

Microfina





nce: Key to Expanding Remittances

By Robert Meins

Over the past decade remittances have emerged from relative obscurity to become a key factor in the well-being of millions of families throughout the world. In 2007 the Latin American and Caribbean (LAC) region received US\$66.5 billion, surpassing the total Foreign Direct Investment (FDI) and Official Development Assistance (ODA) for the fifth consecutive year. The importance of these transfers from migrant workers to their families also has enormous implications at local and national levels. Seven countries in the region receive 12% or more of their GDP through remittances, generating an estimated US\$4 billion in revenues for the businesses that provide transfer services.

Yet the percentage of migrants' families with bank accounts remains unacceptably low due to historic distrust of the banking system by the most disadvantaged or the banking sector's reticence to tap this market. In spite of the fact that banks are the primary payers of remittances, they have failed to turn recipients into account holders. Traditionally, banks have focused on generating revenues by facilitating transactions, rather than expanding their base of depositors or cross-selling financial services. As a result, the bottom lines of financial institutions are not being maximized. More significantly, the benefits to migrants' families and their communities back home are limited.

The Natural Advantage of Microfinance Institutions

Microfinance institutions (MFIs) are particularly well placed to fill this gap, since many of them already serve large numbers of remittance-receiving households. MFIs understand the needs and capabilities of their clients and benefit from a high degree of client trust because they are focused on the concerns of customers normally not served by the banking system. Leading financial institutions are often geographically limited in their scope, while many MFIs extend their services into the rural areas where financial services are less available. MFIs can serve as a conduit for financial education, providing essential information to new customers, while providing migrants' families with services that can help ensure financial independence.

One example is Haiti's Fonkoze, a financial institution that is extending financial services to challenging areas. Despite the barriers of poor energy and communications infrastructures, this institution uses satellite phones to reach out to areas that would otherwise lack direct access to financial services. While the costs of remittances are usually perceived to be limited to upfront fees and exchange rates, the real "cost" is often far higher for a recipient living in rural areas. The time and money spent to travel to the nearest financial institution can increase the cost substantially. In times of rapidly rising fuel prices, these costs represent a sizable drain on the benefit of remittances to a recipient's income.

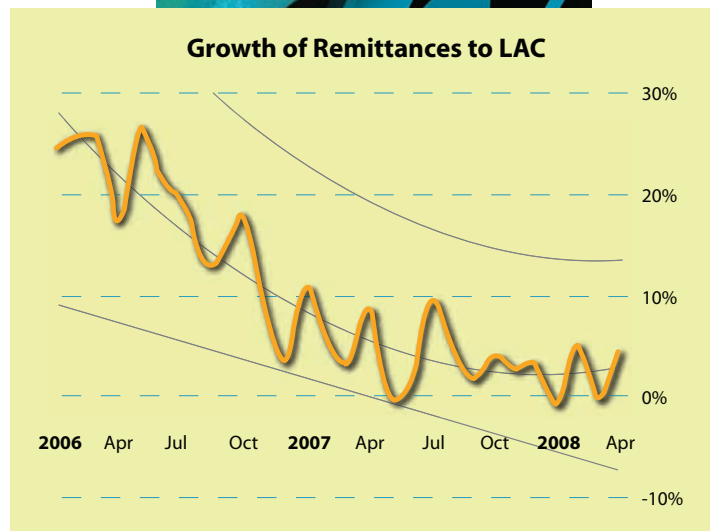
Fonkoze is aware of this problem. By operating close to its customers, this innovative MFI offers remittance senders a low-cost and convenient way to transfer funds through the



earned dollars to remain in the hands of those who need them most. As competition has increased, a variety of new transnational financial services has been developed. Remittance-linked health insurance for migrants' families, cross-border mortgages (see story on page 47) and loans based on remittance receipt are just a few examples of how this flow of money is helping to create services that meet the needs of transnational families.

Increased competition and a new wave of innovation are reshaping the remittance market. Credit and debit cards, along with business models that make use of the Internet and mobile phones, have fundamentally changed the way many immigrants send money home. Traditional means of trans-

mitting money, such as cash-to-cash remittances in which an operator transfers money on the sending side and a bank pays out on the receiving side, have numerous disadvantages that are gradually giving way to a new range of services. Microfinance companies are also increasingly looking to remittances as an opportunity to expand their services, increase revenue and cross-sell more traditional lending services.



formal financial system. In this way, it maximizes the impact of funds to remittance recipients, while using additional revenue to simultaneously increase the growth potential of its loan portfolio. The institution also uses the opportunity to cross-sell other financial services.

The Power of Innovation and Competition

Ten years ago remittance senders were charged transaction fees as high as 15% of the amount transferred. This rate has dropped by almost two-thirds over the past decade, allowing hard-

Challenges

Recent IDB publications have shown that the growth of remittances to the region has slowed markedly in 2008. Growth in remittances to Mexico was negative in the first quarter of this year and Brazil was the first country to experience a drop in 2007. Fortunately, the news is not all negative for companies working in the remittance sector. Despite the economic slowdown in the United States and stricter enforcement of immigration laws, most money transfer companies continue to report an increase in remittance flows. In the long run, there

is not only an economic rationale for Latin American migrants to seek a better future north of the border, but also a vital demographic need for new young workers in the United States. This logic suggests that the slowdown in remittances is only temporary, and that remittances will continue to grow in the future.

Despite the slowdown in Mexico and Brazil, Central America continues to experience above-average growth in remittances, while the Andean region is seeing an influx of euros due to the currency's appreciation against the dollar. Even with changes taking place in the remittances marketplace, opportunities remain strong for MFIs willing to broaden their services.

Nonetheless, providing remittance services is a challenging enterprise for MFIs. As a rule, every branch of an MFI should be capable of processing at least 10 remittance transfers a day, which requires about US\$2,000 cash

be available at each location, exclusively for paying remittances. This can present a cash flow problem, especially at rural branches and those with small revenue streams. On average, MFIs in Latin America and the Caribbean have 12 branches. As a result, an MFI seeking to provide reliable remittance services in each of its branches should be able to pay out US\$24,000 per day. If underutilized, holding these funds also implies a significant opportunity cost. Together with the required investments in software and compliance issues, the cost of providing remittance services can be significant in proportion to the revenue stream of many MFIs. Thus, these services are offered most economically by larger MFIs and/or networks that can achieve scale and guarantee the timely availability of funds to their clients. Unfortunately, this limits the geographic reach of an essential service.

The Multilateral Investment Fund (MIF) at the Inter-American Development Bank has long been at the forefront of the issue of remittances to Latin America. The MIF has contributed to the understanding of this field through research, outreach and, most importantly, the funding of innovative projects that have pushed the marketplace forward. Technology continues to help reduce the cost of sending money home while entrepreneurial microfinance institutions develop new services to help those who have traditionally been underserved. In doing so, MFIs are maximizing the impact of remittances on the development of surrounding communities and playing a vital role in the lives of migrants and their families.



Links:

www.fonkoze.org

www.migrantremittances.org

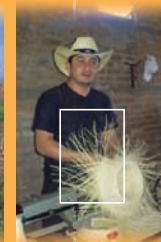
We support promotion and consolidation of micro-entrepreneurship



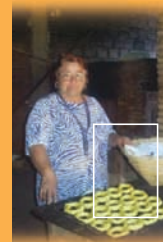
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