Entry of MFIs into the Remittance Market: Opportunities and Challenges

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I. Introduction: Remittances, the Remittance Market and Transnational Families in Today's World

In 2005, migrant worker remittances – the portion of migrants' earnings returned to their country of origin – totaled approximately US$232 billion globally – three times official development aide of US$78.6 billion dollars. In fact, formal remittances constitute the second largest source of external funding for developing countries behind Foreign Direct Investment. The $46 billion in remittances sent to Latin America and the Caribbean last year by 30 million migrants was nearly equal to all foreign investment in private companies! Moreover, migration and remittance experts argue that unofficial transfers could be almost as large as, if not larger than, the formal flows.[3]

The importance of the flow of remittances for developing countries cannot be underestimated. Remittances account for more than 10 percent of the gross domestic products (GDP) of 15 developing countries studied by the International Monetary Fund (IMF). This is true for some islands in the Caribbean and Pacific and for several labor-exporting countries such as Albania, El Salvador, Jordan, and the Philippines. Remittances account for over 29 percent of Nicaragua's GDP.[4] In Jamaica, remittances generate more revenues than foreign trade. In Haiti, in every year since 1996, remittances have been consistently greater than the total amount of revenue generated

[3] Manuel Orozco, "Sending Money Home: Can Remittances Reduce Poverty?" id21 insights, #60, January 2006, p. 1.
[4] Michelle Wucker, "Remittances: the Perpetual Migration Machine," *World Policy Journal*, Summer 2004, p. 37.

by merchandise exports each year. In 2003, they represented more than 233% of merchandise exports.

Moreover, remittances are growing at a double-digit annual rate. In 2003, the United Nations Development Program, the World Bank, numerous governments, financial institutions and scholars recognized that in the aggregate, migrant remittances now constitute a relatively stable source of vital income to many developing countries as well as an important form of economic activity among nations.[5] In short, remittances represent a source of funds that is being acclaimed as the "great new hope for the developing world." [6]

The number of participants in this market is extraordinary. Estimates are that somewhere around 200 million transnational labor migrants sent money home to their families in 2005.[7] The number of domestic labor migrants is even larger. Most migrant workers send home between US$2,000 and US$5,000 a year – or between 20 and 30 percent of their earnings.[8] Most often, these migrants are low-income workers in the service or agricultural industries who are responding to a demand for foreign labor in the host country. But increasingly, when they leave their home countries, they do not leave their families. In essence a new, transnational way of life is emerging in which immigrants participate in two communities at once: they pursue financial goals for themselves and their families in the host country, while at the same time planning joint investment projects with their families back home.[9] These families that live in two countries at once are, in fact, highly integrated transnational economic units.[10]

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[5] Roberto Suro, *Remittance Senders and Receivers: Tracking the Transnational Channels*, Multilateral Investment Fund (MIF) of the Inter-American Development Bank and Pew Hispanic Center, Washington, D.C., November 24, 2003, p. 3.
[6] Wucker, p. 37.
[7] Orozco, p. 1.
[8] Idem.
[9] "Leveraging the Impact of Remittances through Microfinance Products: Perspectives from Market Research," *ACCIÓN InSight* No. 10, May 2004, p. 1.
[10] Suro, p. 4.

The Multilateral Investment Fund of the Inter-American Development Bank (MIF/IDB) perhaps puts it best, "remittances are the expression of profound emotional bonds between relatives separated by geography and borders, and they are the manifestation of a profound and constant interaction among these relatives regardless of the distances between them. Decisions about where to seek income and how to spend funds are often the results of consultation. Even an individual's decision to migrate frequently emerges from a family consensus about the need to develop a source of remittance income."[11]

In addition, there is a multi-million dollar industry devoted to money transfers, with profit margins as high as 30 percent. Estimates are that the remittance market will generate more than $15 billion in annual revenues in 2006.[12] The intermediation of transfers is a hidden business jewel with almost unlimited potential.[13] Wire transfer companies such as Western Union or MoneyGram have traditionally been the most common formal means of sending remittances, with banks and other formal financial institutions a distant second and third. But this may be changing. Banks are increasingly upgrading their technology so as to compete with money-transfer companies. And, new companies are forming and then being bought out with increasing regularity.

There is no question that an increasing number of pro-poor microfinance institutions (MFIs) are interested in entering this dynamic and rapidly growing market. Moreover, both donors and researchers conjecture that the close proximity of MFIs to client groups and communities that are likely to receive remittances, as well as their experience serving low-income populations, may uniquely position MFIs to reach recipient populations with

[11] Ibid., p. 4.
[12] Wucker, p. 38.
[13] Manuel Orozco, *Remittances – Global Opportunities for International Person-to-Person Money Transfers,* London: VRL Publishing, 2005.

low-cost transfer products and to offer them access to other financial products that they may not have found accessible heretofore.

The purpose of this paper is to explore both the opportunities and the challenges of MFI entry into the remittance market. The opportunities are both social (providing pro-poor clients a quality product at a lower cost that helps them build a safety net) and financial (attracting new clients, cross-selling existing services, strengthening customer loyalty, increasing revenues, mobilizing savings). The challenges to entering the market are equally formidable and include (a) the regulatory and licensing environment, (b) the readiness and capacity of the institution in terms of management, staffing, systems and marketing to provide the service, (c) the identification and penetration of an appropriate market niche, (d) the costs of entry into the market, and (e) the identification of partners with the same values and negotiation of mutually advantageous partnership agreements.

An understanding of these opportunities and challenges helps to explain both why there is growing interest among the MFI community, but also why the number of successful entries into the remittance market by MFIs has been limited – by most estimates to fewer than 100. The paper will also describe some of the newest initiatives and ideas for making entry into the remittance market easier for pro-poor microfinance institutions.[14]

II. The Opportunities of Entry into the Market

The opportunities that entry into the remittance market represents for pro-poor microfinance institutions are numerous. In this section, we will enumerate and discuss the opportunities without consideration of the

[14] For purposes of this paper, we are defining a pro-poor microfinance institution as an entity that offers microcredit loans and possibly other financial and non-financial services to very poor people with an explicit mission of assisting these beneficiaries in making their way out of poverty.

challenges. In the following section, we will analyze the challenges, which are equally numerous.

A. Provide hard-to-reach clients of pro-poor institutions a quality product at a lower cost

There is no question that money transfers do represent both a perceived and a real need of the same clients targeted by pro-poor microfinance institutions. Sending money home is a commitment to a family's needs. Transnational families are more and more common in virtually every developing country. In many countries, it is families in poverty or close to poverty that are most likely to be recipients of remittances. Survey data from both senders and recipients confirm that remittances are most likely to be spent on basic family welfare such as food, housing, education and health care, especially for the poorest families. Moreover, a large proportion of those families do in fact receive remittances. And finally, in many countries the majority of remittance recipients are women.[15] In short, remittance flows tend to target women, target families in poverty, and target basic survival needs – much like pro-poor MFIs do. In addition, remittances are likely to be the first and often the most common financial service that the target population of MFIs accesses. How then, one might ask, can a pro-poor MFI ***not*** consider offering a remittance product? It represents a tremendous opportunity for them. After all, once an MFI has developed an infrastructure that is capable of offering low-income clients credit in remote rural areas or in difficult-to-serve urban areas, doesn't it only take one more step to add remittance services to the offerings?

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[15] For instance, in a study conducted by the MIF and the Pew Hispanic Center found that in every country they studied (Mexico, El Salvador, Guatemala, Honduras and Ecuador), the one characteristic that clearly distinguishes remittance receivers from the general population in the country is that a majority are women. Suro, p. 4.

Moreover, conventional wisdom suggests that remittances, like microcredit, are closely linked to poverty reduction, a central goal of pro-poor MFIs. Although relatively little systematic attention has been paid to the effect of remittances on poverty and income distribution in developing countries, new research by the World Bank's International Migration and Development Research Program shows that international remittances can reduce both the level of poverty (the number of people living below the poverty line) and the depth of poverty (how far the income of the average poor person is below the poverty line). In general, the largest effects of remittances on poverty are observed in countries located close to major labor-receiving areas.[16] For instance, In Guatemala, which is close to the United States, international remittances reduce the level of poverty by 1.6 percent and the depth of poverty by 12.6 percent. In that country, remittances account for over 60 percent of household income for the poorest 10 percent of the population.[17] According to the World Bank's research, if worldwide there were a 10 percent increase in international remittances from each individual migrant, there would be a resulting 3.5 percent decline in the segment of people living in poverty.[18]

It is easy to conclude, then, that pro-poor MFIs should ***want*** to offer remittance services. The question is: ***can*** they provide their

[16] Unfortunately, countries with the highest levels of poverty, such as those in sub-Saharan Africa, do not produce as many migrants and so relatively fewer people in those countries receive remittances.
[17] Richard H. Adams, Jr. "Do Remittances Reduce Poverty?" *id21 insights,* #60, January 2006, p. 2.
[18] Idem. Interestingly, studies have shown that the average cost of sending money home is almost 10 percent of the total sent, due to market inefficiencies such as limited competition, costly transfer methods and inadequate means of transferring money. In recent years, the Inter-American Development Bank, among others, has been working hard to find ways to lower the average cost of sending money home and thereby increase the amount that does arrive in the home country. The United Nations even established as one of its Millenium Development Goals to reduce the cost of remittances by 50 percent before 2020.

clients with a quality product at a lower total cost? Some MFIs that we will discuss in this paper have demonstrated that it may in fact be possible in some countries to offer better service at lower prices and develop remittance products that are appropriate to the market. At the same time, little empirical evidence has been collected to analyze the actual performance of MFIs that have entered the market.[19]

B. Help clients build a safety net

As discussed above, there is a relationship between remittances and poverty reduction. While research has documented that most of the money sent home is spent on the family's basic needs, some proportion of the money received is often saved or invested. For example, in Central America, while 90 percent of remittances are spent on basic needs, which include education and health care, the other 10 percent is saved or invested. Moreover, other studies have shown that a growing number of recipients – between 25 and 33% – put some proportion of their money in savings. In addition, some estimates are that as much as a third of remittances go to housing construction, which can be considered investment as opposed to consumption.[20] It is also interesting that in Latin America and the Caribbean, slightly more women than men report using remittances for investments, savings and businesses.[21] Remittances do, therefore, have the potential to increase savings and investment for the household as well as to generate wealth – all of which can serve to build a "safety net" for the family.

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[19] Manual Orozco and Eve Hamilton, "Remittances and MFI Intermediation: Issues and Lessons, *Remittances, Microfinance and Development: building the links, Volume 1: A Global View,* Judith Shaw, editor (Brisbane, Australia: The Foundation for Development Cooperation, 2005), p. 52.
[20] Wucker, p. 43.
[21] Sarah Mahler, "Gender Matters," *id21 insights*, #60, January 2006, p. 8.

Interestingly, there is evidence to suggest that remittances do not necessarily decrease with global economic downturns. In fact, they may even offset the normal ups and downs of economic cycles.[22] For instance, the number of senders and the amount of money sent home grew even when the U.S. economy slowed in 2001-2002, according to research by the Pew Hispanic Center and the Multilateral Investment Fund.[23]

Thus, there is convincing evidence that remittances can and do help recipients to build safety nets that can work in conjunction with other microfinance programs to strengthen the livelihoods of clients. Well designed remittance products can in fact encourage this type of savings and investment and may result in a positive development impact on recipient communities.

Two examples of MFIs that are providing tailored financial services to remittance clients illustrate the point.[24] Banco Solidario in Ecuador created a special account called "My Family, My Country, My Return," which offers clients bundled savings options, such as a credit line packaged with home buying credit, savings accounts and insurance. Their strategy has been to trans-nationalize its clientele with financial products designed for both remittance senders and recipients.

The second example is Salcajá in Guatemala, which offers remittance recipients pension funds, life insurance, medical insurance, small business credit, home equity funds and various savings packages such as the Infant/Youth Savings Plan, which encourages parents to invest in their children's schooling over the long-term.

[22] Orozco, p. 2.
[23] Suro, p. 4.
[24] Both examples are discussed in Orozco and Hamilton, pp. 58-59.

Finally, ACCIÓN International conducted extensive market research to explore the financial needs and investment goals of senders and recipient families and the market potential for products linked to microfinance. They concluded that "opportunities may indeed exist to link remittance services with microfinance products. . . . Channeling remittances directly into savings accounts . . . can provide a means to increase the ability of immigrants and their families to achieve investment goals."[25] Thus, remittances can improve the clients' chances of leaving poverty. The next section explains that it can also strengthen the MFI's chances of success.

C. Attract new clients and open opportunities to cross-sell other microfinance products

Every client that walks into an MFI to receive a particular service represents an opportunity for that MFI to cross-sell its other products. Often unbanked remittance recipients are quite open to learning about the other services that an MFI offers, and the evidence suggests that if they are happy with the remittance service they receive, they may be more than willing to try other financial services.

For example, the World Council of Credit Unions (WOCCU) conducted a study in the Spring of 2004 of poor unbanked remittance recipients who receive their transfers at IR*net* credit unions. They found that such clients tend to become members of the credit union, deposit some savings and participate in the financial sector.[26] This is illustrated by the efforts made by

[25] *ACCIÓN Insight*, p. 15.
[26] Mesbah-Khavari, Dina, Anna Cora Evans, and Janette Klaehn, *Credit Union Remittance Services in Guatemala: Expanding the Access of Low-Income Remittance Recipients to Financial Institutions,* prepared for USAID, World Council of Credit

Parroquial Guadalupana credit union, based in Guatemala City. It seeks to attract new members by marketing to non-member remittance recipients. Because tellers are trying to reduce the wait time, they are not always able to do a good job of cross-selling the credit union services. Therefore, the credit union has launched two marketing initiatives. First, a staff person began calling all remittance receivers who had previously received a remittance. The staff person asks for feedback on the quality of service and then promotes the advantages of credit union membership. Second, the credit union sent letters to all those who received remittances, describing in detail the financial products and services available to them.[27]

Other MFIs have found the same thing. If someone comes into the MFI to receive a transfer, they are also likely to use that MFI for exchanging their US dollar transfer into the local currency, if that is a service that is offered, and may even opt to open a savings account and deposit a portion of their transfer into that account, thereby increasing the volume of savings held by the MFI.

Other MFIs that have grown as a result of their cross-selling efforts include: (1) ACLEDA, which reports that most remittance receivers hold an account in the bank and use their other services; (2) Kasabank in Kosovo, which offers free incoming transfer services because the other business generated from these clients far outweigh the costs incurred; (3) Nuevo Siglo credit union in El Salvador, which reports that they have succeeded in encouraging some receivers to open 60-day fixed term deposits with portions of

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Union, Inc., July 2005. As referenced in *Migrant Remittances,* Volume 2, No. 2, August 2005, p. 5.

[27] Anna Cora Evans and Janette Klaehn, *A Technical Guide To Remittances: The Credit Union Experience*, World Council of Credit Unions, Inc. Technical Guide #4, March 2004, p. 14.

their remittances; and (4) Fonkoze, which reports a significant income stream just from remittance clients who decide to change their US dollar transfers into gourdes.[28]

According to WOCCU, "Recognizing the business potential of attracting unbanked clients as credit union members, the national credit union organizations and credit unions focus on non-member remittance receivers as future savers, borrowers and insurance policyholders."[29] Reasoning that the best way to lower prices and make remittances more transparent is through financial institutions, the Inter-American Dialogue Task Force on Remittances reported, "the single most important task, for both governments and non-governmental agencies, is to encourage senders and recipients to make use of banks and other financial institutions."[30] It recommends that governments open the remittance market to such financial institutions as credit cooperatives and microfinance institutions and develop strategies to increase participation in formal financial services so that recipients can not only receive their remittances but also make deposits and apply for credit.

D. Increase loyalty among existing clients

It is generally understood today that microfinance is far more than microcredit alone. Clearly if an MFI can respond to the multiple financial needs of their clients, they are more likely to succeed. More and more MFIs are interested in offering a full range of financial services that might include credit, savings, remittance

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[28] Evans, et al, p. 9.
[29] Evans, et al, p. 14.
[30] *All in the Family: Latin America's Most Important International Financial Flow,* Report of the Inter-American Dialogue Task Force on Remittances (Washington, DC, January 2004).

services, currency exchange services, micro-insurance, etc. By offering a range of different services, an MFI is more likely to increase loyalty among existing clients, as well as to attract new clients, as discussed below. In an age of growing competition among MFIs in many countries, offering remittance services can give an MFI a competitive edge in the marketplace.

Client retention is something that cannot be over-emphasized. For most microfinance institutions, it is only after several cycles of loans that clients begin to be profitable to the institution. Thus, keeping a client is at least as important if not more important than bringing in new clients. Research has documented that a low rate of client turnover is a major indicator of MFI success.

Because a relatively high proportion of MFI clients are likely to also be remittance recipients in developing countries that receive significant remittances, providing them with services other than microcredit, such as remittance products, can increase client loyalty and make it less likely that the client will drop out of the institution. Often, remittance recipients have to travel long distances to receive their transfers while MFIs tend to be located close to their clients, which may give them a significant advantage.[31] Simply by bringing the distribution network closer to the client, the institution has decreased the cost of the transaction to the client – a significant client benefit that can increase client loyalty.

Fonkoze in Haiti is making a considerable effort to assist its clients, most of whom are based in very rural areas. With its network of 27 branches all over the country of Haiti, there is no other financial

[31] On the other hand, in many countries, retail shops and post offices throughout the country offer transfer pickup points, which constitute competition for the MFI. Thus, if the MFI is concentrated in a single part of the country or limited to urban areas, they will not have an advantage.

institution in Haiti that can claim the same reach. Fonkoze is now considering going the extra mile by actually paying remittances in its credit centers, many of which meet as much as two hours by motorcycle and significantly longer by donkey from the closest branch office. Fonkoze is trying to take not only microcredit but also remittances to the client, rather than asking them to come to the bank. The principal reason for doing this is to increase customer loyalty.

E. Generate income (and ultimately profits) from a fee-based product

Of course, a principal reason that many MFIs are interested in entering the remittance market is because remittances can represent a new revenue stream. While entry into the market can be costly, as we will discuss later, because remittances are so important in developing countries and because migration is not likely to decline in the coming years, one can only imagine that remittances will continue to grow – and will do so rapidly. In fact, in recent years, migrant remittances have been growing at a double-digit annual rate.

Total industry revenues in 2003 are estimated at approximately US$18 billion. The profits earned by the leading players in the industry are also significant. For instance, Western Union reported US$1.23 billion in operating profits for 2003, while MoneyGram, a distant second leading player, reported US$112 million in that same year.[32] Even though other money transfer companies do not earn the same margins as the "big guys," the market is clearly profitable.

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[32] Jennifer Isern, Rani Deshpande, Judith van Doorn, *Crafting a Money Transfers Strategy: Guidance For Pro-Poor Financial Service Providers,* Occasional Paper No. 10 (Washington, DC, Consultative Group to Assist the Poor (CGAP), March 2005), p. 3.

Whether and how many MFIs can turn remittance products into additional profits is still an open question. For instance, Fonkoze, a microfinance institution in Haiti, has been offering a money transfer product for seven years and only last year was able to report that its service was profitable. Although those microfinance institutions that do offer international or domestic transfer services often can report significant and rapid growth in the number and volume of transfers they are executing, this does not necessarily mean profits for the institution. Still, the growth is impressive, and volume is usually linked with profitability.

For example, in the year 2000, the World Council of Credit Unions, through its International Remittance Network (IR*net*) formed a strategic alliance with VIGO in order that VIGO could access WOCCU's substantial network infrastructure throughout Central America and the Caribbean. As of December 2003, senders in the U.S. could send funds either from one of VIGO's 3,200 outlets in 38 states or from one of 201 credit unions with 950 points of service in 35 states for distribution through six WOCCU affiliates in six countries in Central America and the Caribbean with a total of more than 590 points of service. In Guatemala, 25 credit unions with 125 points of service captured 6.7 percent of the $2.7 billion in remittances sent to Guatemala in 2004.[33] In 2005, IR*net* added Ecuador to its list with 12 credit unions and 77 points of service. In the first five weeks, the credit unions distributed over 1,187 remittances worth more than $370,000.[34]

[33] Evans and Klaehn, pp. 5-6.
[34] Cerstin Sander, ed., IR*net:* Linking Credit Unions to the Money Transfer Market, *Migrant Remittances*, Vol. 2, No 2, August 2005, United States Agency for International Development and the United Kingdom Department For International Development, p. 5.

In Cambodia, ACLEDA Bank Plc., originally founded in January 1993 as an non-governmental organization (NGO) and then transformed to commercial bank status in December 2003, began offering local money transfer services in early 2001. In April of that year it started offering international funds transfer through a partnership with Western Union. In January 2004, ACLEDA started offering direct international funds transfer via SWIFT. Volumes of all its products have grown steadily. Domestic transfers grew from $145 million in 2004 to close to $120 million in the first half of 2005. In 2004, ACLEDA transacted over $22 million in remittances via Western Union and bank transfers, while in the first half of 2004, the bank transacted close to $26 million in incoming remittances from abroad.

These are just a few examples of how rapidly the number and volume of transactions can grow once an institution begins offering remittance services. Again, it is important to underscore that number and volume do not *necessarily* translate into profits, but they do give an idea of the profit potential of remittance products for pro-poor MFIs.

F. Mobilize savings from incoming remittances as a means to strengthen the lending capacity of the MFI

The potential for remittance clients to increase the savings volume of pro-poor MFIs that accept savings and then re-lend them is worthy of special attention. While no one is quite certain how much savings is or could be mobilized from incoming remittances, it is clear that some portion of remittances do go into savings accounts and more could go there with well-designed savings products offered by the remittance payer.

For example, the same market research by ACCIÓN cited earlier also demonstrated that direct deposits of money transfers into savings accounts, as opposed to receiving the remittance in cash or as a check, is a popular product among both senders and recipients.[35] The product addresses the security concern that clients can be victims of street crime when they go to pick up cash at a money transfer company or when a money transfer agent delivers money to the home on a regular basis. In some countries, recipients have to wait in line twice to receive their remittance, once to pick up the check at the remittance company and a second time at the bank to cash it. Of course, in some cases, focus group participants in the ACCIÓN study did not have confidence in the financial institutions in their country – microfinance institutions may be able to allay those fears. Some also worried about additional fees that might be charged with the savings accounts.[36]

Fonkoze's money transfer system requires that senders deposit money into a free savings account in the institution because they want to encourage savings. The client is free, of course, to withdraw the entire amount at any time, but Fonkoze reports that many clients choose to leave the savings in the account and withdraw it as needed over time. It also reports that often sending clients choose to open the accounts in their own names in order to achieve their own investment goals, especially if they are not comfortable banking in the U.S. because of language ability, lack of legal status or literacy level or if they plan to return home someday.

The ACCIÓN report corroborates Fonkoze's experience:

[35] *ACCIÓN Insight,* p. 6.
[36] Idem.

> *A significant number of [focus group] participants were already actively engaged in building assets back home. In each focus group, several participants were currently saving for specific goals such as buying property or houses, starting a business in their home country, or dedicating a portion of their remittance funds to a mortgage, investment or loan payment.*[37]

There are a number of specialized savings products linked to remittances that are currently being offered or being considered by MFIs in addition to direct deposit of money transfers. They include: (1) direct deposit with a debit card that could be used for ATM withdrawal (2) a programmed savings product that enables the sender to designate an amount or percentage of each transfer to be deposited into a savings account (3) a savings account specifically designed for saving for a particular purpose – such as the down-payment on a home loan.

Credit unions, MFIs that offer remittance services, and experts all agree that savings mobilization is a possible byproduct of entering the remittance market, if an institution sets out to do so and if it designs easy-to-use, secure savings products that meet client needs.

III. The Challenges Of Entry Into The Market

While the opportunities of entering the remittance market may be numerous and extremely enticing, it would be a grave error for an MFI to minimize the challenges to a successful entry. In this section, we will describe some of the most imposing challenges that a pro-poor MFI must face.[38]

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[37] Ibid., p. 5.
[38] Many of the ideas for this section are discussed in much greater detail in CGAP's Occasional Paper No. 10, cited above in footnote 32. In addition, CGAP is currently working on a *Money Transfer Operational Guide for Microfinance Institutions* to help

A. The regulatory and licensing environment

Governments in both sender countries and recipient countries seek to regulate and control illicit money transfers, money laundering and the financing of terrorism. There may be no greater determinant of what options, if any, are open to a pro-poor MFI seeking to enter the remittance market than the regulatory and licensing environment in the country in which it is operating. Regulations will determine whether, in the recipient country, the MFI will have: (1) to have a license in order to enter the market (2) direct access to foreign exchange (3) the legal right to become an agent or sub-agent of a money transfer company (4) access to the national payments system (5) to monitor transfers and report suspicious activities to government agencies and (6) the authority to make payments to clients in foreign currency.[39]

In some countries, the regulatory environment is so "unfriendly" that no MFIs have chosen to enter. Bangladesh provides one example. Although Bangladesh is in the forefront of microfinance development and innovation, until now Bangladeshi MFIs are not involved in international transfers because the existing legal framework prevents them.[40]

MFIs determine whether to offer money transfer services, and if so, to outline the necessary strategic and operational decisions. The draft guide will be available in August 2006 for review and field testing. Anne Hastings would like to thank the authors of this work for sharing an annotated outline of it, which also helped in writing this section.

[39] Ibid., p. 17.

[40] Tasneem Siddiqui and Chowdhury R. Abrar, "Migrant Work Remittances and Micro-Finance in Bangladesh," Working paper No. 38, Social Finance Programme, International Labour Office, September 2003, p. 6. Siddiqui and Abrar go on to argue that, according to senior management of two of the largest MFIs, Grameen and BRAC, there is some future potential if they can develop correspondent relationships with banks and exchange houses abroad. Grameen is allowed under its present legal framework to handle remittances but it cannot handle foreign exchange. BRAC and other MFIs would require a change in the legal framework under which they operate.

Even in those countries where it has been possible, the barriers are often difficult to overcome. Several examples may help to illustrate the significance of the role regulation plays in circumscribing an institution's options. For instance, in 2001 South Africa imposed stringent "Know Your Customer" requirements. Financial institutions are required to obtain clients' full name, date of birth, identity number and residential address and then compare this information with an identification document. When necessary, these particulars must also be compared with information from an independent source. In the event that a financial institution does not receive the necessary information, the law requires that the accounts be frozen until identity is verified. Fortunately, in the process of trying to implement the new requirements, the authorities realized the problems they were causing and agreed to negotiate with the private sector and consumer groups. The outcome was a decision to relax requirements for a class of clients known as "mass banking clients" – i.e., those with small balances and small transaction sizes. In the meantime, however, some providers were forced to drop out of the market.

The example of Somalia provides a less happy ending. Approximately one million Somalis send US$1 billion back home every year. In 2004, remittances constituted 67% of GDP and more than ten times the value of exports, making the Somali economy more dependent on remittances than any other in the world.[41] However, in November 2001, the U.S. Treasury Department froze the assets of the largest Somali money transfer company because of alleged links with terrorist organizations. To comply with the new regulations, transfer companies have to obtain expensive licenses,

[41] Ismail I. Ahmed, "New Regulations Restrict Somali Remittances," *id21 insights*, #60, January 2006, p. 5.

bonds, and minimum capital as well as invest in technology to ensure compliance with regulations – all of which have led to significant increases in the price of sending money home and restricted all but the biggest institutions from entering the market.[42]

Guatemala applied its 2002 Law Against Money Laundering and Other Assets to credit unions in January of 2003. According to the law, the individual credit union that delivers the remittance to the receiver is responsible for compliance with the law. That means each credit union that pays remittances must designate a compliance officer and report directly to the country' Special Verification Intendency (IVE). This person must submit an electronic report of all recipients who receive more than US$3,000 per month in remittances. All new members must be required to complete a "start of relationship" form that provides individual information to the government. Even pre-existing members must complete the form if they conduct a transaction for an amount over US$10,000.[43]

Fonkoze in Haiti has also had to document for the bank in the United States that receives transfers on its behalf that it knows its clients well. In 2005, for the first time in seven years, the CEO of the US bank requested documentation that every client who had been using money orders to send funds to Fonkoze's account is known to Fonkoze. Fortunately, Fonkoze had been collecting names and addresses for both the senders and the recipients in order to maintain a good list for marketing purposes. In preparation for its audit by the state of New Jersey, Fonkoze had to send an entire package of information documenting that it knew both the senders

[42] Idem.
[43] Evans and Klaehn, p. 13.

and the recipients. Fonkoze conducted interviews with clients who consistently used money orders to understand how the funds were being used in Haiti. (Often it was to build homes for the senders' retirement when they return to Haiti.) Without the ability to contact both senders and recipients, Fonkoze could have been at greater risk. The time involved in contacting senders and recipients was ultimately worth the effort in that it gave Fonkoze a better understanding of this segment of its client base and it also reassured the U.S. bank that Fonkoze had the necessary controls in place.

All of these examples suggest that the capacity of management, staff and systems to handle a money transfer product is quite different from the core service of lending that an MFI is set up for. Microfinance clients are typically low-income, may be self-employed, do not own assets that are conventionally accepted as collateral, and may have uneven streams of income. This client profile reduces the risk of such institutions being used for money laundering. The minute the MFI enters the money transfer arena, however, that risk increases tremendously. Of all the financial services low-income people access, money transfers are probably the most open to both money laundering and the financing of terrorism especially if the transfer is international.

The main challenges that MFIs who enter the international money transfer market face arise from the obligation to undertake customer due diligence and to absorb the potential costs of correct implementation of the regulations. Since the introduction of new or tightened regulations may have the unintended consequence of reducing the access of low-income people, CGAP argues for policies that allow for gradual implementation of new measures, the adoption of a risk-based approach to regulation, and the use of exemptions such as South Africa adopted for low-risk categories of transactions.[44]

B. Readiness and capacity of the institution to provide the service

Virtually every institution that enters the remittance market agrees that operating a money transfer service puts to the test the institutional capacity of the MFI in terms of its management, staffing, systems and marketing. The institution must be well managed and governed, with stable, profitable and transparent operations for existing financial services. With increasing competition among remittance providers, the quality of service that the institution can offer is all the more important. If an MFI's remittance partner suspects that service quality is below average, they will break the partnership. If clients do not receive the quality of service they are seeking, they will go elsewhere. If agents on the sender side hear that one client has not been well served, they will stop sending all clients. If the sender is unhappy with the service, they usually have many other options for sending money home.

This is the reason that WOCCU insists that all credit unions distributing remittances participate in capacity-building efforts offered by WOCCU and funded by USAID. The capacity building usually occurs over an extended period of several years and seeks to ensure that each credit union distributing remittances has reached the level of financial soundness and operational sophistication required to manage and market remittance distribution.[45]

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[44] Jennifer Isern, David Porteous, Raul Hernandez-Coss, and Chinyere Egwuagu, *AML/CFT Regulation: Implications for Financial Service Providers that Serve Low-Income People,* Focus Note No. 29, (Washington, DC, CGAP, July 2005), p. 6.
[45] Evans et al, p. 7.

CGAP cautions that it is important that pro-poor MFIs evaluate themselves before deciding whether or not to launch any new service and especially money transfers.[46] The considerations that must be taken into account are:

1. Money transfer operations require a significant investment in skilled human capital. Specialized staff is needed for customer relations and back-office functions. Fonkoze discovered just how difficult it can be to keep its partners satisfied with the quality of service because it has had a very difficult time convincing its employees that the communication channels back to its partner money transfer company are important not only when the client has received his/her transfer but also when delivery has not been made. Those companies that are trying to excel at customer service demand that if the client cannot be found due to an incorrect phone number or a wrong address that the agent in the sender country is informed quickly. Teaching its staff all that customer service entails, especially in a country with poor communication channels on the best of days, has been challenging.

2. Information systems must be capable of managing the volume of transfers, ensuring speedy delivery, guaranteeing transaction security, interfacing with other partners, and generating reports to comply with regulations. For example, when BancoSol in Bolivia decided to end its relationship as a sub-agent to Western Union and begin to work directly with small and medium-sized remittance companies, it had to develop a proprietary database system that enables the bank to receive and integrate transaction information from different

[46] Isern et al, *Crafting a Money Transfers Strategy,* p. 18.

companies in a standard format.[47] Financiera El Comercio in Paraguay, which does operate as an agent of Western Union, has not yet been able to download transaction information to its own system to link transfer to client account information or other financial products. This constitutes a key challenge for this MFI.[48]

3. Continuous targeted marketing is the key to attracting new clients. Although some marketing on the receiving side is necessary and effective, marketing appears to have the most impact on the sending side, near the point of sale. A principal way that leading money transfer companies maintain their dominant market share is through very expensive media campaigns. This makes it important that the MFI in the recipient country ensure that its partner in the sender country has an effective marketing campaign. MFIs without such partners are rarely able to compete with the well-financed media campaigns that the leading money transfer companies launch and must therefore design specialized strategies targeted at specific ethnic communities.

4. Remittances require significant liquidity, which in turn requires careful management and often increases foreign exchange risk if the MFI is paying in non-local currency. Often an MFI has a strong motivation to limit the amount of cash that it is handling in order to minimize security risks and maximize income from the investment of cash. Yet entry into the remittance market demands that cash be available on a consistent basis. Most transfer recipients expect to receive the full total of their transfer in cash, yet it can be difficult,

[47] Sander, ed., p. 8.
[48] Idem.

especially in the early days, to anticipate the quantity of cash an MFI (or even a particular branch office) will need on a regular basis. And, to the extent that an MFI is successful, that quantity will continue to grow. Cash needs may vary by season: for instance cash needs often increase dramatically around holidays. For example, WOCCU member Caja Popular Mexicana received $1.2 million in remittances during the five months of its pilot test in 2003, challenging its liquidity management. The Jamaica Co-operative Credit Union League (JCCUL) understood the need for managing funds closely and issued a *Model Risk Analysis Checklist, Internal Control Policies for Remittances,* and *Model Cash Handling Procedures for Remittances* for the 18 credit unions that receive remittances in Jamaica.[49] The cash handling procedures specifically addressed how to analyze minimum and maximum amounts of cash needed.

5. Because entry into the remittance market can require significant investment and is expected to generate profits, initial financial projections and ongoing financial analysis capabilities are critical. For instance, it is very important for an MFI to be able to make revenue projections of the market potential before making a decision to enter the market. MFIs must have the capacity to estimate not only projected revenues from cross-selling of other products but also the savings generated by increased customer retention.

C. Identification and penetration of an appropriate market niche

According to CGAP, money transfer providers:

[49] Evans, et al, p. 11.

> *face a problem that seems deceptively simple: how to move funds from a sender to a recipient and make a profit. Yet the choice of partners, transmission mechanisms, and customer interfaces involves a complex set of strategic considerations. These include market factors, the regulatory environment, and the institution's own internal capacity. Market considerations are particularly important for pro-poor [providers] that enter the money transfer business, since they must typically compete with established – and often specialized – money transfer companies. [These providers] need to find a market niche and craft their money transfers strategy accordingly.*[50]

To identify an appropriate market niche, CGAP recommends that the MFI conduct a thorough market study to assess the potential value of offering money transfer services. Different remittance markets have different characteristics, depending largely on national preferences. On the receiver side, for example, does the recipient prefer to go and pick up her remittance, to receive the remittance as a direct deposit into her savings account, or to have the funds delivered to her home? CGAP recommends analyzing client preferences such as these, in addition to competition, institutional issues, and market and environmental factors in order to craft a robust money transfer strategy.[51] Unfortunately, according to a recent survey of 27 MFIs and two credit union federations operating in Latin America and the Caribbean, only two – Financiera El Comercio in Paraguay and Genesis Empresarial in Guatemala – carried out market research to identify the size of the potential remittance recipient clientele and the services they already receive or could potentially receive.[52]

Some of the key decisions that need to be made in identifying an appropriate niche after analyzing the market include:

[50] Isern, Deshpande, and Van Doorn, p. 14.
[51] Ibid., pp. 14-15.
[52] Orozco and Hamilton, p. 60.

1. Will the service target the domestic or the international market? For example, First MicroFinance Bank Limited Pakistan (FMFB) has been providing a domestic electronic inter-branch transfer service since 2003. It is currently the only microfinance provider in Pakistan to offer this service. Similarly National Microfinance Bank of Tanzania, with a network of 108 branches, offers one of the main domestic money transfer services in the country, handling government payments and private sector transfers.[53] Other microfinance providers, such as BancoSol in Bolivia and Fonkoze in Haiti, have chosen to offer international remittances.

2. What model will provide access to a network of sending and receiving clients? Some microfinance providers act as sub-agents for international companies like Western Union or MoneyGram, as does Financiera El Comercio in Paraguay. Others prefer to work directly with small and medium-sized money transfer companies as a paying agent. Still others, such as ACLEDA Bank Plc in Cambodia, offer direct international funds transfer via SWIFT. Through its International Remittance Network (IR*net*), WOCCU offers credit unions both in the United States and abroad a vehicle by which to send and distribute remittances at low cost.

3. What payment mechanism will be employed? Potential payment mechanisms can include (a) cash-based transfers, the most common type (b) paper-based transfers, which include checks and bank drafts, money orders and international payment orders (c) card based, including credit

[53] Cerstin Sander, "Capturing a Market Share? Migrant Remittances and Money Transfers as a Microfinance Service in Sub-Saharan Africa," *Small Enterprise Development*, Vol. 15, No. 1, March 2004, p. 31.

cards, debit cards, and prepaid cards (d) electronic mechanisms that include ATMs, SWIFT, Telex, International ACH networks cards, International GIRO, Internet and even mobile phone schemes. There are some institutions that argue that technology solutions are the current frontier in remittances. Manuel Orozco, the leading expert on remittances, argues that current technologies can offer at least four advantages to both the remittance and MFI industries: "functionality, value added innovative abilities, business and development impact, and cost effectiveness."[54] However, as he points out, "the investment, administration, maintenance and training costs of such [technology solutions] . . . are often outside the reach of MFIs.[55]

4. What competition will the MFI face? Without an in-depth understanding of the formal and informal money transfer agents operating in its region, the transfer mechanisms they use, the volume of transfers they process, and their strengths and weaknesses, identification of an appropriate niche is impossible. Moreover, the number of players in the market may not be small and may include commercial banks, money transfer operators, credit unions, post offices, foreign exchange bureaus, and other MFIs. Informal actors may include travel agents, couriers, bus drivers, shop owners, business people, family, friends, and migrants themselves when they return home.

D. How much will entry into the market cost the MFI? These costs can be daunting. In order to distribute remittances efficiently, MFIs must invest in (1) the initial market study and strategy

[54] Orozco and Hamilton, p. 60.
[55] Ibid., p. 61.

development, (2) information technology systems to manage and distribute remittance and receiver information, (3) staff training to prepare them to work in the operational areas, (4) internal control systems that include basic safeguards as well as directions for handling each remittance transaction and for regular reconciliations, and (5) sophisticated marketing programs.

Although there is very little information available on exactly how much a pro-poor microfinance institution can expect to invest, it is clearly a significant investment that requires careful planning and monitoring to ensure that the service will eventually be able to cover its costs and still offer a quality product at a competitive price.

The complexities, costs and risks of entering the market successfully is one of the principal reasons that many MFIs choose to form a partnership with an existing remittance service provider by becoming a paying agent or sub-agent. Such partnerships can significantly reduce both the cost and the risk to entry into the market by providing access to international payment networks, foreign exchange access, and risk management expertise. In addition, these companies often will provide stand-alone data systems to the MFI, train the MFI staff and absorb all or most of the marketing costs. For the money transfer company or commercial bank partnering with an MFI, the advantages of an existing customer base, multiple locations in hard-to-service areas, and client trust in their services often make MFIs attractive partners.[56]

E. Identifying partners with the same values and negotiating mutually advantageous partnership agreements.

[56] Isern, Deshpande, and van Doorn, p. 20.

If an MFI decides to enter the market as an agent or sub-agent to another money transfer provider, other challenges arise. First, it is important that the MFI identify partners that hold the same values it does. For instance, Fonkoze is committed to making its clients, both those living in Haiti and those living abroad, better consumers of financial services. Thus, although it is currently a payer for multiple companies, it works hard up-front to ensure that those companies also believe that a well-informed customer is a better customer. Fonkoze is also interested in providing its clients with maximum choice, so it has refused to sign any partnership agreements with exclusivity clauses. It is clear that this multi-partnership model requires the MFI to have a strong negotiating position with its potential partners as well as strong management and systems capacity. Finally, it requires management expertise to concurrently manage several business relationships, which can be difficult, especially when dealing with problem transactions.

For instance, to work with multiple partners, BancoSol in Bolivia had to develop a proprietary data platform that enables them to receive and integrate transaction information from different companies in a standard format. This was a significant added cost.[57] The advantages, however, outweighed the costs in this case because BancoSol is able to receive the full commission as the paying agent rather than a reduced commission as a sub-agent of Western Union. It also helped BancoSol establish a strong network of partners in strategic markets where it most wants to operate.[58]

In an effort to enter the remittance market, some MFIs have become payers or sub-agents from some of the highest priced

[57] Sander, ed., p. 7.
[58] Ibid., pp. 7-8.

providers. This can lead to two different problems: first, the charges can be comparatively out of sync with the level of charges the MFI levies on other services it provides and make it impossible to offer a lower-cost product; second, the market share enjoyed by the MFI can decrease accordingly. For instance, Financiera El Comercio in Paraguay has been a Western Union agent since 2004. The high fee Western Union charges has been a principal challenge for the MFI, but because of the high volume Western Union produces and the potential for cross-selling efforts, El Comercio maintains it was the right decision.[59]

Having the requisite negotiating skills can also constitute a challenge. It is important that the MFI carefully consider the competitive advantages that it can offer. Some of these might be:

1. Location
2. Branch infrastructure
3. Reputation among pro-poor clients (confidence in the institution)
4. Local knowledge of the client base
5. Access to pro-poor clients
6. Client mistrust of other banking institutions
7. Ability to win the confidence of potential clients
8. In-depth knowledge of the locations and decision-making processes of the remittance senders

Once these competitive advantages have been identified, the MFI can be better positioned to negotiate a mutually beneficial partnership.

[59] Ibid., p. 8.

IV. Easing The Entry Of MFIs Into The Remittance Market

Earlier sections have discussed how new measures to combat money laundering and the financing of terrorism are actually complicating the already difficult entry of an MFI into the remittance market. Are there ways at a policy, financing or technology level that we could ease the entry of MFIs into the market place in the hopes that more MFIs will be able to realize the opportunities that are present? Three come immediately to mind:

A. Policy changes in the legal and regulatory environment. As argued herein, the biggest single determinant of whether an MFI will be able to enter the remittance market is the legal and regulatory environment in the developing country. Some countries simply do not allow unregulated institutions to transfer money or to engage in other kinds of currency payments. This is especially true in several Asian countries and in Sub-Saharan Africa. CGAP recommends that with respect to new measures to combat money laundering and the financing of terrorism, policymakers can make provisions to gradually implement new measures, adopt a risk-based approach to regulation and use exemptions for low-risk categories of transactions. There are also numerous other policy changes that could have the effect of easing the entry of pro-poor MFIs into the remittance market, although what these are depend on the country-specific regulations. In some countries, it may be as easy (or difficult?) as changing a regulation to allow certain types of MFIs to handle foreign exchange or to accept savings or to become agents of money transfer companies.[60]

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[60] The alternatives are to change the legal status of the MFI or to seek partners with appropriate legal status or licenses.

B. The capacity of the MFI is the second single biggest determinant of successful entry into the remittance market. Donors can assist MFIs to address this problem by increasing the technical assistance being provided to them in such areas as market research, product design, commercialization strategies, and technology development.[61] And, they seem to be starting to do so. For instance, the International Fund for Agricultural Development (IFAD), the European Union and CGAP are soon going to launch a global technical assistance fund for MFIs seeking to introduce or refine existing money transfer services. IFAD and the MIF/IDB have a similar fund for the Latin America and Caribbean region.

C. An especially interesting idea, being developed in Ireland, is to build a global remittance network coalition that brings together like-minded pro-poor MFIs, community banks and microfinance institutions. The coalition would provide managed technologies to enable international funds transfer services and remittance capability. MFIs would have access to a technology platform linking them with key banks, nonbank financial institutions, and existing small-scale money transfer partners to enable cross-border remittances. The hope is that this network will allow microfinance institutions from around the world to enter the market with less investment cost and to be able to provide a competitive service at reduced cost, thereby building sustainability and further profitability for the MFI. In addition, the technology has the potential to solve problems related to compliance and regulation caused by the Patriot Act in the USA and similar legislation in other countries. These regulatory concerns have prevented many first world banks from entering into or staying in the remittance market and from building partnerships with MFIs in developing countries. The nature of the problem of entry into the remittance market for MFIs is not

[61] Ibid., p. 62.

easily solved at a local level. This solution would take a strategic view to create value, aggregate activities and cut costs.[62]

V. Answering the key questions: Can pro-poor MFIs overcome the challenges and successfully enter the remittance market? Can those who do succeed leverage remittances for local development and deliver a reduction in poverty?

The answer to both these questions is a qualified "yes." Yes, there are some few pro-poor MFIs who have demonstrated that in some countries it is possible for them to enter the remittance market and be successful at it. However, at this point, the number of MFIs who have succeeded is relatively small and the extent to which they have succeeded is not yet fully documented. As we have seen, there are two principal reasons for this: first, the regulatory environment will not allow it and second, the MFIs themselves may not have the capacity to do so. They are lacking the management talent, the skilled staffing, the information and/or control systems, the liquidity, the locations, or the marketing capacity to do so. Or, the market in which they are functioning does not have sufficient numbers of transfer recipients or it is already saturated with other providers that are satisfying the demand.

So, while there are a few interesting success stories, such as those mentioned in this paper, most turn out to be regulated financial institutions that are not especially pro-poor in focus or payers for other existing remittance companies or commercial banks, which limit their ability to offer a lower-cost product. This is not intended to minimize the successes that some have had and the probability that others will follow, but only to caution against thinking that we will see a massive entry of pro-poor MFIs into the market.

[62] See the article entitled "Newsquare expands worldwide network with US deals" in *The Sunday Business Post*, December 11, 2005. http://www.thepost.ie.

With respect to the second question, "Can those who do succeed leverage remittances for development purposes and deliver a reduction in poverty?" again the response is a qualified "yes." According to the study of MFIs in Latin America and the Caribbean that have entered the market, Orozco and Hamilton concluded first, that most of those surveyed have a moderately effective presence vis-à-vis the major competitors. This suggests that they are "potentially and strategically placed to provide a wider range of financial services than remittance recipients might otherwise have." Secondly, they do offer transfer costs below the market average making marginally more money available to low-income senders and recipients, thereby reducing their poverty level. Thirdly, however, not all have sought to provide other financial services to their remittance clients and only one-third of those surveyed offer tailored financial services to their clients. Yet such services – such as loans to purchase homes or start businesses, safe interest-earning savings products, and life and/or medical insurance – are critical to whether they are in fact successfully banking the unbanked and leveraging the development impact of remittances.[63]

It will take more MFIs like those that have successfully entered the market and more documentation of those that do before we will be able to conclude that not only are MFIs able to offer a quality pro-poor product at a lower price but that they are also able to leverage the development impact of remittances and deliver reductions in poverty.

[63] Orozco and Hamilton, p. 62 and p. 58.

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