neighborhoods with the highest percentage of poor families) that did not have any banking service points within 500 meters. Data were collected on the locations of the branches, ATMs, and agents in each neighborhood. The information was received through detailed conversations with the companies managing these transaction points; the data collection process lasted until the first half of 2009.

By June 2009, the agent model in Colombia had reached a total of 5,162 points, 4,170 of which belonged to Citibank through an agreement with the lottery network to facilitate the repayment of its mainly middle- and upper-income clientele's credit card payments. Only 65% of the points had actually registered a transaction. Similarly, 2,991 agents were located in the six largest cities of the country, all with a population of more than 100,000; 2,681 of the agents belonged to Citibank. For this third tender process, Citibank´s network was not considered in the calculation of overall agent coverage.

The geo-referencing work confirmed that there were 26 zones[11] in the six major cities of the country (the capital, Bogota with a population of over 6 million; Medellin and Cali with more than 2 million; Barranquilla and Cartagena with more than 2 million; and Bucaramanga with half a million) that lacked coverage as mentioned above with a total population of 1,025,220.

As geo-referencing was being conducted in marginal neighborhoods, interviews were conducted with the eight banks that had the largest agent networks in the cities. Even though several banks showed interest in setting up agents in marginal neighborhoods of major cities, they stated that a viable business model was the biggest obstacle. Less business was expected at higher costs coming from the need to establish banking strategies. This would include promotion costs and the use of a marketing adviser to manage the agent, as well as the implementation of greater security controls and liquidity management. These areas also did not have cash transport services, or if they did, it came with a much higher cost to cover the higher risk.

During the second half of 2009, BdO began designing a new incentive that offered banks enough incentive to enter these urban areas. BdO concluded that there was not only a perception of risk, but more importantly, banks could not see a viable business model because they did not know what products the population needed. To incentivize banks to open agents in these areas, a subsidy would be required—not a guarantee—to improve the business proposition. BdO decided to turn to the system used to broaden coverage in 2007 for microfinance NGOs and cooperatives: a system of co-financing. The fact that this tender process focused on the poorest urban areas deflected accusations that the program was subsidizing banks that were already very profitable on their own.

[11] One in Bucaramanga, three in Cali, three in Medellín, three in Barranquilla, six in Cartagena, and 10 in Bogotá.

BdO set the amount of co-financing at a maximum of 50% for the first year, lowering it to 25% for the second year, and eliminating it for the third year, at which point the entity that won the bid would have to keep that agent operating.[12] The financial institution that requested lowest subsidy in absolute terms would be selected. Because some institutions' models had a cost structure that varied in time (some with a higher investment effort at the beginning, others with a higher variable cost during the implementation), the requested subsidy had to be expressed in net present value (NPV), calculated with a discount rate defined in the tender.

The type of costs that would be co-financed was clearly stated: the investment costs, the operations costs, and the costs for staff to support banking in the area where the agent would be installed. These costs would have to be itemized quarterly in the proposal. The tender also defined minimum transactions, such as collections, deposits, funds transfer, withdrawals, balance inquiries, credit disbursements, account opening, and payment obligations.

The cost model was once again updated to establish the reference ranges and define the budget of the tender. Even though the ease of establishing agents in the city was taken into account in terms of infrastructure, the cost model also included costs related to supporting a marketing adviser. A maximum co-financing amount of $14,000 per agent was established (one agent in each of the 26 zones), increasing the total assigned budget to $364,000.

The invitation to tender was presented in November 2009; the deadline to respond was in two months. This deadline had to be extended twice on the banks' request, and the tender finally closed in March 2010.

This time two private banks participated, Banco Caja Social (BCS) and Bancolombia. BCS made a proposal for 20 of the 26 selected zones; Bancolombia made a proposal for two of the 26. Banco Agrario made a proposal for 12 of the 26 zones. Since the winner of each area would be the bank that requested the lowest co-financing amount, BCS succeeded in capturing the 20 areas for which it made a proposal. Banco Agrario captured the two areas, where it did not compete with BCS. Bancolombia was not selected in either of the two areas where it presented an offer because it requested the largest subsidy—twice that of Banco Agrario's. This left four zones without any bank coverage. With the assigned offers, 23% of the originally assigned budget was committed, indicating that the technology options and operating models of the financial institutions had very different cost structures than what had been budgeted. The solution of each service point required a subsidy of just $3,800 per agent, accounting for 24% of the budget per agent.

[12] In the case of the microfinance NGOs and cooperatives, it was possible to select the channel to be used. The proposal selection had two criteria: first, type of municipality where it wanted to extend coverage (as long as it was a municipality with fewer than 50,000 inhabitants) and, second, the least amount of co-financing requested within the 50% limit established.

Table 4: Summary of the Main Differences among the Three Incentive Schemes

No. of Municipalities covered	128	59	26 neighborhoods in 5 major cities
Max. Guaranteed Transactions	1,400	2,200	0
Price to Be Paid	$0.5	$0.5	0
% Recognized Price	Price (%) Year 1: 100% Price (%) Year 2: 50% Price (%) Year 3: 0%	Price (%) Year 1: 100% Price (%) Year 2: 75% Price (%) Year 3: 50% Price (%) Year 4: 0	0
Max. Co-financing			Up to 50%, the least absolute value per agent, max. $14,000 per agent
% Co-financing per Year			Year 1: 50% Year 2: 25% Year 3: 0
Budget per Agent	$12,600	$29,700	$14,000
Total Budget	$1.6 million	$1.75 million	$366,000
Budget Used	$850,000	TBD	TBD

3.2 Implementing Agents and Controlling Incentives

Managing incentives is complex not only in their design, but also in their implementation by the program that assigns the incentives and the institutions that obtain them.

First, the tenders had some obligations in terms of the deadline by which agents had to be installed and working. In all three cases, the deadlines to make a proposal had to be extended.

Different difficulties arose in the first two tenders, which involved rural municipalities. The first difficulty was related to the technology that enabled the bank to connect with each agent through the Internet, which involved installing a satellite antenna to ensure communication.

The second difficulty arose in the selection of the actual agents. Each agent had to be authorized to operate as an agent because the model used by most banks in Colombia requires the authorization of a credit limit for each agent. Thus, the agent had to pass the bank´s risk assessment and also be willing to take on the cost and risk of transporting cash to the nearest branch. This task turned out to be much more complex than it initially seemed because of the new bank staff were unfamiliar with the areas where they were working. For example, certain businesses could not become agents because the business owners opposed the current mayor in that municipality. In another case, the mayor did not authorize agents because he wanted a bank branch instead. In two other municipalities there was opposition from the indigenous councils that did not want a financial presence in their area. Finally, in four municipalities it was impossible to open agents because of security concerns. These locations were substituted with villages located in remote regions far from the main urban centers of the municipalities. Because of these inconveniences, the last agent was installed in October 2008, six months after the incentive was awarded.

In the second tender, it was necessary to extend the deadline three times because of difficulties that arose in several municipalities. The final agent opened in February 2011, 14 months after the incentive had been awarded.

The most surprising aspect was that these same difficulties occurred in the third tender, which focused on major cities. The private bank that was selected to extend the model to most of these areas quickly recognized that it was not able to individually find businesses that could operate as agents. Instead they partnered with a firm that had access to these communities and had staff that worked within the community. After three months, however, even the firm had not been able to recruit any businesses. In addition, staff had been mugged several times in these neighborhoods. The biggest difficulty was the high risk perceived by potential agents in operating as a bank agent because of the need to move cash to the nearest branch. The difficulties were so great that the bank was about to rescind the contract, which would have led to penalties and payment of the compliance policy that had been required. Since the objective of the project was clearly not to apply penalties, BdO moved the deadline several times and met with the bank to convince it to keep its commitment. The bank made a second effort, used its own network of microcredit advisers, and was finally able to select the 20 agents it had committed to opening. The bank began setting up the agents in January 2012 and finished establishing the branches in the first six months, more than a year after it had been awarded the incentive.

Once these difficulties were overcome, problems began with the operation of the agents themselves. In the three cases, the banks reported difficulties stemming from agent turnover. This happened with 25 agents during the first tender and nine agents during the second. This was a more serious problem in the third tender because so little time had passed. Of the two agents established by Banco Agrario, one already needed to be changed by the bank.

The biggest problem was cash management. There were agents from the first tender that had to travel for several hours to get to the nearest branch to deposit cash. There were two agents where this could take up to a day, such as Carurú and Taraira in the Department of Vaupes, and even longer depending on weather and security conditions.

Box 1. What do agents think?

"I have been an agent for 27 months. Imagine that since 1992 when the guerilla blew up the Caja Agraria, we have not had any financial presence in the municipality. I do 350 transactions a month, including Familias en Acción payments, deposits to suppliers, police payroll, and collections for public utilities. Being an agent has been a blessing from God and I feel proud of providing a benefit to the community. Now I collect mobile phone payments, whereas before people had to pay $15,000 to $20,000 pesos to send the bill to the town of Villavicencio to pay the bill. Also, now the FA families don't have to go collect their payments all at the same time as before when they would bring a helicopter, and the manager of the San Juanita branch would have to come with a cashier to pay. I don't make much money and I take a risk when taking cash to Villavicencio. Sometimes I have to ask relatives to take $5 or $10 million pesos ($2,300 to $4,500) to be deposited in Villavicencio.

But I do it for personal pride, for the service I provide to the community and to my people, which is enriching."*—Nelson Orlando Alferez, Agent of the Municipality of Calvario Meta (2,205 inhabitants)*

Despite increasing the amount of money agents could manage, which in extreme cases went up to $27,000, most of the agents complained about having to take the cash to the branch too many times. (See boxes 1 and 2 for opinions expressed by agents interviewed from two of the municipalities). In the case of the marginal neighborhoods, this problem was even more acute since the bank's risk department authorized a limit of only $2,271 for each agent, despite being one of the banks with the highest microcredit activity in the country. The only agent registering transactions was carrying out an average of 1,600 transactions a month.

The authors interviewed two business owners serving as agents. They had a positive view of their role because of the beneficial impact it has had on their communities, which was more important to them than the commissions received from the bank or the boost in their own business sales. Both agents

Box 2. What do agents think about the business?

"I have been an agent for 15 months. The greatest benefit I get is recognition from the people. They now say, "Go to Banco Agrario´s agent". What I do most is Familias en Acción payments and utility bill payments, also deposits, even Servientrega and Interrapidísimo (postal couriers) deposit here. They call me and tell me, "Efren, do you have float? I have a limit of $15,000 and I have to go deposit it four times a month. Now there are three branches to deposit at and the closest one is 30 minutes away.

I do this to provide a service to the community because what I make is very little and I take a risk, but because it is good for the community, I take it."*—Efrén Mancera, agent from Guayabetal–Cundinamarca (4,864 inhabitants)*

disbursed subsidies for FA beneficiaries and have organized payment days to avoid congesting their businesses. One of them said that he feels unprotected because he does not have cash management insurance and has to travel to the branch closest to the municipality to deposit cash. But even when they receive low commissions or sales have not increased significantly, they recognize the benefits of having an agent in the community and that is why they have continued their work.

For the two banks, participating in the tenders involved significant operational effort compared to the monetary benefit gained. In retrospect, they should have disaggregated the costs that are difficult to break down, such as bank staff visits to agents and other costs that probably cannot be covered. With regard to BCS, this was its first involvement in this type of contract with the government, and it was difficult for BCS to comply in practice with the strict terms and deadlines.

4. Results[13]

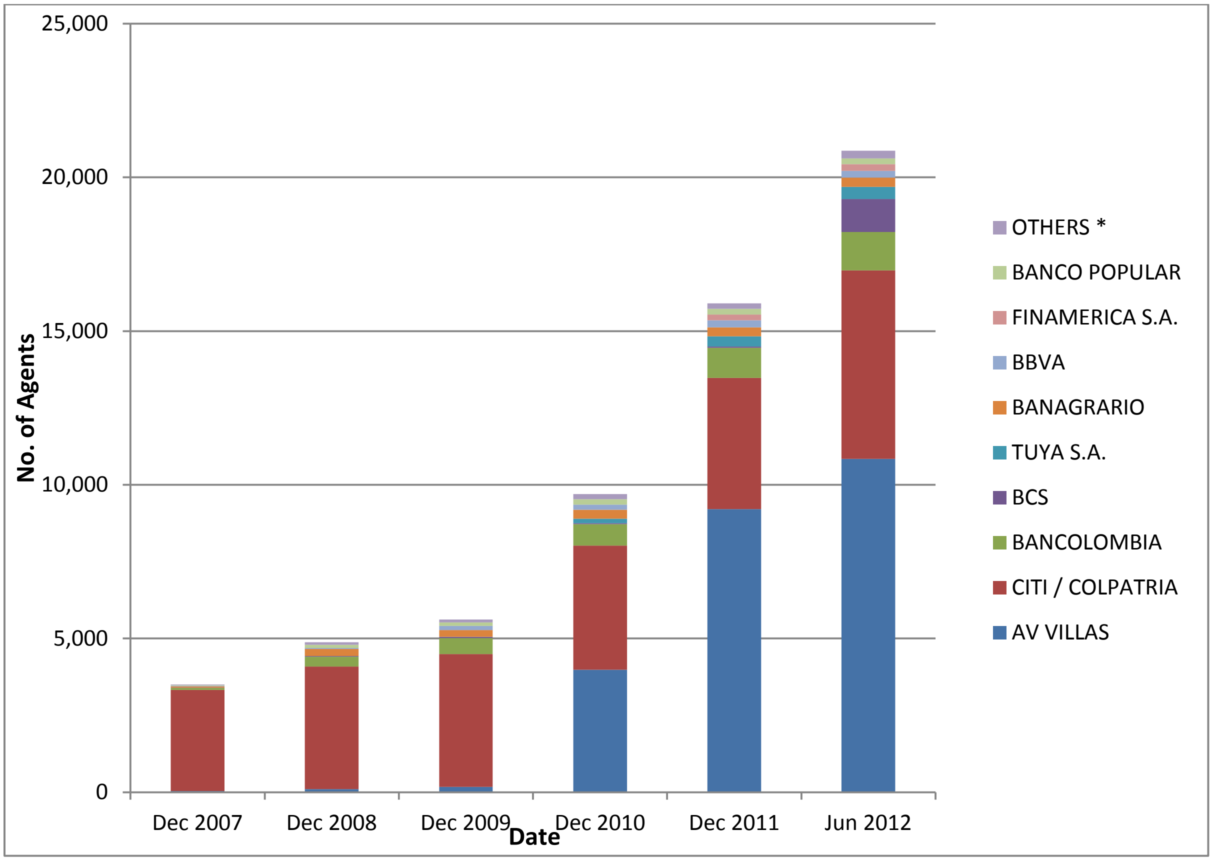
To put the results in context, it is necessary to consider the evolution of the agent model in Colombia, highlighting the differences and similarities with the development of those agents opened under the incentives given by BdO.

4.1 Agents in Colombia Evolve in a Positive Way

After the regulation that allowed the use of agents was issued in August 2006, its implementation was slow in terms of number of locations, number of banks establishing them, and ways agents were being used. The number of agents went from 3,500 in December 2007 to 20,865 agents in June 2012 (without double-counting the lottery network shared by Citibank and Bank Colpatria). Equally important is the fact that, by the end of 2007, only nine banks were using this channel, whereas today 17 financial institutions use it, 13 of which are banks, three are finance companies, and one is a cooperative.

[13] To understand the results obtained in the tenders, interviews were held with BdO directors, but also with those responsible for the channels in the participating banks, whom we thank for the information given and their willingness to share the lessons learned.

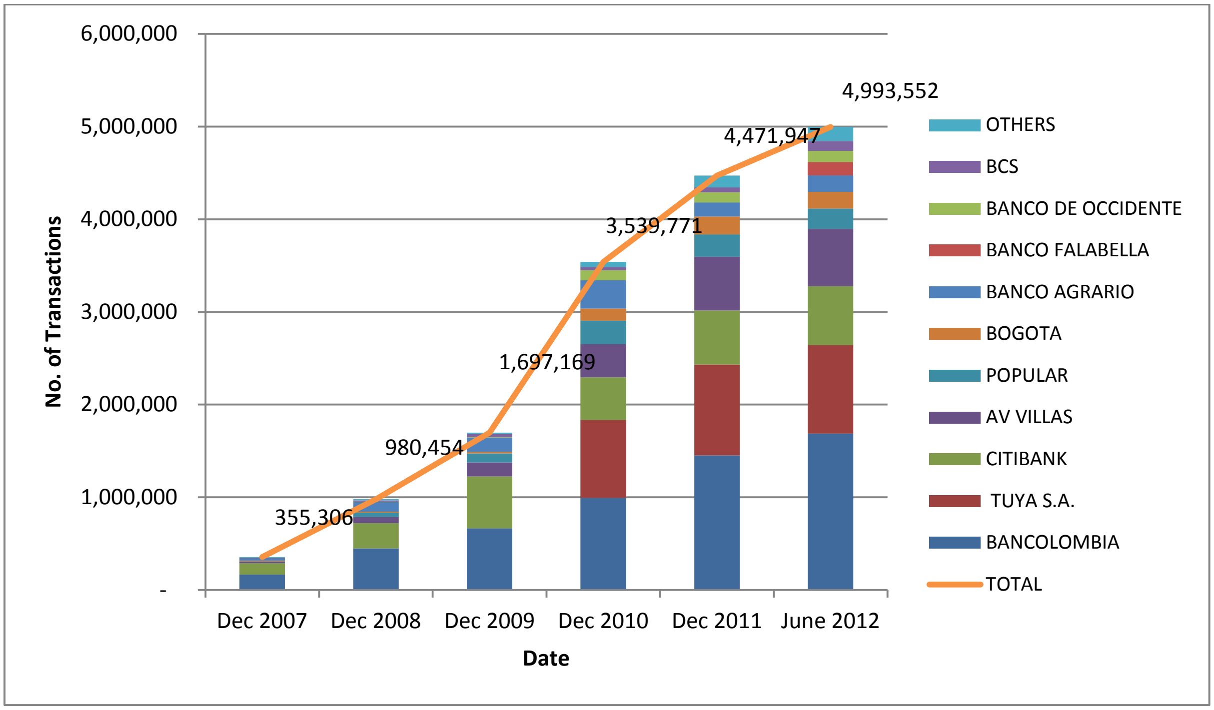
Graph 1: Evolution of the Number of Agents in Colombia 2001–2012



*The Other category was made up of three banks in December 2007, and by June 2012 it represents six financial institutions, each with fewer than 100 agents.
Source: Created with information from BdO

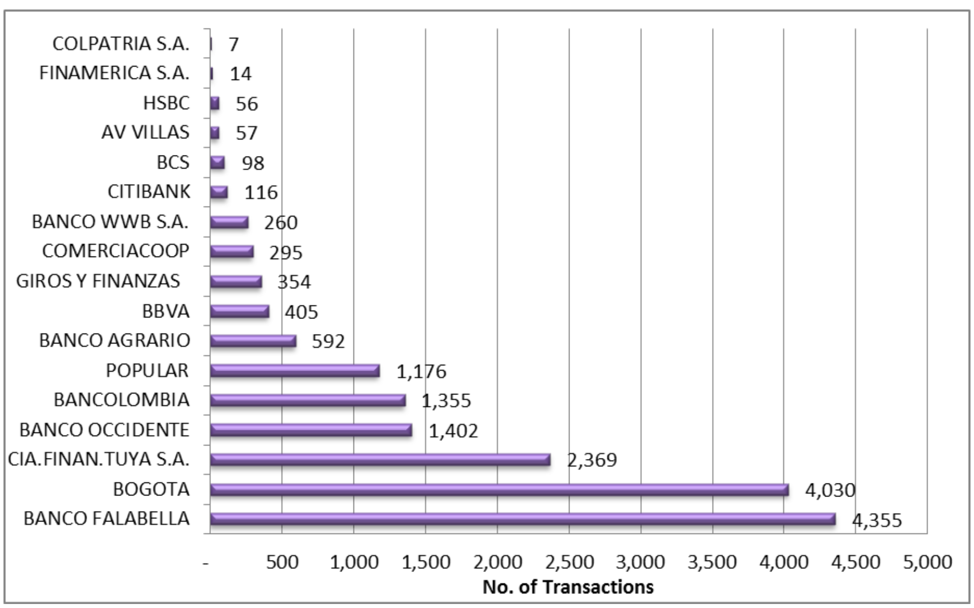
The number of transactions was a little over 300,000 a month at the end of 2007 and almost 5 million a month by June 2012. However, when analyzing the total number of transactions per institution, it was evident that each bank's network was affected by the promotion and marketing carried out by the bank, and the types of transactions that had been enabled. The banks that performed the most transactions were not necessarily those with the biggest network.

Graph 2: Total Number of Transactions Performed at the Agent, by Financial Institution. 2007–2012



Source: Created with information from BdO

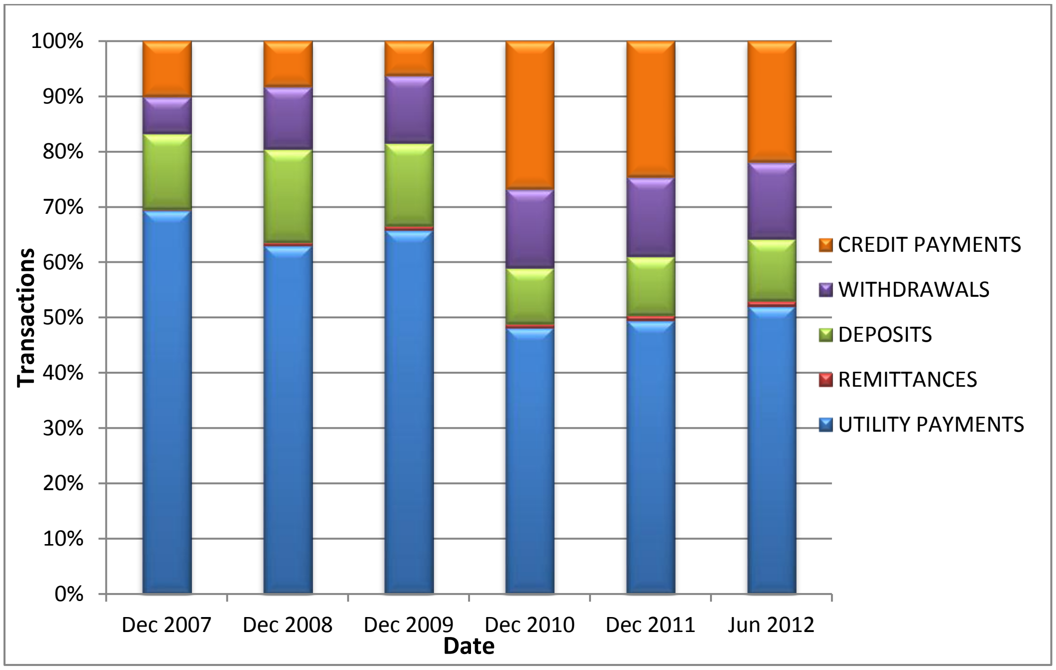
Graph 3: Average Number of Transactions per Financial Institution, June 2012



Source: Created with information from BdO

Finally, it is useful to analyze the variety of transaction types carried out by this channel. Initially, agents were primarily used for collecting utility payments (70% of the transactions in 2007). This transaction type now accounts for only 50% of the total number of transactions, giving way to credit payments, especially credit card payments, and account withdrawals.

Graph 4: Type of Transactions Done at Agents. 2007–2012



Source: Created based on information from BdO

Out of a total of 925 million monetary transactions performed by the financial system during the second half of 2011, 23 million were conducted at agents, compared to 263 million at ATMs and 1.6 million using mobile banking. Agent and mobile transactions had the highest growth rates.

4.2 Invitations to Tender Made Extending the Model to Rural Areas Possible

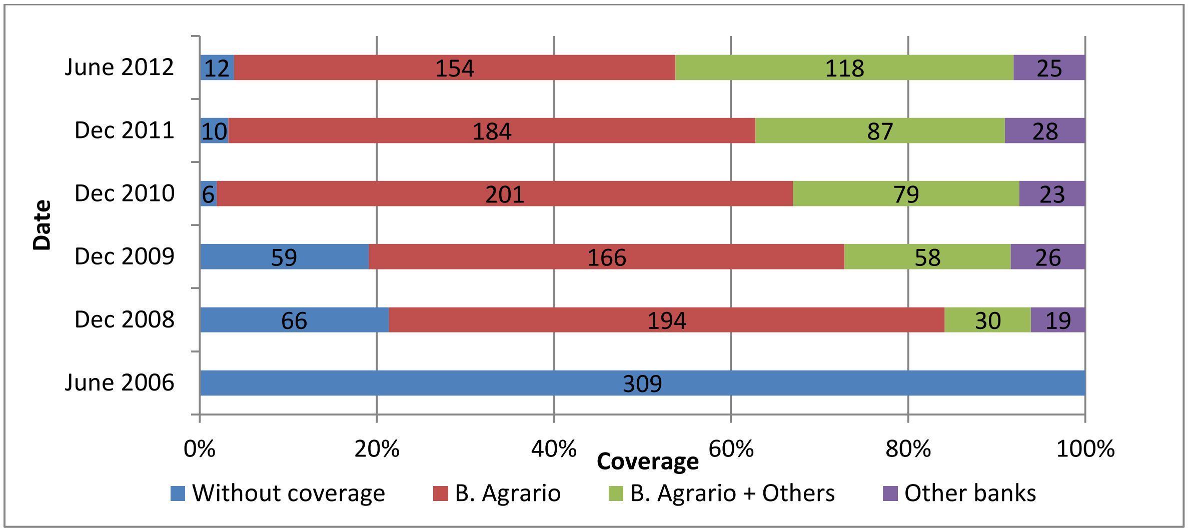
The subsidy intervention by BdO had a positive impact, not only because it increased the presence of formal financial entities in remote areas and a large percentage of municipalities with a population of fewer than 10,000, but also because it mobilized other banks to conduct business in these same areas. It is expected that in some of these areas, coverage will be maintained without the subsidy once the current contracts are over.

Subsidies during the first two tenders were given in 187 municipalities, 77% of which had populations fewer than 10,000. In June 2006, before the Financial Superintendence authorized agents, Colombia had 309 municipalities without a financial presence. While the first tender was being designed, several banks extended their network to 25 of these municipalities. These banks further extended to 59 more while the BdO program was being implemented.[14] This process continued, and the country had complete

[14] The banks that opened these agents were Bancolombia, Banco Agrario, and Citibank from their partnership with the lottery network.

coverage of all municipalities by December 2010, except in the six where it proved impossible to install an agent under the tender.

Graph 5: Total Evolution of the 309 Municipalities without Coverage (June 2006–June 2012)

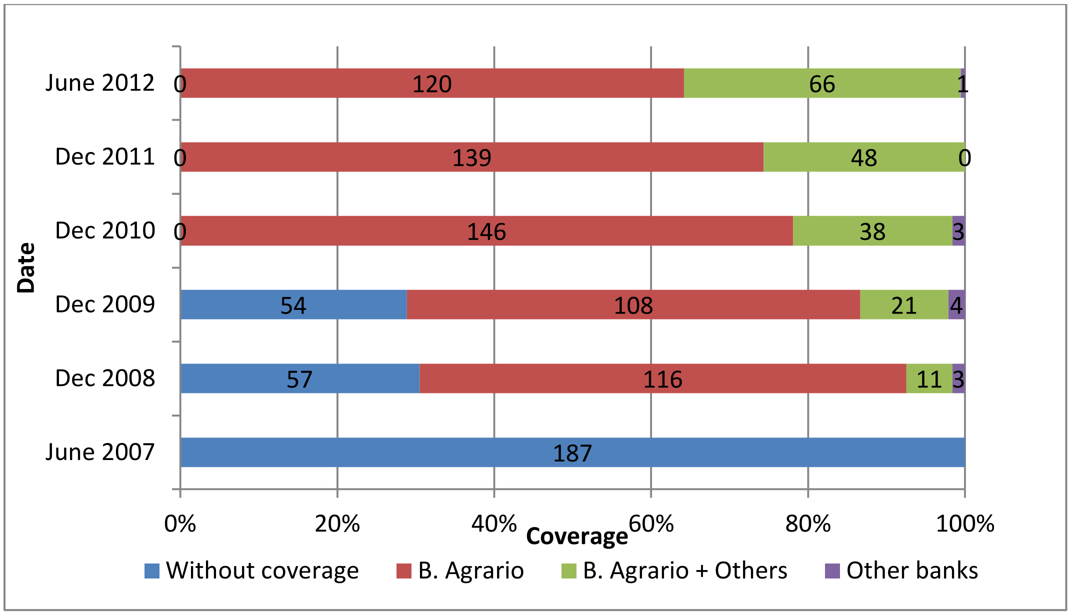


Source: Calculations based on information provided by BdO

According to the latest data available as of June 2012, 12 municipalities did not have a financial presence because six agents had been closed due to security concerns, the lack of access routes, or simply because of opposition from political employees or indigenous councils.

The invitations to tender were intended to help BdO achieve its goal of increasing coverage to all municipalities in Colombia as quickly as possible. However, some banks managed to establish agents in some of these municipalities without any subsidies. Looking at the history of the 187 municipalities with agents subsidized by BdO, other banks have opened up agents in 66 of these municipalities during the four-year period (see Graph 6). This trend was seen particularly after 2010 and primarily in larger municipalities.

Graph 6: Evolution of Coverage in Municipalities of the First and Second Tenders, June 2007–June 2012

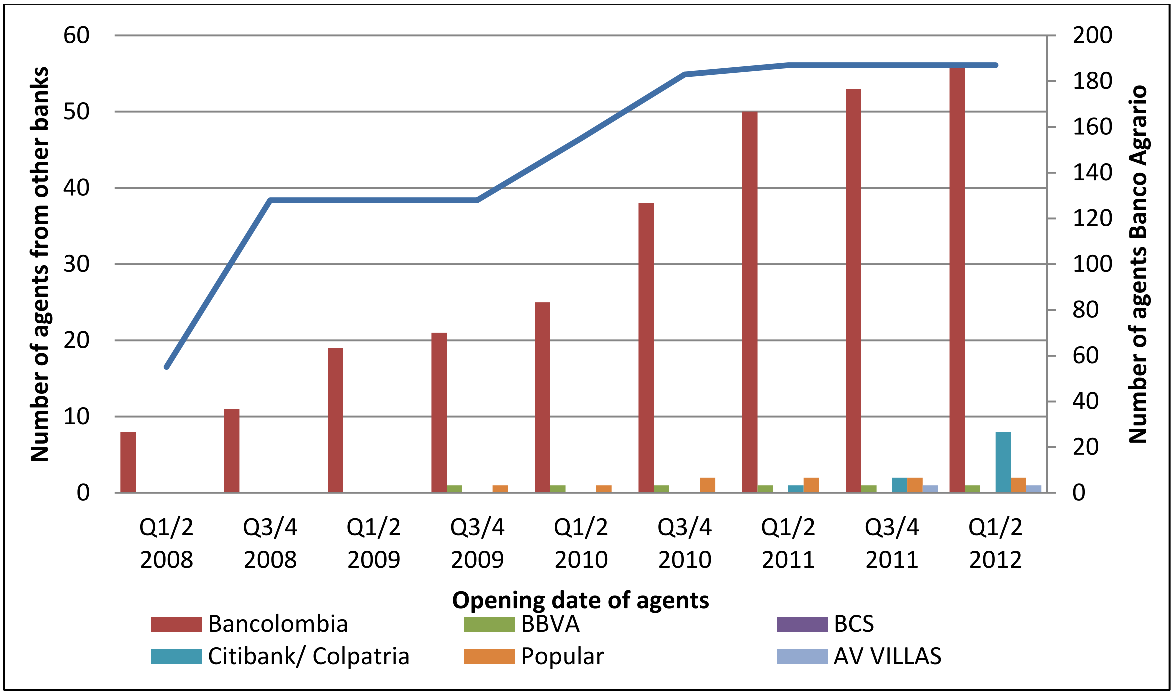


Source: Calculations based on information provided by BdO

Bancolombia has been the most aggressive bank in reaching these municipalities. It opened agents in 57 municipalities as part of its growth and expansion strategy. Agents have the support of a commercial adviser who promotes the agent and signs up clients, generating high transaction volumes. Its strategy today is to cover 100% of the municipalities in Colombia. The bank acknowledges that it did not participate in the first two tender processes because the business case was not favorable at the time, even with minimum transactions guaranteed by BdO. The channel was very young, and the bank was still in the learning process. At that time, it also did not have a manager in those municipalities to reach such remote areas to oversee registrations and cash management. However, the bank has gradually increased its participation and currently has 1,246 agents, several of which are located in municipalities with a population of fewer than 10,000. The bank has stated that under current conditions, if the invitation to tender were presented today, it would participate. Other banks installed agents in seven of these municipalities, and in nine municipalities (five of which have fewer than 7,000 inhabitants) more than two agents from different banks have been opened. Among the larger municipalities, the volume of transactions actually justified opening a branch.[15] The growth of each individual institution in these municipalities is shown in Graph 7.

[15] In Pailitas, which has a population of 15,000, Banco Agrario opened a branch and Bancolombia set up an agent; in Galapa, which has a population of 5,800, Bancolombia opened a branch; and in Guatapé, which has a population of 31,000, Banco de Occidente opened a branch.

Graph 7: Chronology of Agent Openings in Municipalities with Incentives from BdO, 2008–2012



Source: Drawn up with information from BdO
Note: Accumulated opening numbers

4.3 Evolution of Transactions

As noted, the design of the first two tenders incorporated two basic elements: they were temporary and they decreased over time. Both of these elements were meant to motivate the bank to make a commercial effort to make each agent profitable.

For the first tender, the subsidy used only 53% of the estimated budget of $1.6 million. Sixty-seven agents were not able to surpass the minimum number of guaranteed transactions in any month. In four municipalities, the agents were able to surpass the minimum number of guaranteed transactions during their first year of operation, while the rest did so at some point during the course of the 36 months of the contract, as Table 5 shows. However, no agent surpassed the minimum number of guaranteed transactions for all 36 months of the program. Assigning the guarantee per group rather than per individual agent led to a savings of $150,000. This was because excess transactions at certain agents in the group compensated for the lack of transactions at other agents.

Table 5: Number of Agents per Month That Surpassed the Guaranteed Transactions—Tender II

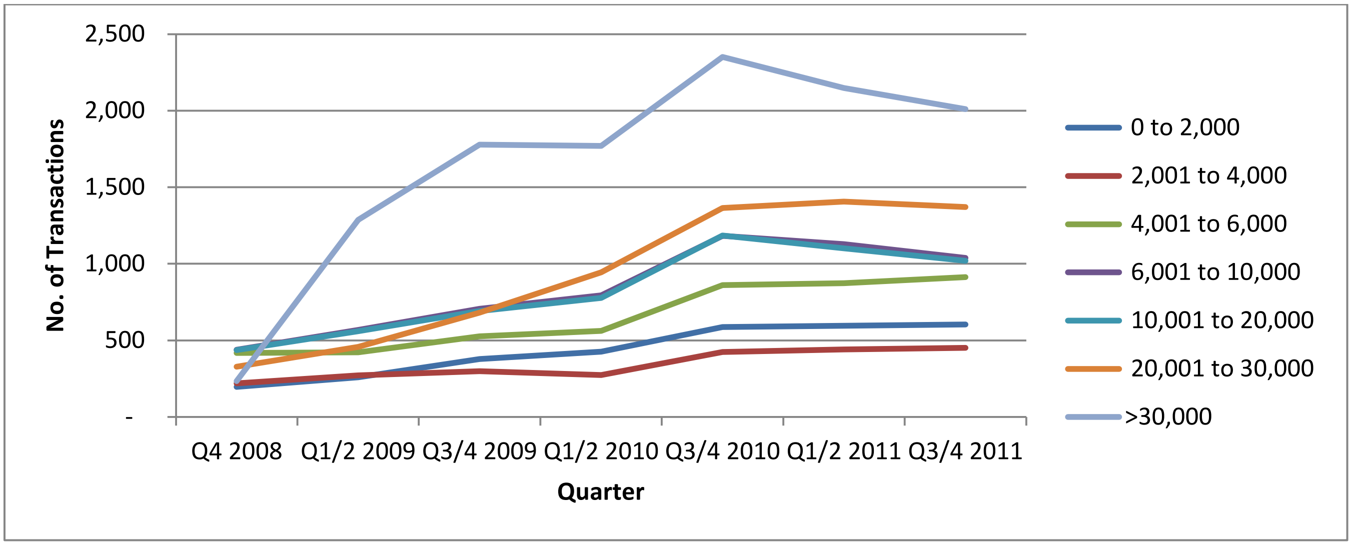
No. of months agent surpassed minimum transactions	No. of agents	%
0	67	52
1	9	7
2	6	5
3	10	8
4	10	8
5	3	2
6	3	2
7	2	2
8	1	1
9	3	2
13	1	1
14	1	1
16	1	1
19	1	1
22	1	1
23	1	1
25	3	2
27	1	1
28	1	1
30	2	2
33	1	1
Total	128	100

Source: Calculations based on information from BdO

Note: The only agent that surpassed the number of guaranteed transactions in the municipalities with 0 to 2,000 inhabitants did it in just one month. In the case of municipalities with 2,000 to 4,000 inhabitants, the agent was able to surpass the number of guaranteed transactions for a period of five months, intermittently during the last year.

The assigned budget for the second tender was \$1.6 million; during the first year of operations, 40% of had already been used. Just two of the 59 agents had been able to reach the minimum number of guaranteed transactions in any of the months. One of these agents was located in a municipality with a population of 10,205 and made 3,200 transactions a year after opening, of which 2,205 were FA payments. The second agent was located in a municipality with a population of 33,000, and two years after opening was making 2,941 transactions, of which 88% were FA payments. All agents gradually increased the number of transactions. However in municipalities with a population of fewer than 4,000, some agents had not yet surpassed an average of 600 transactions a month even after four years of operation, jeopardizing their sustainability.

Graph 8: Number of Average Monthly Transactions per Six Months per Municipality Size—Tender Process II



Source: Calculations based on information from BdO

Comparing the growth in transactions by size of the municipality between the first and second tenders shows that the transaction growth in the second tender was faster as a result of the support of the commercial adviser who spent two days a month in municipalities with fewer than 10,000 inhabitants and five days a month in municipalities with more than 10,000 inhabitants. This is validated when comparing the first three quarters of operations, which shows that the number of transactions reached by agents in municipalities of the same size during the third quarter of operation was higher in the second tender than in the first. That is, the second tender exhibited a higher growth rate in agent transactions over the duration of the contract than the first tender.

Table 6: Average Number of Transactions per Municipality Size—Tender Process II

Population of Municipality	No. of Municipalities	Q4 2008	Q1/2 2009	Q3/4 2009	Q1/2 2010	Q3/4 2010	Q1 2011
0 - 2,000	4	297	350	380	402	556	521
2,001 - 4,000	27	226	281	293	255	400	364
4,001 - 6,000	28	319	343	434	434	707	621
6,001 - 10,000	36	325	425	550	635	1,032	853
10,001 - 20,000	26	429	560	746	923	1,387	1,214
20,001 - 30,000	6	995	1,094	1,178	1,188	1,175	1,044
30,001 - 40,000	1	234	1,285	1,752	1,704	2,306	1,994

Source: Calculated with information provided by BdO

Note: The reduction in the number of transactions during the first quarter of 2011 shows a lower number of FA payments.

Table 7: Number of Transactions per Municipality Size—Tender Process II

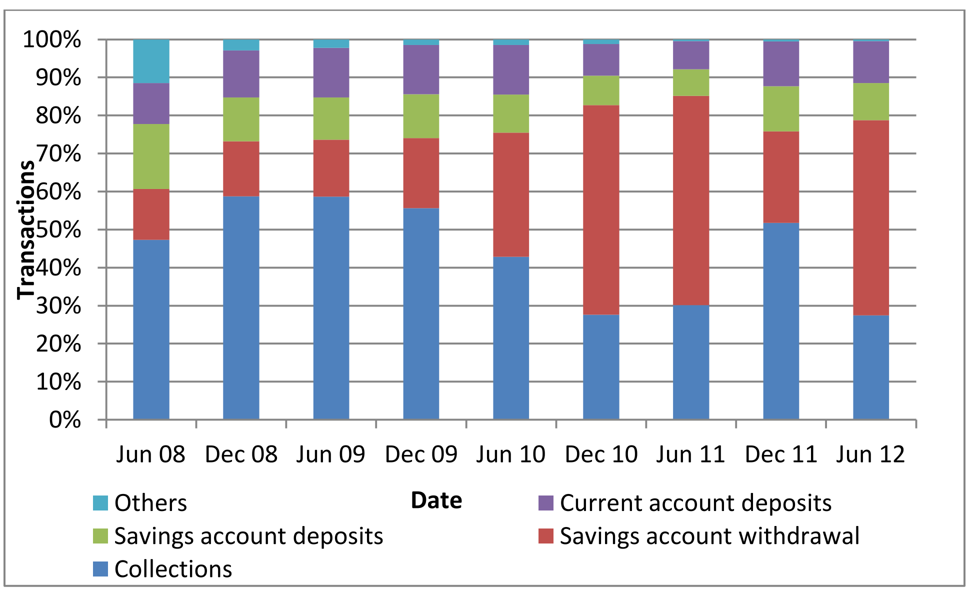
Population of Municipality	No. of Municipalities	Q3/4 2010	Q1/2 1011	Q3/4 2011
0 - 2000	14	188	254	312
2,001 - 4,000	25	273	380	474
4,001 - 6,000	8	411	493	626
6,001 - 10,000	6	397	497	709
10,001 - 20,000	5	507	655	1,008
> 30,000	1	1,289	1,859	3,113

Source: Calculated with information provided by BdO
Note: 0 to 2,000 inhabitants calculated with an average of 13 agents; 2,001 to 4,000 inhabitants calculated with an average of 24 agents; 4,001 to 6,000 inhabitants calculated with an average of six agents; 6,001 to 10,000 inhabitants calculated with an average of five agents

4.3.1 Types of Transactions and Importance of the Familias en Acción Payments

Transactions made between June and December 2008 and onward were compared. The highest percentage of transactions made during that period was collections, but an increasingly higher percentage came from withdrawals from savings or regular accounts mostly linked to FA payments. These accounted for almost 40% of the total transactions at agent locations, especially starting in the second half of 2010 when Banco Agrario actively began using agents to make FA payments. The agents also carried out transactions into savings or regular accounts, accounting for 10% of the total transactions made during this period.

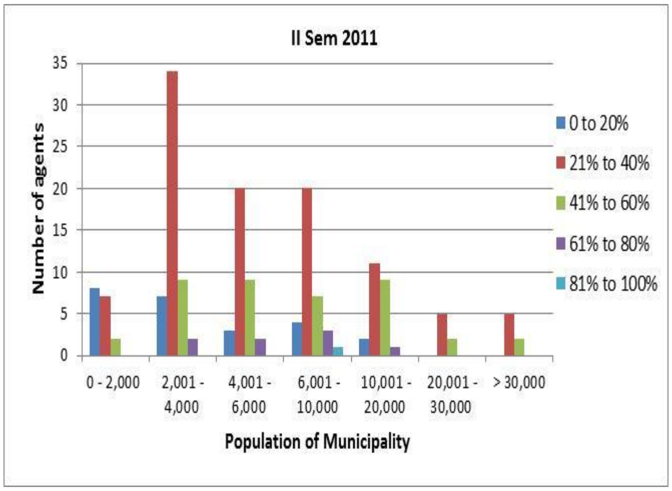
Graph 9: Number of Transactions Made through Banco Agrario Agents (June–December, 2008-2012)

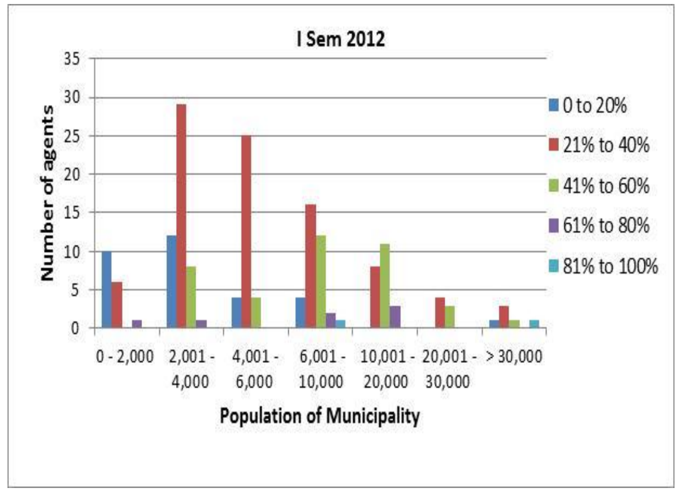


Source: Calculated with information from BdO

To establish the importance of FA payments, two periods were analyzed: the second half of 2011 and the first half of 2012. For most agents, regardless of their population size, 20%–60% of the total transactions were FA payments. If we analyze these numbers by size of the municipality, it is significant that for most of the agents with fewer than 2,000 inhabitants, FA payments account for less than 20% of the total number of transactions. Meanwhile, as the population grows, these payments account for a higher percentage. For most of the municipalities with 2,001–10,000 inhabitants, FA payments account for 20%–40% of the payments, while in the larger municipalities with populations higher than 10,000 but lower than 20,000, these payments account for 40%–60% of the total transactions.

Graph 10: Number of FA Transactions over the Total Transactions per Municipality Size



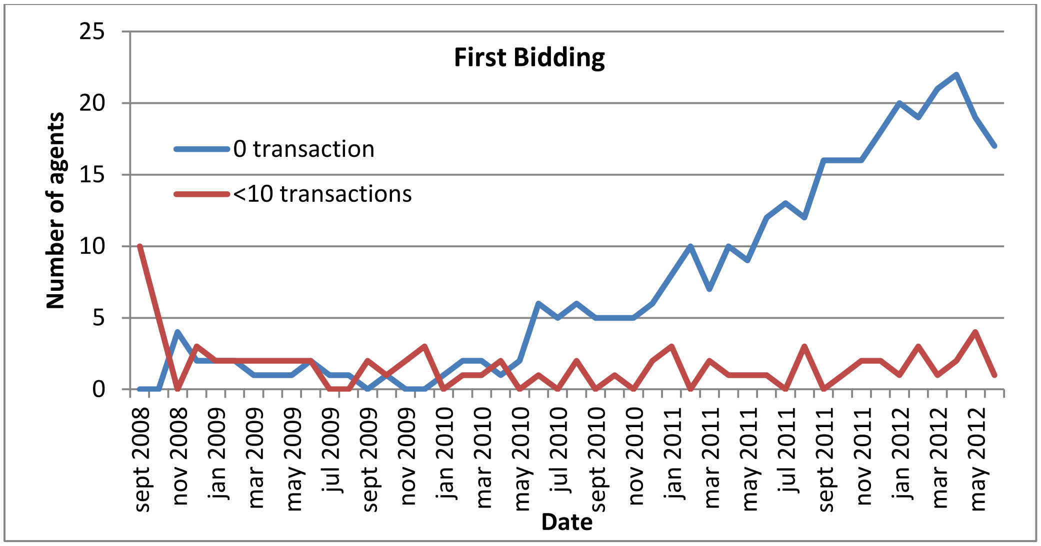


Source: FA transactions and payment statistics per municipality, Banco Agrario

4.3.2 Model Sustainability

The tenders were designed to generate a sustainable offer by eliminating the subsidy in the last year of operation, but forcing the financial intermediary to operate the agent until the end of the contract. Obviously, there was no guarantee that Banco Agrario would continue to keep certain agents in operation after the contract with BdO came to an end. It is useful, therefore, to analyze what happened to the agents that were opened during the first tender. Of the 113 agents opened by September 2008, there was an increase in the number of agents that made no transactions or made fewer than 10 transactions per month. At the time this report was written, the bank had closed six agents, five from the first tender and one from the second; of these, four municipalities already had the presence of agents from another bank.

Graph 11: Number of Agents with Zero or Fewer than 10 Transactions per Month



Source: Transaction data provided by Banco Agrario

4.4 Results in Marginal Neighborhoods

The results from establishing agents in marginal neighborhoods are more recent. Banco Agrario managed to set up the two agents in January 2011, three months after signing the contract. But BCS, despite being a bank that has traditionally reached poorer neighborhoods, has experienced more difficulties, mainly in identifying businesses within the required areas that are characterized by lower income, greater financial informality, and higher risk. The risk departments at both banks that approve new agent registrations have strictly complied with the new registrations requirements. But they have also had to be flexible, mitigating these risks by giving lower limits for cash balances at the agent. As a result of these difficulties, BCS had to request four extensions to the contract and opened the agents more than a year after it was awarded the incentive. It opened 10 agents in January 2012. The other 10 opened one by one with bank staff during the first quarter of 2012. Both banks mentioned that business owners fear threats by speculators and the risk of having a large amount of money in highly insecure areas.

The average number of transactions made by BCS's 20 agents is very low at 200 a month. Collections accounted for 99% of these. Among the two agents established by Banco Agrario, one agent located in Barranquilla had an average of 1,600 transactions per month, FA payments accounted for 40% of the total. The remaining percentage of transactions is divided among collections, deposits, and fund transfers. The second agent opened in Bogota has not performed transactions for the past eight months because speculators, believing that the bank was going to bring competition into the area, threatened the agent. Banco Agrario had to relocate the agent to another neighborhood with the authorization of BdO.

One of the requirements of the tender process was the presence of a commercial adviser eight days a month promoting savings and loan products. BCS mentioned that it had not been able to open accounts because the bank accounts it offers carry maintenance costs that low-income people would find difficult to pay. To date, no products have been launched, but it has motivated the bank to think about the need to open low-value accounts that are appropriate for this client profile. This is another positive outcome of the BdO program.

5. Lessons Learned

In short, the Colombian Government's objective to extend coverage to all municipalities was achieved. Currently, 99% of all municipalities have access to financial services. To reach this level of coverage, several challenges were faced and several lessons were learned from the process of implementing BdO's incentives:

- *A favorable regulatory framework that allows financial institutions to use a low-cost channel, such as agents, is a necessary condition, but it is not enough to achieve coverage in rural and less inhabited areas of the country.* Regulations that allow banks to operate through agents have an impact and yield results among actors who do not necessarily have public policy interests. Therefore, both geographic coverage as well as increased access to new segments of the population may require the adoption of public subsidies that encourage and accelerate the process.

- *The use of incentives cannot go against the dynamics of the market. It may accelerate the process and reduce the time needed to learn, but it cannot skip steps in the learning curve.* In retrospect, it may be that the first tender, which aimed at broadening coverage to municipalities with fewer than 50,000 inhabitants, was launched prematurely when compared to what the financial intermediaries were capable of offering in terms of channels or products at that time. Considering the government's objectives and the needs, it was a valid strategy aimed at bringing financial services to the entire population. But it faced the inability of financial intermediaries to design cost-effective alternatives because the channel was still very new and the banks had not yet stabilized their technological platform nor adjusted their financial and commercial models.

- *The lack of participation by private banks indicated an insufficient capacity to roll out the model to rural areas*. The experience of rolling out a network of agents as a "stand alone" channel was much more challenging than initially expected. These municipalities were outside the strategic focus of most banks, but even if they had been a priority from a public policy perspective, the business model was not clear in the early stages of the process. This conclusion is backed by the fact that banks now have slowly begun reaching 57 of the 187 municipalities initially targeted on their own without subsidies. It may have been more effective to launch various tenders to meet the policy objectives of the government, tracking the roll out of the model to ensure higher participation by potential financial institutions and increased competition in the tenders themselves.

- *Basic problems in an agent model cannot be solved with incentives, at least not the problems that focus on reducing risks or co-financing investments.* There is more to establishing agents in rural or low-income communities than just connecting a point-of-service device. The client proposition has to be attractive for these communities to use formal financial services and enable a basic business model for banks. Cash management risks must be resolved so that sufficient liquidity can be ensured at each point. Governments should consider these issues and manage their expectations once they have issued new regulation and have provided sufficient information throughout the process. This will promote the exchange of experiences among financial institutions, including those from other countries, and accelerate learning.

- *Subsidies that decreased over time were not enough to get the bank to develop an interesting value proposition for customers, even though this would have resulted in a greater use of the channel.* The idea behind decreasing subsidies was to encourage the bank to develop appropriate products so that sustainability could be reached by the third or fourth year. In practice, some of the agents opened by Banco Agrario stayed open even after the BdO contract ended despite conducting no transactions.[16] Keeping the agents open despite recorded losses may reflect the public bank's commitment to maintaining its presence in these municipalities and does not necessarily mean that the incentive's goal of encouraging the bank to offer appropriate products was met. In reaction to the low number of transactions reported by some agents during the first tender, BdO included financing for a commercial adviser in the subsequent tenders. It felt that the adviser would help link the people in the municipalities to the bank. The hope was to help the banks develop a commercial strategy to attract new clients. In the case of marginal neighborhoods, where most of the agents were operated by a private bank, it was clear that even with commercial advisers, the products that banks were offering were not appropriate their new clients. Although subsidies can help lower perceptions of risk or even strengthen the business case by lowering the investment required, an agent network ultimately requires high transaction volumes typical of a truly financially inclusive model.

- *Despite being a low-cost channel, agents do not offer a sustainable solution in very small communities under the model developed in Colombia.* Although the agent model is a low-cost channel compared to a branch or an ATM, it still may not be appropriate for very small municipalities. A low-cost channel such as mobile banking could work as long as telecommunication coverage is available, but even this model requires cash-in and cash-out points that guarantee functionality. For countries such as Colombia, alternative models for managing agent networks should be considered—for example agents that prefund their own float so that they do not use a line of credit from a bank. This model is used for mobile wallets, such as M-PESA in Kenya, and it limits bank risk by making each agent responsible for developing its business according to its own capacity. This system, however, has not been used in the Colombia to date.

- *The type of incentives may vary and must be adapted to the circumstances of each case.* A transaction guarantee was useful in the first tender because if lowered risk perceptions and prevented paying subsidies in municipalities where transactions increased quickly. This was not so clear in the case of smaller populations, such as the ones that were the focus of the second tender, where 66% of the municipalities had fewer than 4,000 inhabitants. Due to smaller market potential, the minimum transaction level was not likely to be reached. It may have been more appropriate to use a co-financing tool to cover the costs of setting up the agents in this type of municipality, as was done in the urban tender.

- *The subsidy auction is sound mechanism to assign fiscal resources to financial intermediaries as long as a minimum degree of competition is ensured; otherwise it is important to set limits to avoid paying for inefficiencies.* Any tender process should seek to generate strong competition. The benefits of competition were clear in the third tender where the investment per agent was

[16] As of June 2012, this was the case of 15 agents out of the 133 that were being monitored.

radically lower than in the previous tenders. The difference in cost cannot only be attributed to the higher underlying costs of reaching the remote communities covered in the first two tenders. The potential interest of any country's financial institutions to participate in this type of tender should be measured. If low competition is expected, reference models should be available to allow setting reasonable limits to improve the efficient use of public funds.

- *Reaching the poorest populations, normally found in rural areas, and reducing transaction costs of delivering payments to beneficiaries are crucial elements for conditional cash transfer (CCT) programs.* CCT programs suffer greatly from the financial system's lack of coverage. These programs are instrumental in broadening the financial sector's coverage because they may provide both the minimum transaction volume required for an agent's sustainability and the minimum income to the bank that operates the channel. But, *who* should take on the cost of building this financial infrastructure? In the Colombian case, the cost of expanding coverage was assumed by BdO—that is, by a financial inclusion policy entity—allowing FA to make payments at a cost lower than it would have incurred if the agent network had not been available. The BdO tenders proved successful and generated greater transparency than if it had been carried out by a social protection entity. In other countries where an entity such as BdO does not exist, however, CCT programs may be forced to take on this expense.

6. Conclusion

Colombian's use of public policy incentives to promote agent networks as an appropriate channel for delivering services to low-income and rural populations offers innovative ideas that can be used in different contexts. These incentives were an essential part of the strategy to promote financial inclusion launched by the Colombian Government in 2006 by way of BdO, which also promoted regulatory changes to make financial inclusion possible.

Evidence shows that the extension of this agent network would have been much slower if it had not been for the incentives and the tenders presented by BdO. Even the public bank would have taken many more months or perhaps even years to reach communities as remote as the ones in the Colombian Pacific. Not only would it have taken much longer to attain a financial presence in the most remote municipalities of the country, as has been the case in other Latin American countries, but also the development of business models and lower technology costs that are currently available in the market and are being used by many banks in the country would have developed at a much slower pace.

Public resources totaled $2.5 million, and the tenders covered 187 rural municipalities where more than 1 million people live and 25 marginal neighborhoods, accounting for an investment of $13,000 per municipality or $2,400 per inhabitant. This could be considered worthwhile effort if the extension of the payment infrastructure ensures significant progress in terms of financial inclusion. The big lesson, however, is that even if the outreach of the channel is a prerequisite for offering financial products, it is not enough. More research and analysis needs to be conducted to understand and design business models that allow financial institutions to offer products that are appropriate for the needs of this population.

In the Colombian experience, incentives alone were not enough to stimulate private financial institutions to develop business models to reach remote rural communities, but it did foster their interest in reaching marginal urban areas. To reach rural settings, financial institutions must develop sustainable business models based on their ability to offer products that are appropriate for the needs of these communities to generate the required transaction volume.

It appears that the benefits outweighed the costs incurred by BdO. It motivated financial institutions, directly and indirectly, to use the agent channel, enabled new business models, and even provided cheaper and more efficient technological solutions, serving as key ingredients in the development of the financial inclusion agenda in Colombia. In the end, however, the question comes down to who should take on the cost of promoting the expansion of financial infrastructure. In the case of Colombia, BdO was responsible for promoting access to financial services. This was an ideal situation and generated greater transparency than if social policy had taken it on. In other countries, CCT programs have to bear not only the challenges of delivering payments to poor communities, but also the cost. The advantages and disadvantages of either alternative should be further analyzed to understand their implications on social and financial inclusion policies.