Remittances to Africa : the Microfinance Perspective

October 2010, Gera Voorrips and Annemarie van Swinderen

This article was written on the basis of the Triodos Facet project 'Feasibility of remittances products for 10 African MFIs'. This project was commissioned by Oxfam Novib and INAFI and forms part of a large EU funded project on remittances.

Why are remittances important to microfinance?

Remittances can be seen as another opportunity and the next new product in microfinance, after micro insurance, savings, etc. Most African countries receive considerable amounts of remittances, for example USD 21.5 billion has flown into Sub Sahara Africa in 2010[1].
Remittance flows are often difficult to access and the use of safe (i.e. formal) channels can be costly. In rural areas of most African countries there are few if any out-payment points. Particularly the poor who receive remittances in small amounts, pay high costs of 10-15% on average and sometimes up to 25% of the transferred sum[2] . Microfinance now starts to focus on improving access to remittances and at a better price.

Currently in Africa, participation of MFIs in remittances is more the exception than the rule. But many of the large MFIs in the project were already active and other MFIs are planning to start this new product.

What are the debilitating factors for MFI participation?

Internal and external factors are at play. Externally, microfinance institutions are confronted with regulatory issues, concerning international transfers, cash operations and know-your-customer rules. For example Microfinance Banks in Nigeria are currently not allowed to pay out international remittances and in many Francophone countries[3] and Ethiopia MFIs can only work as sub agent for a bank and not as direct agent for an Money Transfer Organisation (MTO). Another issue is that the large MTOs, such as Western Union and Moneygram, in some cases include exclusivity clauses in the contract with an MFI thus hampering competition (see Box 1).

Also internal factors can impede an MFI to start remittances or can lead to suboptimal benefits for the client and/or the institution:

- **Lack of online, real-time connectivity of the pay-out points**: a large number of African MFIs have branches whose systems are not online connected to the head office. Remittances business relies on real time information exchange, thus this issue must be addressed, before the offering of remittances at a significant scale is possible;
- **Insufficient integration of remittance product in strategy:** in some instances remittances are added to the product portfolio as an easy source of (commission) income for the MFI, but without integrating it into the strategic vision of the MFI, nor with the product and marketing approach. In that case the opportunity to cross-sell with other products and to reach new clients is lost. In addition, innovative remittance products or cooperation with migrant

[1] World Bank Nov 2010, estimate, formal remittances only
[2] Sending Money Home to Africa, IFAD 2009
[3] in the West African Economic & Money Union (WAEMU)

80 avenue Montgolfier, 1150 Brussels, Belgium
Tel : +32 495 32 32 88, Email:info@phbdevelopment.com
www.phbdevelopment.com
Company number 883379889

organizations will be missed. The success of the product and the value to the customer will be suboptimal;
- **Need for pre-financing of remittances and strong cash management at the pay-out points:** Remittances often involve out-payments of cash at the branches. Impeccable cash and liquidity management by the MFI is required in order to offer a reliable product. In addition, the MFI must be able to pre-finance the amounts paid-out because settlement with the MTO is only afterwards.

Recommendations

Addressing regulatory issues

The first issue to be addressed is the exclusivity clauses. MFIs should be aware and avoid these when entering into a relationship with an MTO. Preferably, MTOs should be prohibited to demand exclusivity by law.

The second issue that requires improvement is the regulation of international payments and foreign exchange activities. The regulatory framework should be conducive for MFIs to participate as remittance agent and to serve low-income people with safe and effective remittances products. While money laundering and financing of terrorism must be avoided, the measures to combat it should be appropriate compared to the risk involved, i.e. dependent on the amounts of transactions. This particularly applies to the on average low transactions amounts observed in the remittances business.

Addressing internal issues

Last but not least, in order to become successful, MFIs must make sure their internal operations are ready to offer remittance products in a reliable way.

Box 1 Exclusivity clauses and how the large MTOs may stay the large MTOs

When a microfinance institution starts to expand its services and products, it will soon decide to start offering remittances. As the MFI starts to investigate options, it will be confronted with the regulations concerning foreign exchange and international transfers. These regulations in most countries considerably limit the options for MFIs to offer remittances products. In several countries the only option will indeed be to be an out-payment agent of the large established MTOs. Moreover, the MFI may be attracted by the support that these MTOs provide: they take care of all staff training, systems and software. Equally importantly, these MTOs pay substantial percentages of their fee to the MFI[4]. In this way, working with the large MTOs is an attractive option as a first step in remittances: a relatively easy, potentially profitable, low-risk, low-investment start. However, in many countries the MTOs demand exclusivity from their partners[5]. Through these exclusivity agreements, the MFI is not in a position to experiment cooperating with other MTOs or trying out innovative forms of remittances products. Even though the MFI may originally have meant to only try out remittances through the easy option of the established MTOs, they may find it difficult to switch to another options. The financial reward from alternatives may not be as much and the time investment to change to another MTO may be substantial. The risk is that MFIs stay with the MTO they started off with. As a result, the clients are offered little choice beyond the large, established MTOs which have relatively high cost structures for the end user.

[4] The large MTOs do not want to disclose this percentage. What is known is that the percentage varies from country to country and that most MFI find the percentage they receive worthwhile in comparison to the workload.
[5] In a limited number of countries, exclusivity contracts are forbidden by the regulators.