

Capturing a Market Share?

Migrant Remittance Transfers & Commercialisation of Microfinance in Africa

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by Cerstin Sander
Bannock Consulting
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This is work in progress and a topic of continued interest for the author. Any comments as well as feedback on additions are very welcome. Please send them to cs_sander@yahoo.de or cerstin_sander@bannock.co.uk

Executive Summary & Introduction

In maturing microfinance markets with increasing competition, professionalisation and commercialisation of microfinance are key to sustainably serving the microfinance clientele. In this context, the common uniformity of services and products of microfinance institutions (MFIs) in the same market can be a significant disadvantage.

This paper looks at migrant remittances to and in Africa¹ and the link with the microfinance industry as a provider of money transfer or ancillary financial services to remittances. It explores what transfer services microfinance institutions currently do or could provide and discusses the opportunities and challenges of such services for MFIs. Such a financial service perspective is a relatively new angle in remittance studies compared to the more traditional migrational, anthropological, or economic analyses. A focus on Africa in this context is similarly a contribution to an otherwise strongly Latin America centred interest and documentation on remittances.²

Remittance transfers by migrant workers or professionals have been recognised as a significant financial flow for developing countries. They have also emerged as the fastest growing and most stable flow.

Due to the perceived or actual proximity of MFIs to client groups who typically receive remittances, the opportunity and potential for money transfer services by MFIs has become of growing interest. Money transfer is seen as an opportunity to provide a new and potentially very profitable product which can aid in the commercialisation process. The outreach networks of MFIs are seen as potentially highly compatible for such a service which would also address another need of clients. It could open up an avenue to (better) integrate remittance receivers as microfinance clients and build their financial capital and/or profile. More generally, attracting remittances to formal financial services constitutes a business opportunity to the service provider of the money transfer product as well as for cross selling other financial services they offer.

The findings indicate that there is a high potential for capturing a market share of an underserved market of remittance money transfers. MFIs in Africa, unless operating as regulated financial institutions, however, are not necessarily the best placed to take advantage of this opportunity. This is due in part to their legal limitations as financial service providers, their limited institutional and system capacities, limited capital reserves, and limited networks of service outlets and links to international networks. Nonetheless, there are product opportunities for MFIs which can contribute a competitive and profitable service as part of a commercial or commercialising MFI, such as focussing on domestic rather than international money transfers.

The paper looks at remittance flow and use analysis as a backdrop to understanding the business potential for money transfer services for remittances. This is followed by a discussion of the business opportunity for MFIs. A preliminary review framework of considerations for the uptake of money transfers as a product by MFIs is included.

This paper benefits from work completed by the author on a number of studies on remittances and money transfer, some conducted with fellow experts, researchers, or colleagues. These have been conducted with the support of different organisations, namely the World Bank (Sander, 2003a), the UK Department for International Development (DFID) (Sander, 2003b), the International Labour Office (ILO) (Barro et al., 2003), and MicroSave-Africa (Sander et al., 2001 and Sander et al., 2003). This paper draws in part on these and also builds on them. The author thanks all fellow authors and researchers for excellent collaboration and learning in these studies and the sponsors for their interest and support, both financial and professional. All errors and omissions, however, are the responsibility of the author alone.

1 The paper looks at continental Africa and island nations as a whole for remittance flows though with focus on Sub-Saharan Africa, especially on the financial services and microfinance questions. This is in line with the common definition of grouping Northern Africa with the Middle East rather than Africa.

2 A global scoping study on migrants' remittances indicates that Africa has to date received the least attention in studies or discussions on the subject. This may in part be explained by, in global terms, the relatively fewer emigrants and more dispersed migration patterns of African emigrants as well as the relatively lower portion of global remittance flows going to the African continent. (Sander, 2003a and 2003b)

The Market – Remittance Flows, Channels & Uses

Understanding volumes and significance of remittance flows, the motivations behind sending remittances, how they are sent, and the intended and actual uses are important in assessing the potential of a market niche and with which product and strategy MFIs could attract these money transfers to their business. Similarly, it is important to understand whether current use patterns of remittances might be altered and funds attracted through the provision of options in financial services, such as cross-selling services, especially savings products or other investment or risk management products, such as microinsurance.

Remittance Volumes & Flows Globally

The World Bank's Global Development Finance Report 2003 (GDF) highlights migrant workers' remittances as an increasingly important and most stable source of external finance for many developing countries. Globally, migrants sent US\$ 80 billion in remittances to developing countries in 2002. Compared to 33.1 billion in 1991, remittances have more than doubled over the past decade. The increase of about ten percent from \$72 billion in 2001 illustrates how this growth has accelerated.³

Remittances constitute the second largest flow of external finance behind FDI (41% of FDI flows, 2001) and ahead of official flows (260% of ODA, 2001). Remittances are also more stable than other sources.⁴ Remittances have also outpaced migration, which is currently estimated to grow at 2 to 3 percent annually.

Remittance Volumes & Flows for Africa

Remittances are an important capital flow to the African continent and one that is largely underreported. (see Annex 1 Data Note) It is important despite the fact that growth in remittance flows, especially to Sub-Saharan countries, has not been very pronounced, that flows are almost erratic for some countries, and that aid dependency is relatively high.⁵

The global trends in remittances to developing countries are not mirrored in the flow to African countries. Whereas remittances to developing countries have more than doubled over the last decade, remittances to Africa have grown little and have declined in relative share – for Sub-Saharan Africa from some 8% in 1980 to 5% in 2002.⁶ (see also Figures 1 & 2) Total remittance receipts in Africa over the past decade peaked in 1992 (US\$ 10.7 billion) and were at their lowest in 2000 (US\$ 7.8 billion). (See Figure 2)

In 2002, Sub-Saharan Africa received US\$ 4 billion or 5% of total workers' remittances received by developing countries; for the Middle East & North Africa combined it was US\$ 14 billion or 18%, for North Africa alone about 10%.⁷ In terms of flows to the continent, Northern Africa has received the lion share of almost three quarters of all remittances to the African continent. In Sub-Saharan Africa, East Africa currently receives about one fifth of the share and has overtaken West Africa, though previously the latter was the second most important remittance receiving region. Central Africa does not even register a full percentage point relative to the rest of the continent. (see Figures 3 & 4)

³ GDF, 2003 and Sander, 2003a and 2003b; please see also Annex 1 with a note on data availability and quality

⁴ *ibid.*; see also Buch et al., 2002; Gammeltoft, 2002

⁵ see *ibid.* footnotes 2 and 3

⁶ GDF, 2003; Gammeltoft, 2002

⁷ based on GDF, 2003 and GDF data set

Remittances received in 2002 represent 1.3% of GDP for Sub-Saharan. This compares to 1.3% of GDP for all developing countries and 2.5% for South Asia, the latter recording the largest effect on GDP. Globally, only four African countries are among the top 20 receiving developing countries as a percentage of GDP (2001) (see Table 1).⁸ On a per capita basis, the only African country in the top 10 was Cape Verde on 9th rank (2000).⁹

For selected countries, remittances contribute substantially to the balance of payments. For instance, during the 1980s international remittances covered 80% of the current account deficit in Botswana; compared to almost three quarters (70%) of total commodity export earnings in Sudan; and constituted more than half of the forex earnings in Lesotho.¹⁰ As share of exports and of GDP, remittances scored high for Eritrea with 194% and 19% respectively for 1999 and was substantial for countries such as Cape Verde (51% and 12%), the Comoros (24% and 6%), and even Egypt (26% and 4%) and Morocco (18% and 5%).¹¹

African lower middle-income countries received the lion share over the past decade with close to three quarters, compared to low income countries with close to one quarter. While this has fluctuated somewhat, overall it has shifted in favour of low income countries.

This picture is, however, somewhat skewed due to the low quality data and also lack of data on remittances, especially for Sub-Saharan Africa where data is lacking for about two thirds of the countries. (see Annex 1) Moreover, informal flows of remittances are likely substantial.

While no estimates of informal remittances are available for Africa, in selected countries such as Sudan, informal remittances were estimated to account for 85% of total remittances.¹² Overall relatively weak financial systems and the high proportion of intra-regional migration in Africa suggest that informal remittances are likely to be a substantial share of total remittances. Globally, informal remittance flows are estimated to more than double the officially recorded US\$ 80 billion (2002) to developing countries to as much as US\$ 200 billion.

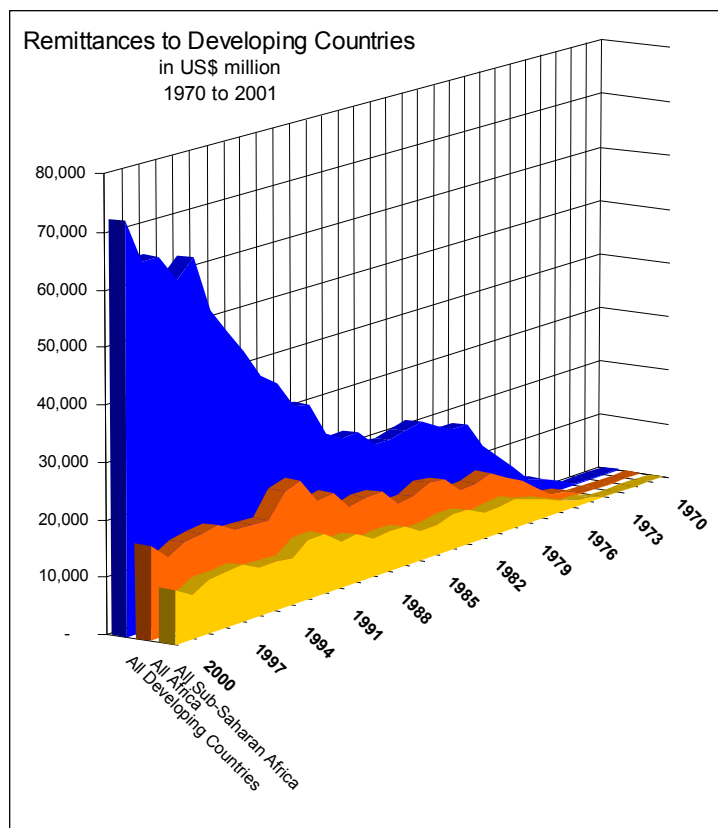


Figure 1
(Source: Sander, 2003a)

⁸ GDF, 2003. In Lesotho in the 1990s, Basotho mine workers' remittances from South Africa accounted for as much as 67% of GDP. (IOM, 2000)

⁹ IOM, 2000

¹⁰ de Haan, 2000

¹¹ see Rapoport et al., 2001

¹² A study incorporating unrecorded remittances into the national accounts in Sudan showed an increase of the proportion of net current transfers from 6 per cent to 45 per cent of the adjusted Sudanese GNP in 1983-84. It also adjusted Net Factor Incomes upwards to 17 per cent of adjusted GNP from 7 per cent of recorded GNP. (Brown, 1982, cited in Puri et al., 1999)

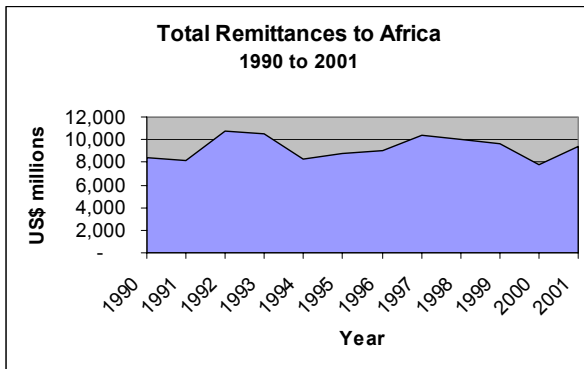


Figure 2

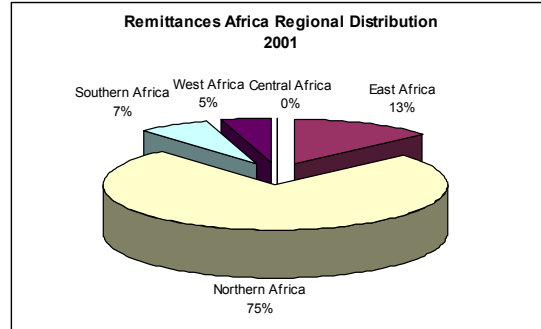


Figure 3

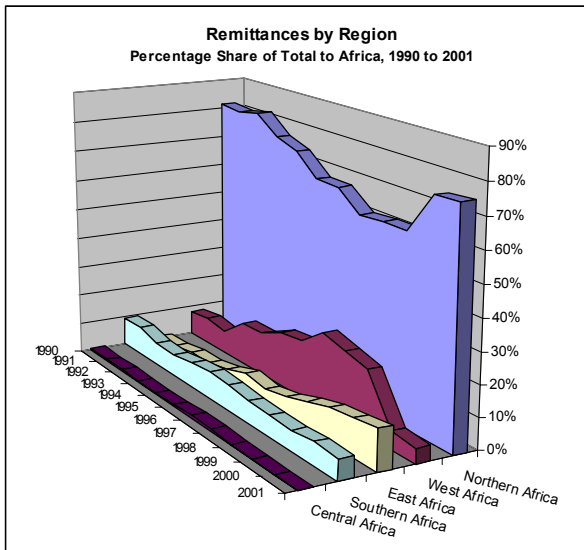


Figure 4

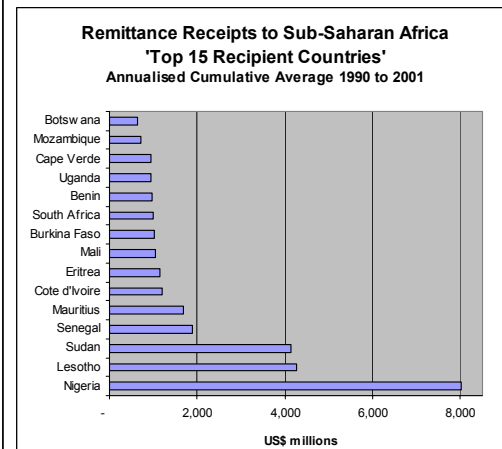


Figure 5

Remittance Receiving Countries

Egypt is the single largest receiver, with Nigeria the largest in Sub-Saharan Africa, followed by Lesotho, Sudan, Senegal, and Mauritius. Morocco and Egypt are the only countries from the African continent which feature among the global top five remittance receiving developing countries. (See Figure 5)

Remittance Source Countries

The top five remittance sending countries in Africa were South Africa, Ivory Coast, Angola, Egypt and Botswana (see Figure 6, recorded as debits). Overseas, in terms of global flows, they were the United States, Saudi Arabia, Germany, Belgium, Switzerland, and France – in descending order for 2001 (see also Figure 7, recorded as debits). The US tops the list with \$28.4 billion, though some sources argue that this is grossly overreported as the US is the main hub of correspondent bank transactions. In terms of remittances to Africa, while not specified in official remittance data, based on migration flows, the list would certainly include North America, and

parts of Europe and the Middle East – countries such as the United States, Canada, France, Germany, Italy, Spain, the United Kingdom and Saudi Arabia.

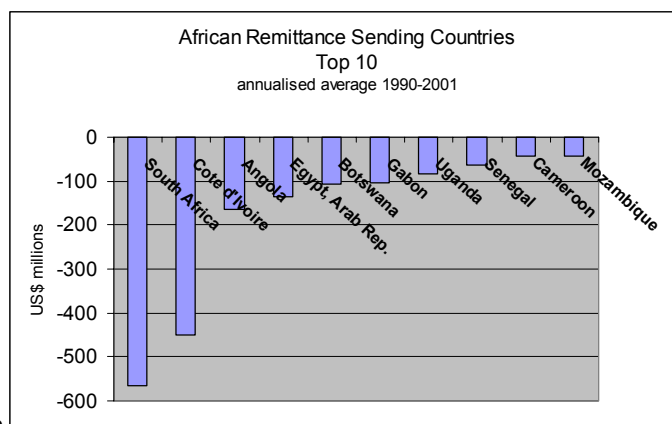


Figure 6

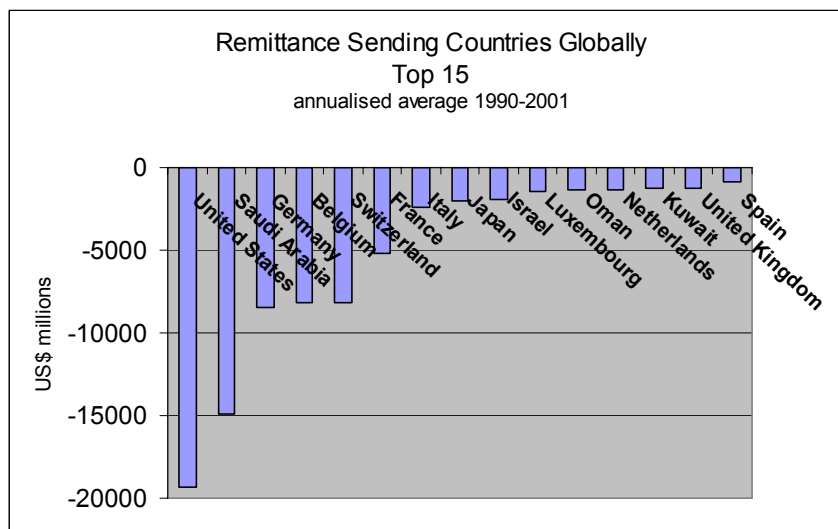


Figure 7

Remittance Recipients & Uses

In the African context, especially intra-regional and domestic urban to rural remittances constitute an important source of income to many households. This varies by country and region within the country. Overseas remittances reach fewer households than those receiving domestic or intra-regional remittances, but as they tend to be substantially higher in value than the latter, overseas remittances typically add a larger portion to household income than other types of remittances.

As elsewhere in the developing world, the vast majority of remittances goes to parents or spouses. The bulk of the funds, about four fifths, is used for consumption and investment in human capital, such as school fees or medical expenses. Investment in land, livestock, and in building or improving a home is also relatively common but secondary to daily needs and human capital expenses. A much smaller portion of remittances is used for investments, such as in

savings¹³ or in business, or to repay debt, such as a loan for the expenses in going abroad. Insecurity tends to be the main motivator for investment, and the type of insecurity affects the type of investment.¹⁴

Typically remittances constitute a transfer from relatively richer to relatively poorer and often female-headed households. The high proportion going to consumption is congruent with the aspect that, to a great extent, migration and remittances are part of a livelihood and poverty reduction strategy of the individual migrant and their families.¹⁵ The positive effect on livelihoods and standard of living is fairly well documented through case studies. Studies show that remittances are a net positive transfer and family welfare system which smoothes consumption, alleviates liquidity constraints, and is a form of mutual insurance.¹⁶

Average Remittance Value & Transfer Cost

The amount migrants send per transaction typically ranges between \$100 and \$1,000 for international remittances; for intra-regional and domestic remittances they are generally significantly lower.¹⁷ GDF (2003) quotes \$200 as a global average transaction value. This tends to be based on quite extensive research on remittances between the US and Latin America, whereas remittances to African countries are less well researched.

Though comprehensive data is lacking, the following are illustrative examples from selected studies:

- Senegalese migrants in France sent around FF 8,000 annually (ca. 2002)¹⁸
- Ghanaians sent home between US\$ 1,000 and 14,000 annually (1999 & 2000); males sent more than female migrants; family influenced migrants sent more than those who were not influenced
- Migrants from Ivory Coast sent home between US\$ 6,000 to 9,300 annually (2000)¹⁹
- migrants in South Africa sent home an average of R 2,300 (2000)²⁰
- Egyptians in the US sent home an average of about US\$ 300²¹

The use of remittances shows fairly consistent patterns across a number of studies. The majority is used for:

- ⇒ Daily needs and expenses (70-90%) -- typically labelled as consumption or as improving the standard of living
- ⇒ Medical / health care expenses or education – grouped together with the above when seen as improving the standard of living
- ⇒ Consumer durables (stereos, televisions, washing machines, etc.)
- ⇒ Improving or building housing, or buying land or livestock
- ⇒ Investment in socio-cultural life (birth, marriage, pilgrimage, death)
- ⇒ Loan repayments (often loans to pay for cost of migration)
- ⇒ Savings
- ⇒ Income or employment generating activities

Source: Sander, 2003a

¹³ As land, livestock and buildings are typical ways to invest and save in many of the migrants' home countries, the distinction is one of saving within the financial system.

¹⁴ E.g. land rather than a financial investment if the currency is volatile or there is high inflation. Insecurity as the motivator for investment is a point made by AFFORD (2001). Similarly, a study in Egypt in the early 1990s found that remittances were invested primarily in land where the economic rates of return were higher than in other areas. (cited in El-Sakka, 1997)

¹⁵ e.g. de Haan, 2000; or in Ghana: 70% for recurrent expenditure (school fees, health care, etc.), less than 30% invested in assets (land, cattle, construction) (Eurostat, 2000); in Mali: 80-90% on consumption; moderate to no investment in local business (Martin et al., 2002)

¹⁶ see also syntheses and discussions such as Buch et al., 2002; Rapoport et al., 2002, and Sander, 2003a and 2003b

¹⁷ This follows in part logically as income levels for migrants in industrialised countries tend to be higher than for domestic or intra-regional migrants. See also, for instance, Cox, 2002 on Viet Nam and Sander et al., 2001 on Tanzania and Uganda regarding lower values for domestic remittance transfers.

¹⁸ conversation with C. Diop, Senegal, July 2003; see also Eurostat, 2000

¹⁹ Tiemoko, 2003 – for bullet points on Ghana and Ivory Coast

²⁰ Immigration Laws, 2000

Remittance Transfer Services & Transactions

Money transfer services to and within Africa include financial as well as non-financial service providers.²² Formal channels include money transfer services by banks and post banks as well as by non-bank financial institutions, such as forex bureaus or dedicated money transfer operators. Best known among the latter are Western Union and MoneyGram. In domestic or intra-regional markets, bus, coach, or courier companies can be found to offer money transfer or transport services.²³

Informal remittance systems in Africa tend to be similar to the elsewhere well documented Hawala or Hundi style services with networks of agents or single destination services.²⁴ Similarly, still also very common are transfers or transport based on personal relationships through business people, taxi, bus or truck drivers, friends, relatives, or carried by oneself.²⁵ In several studies around microfinance, savings, and money transfer in Africa there is, however, a noticeable decline in trust in informal systems and heightened sense of insecurity due to theft and robberies.²⁶

Factors such as trust, familiarity, service in the migrant's mother tongue, and having the service within easy reach – in the neighbourhood or accessible as part of a regular shopping route – can often be as important as the cost. The choice of service or channel is also influenced by factors such as accessibility both at the sending as well as the receiving end. Many of the MTOs and also the informal services are successful because they work with a market segment of migrants who are located in 'micro-markets' – often certain cities and neighbourhoods within them.²⁷ Thus, for instance, Kenya Post Office Savings Bank, the main Western Union agent in Kenya, organises regular marketing events with Kenyan diaspora in locations such as Minneapolis, Minnesota, and Columbus, Ohio. They mentioned that the loss of a point of sale in a key area has noticeably reduced the number of transactions.²⁸ South Africa is a good example of a high volume market where a dedicated financial institution, Teba Bank, is closely linked with the mine workers and provides money transfer services to many migrant miners, both in South Africa and across the borders.

While capitals and other urban centres have fairly good financial service availability, rural regions tend to be much less well serviced by the financial industry. The choice of service can further be limited by unfamiliarity with the service, or, for instance in the case of banks, due to perceived or actual rejection of the potential client by the service provider. Banks can be intimidating to people not used to dealing with them and banks typically prefer to target high net worth individuals and

²¹ Orozco, 2002

²² this section draws on Sander, 2003a and 2003b which can be referenced for examples from other developing regions; examples here refer to Africa only; other key sources include Orozco, 2003; GDF, 2003; Genesis, 2003; Cross, 2003; and Sander et al., 2001

²³ the distinction between transfer and transport services is that the former books the transaction through some form of accounts and system of reconciliation, whereas the latter involves physical transport of the valuta; see also Sander et al., 2001, where this distinction is made, and transport services, such as coaches and courier companies, are described based on market research in Tanzania and Uganda.

²⁴ see, for instance, El-Qorchi et al., 2002 for an excellent description and analysis of Hawala

²⁵ see, for instance, Genesis, 2003; Sander et al., 2001

²⁶ e.g. Sander et al., 2001; other information is based on research in East Africa as well as conversations with African diaspora in UK; on Somali remittances and system, see especially also Omer, 2002. See Cross, 2003, on the effect of theft and robbery in South Africa on rural post offices which as a result no longer offer the service. Similarly in Senegal, for instance, there is indication of a preference for using formal services. (see Barro et al., 2003)

²⁷ For instance, concentrations of Kenyan migrants can be found in Minneapolis in the US or in Tottenham, North of London, in the UK. To capture their business, MTOs have to be present in their neighbourhoods. Western Union and its Kenyan agent Kenya Post Office Savings Bank, for instance, seek out these communities for marketing trips and events.

²⁸ conversation with KPOSB staff

corporate clients; this is reflected in policies which create access barriers such as account fees and/or minimum balances on accounts.²⁹

The interface of formal international remittance services with service points in the sending and receiving country is an important aspect. Many formal remittance channels weaken or break down beyond an initial 'arrival point' in the migrant's home country. For instance, only banks which are part of international transfer systems such as SWIFT or who have correspondent banks can have international transfers sent to them. In some countries this excludes post banks (for instance in Kenya, which can receive transfers but only as an agent of Western Union). Similarly, ATM systems, given the high set-up cost, are currently still viable only in high volume markets with the requisite infrastructure. Where they have sprung up and are expanding, they are often not yet integrated but either proprietary to a specific bank and for use only with their cards, or limited to one or another network, such as either VISA or Mastercard (e.g. Uganda).³⁰

Such constraints are costly to the sender and the receiver. A study in South Africa, for instance, estimated that as much as 40% of the total value of a remittance of R200 to a rural recipient could go towards banking charges and transport costs.³¹

Market failures, such as weak or mistrusted banking industries and inefficiencies in their transfer systems, have prepared the ground for MTOs. Similarly, post offices, a prime service provider as far as access or outreach is concerned, are often not used in receiving countries because clients have experienced their services as inefficient and unfriendly. Experiences of insufficient cash on hand or other delays in receiving the funds are commonly cited, for instance in East Africa. At the same time, where post offices do operate effectively, such as in many parts of South Africa, post office money orders are a preferred option for domestic remitters. Again because of cost and risks involved, however, not all post offices in the country can handle money orders.³²

Transfer Costs

Globally, studies indicate an average cost of about 13% of the remittance value. Though not much documented research exists on costs for remittance transfers to African countries, some general parameters are valid. Costs vary by amount remitted, service used, the destination, and also from where it is sent; typically they range from a low of 0.2% to about 20% for average remittance transactions.³³ Costs tend to be highest for small transactions as most of the transfer services charge a minimum fee. While some studies find that certain migrant groups show high sensitivity towards cost, others find that familiarity or convenience can often lead to the use of a more expensive service.³⁴ (Please refer also to illustrative examples of percentage fee costs in Annex 2.)

²⁹ For instance, in looking at reasons why some individuals rely on informal means of transfers rather than the bank, even though the bank transfers are usually less costly in South Africa, one study found the following explanations:

- ⇒ People who fall outside the formal economy often mistrust formal institutions such as banks;
- ⇒ Bank branches can be intimidating;
- ⇒ Senders/receivers could be concerned about privacy;
- ⇒ There could be a general lack of product knowledge because of lack of marketing by the formal institutions and/or because of illiteracy of financial illiteracy among potential clients;
- ⇒ Consumer inertia, clients stop looking for alternative means of transfers. Informal systems are 'easier to understand' because 'that's the way people always did it'. (Genesis (2003)

³⁰ Similarly, for instance, the limited availability of bank branches and ATMs in rural towns is a big problem in South Africa. In the Eastern Cape many rural branches had to close in the mid-1990s due to the general economic decline, the rise in violent bank robberies, and the spread of internet banking among higher income groups, of which the latter undercut the need for an expensive risky local bank structure accessible to the poor. However where available, ATMs are becoming increasingly popular as a way of getting around restricted banking hours (Cross, 2003) (see also Genesis, 2003)

³¹ Cross, 2003

³² Cross, 2003; Nagarajan, 2003; Sander et al., 2001

³³ GDF, 2003; Orozco, 2003; Sander et al., 2001

³⁴ Puri et al., 1999

Of the various transfer products, transaction costs are on average higher with MTOs compared to bank transfers between accounts, such as negotiated through SWIFT. At the same time, MTOs have a more demand-oriented network of points of sale, on average much shorter transaction times, and do not have access barriers such as requiring an account. Speed and reliability is part of their service and also their marketing strategy.

For global MTOs such as Western Union and MoneyGram the lowest fees typically start around US\$ 15 but again actual fees depend on the sending and receiving country. The fee structure is by bracket of the transfer value. An average transfer cost per transaction is 10%. Smaller MTOs typically charge a commission on a percentage basis, commonly around 5%, though it can be higher.

Banks typically combine a minimum fee with a percentage fee. Minimum fees at banks range from about US\$ 5 to 50 depending on the sending and receiving country as well as the product. Percentage fees are sometimes flat, sometimes bracketed on a declining percentage for larger amounts. For large transactions, banks tend to be cheaper than other services as their percentage cost can go below 1%.

Informal services charge about 3 to 5% though they can at times be substantially higher. In some cases there are no fees for informal services and the revenue is realised solely from the forex gain or based on mutual 'friendship services'.

Especially in recent years, the competition among service providers in some markets has begun to lower the costs of formal services. This has been observed especially in parts of the Latin American market, such as for transfers from the US to Mexico, but also for some of the African 'destinations'. Thus, the sending cost can often be cheaper when the funds are sent to a high volume destination and, especially, when there is competition in the market, either among MTOs or between MTOs and informal services. For instance, Western Union has standard rates for transactions but adjusted, more competitive rates in a high volume market such as London, UK. There they offer lower rates for money transfers to selected high volume destinations such as Ghana and Nigeria.

The Opportunity? Remittances, Money Transfer & Microfinance

The high and growing remittance flows, and much of it still through informal channels, suggests that there is an underserved market for affordable and good money transfer services. Existing formal financial services have not saturated the market with their transfer products. Commercial financial providers have various limitations such as limited representation outside the capitals and other access issues, low quality services, high cost, and in some cases also loss of trust in the banking system due to recent collapses. There is scope for other services as even the continued expansion of established as well as of new MTOs indicates who seek better and different agents from the traditional banks to better reach existing and new client segments.

This also suggests that microfinance providers, with their networks reaching many trading nodes and remittance receivers, have some of the prerequisites and good potential for a profitable and appreciated service. Similar to bus and courier companies, who provide money transfer services in some countries, the existing setup of MFIs could lend itself relatively readily to incorporating money transfer as a new service – either in alliance with existing service providers, such as Western Union, or independently. Such services are also more conceivable for MFIs as technologies and infrastructure are improved, in particular telecommunications. The profitability of money transfer services for MTOs, banks, and also for some microfinance institutions might suggest that, given the added outreach of the latter's networks, money transfer may provide a fail-safe profit-maker for microfinance.

Understanding differences in markets and cost structures of existing formal services and their different business structures are, however, important for any assessment of potential improvements in services or cost reduction. Similarly, understanding the business environment and capacities of microfinance institutions is crucial in considering whether they can capture a market share in money transfers by providing alternative, improved, or lower cost services.

An Opportunity in MFI Commercialisation?

As MFIs seek to commercialise and offer a wider range of financial services to their clients, money transfer for remittances has gained an attractive allure. Not only does it seem to promise high returns as a fee-based product, but also opportunities of cross-selling for instance of loans and also products such as savings or overdraft facilities, at least for those MFIs authorised and qualified to do so. Similarly, in the context of the discussion around cost and access to money transfer services for remittances, there has been growing interest in looking at microfinance institutions as service providers who reach client groups who are likely to be remittance receivers and are often un- or underserved by formal financial services.³⁵

Examples of MFIs already engaged in remittances do exist and include National Microfinance Bank of Tanzania (NMB) and Uganda Microfinance Union (UMU) (domestic transfers), Fonkoze in Haiti, Banco Solidario in Ecuador, PRODEM in Bolivia, Kosovo's microfinance bank, Equity Building Society in Kenya, and Centenary Rural Development Bank in Uganda

MFIs are not the panacea either to lower cost and more accessible transfer services or to the integration of low-income remittance receivers with broader financial services. At the same time, the opportunities for MFIs as niche market providers can be there but need to be looked at very carefully, including in terms of sufficient business volume and some promise of continuity over time. As with other products, MFIs wishing to develop money transfer as a product need to look at their institutional capacity as well as the regulatory requirements and the potential market for the service.

³⁵ If not otherwise identified, sources for this section include conversations and/or email exchanges with Judith van Doorn, ILO, Elisabeth Rhyne, Accion, Doug Pearce, CGAP, Dave Grace, WOCCU, Anne Hastings, Fonkoze, as well as the research for Sander et al. (2001) in Uganda and Tanzania and a follow-on study for Kenya currently in progress.

(domestic and international transfers).³⁶ Four of them, NMB, UMU, Fonkoze and BancoSol, are briefly described in Annex 3. While this is far from a comprehensive list, overall they are still relatively few and far between, for reasons discussed below.

In sum, three aspects make money transfer services by MFIs a worthwhile consideration:

- MFIs' focus on the lower income populations and their outreach into unbanked segments of the population would appear to provide an opportunity for potentially lower cost and more accessible services.³⁷
- As microfinance has begun to mature into an industry and sustainability and commercialisation have become acceptable and desirable, money transfer as a fee-based product, could provide an important source of revenue.
- As remittances are seen as an opportunity to better integrate senders and recipients into financial services, MFIs could offer the opportunity to provide a better spectrum of microfinancial services, especially to the receivers of remittances.

These are comparative advantages of proximity to clients who on average presumably fit the profile of remittance receivers - proximity both in terms of physical location and accessibility as well as in terms of service culture and the desire to attract this client segment. In comparison, MTOs on their own do not and cannot offer additional or complementary financial services and banks are often not interested in attracting the client segment.

These comparative advantages are, however, often overshadowed by comparative disadvantages, which include:

- not (readily) meeting the regulatory requirements to engage in money transfer services
- the capacity of MFIs to take on such a product (systems, operations, management, liquidity, reserves)
- that MFIs are not typically part of any transactional service networks, neither domestically nor internationally
- that MFIs often operate in very limited markets (e.g. few locations within a country)
- that MFIs are typically still limited to microcredit coupled with some (compulsory) saving, and only few provide broader financial services including, for instance, savings or insurance products

At the crux of much of the above caveats are capacity and market on the one hand, and the enabling environment on the other. The latter includes regulatory aspects as well as weaknesses in the National Payments System and little reflection on how to create 'access portals' for MFIs.

Thus, looking at the MFIs, the questions are:

- is there a sufficient market for money transfer services where the MFI operates and likelihood of uptake
- is it a sound and strong MFI that has the operational, managerial, and financial capacity to take on such a product
- can it be more than a conduit for remittances and actually offer ancillary financial services such as savings
- can it do so from a regulatory point of view
- and what does it take to link into an existing service or build up one's own

³⁶ In terms of domestic money transfer services more related to business and personal transfers more generally than workers' remittances specifically, National Microfinance Bank of Tanzania and Uganda Microfinance Union in Uganda are a couple of examples. The latter, however, operates this on a very limited basis between two locations for a small number of businesses, whereas NMB Tanzania operates on a country-wide and growing basis for businesses, salary payments for government, and personal transfers.

³⁷ While MFIs are often also located in capitals and major towns, as are commercial banks, they tend to locate their branches close to trading centres or markets to be accessible to their target clientele. Moreover, many MFIs have mobile staff. Overall, while their outreach into rural areas is in many cases still also quite limited, their outreach and accessibility surpasses that of most commercial banks.

From a regulatory context the main questions are:

- can the MFI be licensed as a forex dealer or is there a way around it through an agency setup (see Annex 5 on a background discussion on regulatory aspects of MFIs and money transfer services)
- is the MFI or can it become a bona fide deposit taking institution so as to offer broader financial services

Most of the current examples of MFIs operating in this product market display common characteristics worth highlighting:

- with few exceptions they are registered as commercial banks
- they frequently start out as agents to existing MTOs

As licensed banks, dealing in forex requires central bank authorisation but not a separate license. MFIs which are not licensed financial institutions will find it difficult to receive central bank permission.³⁸ Alternatively, such MFIs could seek to develop money transfer products and systems which 'cut out' the forex issue, either by finding an intermediary authorised in forex trade, so that the transaction at the MFI is limited to local currency only; or by limiting the service to the domestic market for money transfers for remittances and payments or transfers more generally, such as for school fees or trading purposes.³⁹

Demand for money transfer services would have to be fostered to some extent to get potential clients to change from their current 'mode'. In part this could be achieved through good marketing, but primarily also through heeding the messages of users and potential users when designing the product. They are looking first and foremost for *a more secure way to transfer money* and then for the following features, many of which are commonly expected of financial products – a service that is

- ⇒ accessible both at the point of origin and of destination of the funds
- ⇒ safe & reliable
- ⇒ efficient
- ⇒ timely
- ⇒ client & service oriented
- ⇒ moderately priced

A list of initial guiding questions for MFIs to consider should they want to develop a money transfer service is included in Annex 4. It highlights questions of capacity, regulation, market, and whether to enter the market through an agency agreement or a proprietary service.⁴⁰

All considered, MFIs are not the panacea to lower cost and more accessible transfer services nor to the integration of low-income remittance receivers with broader financial services. At the same time, given that remittances are concentrated in niche markets, some of which are serviced by MFIs, the opportunities can be there but need to be looked at very carefully. Given the niche specificity, however, sufficient volume and the promise of continued sufficient volume over a number of years are also critical.

³⁸ A membership-based MFI in Uganda, for instance, first did not receive Bank of Uganda's approval to become a sub-agent for Western Union and later received approval on condition of a successful registration as Micro Deposit Taking Institution (MDI) – a new level of non-bank financial institution designed to help microfinance institutions mature and integrate into the financial industry.

³⁹ Both domestically and between countries, both for remittances as well as for payments more generally, many individuals and businesses still have to arrange for their own money transport. For businesses for instance between their banking hub in the capital and their operations up-country. Companies such as petrol stations and buyers of agricultural commodities such as coffee or tea would happily use a reliable service instead. Other businesses who need to pay for supplies arriving from the capital, similar to petrol stations, or companies that have distribution networks outside the capitals, such as distributors of beverages (e.g. beer and sodas in particular), could also be potential customers. Similarly decentralised government operations and a growing middle and salaried class suggest a good potential for growing demand.

⁴⁰ Sander et al. (2001)

ANNEXES

Source: Sander, 2003a

A Note on Data

Official remittance data is an excellent starting point for analysing remittance flows. An important caveat is that the key data set on workers' remittances in the IMF's Balance of Payment (BoP) Statistics Yearbook suffers from low quality data submissions as well as lack of reporting at the country level.

Data for African countries is particularly weak. For instance, figures are only available for about 60 percent of all African countries for 2000 and 2001.⁴¹ For Sub-Saharan countries, for instance, data is only reported for about one third (16 of 49 countries).⁴² If a country does not report on time, a proxy is used to generate an estimate which appears in the statistics.⁴³

The data also suffers from varying levels of mis- or underreporting, such as due to transfers via informal channels. Underreporting can be significant and tends to be higher for higher countries with weak financial sectors, unstable polit-economic situations, or where migration is within travel distance of alternative or informal remittances channels (regarding travel distance or service availability such as by bus drivers). For Sudan, for instance, a case study estimated that 85% of all remittances went unrecorded.⁴⁴ Kenya has no reported data but apparently received on the order of KSH 32 billion in 2002 (ca. US\$ 420 million).⁴⁵

The data reported is also not always a reflection of private transfers through regulated channels, such as banks. For instance, Uganda, currently in the process of improving its data collection, has to date been reporting residual forex transactions as remittances.⁴⁶

Data presented in this study is based on the source used in the respective studies quoted. Where data is analysed in figures and graphs referring to the data set used in GDF, 2003, these are based on the original data set for 1970 to 2001 kindly shared by Dilip Ratha, the GDF author on remittances. This set is based on Balance of Payment data including workers' remittances, migrant transfers, and employee compensation (BoP item codes 2391, 2431, 2310).

⁴¹ based on data set used for GDF, 2003 complemented in a few gaps by data drawn from World Development Indicators online (WDI)

⁴² for 2000, see WDI online data for 2000)

⁴³ see Buch et al., 2002)

⁴⁴ Choucri, 1984 referenced in Puri et al., 1999

⁴⁵ Based on conversations with staff of commercial banks in Kenya, January 2003.

⁴⁶ based on conversation with Bank of Uganda and Ministry of Finance staff, C. Sander, February 2003

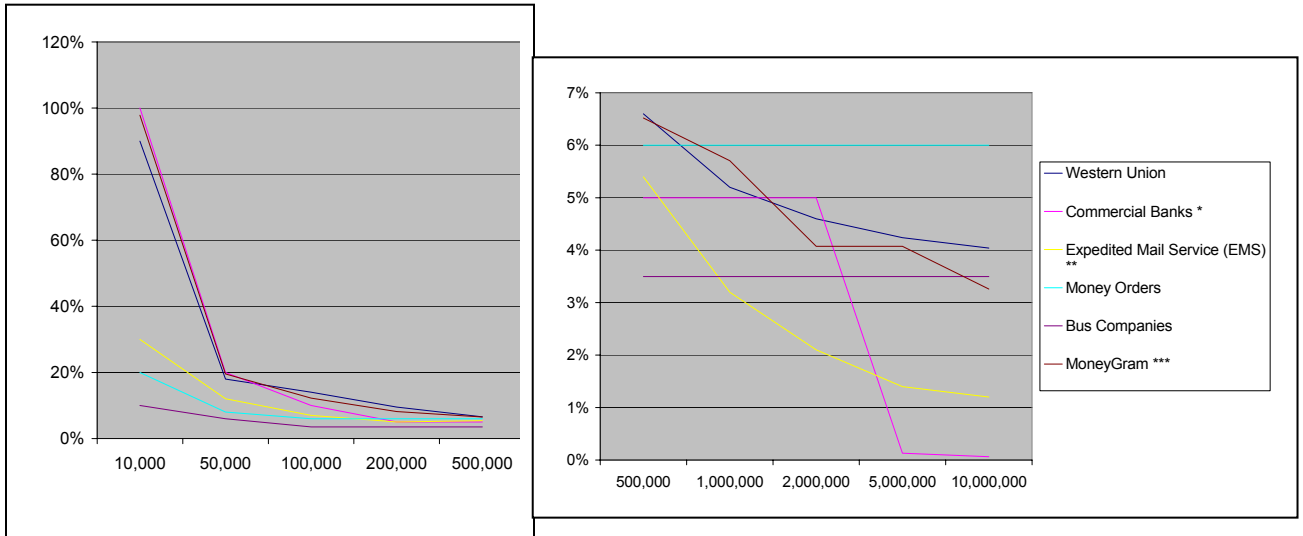
Annex 2: Examples of Transfer Amounts and Costs

Source: Sander, 2003a

country (data source)	amount & cost of transfer	year of estimate	Notes
Egypt (Orozco, 2003a)	13.8% of \$200 via major MTOs in the US	2003	Formal; estimate of transfer costs from the US based on 2 MTOs
Morocco (Iskander 2002 as cited in Orozco, 2003a)	<u>Groupe Banque Populaire</u> : 1. Transfers to a BP account costs 0.1% of the total value provided it's over \$100. 2. Credit to pick up at any BP branch costs 90 dirhams or \$9 dollars independent of the amount.	2002	Formal; approximately 60% of all remittances go through Banque Populaire according to the study
South Africa (Immigration Laws, 2000, Number 23)	R120 (Average cost/ transfer)	2000	Informal; Western Union estimate
South Africa (internal money transfers) (Cross, 2003)	For a transfer of R200: 1. "Face-to-face" withdrawal at bank: R16-25 or 8-13%/transfer; 2. Bank ATM (Teba Bank): R3.70-4.70 or 1.5-2.4%/transfer, 3. Post Office ATM (SASWITCH): R9 or 4.5%; 4. Post office money orders: R28.25 or 14%.	2002	Formal; there are charges at the receiving end, for all transfers except for the post office money order, where the sender pays the charge up front.
South Africa (internal money transfers) (Genesis, 2003)	Transfer through: 1. Friend, between 0 and R10 for a R250 transfer 2. Taxi driver, between R15-R25 for a R250 transfer	2003	Informal; chance of money going missing yields a probability-based cost.
Senegal (Dieng, 1998)	Between 3-10% of the transfer amount, decreasing scale	1998	Informal; through a Senegalese Association in France, i.e. GIE
Ghana (Orozco, 2003b)	7.5% of the transfer amount (US\$200)	2003	Transfer through Ethnic Store /Exchange House in the US
Zimbabwe (Orozco, 2003a, 2003b)	11.9% of the transfer amount (US\$200)	2003	Formal; major MTO in the US
Mozambique and Swaziland (Orozco, (2003b))	1% of the transfer amount (US\$200)	2003	Formal; low cost is a result of services offered by Theba Bank, a miners' bank that transfers remittances from South Africa to migrants' families who have bank accounts in the recipient countries.

Source: Sander, 2001

Figure A2: Pricing of Formal Transfer Products in Tanzania
(1 US\$ ca. TSH 800)



The first diagram shows low value transfers (ca. US\$12 to 625) and the percentage fee cost per transaction; the second diagram shows the percentage fee costs for higher value transfers (up to ca. US\$ 12,500).

For black&white version print outs, in order of each lines' starting point on the left hand side, reading the lines from top to bottom they represent:

1. diagram (low values): commercial banks, Western Union, MoneyGram, EMS, money order, bus companies
2. diagram: Western Union, MoneyGram, money orders, EMS, commercial banks, bus companies

Annex 3: MFI & Money Transfer Services – Case Examples

Source: Sander et al., 2001

Uganda Microfinance Union (UMU) Domestic Money Transfer Pilot

THE UMU WAY

Uganda Microfinance Union is a member-based organisation. Established in 1997, it is one of the smaller MFIs in Uganda but among the top 5. UMU has developed a spectrum of innovative and client-oriented products, calling it the UMU WAY. It focuses on individual savings and credit. With 5 branches and 2 agencies it is already financially sustainable, albeit on a small scale and still benefiting substantially from various donor support.

UMU started a pilot of a money transfer product in April 2001 with financial support from the CGAP Challenge Fund. The initial pilot is limited to their branch in Kayunga. Kayunga is located roughly half-way between Kampala and Jinja (the second largest city), but around 20 km off the main highway. With the closure of the Cooperative Bank in the banking crisis of the late 1990s, Kayunga was left with only a Post Bank which offers deposit accounts and transfers within its network.

In the first 3 months of this pilot, UMU Kayunga has a small number of clients using the service. Neglecting the initial cost of capital, UMU already realises a small profit through the fees.

To date the clients are primarily large corporations or franchises that have to move cash regularly to secure supplies either to or from the area - commodities like tobacco and petrol. Some clients use the service as often as 2 to 3 times weekly, others weekly or only twice a month.

Transfers go both ways, from Kayunga to Kampala or vice versa, though most still go to Kampala. Transfers typically range between US\$ 3 and 40 million.

How it works: Clients in Kayunga deposit their funds. The branch manager calls the Kampala office. In Kampala, the client picks up a cheque. The cheque draws on UMU's bank account. The clients were able to establish acceptance of the UMU cheques with their suppliers. Actual transfer time is usually no more than 30 minutes.

From Kampala, the client deposits the money into UMU's bank account and takes the deposit slip to UMU Kampala. The branch receives the information by phone call for head office (the CEO or the Director Operations) and the client can access their funds in Kayunga.

Cash is physically transferred once or twice per month with an armoured service vehicle from the branch office to Kampala.

Costs: To the client -- UMU charges a fee of between 0.25 and 0.4% of the transfer value, negotiable with the (branch) manager. The minimum fee is US\$ 17,500 (ca. US\$ 10).

To UMU -- The main costs are the rental of the armoured vehicle service and additional insurance.

Why do clients use it, or not use it? The main concern for businesses is security. Also important is reliability of the service and sure access to the funds when they are needed. This is critical for arrangements such as in the petrol industry where minimum orders have to be placed.

Clients who are interested but not yet using the service feel the fee is too high. They would like to see a lower fee for smaller amounts, e.g. up to US\$ 10 million -- quite to the contrary of common pricing practice.

Challenges: Initial challenges included sufficient liquidity in UMU's bank account. Also part of the early days was sorting out the client requirements to establish the liquidity requirements for the branch and the cash transport needs.

The current challenge is how to expand the client base for the product and, relatedly, how to reach clients other than the corporate clients. With more clients and more transfer business the Union might be able to reduce the fees.

What to watch out for? Asked what to watch out for, UMU management highlighted tight controls to prevent fraud as a prerequisite for a money transfer product. This calls for improved controls and monitoring systems for the transactions.

Domestic Money Transfer at National Microfinance Bank, Tanzania

A CORE PRODUCT

National Microfinance Bank (NMB) of Tanzania holds over 700,000 deposit accounts - close to half of all deposit accounts in Tanzania. With a structure of 101 branches, it has the largest network in the country. It is still a para-statal bank but scheduled to be privatised.

NMB offers one of the premier domestic money transfer services in the country handling government payments and private sector transfers. Apart from government for salary and pension payments, clients include large scale traders in agricultural produce, mining companies, and generally businesspeople in commerce and small trade.

Currently NMB employs a range of technologies depending in part on branch location. Twenty of its branches are connected on an intranet; by September 2001 another twenty will be added selected based on transfer volumes. Other branches manage transfers via fax and phone. A very limited number of transfers is still done by mail. While the latter can take 1-2 weeks, all the other options are a 'same-day-service' and intranet can be used also as an instantaneous service, if needed.

Transfer amounts vary widely. An average transfer amount is around TSh 3 million. Larger transfers cluster around TSh 50 to 100 million though transfers of several hundreds of millions are also quite common. For some of the 15-20 branches per each of the six zones of Tanzania there are seasonal patterns in the transfer business, usually subject to the core agricultural produce in the sub-zone.

Liquidity in the branches is ensured through a system of designated branches which serves as cash centres. They link NMB to the Bank of Tanzania's cash centres. From the designated branches vehicles with armed escorts supply the other branches in the area.

How it works: Both account holders and non-holders can use the service. All options are possible: for instance, non-clients can transfer to customer accounts and account holders can transfer to non-clients; even non-account holders can transfer to another non-holder, though it happens relatively rarely.

All transfers go with test codes as a security feature on any of the systems (intranet, fax, or phone). Account to account transfers as well as transfers by non-account holders into a client account are straight forward requiring no additional security features. For non-account holder recipients of transfers NMB requires instructions by the sender as to what name and type of ID to expect. This information forms part of the transfer instructions.

Costs: To the client -- Fees are the same for both account holders and non-holders. The minimum fee is TSh 4,000 plus a standard transmission fee of TSh 5,000. For amounts up to TSh 1 million the charge is 1% plus the transmission fee. The percentage fee drops down incrementally to its lowest at 0.25 % for amounts of TSh 250 million and up. (Please refer to the annex with Examples of Service Costs for the detailed fee structure.)

To NMB -- The main costs are the security and vehicles to transport the cash within their network. Relatedly, cash management overall is a substantial cost.

Why do clients use it, or not use it? Government, companies, and traders use the service for timely and secure transfers or payments. Potential clients for the service who do not yet use it are reluctant to pay the fee.

Challenges: Early on the challenge was providing a timely service. Now challenges include recovering the cost of investments such as for the infrastructure necessary to provide an efficient service. Other challenges are marketing the service, especially in such a way that a potential client will understand and accept the fee charged. Packaging of the service is also part of it. This can even include the appearance of branches when potential customer will tend to put more trust in a nicely furnished office with the latest technology.

FONKOZE: Ayiti Dirèk Dirèk

Haiti's Fonkoze is a microfinance NGO with 18 branches in Haiti. In addition to money transfer (Ayiti Dirèk Dirèk), they offer savings accounts, microloans to street vendors, currency exchange as financial services and business development and educational services. Fonkoze is in the process of spinning off its financial services into a commercial microfinance bank.

In 2002, Fonkoze received around USD 2.5 million in remittances. This cost their clients USD 15,000 - roughly one sixth of a percentage point. An additional cost is, however, incurred by the client for depositing the funds into Fonkoze's US account such as in the form of a wire transfer, money order or cheque.*

Fonkoze estimates that on average about USD 1 billion are transferred to Haiti each year, constituting about 17% of the country's GDP. The majority of the Haitian diaspora can be found in the US and the Dominican Republic. An average remittance is about USD 100 to 200 per transaction.

Fonkoze identified two types of remitters - individual workers sending money to their families and churches and charitable organisations who send money for community development projects. With these two markets in mind they set out to look for a US-based bank as collaborator and did not find it easy. Eventually a contact with a Haitian-American CEO provided the breakthrough and City National Bank of New Jersey (CNB) became the partner.

Churches, parishes, associations, and small charitable organisations have found Fonkoze's service to be very attractive. Haitian migrants, however, are much more suspicious of the service. Part of their hesitation is the fact that there is no physical office and they are afraid to fall prey to a scam. Fonkoze plans a campaign in the US of awareness of its services combined with financial literacy training and educating Haitian migrants about the benefits of forming associations along the lines of the Home Town Associations of Mexican migrants in the US.

How does the transfer works:

- Fonkoze keeps the majority of their microcredit reserves in CNB making it a major client of the bank
- CNB dropped all bank fees, including fees for the acceptance of wire transfers.
- CNB sends a daily email detailing the day's deposits into Fonkoze's account
- Fonkoze has a Haitian American fluent in English, Creole, and French as their U.S. Customer Service Representative working from home with a computer, an AOL account, and a free access 1-800 number
- deposits are made into Fonkoze accounts for a flat fee of \$10 by depositing the funds with Fonkoze's account at CNB. Accounts are free, can be opened by the sender or receiver and can be denominated in U.S. dollars or in gourdes. The minimum opening balance is 100 gourdes (under \$3 US).
- the funds become available the same day or within 24 hours of their receipt by CNB

Sources: Fonkoze, 2002; FONKOZE, Port-au-Prince, Haiti. <http://www.fonkoze.org>; Fonkoze@aol.com
This compares to an average cost of 13% of remittances from the US to Latin America (Orozco, 2003).

Banco Solidario: Programa de apoyo al emigrante – Emigrant support programme

In 2001 an estimated 2.5 million Ecuadorians lived outside their country and sent home around US\$1.425 million worth of remittances. This was equivalent to 8% of the country's GDP that year. The average size of remittances from the US to Ecuador is estimated at about \$450, whereas from Spain they are thought to be a bit higher, at about \$700. The Ecuadorian Diaspora is mainly concentrated in the US, Spain and Italy. In June 2002, there were at least 388,000 Ecuadorians living in Spain and their remittances alone accounted for over \$400 million.

In 2002, Banco Solidario joined forces with a number of Spanish Savings banks to capture a share of the Spanish remittances market and to offer an innovative and complete range of services to Ecuadorians living in Spain. In 2002, agreements were signed between Banco Solidario and Confederación Española de Cajas de Ahorros (CECA), Caja Madrid and Caja Murcia, with the addition of La "Caixa" in February 2003. Caja Madrid and Caja Murcia have around 6,900 retail branches points in Spain and La "Caixa" has around 4.800 offices.

Banco Solidario's entry point is their low-cost and secure remittance transfer service which is complemented by a series of other products to meet the financial needs of both the emigrants and their families in Ecuador. So far four product ranges have been launched within the overall "Programa de apoyo al emigrante": low cost transfer of remittances, low-cost (18% interest) short-term credit to cover urgent needs in Spain, long-term low-cost credit such as mortgages (also around 18%), and an integrated dollar savings account called "Mi Familia, Mi País, Mi Regreso".

This versatile savings account facilitates the banking of both the emigrant and his/her family in Ecuador and allows the emigrant to have full control of his/her money while abroad - only whatever amount the sender has made "available" to withdraw can be removed by the named account holder in Ecuador. The service also promotes long-term savings with a view to provide for a future return to Ecuador. For example, the emigrant can voluntarily block-off part of his/her remittances to save up for a house or to start up a business upon return. The emigrant can also use his/her remittances to service any loans that s/he may have with the bank. This may for example include paying off credits given to the migrants to finance his/her initial travel to Spain, including airfares and initial living expenses¹.

The services offered by Banco Solidario are among the most complete offered to immigrants in Spain today. With sponsors, such as the Inter-American Development Bank, they have managed to lower the cost and improve the reliability of remittance transfers between the two countries. Thanks to the alliances formed with Spanish Savings Banks (as mentioned above), emigrants are able to access the bank's integral package of services from almost all parts of Spain. The agreements allow for anybody to transfer remittances from any of the Spanish banks' branches¹. Senders do not have to be clients of any of these banks, nor do they need to have a regularised migratory status in Spain. In Ecuador payments can be withdrawn at any of Banco Solidario's 24 branches (December 2002), at any of the BANKRED's 836 ATMs (July 2002), or at any of the around 100 cooperatives with which the bank has formed strategic alliances.

In spite of this, Banco Solidario has a rather limited share of the total remittances market. Between January and August 2002, it completed 275 remittances transfers from Spain totalling \$294,744. This was equivalent to an average of \$1,072 per transfer. During the same period, 14% of these transfers (\$41,396) were used to open 99 new savings accounts.

How the transfer works:

- Transfers are made through inter-bank transfers
- The cost to the sender is a fixed 4% of the total amount with a minimum of \$7 dollars and a maximum of \$20 dollars
- The transfer is made in dollars (based on a competitive EURO to US Dollar exchange rate)
- The maximum length of transfer is 72 hours, although the average is around 24 hours

Sources: Banco Central del Ecuador; Eguez, 2001; IADB/MIF, 2003; World Development Indicators 2002; <http://www.solidario.com>

Annex 4: Microfinance & Money Transfer Services – Guiding Questions

Source: Sander et al., 2001

If there can indeed be opportunities for a marriage of microfinance and money transfer, what are the criteria under which it should and should not be done? As with any product, a careful consideration of product development issues should be a first step.⁴⁷ In this case, these would include:

legal & regulatory framework

- what does the legal and regulatory framework stipulate? For instance, those not licensed to take deposits have to find viable alternative ways in designing a product.

compatibility between product and MFI

- how compatible is such a service with the MFI -- e.g. its mandate, its systems, its organisational capacity and skills, its financial and cash flow capacity as well as liquidity management, or its other products ?
- can the MFI afford to hold the necessary liquidity reserves ?
- does such a product require changes in financial controls or other aspects of the operation (e.g. authorities of branch managers) ?
- who can and should have access to such a product (e.g. only members or clients or also non-clients; this is in part defined by the legal and regulatory framework)?

risks

- what are the risks of physical cash transfer in the MFIs location ?
- is adequate insurance coverage available and affordable ?

market potential and market position

- what is the actual demand in the specific market in which the MFI operates (e.g. volume and regularity of transactions, acceptability of projected fee; are only certain branches likely to have a sufficient market) ?
- who would be the users ? and for what purposes ?
- is the demand regular or seasonal, or maybe with seasonal peaks ?
- what is the potential for market growth or at least stable demand ?
- what is the market position vis-à-vis any competitors ? (what is it currently ? what can it expected to be in future ?)

pricing

- what are fees for comparable services ?
- what has to be considered in costing one's own product (e.g. cost of capital and of additional insurance, cash transports, security service, staff training, communication) ?
- what hidden or opportunity costs may a money transfer product incur (e.g. speed is a factor - to what extent could it affect the quality of delivery of other services)?
- break-even points for the service ?
- break-even points for potential clients compared to their current options ? (e.g. cost of transporting the funds oneself)

marketing

- what is an effective marketing strategy for the product ?
- how to communicate and make service costs transparent ?

⁴⁷ See also the documentation on product development and testing by *MicroSave-Africa* available on their webpage at <http://MicroSave-Africa.com> ; more detailed references are provided in the annex under 'Bibliography & Resources'.

operating independently or in alliance with others ?

- is an agency arrangement for an existing product a better option than developing a proprietary product ?
- could a collaboration with other MFIs or a commercial business, such as a bank or a bus operator, be useful, for instance to expand the service network for the product ?

of all the product development choices...

- what is the comparative advantage of a money transfer product over other potential products or expansion or improvement of existing products ?

There is no general yes or no to money transfer as a microfinance product. Money transfer can be a profitable product but poses its own challenges, such as in liquidity and cash-flow management, market acceptance vs. demand, and in how to offer the service to a broad spectrum of clients rather than the few with relatively larger amounts to transfer. An MFI interested in a money transfer product should search its institution's 'soul', research its market, and design, pilot, and monitor its product. The answer depends on the context of the potential service provider.

Annex 5: Legal & Policy Issues for Money Transfers Services by MFIs in Africa

In the context of MFIs as money transfer service providers and also their scope for integrating remittance receivers with financial services, at least three areas of policy and regulatory environment are important: licensing and regulation for money transfer services; financial market liberalisation vs. control, especially regarding foreign exchange; and licensing or regulation of MFIs especially regarding aspects of deposit taking, forex trade, and money transfer services. Whereas the latter two are contextual and define in part the market and demand environment, the first affects whether a MFI can even offer such a service and how. This is the focus here.⁴⁸

In most cases, unless registered as banks or non-bank financial institutions, MFIs generally or even MFIs which are regulated in some form, are unlikely to receive authorisation to provide money transfer services on their own. Even as sub-agents to bank services, the precautions around exposure on forex trade, reserve requirements, system requirements such as solid MIS networks, etc are unlikely to be met by the majority of MFIs. While such requirements are typically not clearly spelled out, conversations with several central banks and government representatives in charge of overseeing or supervising either the finance or the microfinance industry, suggest that these are among the typical criteria.

Thus, for instance, in Uganda, Centenary Rural Development Bank, a microfinance bank, represents one of the global MTOs, Western Union, as a sub-agent to a commercial bank, Nile Bank. A recent application by an MFI to become a sub-agent has been put on hold subject to their successful transition to a regulated microfinance deposit taking institution (MDI), a tier 3 institution under new legislation.

More generally, licensing or the granting of permission for money transfer services (MTS) is not consistently regulated. Where it is addressed by law or process, it is usually handled by the central bank. As different entities provide MTS, however, such as banks and forex bureaus, different parts of the central bank deal with licensing or permissions in connection with remittances. The two key departments tend to be bank supervision and foreign trade.

Where forex trade or remittances themselves are state controlled, the central bank or a government bank is the officially licensed channel. In countries where forex trade has been liberalised, typically commercial banks, or at times also forex bureaus, offer money transfer services or act as agents to one of the MTOs.

Banks are generally licensed to deal in forex as part of their bank licence. This is, however, not true for many of the postal banks which tend to operate under communications as opposed to banking acts. Either, however, is typically required to consult with the supervision department of the central bank to get approval prior to introducing a product which involves forex. Failure to do so can lead to closure of the service.⁴⁹ FATF initiatives and pressure to comply with these have made central banks and policy makers even more cautious and conservative in their licencing

⁴⁸ Regulatory policies and remittance flows are also affected or conditioned by aspects such as whether remittances are compulsory (e.g. Lesotho and Mozambique), whether forex trade is liberalised, whether forex holdings or investments are possible in the home country, and, in the sending country, whether forex or cash restrictions apply (e.g. in South Africa). See Sander 2003a and 2003b regarding such regulatory and policy contexts both in sending and receiving countries discussing hampering and enabling conditions for remittance flows and their investment and for factors affecting either the availability and accessibility of financial services and products or the ease or attractiveness of investing in financial products or a business.

⁴⁹ This happened, for instance, to Kenya Postal Savings Bank when they started as an agent to Western Union which led to a suspension of the money transfer operation until the Central Bank of Kenya granted the authorisation.

assessments or willingness to consider new interpretations or revisions to legislation to offer a less restrictive environment and opportunities for legal services.⁵⁰

The licensing for MTOs varies by country. The vast majority of African countries likely do not have specific licences for MTOs but want to treat them as part of banking licences. In much of the African network, the agents to international MTOs are licensed banks and they have to seek permission by the central bank to offer the service. Other types of agents are typically sub-agents to banks, such as forex bureaus. They typically require a license to trade forex, usually granted by the central bank. This license is again not sufficient on its own to set up as MTO or operate a MTS; they too are required to seek permission of their regulator within the central bank.

Central banks are on average more inclined to grant permission to a bank than to a forex bureau. This depends on the country, however. For instance, Bank of Uganda's Forex and Trade Department is generally supportive and positively inclined towards granting permission, whereas the Central Bank of Kenya seems less keen. Similarly, South Africa has a preference for banks to deal with money transfers, particularly following the experience with Western Union and Union African Money Transfers (UAMT) which ran afoul of compliance with forex control regulations.⁵¹

⁵⁰ Other changes in the financial services industry are likely to occur once the current round of GATS negotiations is concluded. This includes negotiations on liberalising the access of financial services to all member countries. An assessment of the discussions and potential implications for remittances goes beyond the scope of this study. It would require separate research and analysis of a debate which is highly polarised and politicised.

⁵¹ Genesis, 2003 for South Africa and author's own research in East Africa.

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