Making Money Transfers Work for Microfinance Institutions

A Technical Guide to Developing and Delivering Money Transfers

March 2008

CGAP

Consultative Group to Assist the Poor

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Making Money Transfers Work for Microfinance Institutions: A Technical Guide to Developing and Delivering Money Transfers is available for download from the CGAP Web site (http://www.cgap.org/) publications page.

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Acknowledgments

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Launched in October 2005, the advisory group for this initiative advised on the initial concept and reviewed annotated outlines of the manual. Advisory Group members included Vanessa Vizcarra Bianchi (MFIC), Massimo Cirasino (World Bank), Anna Cora Evans (WOCCU), José Antonio Garcia Luna (World Bank), Dave Grace (WOCCU), Gautam Ivatury (CGAP), Tom Jahnes (Western Union), Tim Lyman (CGAP), Manuel Orozco (Inter-American Dialogue), Doug Pearce (DFID), Valsa Shah (DFID), and Gregory Watson (Inter-American Development Bank).

Isern, Grace, and Glisovic-Mezieres designed the CGAP e-conference on money transfers in March 2006. Grace facilitated this five-day conference,which addressed operational issues for MFIs offering money transfer services. The e-conference was co-sponsored by CGAP, the World Council of Credit Unions (WOCCU), the International Fund for Agricultural Development (IFAD), and the Inter-American Development Bank (IADB)/Multilateral Investment Fund (MIF).

A draft of this document was released in December 2006 for public comment. Maria Jaramillo (ACCION), Grace (WOCCU), Anne Hastings (Fonkozé/Haiti), Antonio Garcia Luna (World Bank), Massimo Cirasino (World Bank), Vizcarra Bianchi (MFIC), and Ignacio Mas (CGAP) provided detailed comments to the technical guide. In addition, the authors are grateful for helpful comments and contributions of text boxes from Alex Berthauud (AMUCSS/Mexico), Peter Van Roosmalen (Inclusion Group), Phyllis Mbungu (SMEP/Kenya), Randy Gutierrez (Alianza International), Julio Vega (Foreign Ministry of Peru), Ben Knoll (Grupo Express), Arun Kashyap (UNDP), Tom Jahnes (Western Union), and Martin Alsop (DFID).

Foreword

The Consultative Group to Assist the Poor (CGAP) produced *Making Money Transfers Work for Microfinance Institutions* to help financial service providers determine whether offering money transfer services is in their interests. And if so, to help them determine what strategy, products, and institutional structure are needed to support a successful money transfer operation.

CGAP welcomes comments or questions on this publication (mailing address: 1818 H Street N.W., Washington, DC 20433, USA; fax 202-522-3744).

Elizabeth Littlefield
Chief Executive Officer
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Executive Summary

Money transfers, including international remittances, are a growing global market. In 2006, formally recorded international remittances exceeded US$300 billion. And it is believed that informal remittances (those that are untracked or that go through nonlicensed institutions) may be as high as an additional $150 billion.

Because of the growing market and potential for profit, companies of all types are entering the money transfer market. Given the necessary infrastructure, this includes not only formal banking institutions, but also telecoms, software and hardware companies, and governments that recognize the need for regulation as well as an opportunity to extend public services.

Likewise, this market presents a unique opportunity for MFIs to grow and extend not only their business, but also their mission. MFIs that already serve low-income clients are well placed to expand their services; many MFIs are located in areas where few others offer money transfers. If designed well, money transfers can be a valuable financial service for clients, and they can bring additional revenue for the MFI.

However, a poorly designed or poorly implemented transfer service can overwhelm the MFI with problems and can become unprofitable. An MFI should not simply decide to offer a transfer product, it must first understand the mechanics of transfers (such as how funds move from sender to settler to receiver) and the environment in which it hopes to offer the product.

The money transfer market is complicated. It is constantly changing and growing as new players enter. The MFI must undergo critical self-examination to determine whether it is ready to handle the impact of the new service. Offering money transfers requires significant development in all areas of business, including human resources, internal systems, customer service, marketing, regulation, and risk management. Indeed, providing a money transfer service can radically alter the way an MFI operates.

Partnering with a more established money transfer company (MTC) is often the best course of action, because a partnership can offer the MFI a tested blueprint and help dealing with obstacles. But partnerships come with their own risks, and no relationship is guaranteed to be successful.

Despite significant challenges, MFIs of all shapes and sizes have entered the market and created a multifaceted environment. From one-on-one relationships to large consortia, MFIs have found numerous ways to leverage weaknesses into strengths. From banking by phone to virtual banks, MFIs are offering new and more creative products and services all the time. Well-informed MFIs that have entered the money transfer business thoughtfully have discovered that the risks are worth the rewards, both to their bottom line and to the lives of their clients.

This Guide

Although the money transfers market offers tantalizing opportunities for financial service providers, the risks can be high. The purpose of *Making Money Transfers Work for Microfinance Institutions* is to help financial service providers determine whether offering money transfer services is in their interests. And if so, to help them determine what strategy, products, and institutional structure are needed to support a successful money transfer operation.

The purpose of this Technical Guide is to help financial service providers determine what strategy, products, and institutional structure are needed to support a successful money transfer operation.

This guide is primarily written for use by financial service providers, such as MFIs and other institutions that serve low-income clients. MFIs are defined as financial cooperatives, nongovernmental organizations (NGOs), specialized financial institutions, nonbank financial institutions, savings and postal banks, and others. The guide seeks to help senior managers and directors launch new money transfer services or improve existing ones. However, policy makers, regulators, funders, and others involved in the money transfers market may also benefit from this guide.

This guide is organized into five chapters, with the first half of the guide being informative (*what is the money transfer business?*) and the second half being directive (*starting a money transfer business*).

"Chapter 1: Opportunities in the Money Transfer Market" provides an overview of the market, with particular emphasis on recent trends in financial remittances.

Formal money transfers involve a complex process from sender to receiver. **"Chapter 2: How Money Transfers Work"** explains the process in detail.

MFIs can choose from a variety of business models. **"Chapter 3: Business Models for Money Transfers"** describes the basic business models for MFIs involved in money transfers and examines their advantages and disadvantages.

Beginning a successful money transfer business involves rethinking current practices or creating new ones. **"Chapter 4: Developing a Money Transfer Business"** provides a guideline for setting strategic goals, a process for evaluating the MFI's preparedness for entering the market, and an outline for developing an appropriate infrastructure.

Alliances that allow MFIs to offer money transfer services may be the best approach for new market entrants. The customer base, location, and existing distribution infrastructure of MFIs can make them attractive partners for international money transfer operators. The international operator's network, foreign exchange access, and risk management expertise can, in turn, reduce both the cost and risk of an MFI's market entry. "**Chapter 5: Negotiating Partnerships**" provides explicit instructions on crafting favorable alliances.

These chapters are supplemented with material on the concepts discussed in this guide. "**Annex 1: The Building Blocks of Retail Money Transfers: Payment Services and Instruments**" serves as a primer on money transfers. Readers who are unfamiliar with money transfers are strongly encouraged to review Annex 1 before reading the main chapters, because it provides definitions and background on terminology used in this guide. "**Annex 2: Formality of Financial Channels**" offers a comparison, along with examples, of formal, semi-formal, and informal financial channels. "**Annex 3: Summary: General Principles for International Remittance**" provides guidelines for creating better markets for financial remittances developed by the World Bank and the Bank for International Settlements Committee on Payments and Settlement Systems. "**Annex 4: Taking Stock Checklist**" is a tool MFIs can use to evaluate their strengths and weaknesses before entering the money transfer market. Similarly, "**Annex 5: Selecting a Partner: Quick Reference Guide**" provides a simple checklist of information to consider when evaluating a partner.

The field of money transfers is broad and changing rapidly.

While this guide strives for completeness, the field of money transfers is broad and rapidly evolving. Each MFI should compare the information presented herein with the realities of its own markets.

1

Opportunities in the Money Transfer Market

Financial service providers that cater to the poor have been drawn to the money transfer market because it offers them the opportunity to fulfill their financial goals and their social objectives. As a fee-based product, money transfers can generate revenues and bolster the bottom line. Because microfinance institutions (MFIs) often serve low-income clients and clients in underserved geographic areas, money transfers help MFIs meet their social goals by delivering an additional service demanded by low-income customers—often at a cost lower than that of mainstream providers (Isern, Deshpande, and van Doorn 2005).

Banking access rates are still quite low globally and lowest in Africa, where only one in five people has access to a bank account. In a recent survey of Latin America, only one-third of money transfer recipients use a bank account (Orozco 2006). Given such low levels of bank use among money transfers clients and MFI penetration into unbanked markets, MFIs are uniquely situated to capitalize on the market for money transfers.

THE MONEY TRANSFER MARKET

The money transfer market offers the opportunity to fulfill financial goals as well as social objectives.

The money transfer industry comprises a vast array of players for both international and domestic payments. In 2001, worldwide cross-border payments exceeded US$330 trillion; this is projected to grow to $604 trillion by 2011. As of 2001, domestic payments worldwide were estimated at $1,447 trillion. They are expected to increase to $2,417 trillion by 2011 (Boston Consulting Group 2003). The flows of international transfers from migrants, or international remittances, historically have been uncounted and even ignored in official statistics. In 2006, officially recorded statistics from central banks estimated that international migrant remittances reached $206 billion. However, it is widely recognized that the actual flows might be undercounted by 50 percent. A 2007 independent study by the multidonor Financing Facility for Remittances (FFR)[1] estimates that in 2006 the overall international remittance flows (both formal and informal) to developing countries reached $300 billion, suggesting more than 1.5 billion transactions of $100, $200, or $300 at a time. By all accounts, available data indicate a very large market.

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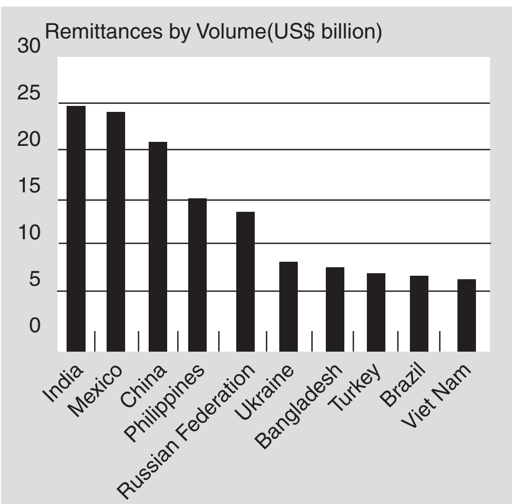
[1] FFR is a multidonor fund composed of the International Fund for Agricultural Development, CGAP, the European Union, the MIF of the Inter-American Development Bank, UNCDF, the Government of Spain, and the Government of Luxembourg. FFR is housed at IFAD headquarters in Rome. For more information, see http://www.ifad.org/events/remittances/index.htm.

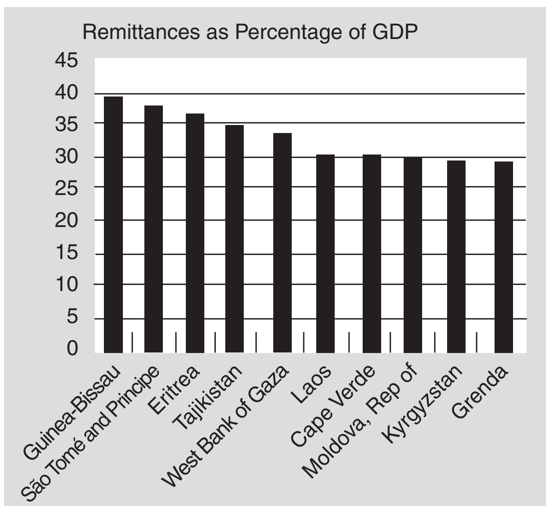
Remittances constitute one of the largest sources of external funding for developing countries, in most cases dwarfing the amount of official development assistance (ODA). Figures for 2006 show that international remittances to Africa totaled US$38 billion, the equivalent of all foreign direct investment (FDI) to Africa. Remittances were the equivalent of 80 percent of all FDI flows to developing countries in Eastern Europe. Likewise, remittances were a significant portion of GDP for Asia ($114 billion), LAC ($68 billion), and the developing economies of the Near East ($28 billion).[2]

Money transfers are attracting increasing attention from the private sector, governments, and development agencies.

Such staggering global volumes, remittances, and other types of money transfers are attracting increasing attention from the private sector, governments, and development agencies. The money transfers market includes all types of customers, including individuals, businesses, and governments. For both international and domestic money transfers, clients from all levels of society use a variety of services, including formal, highly regulated channels and informal, unregulated ones (Isern, Deshpande, and van Doorn 2005). Money transfers are used by people for many purposes: from everyday bill payment, to one-time-only money needs, to delivering money from people in more-developed countries to families back home (**remittances**).

Figure 1: Large countries receive more remittances in raw volume, but small countries receive the most in remittances with respect to their GDP.*





*Adapted from Funding Facility for Remittances 2007.

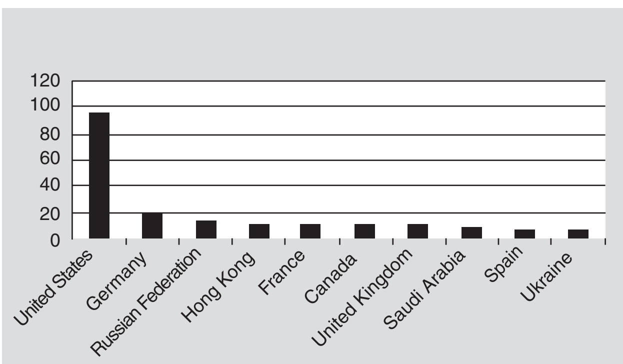
[2] OECD estimates US$103.9 billion in aid in 2006 from the world's major donors to developing countries worldwide (OECD 2006).

Among money transfer products, international remittances have received the most attention. The top three recipients of international remittances in 2006 were India (US$24,504 million), Mexico ($24,354 million), and China ($21,075 million). But smaller countries top the list when comparing remittances to national GDP: Guinea-Bissau (48.7% of GDP), Sao Tome and Principe (39%), Eritrea (37.9%), and Tajikistan (36.7%). Based on new data developed by FFR, a majority of countries in most developing regions show annual remittance inflows of more than $1 billion: Asia and Oceania (17 countries), LAC (13 countries), Europe (12 countries), and the Near East (9 countries). A further 18 African countries received more than $500 million in formally documented international remittances (Funding Facility for Remittances 2007).

South-south remittances account for 30 to 40 percent of the remittances received in the South.

Wealthy countries and economies in transition are the main source of remittances to developing countries, as seen in Figure 2. The United States is by far the largest source, with approximately US$95 billion in outward flows, followed by Germany and the Russian Federation. It is conventionally believed that migration flows are from south to north and that remittance flows are from north to south. However, south-south migration is actually estimated to be *at least* as large as south-north migration, and south-south remittances account for 30 to 45 percent of the remittances received in the south (Ratha 2005). Further, migration within countries, especially from rural to urban areas, is growing globally. As one example, approximately 100 million people were recorded officially as domestic labor migrants in China in 2005 (Cheng and Xu 2005).

Figure 2: Rich countries are the largest sources of remittance to developing countries in dollar terms*



*Adapted from Funding Facility for Remittances 2007.

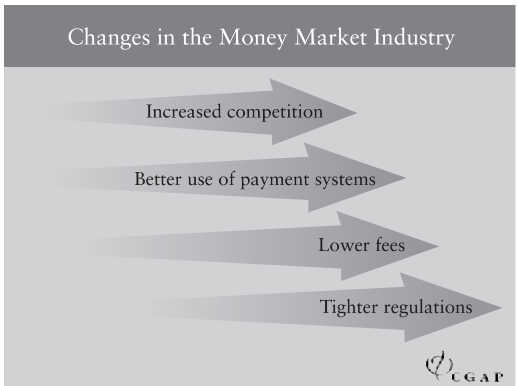
Remittances benefit low-income people directly—and on demand.

International remittances are qualitatively different from other sources of development finance. They are both relatively stable and countercyclical in nature, because migrants tend to remit more during periods of economic downturn in their home countries. Because remittances represent private money sent person to person, they benefit low-income people directly—and on demand. International MTCs have long dominated the global market, but smaller regional and national providers are beginning to explore the market potential (Isern, Deshpande, and van Doorn 2005).

While international remittances and other transfers represent a sizeable market, the potential for money transfers is even broader when domestic money transfers are considered. In many countries, domestic money transfers are growing rapidly as more countries develop national electronic payment infrastructure. For most MFIs, offering domestic money transfers represents a significant opportunity that may have fewer hurdles than international transfers (Isern, Deshpande, and van Doorn 2005).

The money transfers industry is changing rapidly.

Some of the most important changes over the past five years include the following:



- **Increased competition** among formally licensed MTCs as new firms have entered the international, regional, and national markets.
- **Better use of existing payment instruments,** such as card, phone, and Internet-based payments.
- **Lower fees** for money transfers as a result of increased competition. For example, in Latin America, the cost of sending US$200 internationally is estimated to have dropped from over 15 percent to less than 5.6 percent from 2001 to 2005 (Orozco 2006).[3] Other international and national markets are also beginning to see price reductions, and this has implications for MFIs that seek to enter the market.

[3] The actual price decrease varies considerably and depends on the number of MTCs and the level of competition in both the sending and receiving countries.

- **Tighter regulations** from national and international authorities on anti-money laundering and combating the financing of terrorism (AML/CFT). In many countries, MFIs are excluded from making currency operations and cannot access the payment system. However, some countries are starting to open their payment systems to larger, regulated MFIs.

The money transfer market offers tantalizing opportunities for MFIs to attract new clients, increase existing client loyalty, and earn additional revenue. However, MFIs must proceed with caution in evaluating the potential for money transfers. They should learn from the experience of institutions that have already launched them.

The money transfer market offers tantalizing opportunities for MFIs to attract new clients, increase existing client loyalty, and earn additional revenue.

Forming an alliance with a proven MTC may be the best approach for MFIs just entering the market, especially for international money transfers. MFIs' customer base, location, and existing distribution infrastructure can make them attractive partners for MTCs. In return, the international payment networks, foreign exchange access, and risk management expertise of MTCs can reduce both the cost and risk of MFIs' entry into the market.

The domestic money transfers market is a prime market for MFIs. The industry is just starting to grapple with more reliable information on international money transfers, but very little information is available on domestic transfers. Nonetheless, it is clear that the volume of domestic money transfers, including person-to-person remittances, is multiple times larger. Institutions with nationwide coverage are well placed to offer domestic transfers. While many of the same challenges apply, domestic transfers can be considerably easier to launch and manage than international transfers.

2

How Money Transfers Work

By ensuring each step of the value chain is efficient and effective, the MFI can generate superior value for the client and overall success with its money transfer product.

PAYMENT INSTRUMENTS

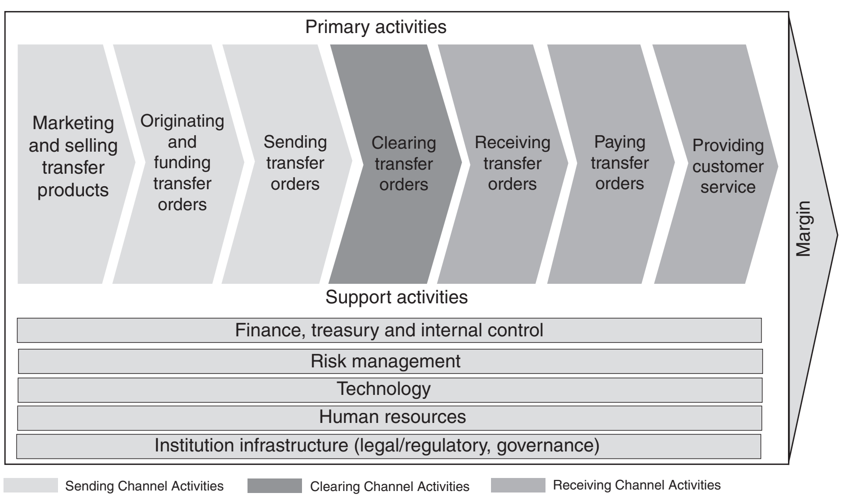
Fund transfers and instruments take many forms. Transfers may be formal and use an established banking channel, or they can be informal and use a hawaladar. Funds may be transferred using a low-tech paper medium or a high-tech electronic one that requires an extensive network of settlement centers and clearing houses. This chapter examines the money transfer process as it relates to formal, more sophisticated channels. It provides an overview of each stage of the process to give MFIs a better understanding of the mechanics behind money transfer products.

See "Annex 1: The Building Blocks of Retail Money Transfers" for more detail on payment instruments.

MONEY TRANSFER VALUE CHAIN

Each step in a money transfer transaction comes together in a value chain, as shown in Figure 3. By ensuring that each step of the value chain is efficient and effective, MFIs can generate superior value for clients and overall success with their money transfer product. While MFIs may not have full control over each step in the value chain—especially if they develop a business alliance with an MTC—it is nevertheless important for MFIs to understand the full process involved in money transfers.

Figure 3: Value chain for the money transfer business



Marketing and Selling Transfers Products

Marketing is instrumental for introducing the new services to clients.

Marketing is especially challenging for money transfers because both the sending and receiving client need to be considered.[4] One of the most promising strategies available to MFIs is marketing that is targeted at specific client segments (e.g., ethnic communities for remittances, salaried workers for regular monthly payments, parents with children for school fees, etc.).

In markets where there are many transfer options available, marketing information can be confusing for clients, and the information provided is often superficial. Successful institutions identify their product advantage (speed, convenience, price, etc.) and highlight these features in their marketing. In environments with few transfer services, marketing is instrumental for introducing the new service to clients. In all cases, continuous targeted marketing is the key to attracting clients.

Many recipient institutions overlook the crucial role that send-side marketing plays in generating transfers. One of the chief ways leading MTCs maintain their dominant market share is through well-funded media campaigns. MFIs that partner with such companies will benefit from their marketing efforts. MFIs that choose other options, however, must compensate for the lack of an established marketing machine (Isern, Deshpande, and van Doorn 2005).

Box 1: Send-side marketing by Fonkoze in Haiti

Send-side marketing is crucial to the success of money transfer services in recipient countries, but it can be easily overlooked. The Haitian MFI Fonkoze learned this lesson when it launched its own, low-cost money transfer service in cooperation with a commercial bank in the United States. Although it negotiated attractive terms with the bank and generated a break-even transaction volume, the new transfer product did not produce sufficient profits to invest in improving the service.

Consequently, Fonkoze formulated a send-side marketing campaign targeted at the Haitian community living in the United States. At first, Fonkoze planned to produce public service announcements, purchase targeted radio

[4] For more background on marketing, the Microsave initiative is an excellent resource (http://www.microsave.org). Additional guidance on marketing can be found on the Microfinance Gateway (http://www.microfinancegateway.org).

and print advertisements, and conduct radio interviews in U.S. cities with large Haitian populations. However, the MFI quickly realized that this type of expensive marketing was better at producing market awareness than at changing client behavior. Because Fonkoze's original money transfer service worked quite differently than a typical MTC (a customer mails a check to the U.S. bank partner of Fonkoze, which then sends the funds to the Haitian MFI), it needed a marketing campaign that could convince potential clients to do things differently, rather than simply change service providers.

The MFI also needed to overcome the image of unreliability that small institutions offering low-cost services often suffer from among many Haitians abroad. The result was an innovative campaign of "family days" at Fonkoze branches in Haiti, during which the institution rented out cyber cafés and gave customers a free five-minute phone call to the United States. Fonkoze also gave nonclients free phone calls, provided they took the money they would have spent on a call and opened an account with the MFI. Using this technique, the first event generated 100 new accounts in a single day. The MFI controlled costs by not paying for individual calls, but by purchasing them in bulk at a deep discount by paying the cyber café's daily rate. During the calls, grateful clients almost invariably mentioned Fonkoze to their relatives, producing a referral from a trusted source—the best kind of publicity the institution could generate.

The institution must attract a high volume of money transfers to break even and eventually generate profits.

The calls also produced a targeted list of clients who already send money to Fonkoze clients regularly, representing an ideal market for its money transfer service. The MFI concluded that this focused strategy yielded better customer conversion rates than the expensive, untargeted media placements used in the past.

Source: Anne Hastings (Fonkoze director), November 2007; Isern, Deshpande, and van Doorn 2005.

To support growth, an MFI must build a broad, active customer base—and to do that, it must offer customers a valued product. At the retail level, money transfers are usually a lower value transaction, especially for the typical customer base of an MFI. As a result, the institution must attract a high volume of money transfers to break even and eventually generate profits. For example, Anelik RU Co., Ltd., in Russia experienced rapid growth in its money transfer business from 400,000 transactions and US$155 million in payment volume in 2001 to over 1.8 million transactions and $830 million in payment volume in 2005 (Veronina 2006).

If an MFI is allied with a money transfers firm, especially as a payout agent, it may not have much control over the volume of money transfers. However, if the MFI is able to attract clients who send transfers, either domestically or internationally, the MFI must have a good process in place to originate and initiate transfers.

Originating and Funding

Selecting the Transfer Mechanism

The originating institution decides on the best transfer mechanism, depending on the client's preferences and the institution's available options and its contract with the client. Typically the following criteria affect the choice of transfer mechanism:

- Is it a cash-to-cash transfer, account-to-account transfer, or a mix of cash and account?
- Is it one time or recurring (monthly, quarterly)?
- Is it urgent (requiring same-day availability of funds to the recipient)?
- Is it high value or low value?
- Is it local or long distance?
- Is it domestic or international?
- How accessible is the transfer channel to the sender and recipient?
- How much will it cost the two parties?
- What risks are involved?

Funding the Money Transfer

Money transfer transactions must be funded before their execution. Clients typically use cash, check, card, or transfer of funds from an account in their name. In addition to the value of the transfer, clients must pay for the cost of making the transfer. Typically, sending clients pay the full cost of the transfer, although there may be other fees (formal or not) that receiving clients pay. Often, there is little transparency in pricing across money transfer channels, making it difficult for senders to compare options before making a decision.

There is little transparency in pricing across money transfer channels, and MFIs should aim for greater transparency with their clients.

For example, some services convert the transaction in U.S. dollars, regardless of where they operate, and thereby generate foreign exchange revenue for receiving as well as paying out—causing a double foreign exchange cost for clients. The currency may be determined by a national currency exchange control. MFIs should be aware of relevant regulations and currency restrictions.

Cost factors for clients include direct costs and indirect fees. **Direct costs** encompass the following:

- Minimum fees
- Sender or recipient fees
- Authorization fees
- Commissions
- Currency exchange fees

Indirect costs include the following:

- Getting to and from the point of service
- A phone call to tell the recipient of the transaction
- Low or unfavorable foreign exchange rates often used by banks and MTCs
- Maintaining a minimum balance or account

Originating the Transfer

The transaction is originated with the sending client.

Once the channel has been chosen and the transfer is funded, the next step is the origination of the payment or transfer order. Currently, origination may be done in the office of the sending institution.This is the most common method for retail money transfers. The transaction is originated with a form, either manual or digital, completed by the client, usually with the assistance of a sales agent. The agent then initiates the transfer using the institution's established procedures, which vary by institution size and complexity. If an MFI is working with another institution, such as a bank or MTC, the MFI may have little flexibility in procedures to originate the transfer.

While this is currently the most common method for origination, technology is changing rapidly, and as new forms of money transfers emerge, origination methods will also likely change.

Sending, Clearing, and Settlement of Transfer Orders

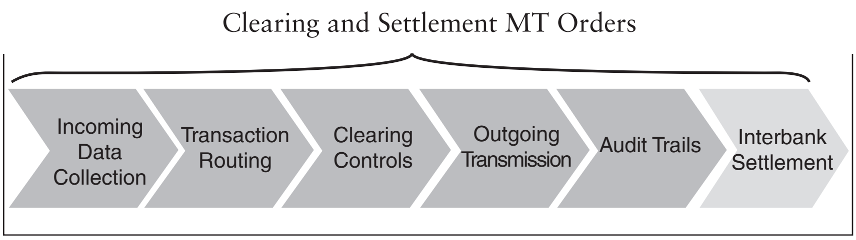
The way the transfer moves between the sender and recipient is determined by the payment instrument and the transfer mechanism.

Clearing is a critical part of the money transfer value chain. In countries with centralized banking systems dominated by a few institutions, many transfer senders and recipients hold accounts with the same institution, making interbank operations unnecessary. But it is far more common for senders and recipients to deal with different institutions, which requires interbank clearing and settlement.

Clearing is the process of transmitting, reconciling, and in some cases, confirming transfer transactions before their final settlement (see Figure 4). During clearing, the sending and receiving financial institutions exchange information about the payment, and the amount of funds to be settled by those institutions is calculated. The outcome is a fully processed payment transaction between sender and recipient as well as a valid financial claim by the receiving institution to receive funds from the sending institution.

Clearing is the process of transmitting, reconciling, and in some cases, confirming transfer transactions before their final settlement.

Figure 4: Clearing and settlement of money transfers



Settlement is the process of discharging the claims of the institutions involved in a transfer. This involves a payment from the sending institution to the receiving institution. The steps include collecting and checking the integrity of the claims to be settled, ensuring the availability of funds for settlement, settling the claims between the two institutions, recording the settlement, and communicating the final settlement.

Many of the activities in the clearing process are not transparent to users, because they happen behind the scenes. Nevertheless, the importance of understanding the clearing and settlement process cannot be overstated—regardless of an institution's direct involvement in the process. Problems arising at the transaction originators or receivers, or within the clearing process, can result in significant operating losses. A routine ACH transaction in the United States costs less than $0.01 to process, but isolating and correcting even a minor error in a transaction can cost more than $30.[5] A small error

[5] Source: Bill Donges, based on various sources. Pheonix Hecht, the U.S. bank price research firm, reports the average price of an ACH origination is US$0.12 and includes originator and originating institution transaction costs, plus the originator's margin. Also, various Federal Reserve Bank studies have shown that ACH processing costs are between $0.01 and $0.02. Costs in other countries will vary considerably depending on context.

during origination of many small transactions, for example, can create a larger discrepancy and place all stakeholders at risk. Thus it is vital that MFIs understand the clearing process even if they are not direct participants.

Four types of institutional arrangements are used to clear payment instructions:

- **On-us clearing arrangements** where the accounts to be debited or credited are held by the same financial institution. Accordingly, the exchange of information and calculation of balances in the clearing process are performed by the same institution.
- **Bilateral clearing arrangements** where two financial institutions maintain agreements about the exchange of information and transfer of funds between accounts.
- **Third-party clearing arrangements** where financial institutions employ a common third party (a separate financial institution known as a **correspondent**) for clearing, with one or more institutions forwarding payment instructions to the correspondent for sorting and processing.
- **Multilateral clearing arrangements** where financial institutions exchange information and, in some cases, funds with other financial institutions through organizations, such as clearinghouses, that operate central clearing facilities and may also act as a central counterparty in the settlement of payment obligations under a multilateral netting arrangement.

Multilateral arrangements offer more efficient coordination of the exchange of payment instructions among multiple institutions as well as greater economies of scale in operating communication networks and providing processing services. The number of clearing transactions and financial institutions involved are the main factors determining the effectiveness of the various types of clearing arrangements.

Receiving a Money Transfer Order

Getting money into the hands of recipients is one of the most important phases in money transfers.

Getting money into the hands of recipients is one of the most important phases in money transfers. While senders may have a variety of choices among money transfer systems, many domestic and international transfers flow into less-developed areas with limited options for receiving funds.

For international remittances, an MFI's main role, at least initially, will most likely be on the receiving end. For domestic transfers, the MFI may be involved on both the sending and receiving side.

The receiving channel for a money transfer depends on the type of transfer instrument and clearing system involved. These channels can be broadly categorized as physical or electronic.

Physical channels used to transport payment instructions include personal transportation and mail. Money transfer instruments that can be transmitted by physical channels include currency, checks, money orders, traveler's checks, debit cards, credit cards, and prepaid cards.

Electronic channels involve the receipt of electronic files of transfer transactions from clearing facilities, by phone, and by Internet. The receiving institution may be a commercial bank, an MFI, a savings bank, a postal bank, or other financial service provider. In most cases, these files contain only the funds transfer instructions; the actual money flows through separate settlement channels. The timing of these two flows may differ by several days to a week or more. During this interval, the receiving institution has a settlement risk, because it may pay out a transfer order before receiving credit for the funds. Given this risk, the institution must carefully reconcile incoming transactions and the settlement of those transactions.

Ideally, an institution that executes money transfers should be able to inform customers when the transfer arrives, whether as a standard or additional service. Indeed, it is good practice to contact transfer recipients, because the cost of such a message is usually less than the cost of interruptions caused when recipients contact the MFI several times to find out if a transfer was received. Such messages can be delivered by phone or by using automated calling systems, email, and text messages. When working as a payer for some MTCs, however, the institution may not receive information on the recipient client. In these cases, the institution may not know the customer until the customer walks in the door with the code to receive a money transfer.

An institution should be able to inform customers when the transfer arrives, as a standard or additional service.

Box 2: Fonkoze offers stored-value cards

Fonkoze, Haiti's largest MFI, is developing a partnership with Central National Bank and Trust Company (CNB), located in Oklahoma, and Alianza International to offer a payroll stored-value card to Haitians living in the United States and Canada. The product allows employers to directly deposit payroll compensation to the card at no charge to either the employer or employee. The card can be used like a debit card, although the employee does not need to have a bank account. Card holders can store funds on the card, make point-of-sale purchases, and withdraw funds from automated teller machines (ATMs) internationally. The cost savings to remitters will be significant: any amount up to US$2,500 can be transferred to Haiti for deposit into the client's Fonkoze account or for cash withdrawal for a flat fee of $6. Transfers can be made by calling a toll-free phone number or by accessing a Web site. In addition, card owners will be able to make low-cost phone calls. The cost savings to the unbanked of no longer having to pay fees to cash their payroll checks combined with the low cost of money transfers and telephone calls to Haiti are expected to make the card very popular in the Haitian diaspora.

CNB is the contracting party and primary prepaid card processor, while Alianza is providing CNB with program/marketing support and driving channel distribution and customer adoption. Alianza is also responsible for developing the remittance delivery network for connecting nontraditional endpoints, such as MFIs and credit unions, for remittance origination and delivery. Fonkoze is responsible for marketing the card in Haitian communities and with employers of Haitians.

Source: Anne Hastings (Fonkoze director), November 2007.

Paying a Money Transfer Order

Disbursement of funds against an authenticated money transfer can occur using local currency, foreign currency (if regulations permit), check, or credit to an account at the MFI. Funds can be disbursed at a branch of the receiving institution, by special delivery to the client's home, at a retail agent, though an ATM, or by credit to an account. The options available for paying out a money transfer depend on the MFI's branch network, systems, and business alliances. Currently, most transfers are paid through cash, foreign currency, or deposit to the account of the receiving client. MFIs must give careful attention to paying money transfer orders. The costs of establishing and maintaining the paying capability are significant and include factors such as office locations, cash management, hours of operation, staffing, ATMs, accounting, and internal controls.[6]

Effective customer service generates customer confidence, trust, loyalty, and repeat business.

Customer Service

Customer service is the final stage in the value chain of money transfer activities. Activities include answering client questions, providing information on transfer

[6] See "Chapter 4: Creating Institutional Capacity: Establishing Delivery Channels" for additional considerations.

services and other available financial services, authorizing exceptional events, maintaining accounts, and resolving problems. Effective customer service—for both senders and recipients—is crucial to the success of a money transfer program because it generates customer confidence, trust, loyalty, and repeat business.[7]

For example, Fonkoze in Haiti discovered just how difficult customer service can be. Fonkoze's management worked hard to ensure that staff would confirm payouts and problems on a regular basis to its partner MTC (Hastings forthcoming). Keeping its partner firm and clients satisfied with its service was a constant and ongoing challenge.

Consumer satisfaction levels reflect positive attitudes toward the industry on the part of remittance senders. A survey of 2,800 remitters from Latin America and the Caribbean showed that over 80 percent of consumers feel satisfied or very satisfied with their MTC (Orozco 2006).

MFIs already have a relationship with their clients; this is a strong asset in launching new products. When offering money transfers, MFIs will need to adjust their client approach. Money transfer services are a different kind of relationship: for money transfers—as with savings—MFIs must win the trust of clients, whereas for lending, clients must win the trust of the MFI.

Perceptions of service quality are affected by many factors, including the following:

- Attitude of staff when delivering services
- Hours of operation
- Convenience of location of offices and their appearance
- Average time required to deliver a transfer, which includes receiving information from the sending agent about the money transfer and waiting time for a client to pick up a payment (or have a payment delivered to his/her location, if that service is available)
- Form and manner of communication with customers
- How problems are addressed and the speed of resolution
- Whether the MFI consistently has sufficient liquidity to make payments on demand

Customer service is effective when people are dealt with promptly, honestly, and knowledgeably.

Customer service is effective when people are dealt with promptly, honestly, and knowledgeably.

[7] For more background on customer service, the Microsave initiative is an excellent resource (http://www. microsave.org). Additional guidance on customer service can be found on the Microfinance Gateway (http://www.microfinancegateway.org).

3

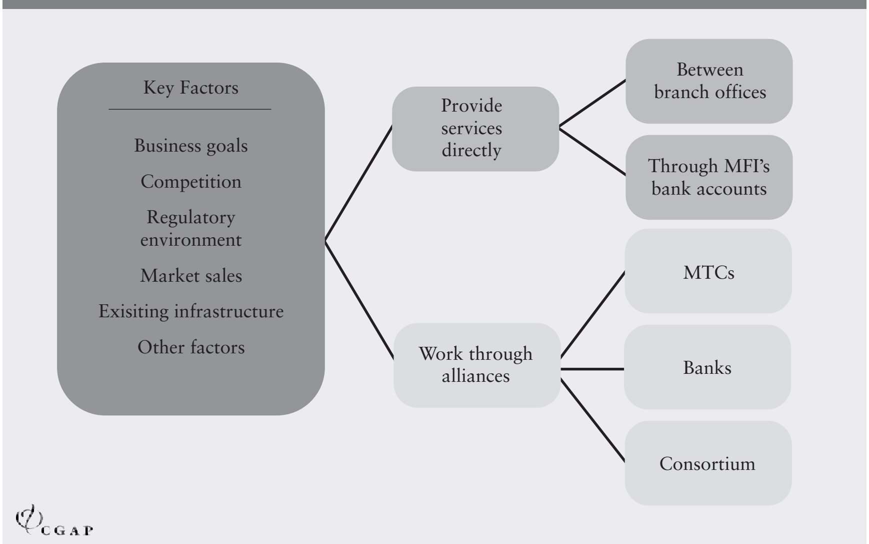
Business Models for Money Transfers

This chapter describes the basic business models for MFIs involved in money transfers.

Readers who are new to the business of money transfers are encouraged to review "Annex 1: The Building Blocks of Retail Money Transfers" for more background on the concepts discussed in this chapter.

This chapter examines models from several regions in order to capture the diverse ways MFIs offer transfer services. However, the models described here are not exhaustive. Many noteworthy experiences are not covered, and as more financial institutions—large and small—enter the industry, the field will continue to evolve.

Different MFIs, Different Approaches



An institution is not limited to one business model. Many financial institutions use a mix of business models.

MFIs may decide to provide services directly or to work through alliances with MTCs, banks, or consortia. It is important to note that an institution is not limited to one business model. Many financial institutions use a mix of business models. For example, a commercial bank might offer its own direct service while also acting as an agent for Western Union, MoneyGram, or other MTCs.

Box 3: Pursuing several models: Guatemala's Banrural

Commercial banks are important players in the Guatemalan transfers market. However, Banrural is the only bank that does not operate as an exclusive agent of an MTC. Banrural is a large commercial bank, with good negotiating clout. Banrural transfers funds through branches in the United States as well as through agreements with more than 80 money transfer operators, some of which manage a very small volume of transfers. Banrural distributes more than 150,000 transfers a month—evidence that it has developed a unique, successful model (Orozco and Hamilton 2005).

Deciding on a business model can be challenging for MFIs.

An MFI's choice of business models is usually limited by **country regulations** and market realities. In many countries, an MFI without a banking license can act only as an agent or subagent of an MTC or establish a correspondent relationship with a commercial bank or other licensed financial institution.

Options also vary depending on the market niche the MFI pursues (whether domestic transfers, international transfers, or both). For example, if the MFI will be mainly on the "receive" side of international transfers and will be making payments to clients who collect their money transfers, the MFI may want to establish an alliance with a specialized company with extensive operations on the "send" side. Alternatively, if the MFI plans to offer money transfers within the country, it may be able to operate independently.

Market structure will also affect an MFI's choice of business model. In some countries one firm—typically a large international MTC—dominates the remittance market. In Latin America for example, MoneyGram and Western Union are dominant players, with more than 35 percent of the market, but new entrants include regional or country-specific MTCs, more than 100 credit unions, and several large Latin American banks that see the large U.S. immigrant population as a growth market (Williams 2006).

Depending on the country context, specialized MTCs may be major players as they target a niche market of migrants, business people, or others with a large volume of transfers for a specific set of countries. Examples of regional or country-specific MTCs include Ria Envia, Dolex, Siguue, Vigo, Delgado, Intermex, Nexar, GroupEx, Money Express, Telepay, and hundreds of others. In other countries, such as Turkey, India, and Mali, one or more commercial banks are the market leaders. As the flow of remittances and other money transfers continues to expand rapidly, many markets are becoming more competitive, creating more opportunities for MFIs.

Deciding on a business model can be challenging for MFIs. Many lack sufficient resources to ascertain their competitive position in their local markets, so they do not have a clear sense of whether there are niches that might be filled or what added value they could offer to potential partners. Similarly, relatively few MFIs have the capacity to conduct proper due diligence on potential partners and thus might not clearly understand the costs and benefits associated with a given business model. Moreover, few have experience working with partners or working as agents. Even large MFIs can be at a disadvantage when negotiating with huge MTCs.

Many MFIs act as payment agents for MTCs.

MFIs can choose from a variety of business models. Some MFIs offer transfer services directly, using in-house systems that range from basic systems built around their core accounting package to more sophisticated systems based on specific electronic funds transfer (EFT) systems. Other MFIs partner with one or more MTCs, such as Western Union or MoneyGram. Such partnerships are far more common, and they take many forms. Many MFIs act as payment agents for MTCs, while others gain access to proprietary networks (such as SWIFT) by working with banks or other financial institutions; some do both.

These options are not mutually exclusive. An MFI could offer paper-based money orders for use in occasional domestic money transfers or bill payment; operate as an agency of one of the MTCs for simple, low-value domestic or international transfers; and establish a correspondent relationship with a bank for higher value, higher reliability international transfers. MFIs can also form alliances with similar institutions to enhance their negotiating leverage with specialized MTCs. Examples of alliances or consortia include networks of state banks and savings or postal banks, credit union federations, and other national or international microfinance networks. [8]

Box 4: Postal networks offer a variety of money transfer options

Around the globe, post offices historically have been one of the most common ways to transfer funds. They have, by far, the largest network of outlets, with more than 660,000 worldwide, and a dense presence in rural areas. There are two kinds of postal service providers: postal operators and

[8] For more information on microfinance networks, including consortia of state development banks and savings and postal institutions, see Isern and Cook 2004.

postal banks. Operators offer traditional postal services. Banks are licensed financial institutions regulated by central banks or other government agencies. Both provide money transfer services, some direct and others indirect.

Direct services offered by postal operators can be used to send cash or checks by mail or to purchase postal money orders (also sent by mail) or telegraphic money orders. Domestic transfers through postal operators vary by country. In the United States, unbanked people often use postal money orders for bill payments and other transfers. For international transfers, however, postal networks account for less than 1 percent of the global market. In some regions, especially Latin America, this decline in use is attributable to a lack of client trust in postal operators. Moreover, postal networks are competing against new technologies that have eroded their traditional business. Postal operators also operate as agents of MTCs, and more than half the world's postal networks have agreements with Western Union or MoneyGram.

The market is much larger for domestic transfers, and competition is typically less intense.

Postal banks offer a full range of financial services. But, like postal operators, they have not established a significant presence in the global money transfer market—despite similar advantages in terms of access to huge branch networks and a strong historical position in the industry.

Recognizing the weaknesses of current services, some postal banks are developing new payment products. Several have introduced debit cards linked to accounts. In South Africa, for example, Postbank introduced a Flexi Card that can be used at post office counters and bank ATMs. Others, such as Brazil's Caixa Economica Federal, offer cards linked to government payment services and a broad range of ATMs. For remittances, both domestic and international, many postal banks are looking to improve products and services by working with payment networks such as Eurogiro.

The Universal Postal Union (UPU), together with Eurogiro, has developed a new product: the TeleMoneyOrder, a two-day money transfer that can be easily traced. UPU has also introduced another electronic product, called the International Financial Network. However, these products have yet to make a significant dent in the market. According to one observer, that is because postal networks have not developed a truly strategic approach to money transfers—one that takes advantage of their competitive strengths. Recently, the

Financing Facility for Remittances initiative began a program with UPU to promote the use of post offices for remittances in West Africa.

Source: Isabelle Segni (World Bank) and Hans Boon (ING), January 2006. See also World Savings Bank Institute 2004 and Boon 2005.

DIRECT APPROACH

MFIs may offer money transfers directly, without a business alliance. Because MFIs may face fewer regulatory and licensing hurdles for domestic transfers, a direct approach is probably more feasible. In addition, the market is much larger for domestic transfers, and competition is typically less intense.[9]

Box 5: Direct payment system in the Philippines and El Salvador

Banks have direct access to payment systems and can make transfers directly within their international branch offices and through international networks, such as SWIFT. The first universal bank in the Philippines to offer international remittances, the Philippine National Bank, began offering transfers in the 1970s through its network of foreign branch offices. Several other major banks followed suit in the 1980s, including the Bank of the Philippine Islands and the Allied Banking Corporation. More recently, four Salvadoran banks—Bancomercio, Banagricola, Banco Salvadoreño, and Banco Cuscatlan—introduced direct payment systems by opening offices in U.S. cities with large Salvadoran immigrant populations, such as Los Angeles, Houston, and Washington, D.C. These banks operate in the United States as MTCs, not as fully licensed banks. Such models are relatively sophisticated, offering rapid and reliable services designed to compete with established MTCs.

MFIs may set up direct money transfer operations using several different options:

- **Transfer funds between branch offices.** The MFI moves funds between its own locations. In Pakistan, First Micro Finance Bank Limited Pakistan, a former NGO that has banking license, offers an electronic interbranch transfer service to its clients throughout Pakistan (USAID 2005).

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[9] Competition for domestic transfers may be less intense from formally licensed firms, but informal money transfers may be thriving. The MFI should analyze all potential competitors. In East and Southern Africa, for example, courier services, taxis, and bus companies successfully offer money transfer services. The bus companies and taxis travel routes that have booking offices at specific stops where money is received or paid out to clients.

- **Transfer funds using the MFI's bank.** The MFI routes funds through its bank account, but it does not formally set up an alliance with its bank. In Mexico, Associacion Mexicana de Uniones de Credito del Sector Social (AMUCSS) is a network of savings-led MFIs, known locally as *microbancos,* that offers transfers using basic technology. One microbanco, Xuu Ñuu Ndavi (XNN), opened dual bank accounts in California and Mexico and offered transfer services to clients who deposited funds directly into the MFI's account. The MFI transferred funds between its two bank accounts and delivered the payment to the recipient client (Fertziger 2004).

If done on a small scale, the direct approach may be relatively quick and inexpensive to launch as a pilot.

Box 6: National Microfinance Bank of Tanzania: The dominant player in the domestic transfer market

The National Microfinance Bank of Tanzania, a recently privatized commercial bank, is the country's main provider of domestic money transfers. The bank is large, with more than 130,000 clients, a tremendous savings base (over US$370 million), and a network with 108 points of service as of September 2003. The bank offers transfers by Internet, phone, fax, and mail, with varying speeds of delivery. To transfer funds, the sender or the recipient must have an account with the bank. Instead of remittances, a major portion of the bank's domestic business involves managing payments for the government (salaries and pensions), as well as for large agribusinesses and mining companies. The bank has earned a reputation for timely, safe delivery of funds—a key element of its success.*

*Sander, Mukwana, and Millinga 2001; see also the bank's Web site (http://www.nmbtz.com), Development Alternatives Inc. (http://www.dai.com), and Tanzania Presidential Parastatal Sector Reform Commission (http://www.psrctz.com).

There are several **advantages** to offering a direct transfer service:

- The MFI **captures the entire fee**, as opposed to sharing it with one or more partners.
- The MFI may be well suited for certain **niche markets**—especially rural markets—where there may be less competition.
- If an MFI already provides financial services in rural areas, it may have **well-established relationships** and client trust that would be a useful base on which to build money transfers services. In the case of AMUCSS, for

example, some of its clients from Santa Cruz de Mixtepec (in the Mexican state of Oaxaca) migrated for work to Santa Maria, California, and AMUCSS maintained its strong client links.

A direct approach typically has relatively high maintenance costs.

- If done on a small scale, the direct approach may be relatively **quick and inexpensive** to launch as a pilot.

There are also **disadvantages** of taking a direct approach:

- Domestic and international money transfers are fundamentally businesses of scale, and there is generally a correlation between more points of service for clients and greater volume of money transfers. Absent a large infrastructure of well-placed points of service, these systems typically generate **low transaction volumes.** This is not always the case with domestic transfers, as the National Microfinance Bank of Tanzania demonstrates (see Box 6).
- While the costs of launching a direct approach may be low, it typically has relatively **high maintenance costs** (on a per transaction basis). If a service does not generate high volumes of transfers, costs associated with development and expansion may become prohibitive.
- By going it alone, the MFI is fully responsible for the **marketing campaign**. Marketing is especially complex for international remittances, where successful operations usually involve a large marketing effort in the sending country.
- The MFI has the sole responsibility of informing itself of, and complying with, relevant **regulations**, including anti-money laundering laws.

Direct Approach	
Advantages	Disadvantages
MFI captures entire fee	Low transaction volumes if small infrastructure
Well-established client base	
Less competition in niche markets	High maintenance costs
Quick and inexpensive to pilot	Responsibility for marketing
	Responsibility for compliance

Despite these risks, taking the direct approach can be simply a first step to entering the money transfers business. Several MFIs that developed their own transfer systems, like Fonkoze, have since expanded their product lines through partnerships with MTCs (see Box 7).

Box 7: Fonkoze expands remittance options

Haiti received over US$1.2 billion in remittances in 2005, comprising about one-quarter of the Haitian GDP. The country's largest MFI is Fonkoze, which has over 50,000 active borrowers and a network of 32 branches that extend into rural areas. Fonkoze began offering remittances through a system it developed with City National Bank of New Jersey. Customers could transfer funds directly to a Fonkoze account, use a money order, or mail a check. Fonkoze's remittance service cost $10 a transfer for transfers under $1,000, with a sliding scale up to $50 for transfers over $5,000, which is much lower than the global average of 10–15 percent fee. The service provides clients with more convenient payout options, better exchange rates, and more financial services than traditional MTCs. Fonkoze's product was cost-competitive, but relatively slow, and it required customers to have a fairly high level of financial literacy.

Fonkoze wanted to reach massive volume and provide its clients with more than one product. At the same time, many MTCs in Haiti were looking for ways to reach rural clients. In December 2005, Fonkoze teamed up with Rapid Transfer, a licensed money transfer agent in Haiti that works on behalf of large MTCs, including UNO Money Transfer and MoneyGram. Based on this successful partnership, today Fonkoze has been able to partner with other large companies, such as Unitransfer, CAM, and Banco BHD in the Dominican Republic.

Source: Anne Hastings (Fonkoze director), November 2007; Fonkoze 2005; and USAID 2005.

PARTNERSHIPS

Many MFIs choose to offer money transfers through partnerships with MTCs or commercial banks.[10] Working with an established partner is the fastest way to gain a presence in the market. Well-established MTCs offer reliable products with the potential to generate a large volume of transactions. Working as an agent usually requires less management attention and fewer internal systems than creating an independent in-house money transfer service. Furthermore, MTC relationships may even become a necessity for maintaining clients as the

Working with an established partner is the fastest way to gain market presence.

[10] Strictly speaking, the partnerships referred to here are contractual supplier or commercial agency relationships.

MFI's competitors begin offering convenient transfer services (Isern, Deshpande, and van Doorn 2005). A growing number of MFIs have established alliances to become an agent or subagent with MTCs, such as Western Union or MoneyGram, or have linked with payment providers, such as Eurogiro.

Part of the attraction of a partnership is simplicity. Many companies offer **turnkey packages** to their agents, providing a preset package of well-tested products, a technology platform, limited training, and marketing materials for the MFI to begin operations. Agents benefit from an established agent network and existing marketing campaigns in other countries, both of which help to generate a larger volume of transfers. Some MTCs provide training, technical assistance, or call center support to guide the MFI, especially when initially launching operations.

Some MTCs provide training, technical assistance, or call center support to the MFI.

In reality, however, few packages are truly turnkey, and the MFI usually needs to adapt to its partner's systems and operations. Often, the MFI must decide the best approach for distributing a payment through its network, integrating payment data from the MTC into its existing accounting systems, providing settlement among its branches, and marketing the product locally.

From an MFI's perspective, there are three general types of partnerships: single partnerships, multiple partnerships, and affiliations with a consortium or clearinghouse. None of these is mutually exclusive, and variations exist within each type.

Single Partnerships

Most MFIs begin with a single partner, such as a bank for domestic payments or an MTC for international payments.

A single partnership has several **advantages**:

- **Start slow.** Starting with one alliance makes sense from many angles, because each relationship may take time to research, negotiate, and implement.
- **Test the relationship.** A single partner may provide enough transfer business for the MFI to test the service before investing further. For example, large MTCs typically offer a significant, if not dominant, presence in the market—providing their agents with significant transaction volume and revenue.

A single partnership also has **disadvantages**:

- **Exclusivity.** A few prominent MTCs require exclusivity arrangements with their agents, so MFIs are legally prevented from seeking other partners. Exclusivity agreements can constrain an MFI's ability to expand market share (Orozco and Hamilton 2005).[11] Many MFIs try to negotiate away the exclusivity requirement (though this may not be possible), while others look for partners that do not require exclusive arrangements. Whether to sign a contract that requires exclusivity is an important issue for an MFI to consider; this aspect is addressed in "Chapter 5: Negotiating Partnerships."

- **Competition among agents.** As one of potentially many agents in its market, the MFI is competing with other agents based on the terms defined by its agreement with the MTC.
- **Relies on partner's strength.** The MFI is limited by the MTC's strength in certain markets, which may not be a good fit for the MFI's branch network. For example, an MFI whose clients receive remittances from Saudi Arabia and the United Arab Emirates may work with an MTC that has offices in only one of those countries.

Partnership (Single)	
Advantages	Disadvantages
Slow start	Exclusivity
Test the relationship	Competition between agents
	Relies on partner's strength

Multiple Partnerships

Multiple partners offer the potential for greater volume of transactions and clients, and thus profits. While most MFIs start with a single partner, as they deepen their money transfers operations, some decide to pursue additional partners. Some MFIs work with large global MTCs, medium-size regionally specific companies, small niche firms, commercial banks, and others.

As they deepen their money transfer operations, some MFIs decide to pursue additional partners.

Using multiple partners has several **advantages**:

- The MFI can gain **strong positions** in countries or regions that best fit its clients' needs.
- The MFI can **diversify its operations and commission income** among several MTCs in case one partner does not perform as expected, cancels the partnership, and/or de-emphasizes it by creating intense price competition among agents.
- The MFI has **better access** to the market in sending countries, rather than being limited by the market share of one partner.

[11] On the other hand, MTCs that require exclusivity suggest that the MFI may receive advantages, such as greater access to training, advertising support, and other agreement terms, from the exclusive arrangement.

- If the MFI has a strong negotiating position (large branch network, for example), it may benefit from an **increased share of fees and commissions**. For example, BancoSol in Bolivia initially offered remittances as a subagent of Western Union. It ended this relationship with Western Union in 2003 to work directly with small and medium-sized MTCs and with savings banks in Spain, such as La Caixa and La CECA, that have a strong presence in key markets with Bolivian migrants.

  Multiple partnerships also have **disadvantages**:
- Multiple partnerships require **more management attention** from the MFI.
- Multiple systems, transfer products, and procedures **require good training** for the MFI staff to avoid confusing the transfer services and to provide good client service.
- The MFI may need to **develop its own system or develop an IT platform** to manage the flow of payments and to adapt to multiple partner systems.

Negotiating with multiple partners is typically most effective when the MFI already has experience in money transfers.

Negotiating with multiple partners is typically most effective when the MFI already has experience in money transfers and has a strong negotiating position, such as a large branch network.

Partnership (Multiple)	
Advantages	Disadvantages
Gain strong positions in countries that best fit the MFI's needs	Requires more management attention from MFI
Chance to diversify operations	Requires strong staff training
Better access to the market in sending countries	MFI may need to develop its own system or IT platform
Increased share of fees and commissions	

POTENTIAL PARTNERS

Money Transfer Companies

Privately owned **proprietary networks** are used by nonbank MTCs to provide low-value money transfers domestically and internationally for people who lack access to or do not wish to use bank transfers. Transfers are carried out through the companies' proprietary EFT networks, though some small operators rely on telephone, email, or fax. Each major MTC operates in a similar manner, with a central database linking all agents. After the sender pays the transfer amount and fee, the funds are immediately transferred. The sender then informs the recipient, usually by phone or text message.

Box 8: IRnet for credit unions

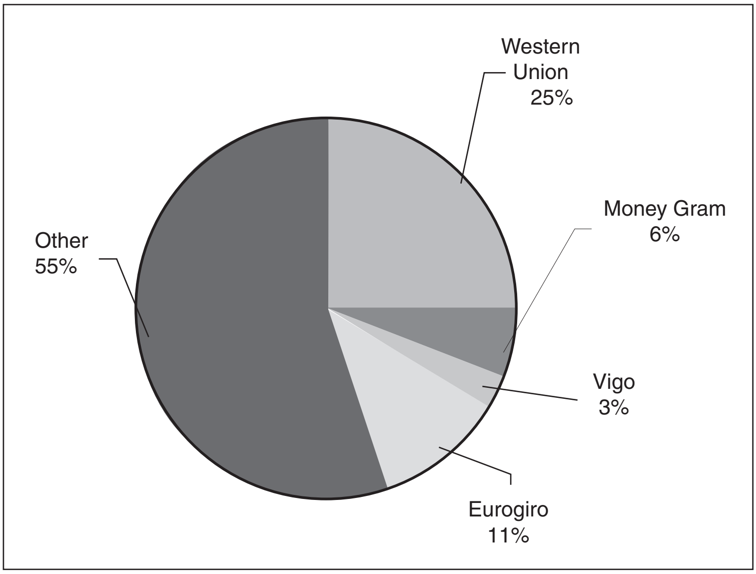
Many credit unions that offer remittances do so through an electronic platform developed by the World Council of Credit Unions (WOCCU) called the International Remittances Network (IR*net*). IR*net* provides credit unions access to the means by which they can offer remittance services. On the sending side, WOCCU has contracted with MoneyGram, Travelex, and Vigo Remittance Corporation, three well-established money transfer organizations, to serve as the transmitter of account-to-account, account-to-cash, or cash-to-cash remittances for IR*net* credit unions. A credit union that joins IR*net* can choose which money transmission services it would like to offer to its members. A choice is provided to each credit union so that remittance senders and receivers have more options for transferring and receiving funds. Remittance senders using an IR*net* credit union can send money from the United States to countries in Latin America, Asia, Africa, Europe, and Australia. IR*net* connects over 900 credit union points of service in Ecuador, Bolivia, Guatemala, Mexico, Honduras, Nicaragua, El Salvador, Jamaica, and Kenya with three vendors. Since its establishment in 1999, over US$1.3 billion has been transferred through the network.*

*World Council of Credit Unions, http://www.woccu.org/prod_serv/irnet/faq.php

Western Union, the largest MTC in the market, reported that it processed approximately 81 million transfers in 2003 (First Data Corporation 2003), which represents roughly 25 percent of the total market (Bezard 2003).

Western Union represents roughly 25 percent of market share.

Figure 5: Estimated market share of international person-to-person transfer providers, 2003*



*Adapted from Isern, Deshpande, and van Doorn 2005.

Market shares of the other major international transfer providers (see Figure 5) are estimated, using the average figure of US$300 per international transfer cited by MoneyGram (2004). These percentages are, however, indicative at best, because average transfer amounts vary widely by region. In any given country, a specialized MTC may have become a major player through targeting a niche market with a large volume of transfers.

It may be easier to negotiate with small MTCs.

MTCs provide their services through their branch offices and through extensive networks of partner banks, postal agencies, MFIs, travel agents, check cashers, change bureaus, grocery stores, convenience stores, etc. MTCs may offer several options for sending and receiving transfers:

- **Cash-to-cash.** Where the sender pays in cash at the originating outlet and the receiver is paid in cash at the receiving outlet. This is the most common form of money transmission.
- **Cash-to-account.** Where the company has partnerships with banks, postal agencies, MFIs, and other types of agencies that allow the sender to pay in cash and have the funds deposited in the recipient's bank account.
- **Internet combinations.** Some companies have Web sites where customers

can initiate a remittance, pay for the transaction with a credit card, and have the payout be received in cash at a receiving outlet.

Small Money Transfer Companies

Some MFIs choose to work with **small MTCs** focused on key countries or regions. For example, Microfinance International (MFIC) is a small company that specializes in offering money transfers through a network of MFI partners. MFIC began in 2004 as an MTC working exclusively with migrants from El Salvador through a pilot program in the Maryland, Virginia, Delaware, and Washington, D.C., in the United States.

Small companies may be eager to sign new partners to expand their network rapidly, and they may offer lower prices to clients and better terms for their agents. It may be easier to negotiate with small MTCs that do not have the massive resources or dominant positions of their larger competitors. As a result, MFIs might consider working with small MTCs as a market entry strategy, to build volume and gain experience.

Working with small MTCs requires carefully weighing costs and benefits. The main tradeoff is between price and volume. While a smaller company may provide a higher commission to its agents, it may not generate sufficient volume of money transfers to cover the MFI's investment. Further, a smaller company may not be as financially stable and could expose the MFI to greater credit and settlement risk. Location is also critical: an MFI must be certain that an MTC has locations in the sending country or region with high concentrations of migrants from regions where the MFI has a strong presence. More guidance is provided in "Chapter 5: Negotiating Partnerships."

Bank Partners

MFIs that partner with banks or other financial institutions may pursue several options. The MFI could be a **subagent** to the bank, who is the primary agent with an MTC.

The MFI could gain **access to payment networks (or card systems)**, such as SWIFT or Eurogiro, and card systems, such as Visa and Mastercard. Access is usually limited to licensed financial institutions and may have membership requirements beyond the means and capacity of most MFIs. The MFI benefits from access to the payment system without having to bear the full burden of licensing, investment, fees, and other requirements of joining the

MFIs that partner with banks benefit from access to the payment system without having to bear the full burden of licensing, investment, fees, and other requirements of joining the payment network or card system.

payment network or card system. As one example, the postal network Posta Moldova has established such a partnership with ING and Deutsche Bank to launch money transfers and develop other financial products.

Correspondent banking involves one bank providing services to another to move funds, exchange currencies, or conduct other financial transactions (see Box 9). Only MFIs with banking licenses can establish correspondent relationships. At present, correspondent banking relationships are typically more important for payment services other than international remittances. As the money transfer industry becomes increasingly competitive, however, banks and other financial institutions are using correspondent relationships to develop more competitive products.

Box 9: Cambodia's ACLEDA Bank and its correspondent banking activities

Cambodia's ACLEDA Bank has steadily expanded its payment services over the past five years. In early 2001 the bank, operating under a special banking license designed for transformed NGOs, began offering domestic money transfer services. Later that year it began offering international fund transfers as an agent of Western Union. Two years later, ACLEDA started offering domestic payment services through local correspondent banks. The final stage of its expansion occurred in 2004, when ACLEDA began offering international funds transfer through SWIFT, after receiving a full banking license in December 2003.

ACLEDA took a different approach from many MFIs. Rather than focusing on remittances, it pursued a broader strategy that provides cash management services as one of four core business areas. Cash management services include payroll services, collections, and money transfers. Clients for these services are different from those for its retail services to the general public. They include local businesses and banks, multinational firms, government, and development agencies. One reason ACLEDA has been able to pursue this strategy is its large network of 136 offices in 19 of Cambodia's 21 provinces.

The number and volume of transactions for all types of transfers have increased consistently since 2001. With US$140 million in volume, domestic transfers are far more important for ACLEDA than international transfers of $38 million in 2004. And although the bank's agreement with

SWIFT was signed more recently than its contract with Western Union, the volume of SWIFT transfers in 2004 was more than four times ($31 million vs. $7 million) that of Western Union (Sai 2005; USAID 2005).

Consortium Approach

Smaller institutions often do not have the leverage to negotiate favorable terms with larger partners. To alleviate this discrepancy, smaller financial institutions sometimes band together to form a **consortium** that becomes the primary agent of an MTC. Institutions with limited geographic coverage or IT systems find this approach especially beneficial, although consortium members typically need a minimum level of systems integration and/or a common IT platform to work together effectively.

Smaller financial institutions sometimes band together to form a consortium.

Box 10: GiroNil shared money transfer platform in Egypt

Established in 2005, GiroNil is an Egyptian–Dutch joint venture that implemented a shared money transfer platform in Egypt, where less than 10 percent of the 70 million inhabitants have a bank account. GiroNil is open to all financial institutions, including MFIs. Because of its nationwide distribution channel of bank branches and postal offices, it offers a low-cost infrastructure for bill payment and remittances.

GiroNil's current Egyptian shareholders are Banque Misr (the biggest public-sector bank), Commercial International Bank (the biggest private-sector bank), and Egypt Post (the largest distribution channel with 3,500 post offices that function as retail outlets for the banks). The Dutch shareholders are FMO (the Dutch development bank) and Inclusion Group.

GiroNil is establishing links with Eurogiro, MFIC, and other international MTCs. The next step will be to open the shared platform to facilitate mobile payments.

Inclusion Group acts as a catalyst and is managing GiroNil during the start-up phase. The group's roots are in the cost-efficient payment system of the Netherlands. It is a small, independent company focused on financial inclusion and the reduction of cash in developing countries.

Source: Peter van Roosmalen (Inclusion Group), November 2007.

The consortium usually takes a percentage of the transfer revenue.

The consortium approach has been used by several financial institution federations, including the Jamaica Cooperative Credit Union League (JCCUL), which has partnered with a local MTC to bundle four foreign MTCs into a money transfer service under its own proprietary brand. Other examples of bundling for both domestic and international transfers include Apex Bank, a network of more than 100 rural banks in Ghana; Rural Bankers Association in the Philippines; and L@ Red de la Gente in Mexico (see Box 11).

Box 11: Bansefi: A network for MFIs

Bansefi, the Mexican government's national savings bank, was created in 2001 to provide financial services to the country's vast unbanked population. In January 2003, Bansefi formed L@ Red de la Gente (the People's Network), a network that includes Bansefi and MFIs that provide remittances from the United States and other financial services.

MFIs that wish to join L@ Red pay US$1,000 to Bansefi for membership. In return, L@ Red provides its members with several advantages. Members benefit from existing agreements with multiple MTCs and government institutions. MFIs are able to provide their clients with access to remittances from a group of nine domestic and international MTCs (Fertziger 2004).*

*See also http://www.bansefi.gob.mx and http://www.lareddelagente.com.mx

Networks or consortium approaches do have their **disadvantages**:

- The MFI **depends on the consortium's ability to negotiate** terms and conditions with MTCs. Negotiations may be difficult, because member institutions must first agree amongst themselves.
- Some consortium members may receive more transfer payment volume than others. **Uneven benefits** to members may cause tension within the consortium, and terms and conditions may need to be renegotiated.
- The **consortium usually takes a percentage** of the transfer revenue.

4

Developing a Money Transfer Business

Sending money transfers across a city, country, or the world demands careful attention to ensure transfers arrive properly and can be quickly paid to the intended beneficiaries. For MFIs without experience in payment systems, the introduction of money transfers can be a considerable challenge.

Many MFIs have struggled to be profitable with money transfers. One MFI that started on its own using a direct approach offered money transfers for seven years before the service became profitable. Others have been profitable in as little as two to three months when working as an agent for an MTC in a region with a high volume of transfers. While many MFIs report significant and rapid growth in the number and volume of transfers they process, this increase does not necessarily mean greater profits for the MFI. Clearly, careful consideration should be taken before embarking on a money transfer business.

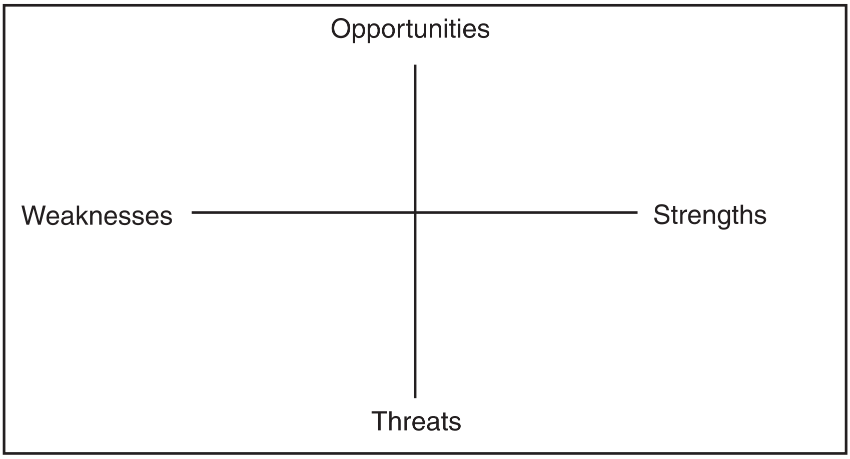
This chapter catalogs many of the challenges and risks that are the initial and ongoing concerns for MFIs in the money transfer business. It provides a survey of the kinds of questions MFIs should ask *before* embarking on a money transfer business. Considering these issues is the first—and crucial—step of entering the money transfers business. In addition to this chapter, "Annex 4 and Annex 5" provide detailed checklists for MFIs to use in their consideration.

SWOT analysis encourages management to think ahead, forces the institution to sharpen its goals and policies, and creates a fit between the institution's objectives, abilities, and market environment.

TAKING STOCK

The MFI must determine if offering money transfers is in its best interests by taking stock of the environment (the market for money transfers) and its own internal capacity. Some refer to this process as a **SWOT analysis: strengths, weaknesses, opportunities, and threats**. Analyzing both internal capacity and external realities will help MFIs systematically decide whether and how to launch money transfers. Such analysis encourages management to think ahead, forces the institution to sharpen its goals and policies, and helps create a fit among the institution's objectives, abilities, and market environment.

Figure 6: SWOT Matrix



Environment

Expansion into a new market demands careful analysis of an MFI's existing and potential customers.

The MFI should understand the business environment of its market. It should survey the broad forces—including financial markets, economic trends, legal and regulatory issues, social and demographic patterns, and technological advances—that will determine the current and future shape of the market for transfer services and its role in it.

An analysis of the environment could include examining the following:

- Socioeconomic profile of the country/countries (or region within a single country)
- Structure of the payment system and who has access to it
- Relevant laws and regulations (international and domestic) for money transfers

Expanding into a new market demands careful analysis of an MFI's existing and potential customers (both recipients and senders), markets, marketing, service delivery channels, and competition. The MFI should examine the following:

- Current clients
- Trends on domestic and international money transfers
- Competitors

The MFI should map the geographic patterns of the transfer flows of interest to it and examine where flows originate and terminate and whether sending clients work or live in concentrated areas.

If clients work or live in concentrated areas, then targeted marketing and clustered points of service are more feasible. If sending clients are dispersed, marketing will be more challenging, and the number of transactions per branch office may be lower, reducing economies of scale. If receiving clients are dispersed, the MFI must tackle the challenges of infrastructure, client outreach, cash management, and security. These factors may vary between urban and rural areas (Isern, Deshpande, and van Doorn 2005).

It is vital to understand the size and characteristics of money transfers from both international and domestic sources. MFIs should examine the following:

- Who receives and sends transfers, based on available market research
- How often their existing clients send or receive transfers
- Size of the transfers

It is important to note the difference between average and modal transfer amounts, because averages can be skewed upward by a few large transfers, while the most frequent transfer amounts may be much smaller. This information is vital for pricing and revenue projections because fees usually depend on the amount transferred.

Patterns of seasonality in remittances can influence marketing efforts, financial projections, and the design of complementary financial products. The MFI should examine the following:

- Likelihood that migration patterns might be disrupted or changed by political or natural events
- Evolution of transfer patterns over time
- Effects of long-term changes in the volume or frequency of transactions

In the case of remittances, research indicates that migrants take some time after immigration to establish regular money transfer patterns and that remittances may taper off after immigrants have spent significant time in the host country. The effect of broad labor movements on money transfers may thus not be felt for several years (Frumkin 2004). Alternatively, there are cases where people migrate specifically to work and send money home, and money transfers may begin much more quickly.

Internal Assessment

The MFI should make an objective self-assessment of its capabilities and constraints for money transfers. Internal analysis includes examining past performance, human resources, financial resources, and technological and organizational capabilities. In addition to thinking about the new money transfers service, the MFI should consider other services and operations that may be strained or affected when introducing any new services.

An internal assessment should include examining the following:

- Overall financial and operational performance (stable, growing, shrinking)
- Available human resources, and their knowledge of money transfers
- Capacity to manage the increased cash flow from money transfers
- Resilience of the MFI's systems and overall capacity for growth in transactions and number of clients
- Capacity for managing transfers effectively (number of transactions, volume of clients to serve, value of payments to distribute)
- How money transfers will affect the MFI's revenue
- Business risks and key risk mitigation measures associated with money transfers
- Marketing capacity

In addition to thinking about the new money transfer service, the MFI should consider other services and operations that may be strained or affected.

Ultimately, where an MFI positions itself in the transfer market partly depends on its current stage of development and its future goals. Smaller or younger MFIs may enter the market with limited participation in remittance services, and later—if growth is the goal—offer additional money transfers, such as domestic payments, salary transfers, etc. Larger or more well-established MFIs may decide to launch several transfer services.

SETTING STRATEGY

Once the MFI has a solid understanding of the environment and its own strengths and weaknesses, and it has determined that entering the money transfer business is in its best interests, the next step is to develop the strategy for launching money transfers.

Strategic planning should be aligned with the scale of the MFI. A comprehensive planning initiative can be a major undertaking, requiring significant managerial and financial resources. Many of the activities involved demand strong analytical skills that may not exist in every MFI and are expensive to contract from external consultants. A small MFI can engage in informal strategic planning using internal resources. A larger MFI may wish to conduct strategic and market planning more formally, perhaps with outside help.

Goal Setting

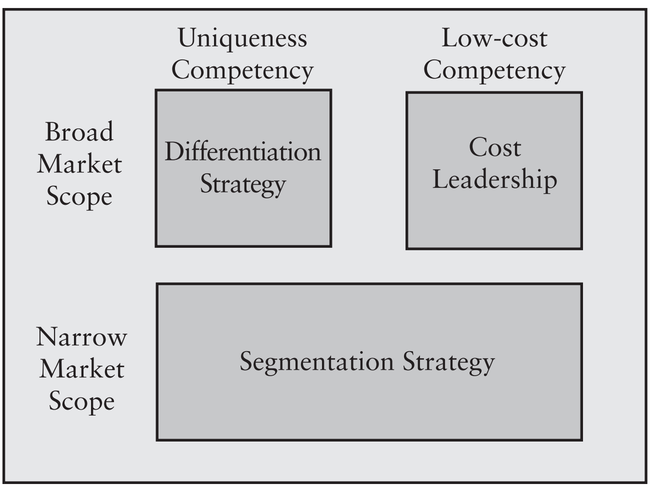
In general, MFIs aspire either to healthy financial returns from the services they deliver or to strong benefits for the low-income clients they serve, or to both. For MFIs launching money transfer services, the typical goals include generating more revenue from the service and/or using money transfers to increase their customer base. For the MFI just entering the money transfer business, it may be difficult to set realistic goals. Indeed, goals set early on may mostly be a wish list until more detailed assessments are complete. For that reason, the MFI should revisit and reassess its goals regularly—as often as quarterly—as it learns of and addresses new challenges. The MFI's goals for the money transfer business should build on those assessments and should be specific, measurable, achievable, relevant, and set with a timeframe in mind.

The MFI should revisit its goals regularly as it learns of and addresses new challenges.

Determining Competitive Advantage

The MFI's strategy should aim to achieve a competitive advantage. In this regard, classic business strategies developed by Michael Porter may be useful to consider. Porter suggested three broad categories of strategy: delivering cheaper services, offering different services than competitors, or focusing on particular customers or products (Porter 1989).

Figure 7: Porter's generic strategies*



*Adapted from Porter 1989.

An MFI can also provide more personalized service, as well as financial education geared toward the needs of low-income clients and microenterprises.

A **differentiation strategy** aims to provide a unique service not yet available in the market. Uniqueness in the money transfers industry may be difficult for an MFI to achieve against commercial banks—particularly with providing payment products, many of which require participating in clearing systems and associations open only to banks. Still, there are substitutes that an MFI could offer more conveniently, reliably, and respectfully. An MFI can also provide more personalized service and financial education geared toward the needs of low-income clients and microenterprises.

Box 12: WIZZIT: New possibilities, but also new challenges

WIZZIT is a "virtual bank"—it has no physical branches of its own. It operates as a division of the South African Bank of Athens and targets the 16 million people in South Africa (48 percent of adults) with limited financial access. Customers use their mobile phones or a debit cards to make payments, purchases, and money transfers. They can deposit money at any Absa Bank or Postbank branch, which effectively gives them more choices than any other bank. WIZZIT does not have a minimum balance or charge monthly fees; it uses a pay-as-you-go pricing model. In lieu of traditional marketing, WIZZIT has over 2,000 low-income young individuals who promote the service to other low-income people and receive a commission for new customers. Despite its flexibility and success, WIZZIT faces many challenges because potential customers are often wary of new technology and many lack even basic financial literacy (Ivatury and Pickens 2006).

A **cost leadership strategy** tries to leverage ways of obtaining a cost advantage. Most of the money transfer products an MFI can offer are subject to economies of scale where larger volumes of transactions will be increasingly more efficient for the MFI. Such a strategy may not be best for smaller MFIs, which typically have fewer customers and smaller volumes of lower value transactions; unit costs may be higher for smaller MFIs than for their competitors, such as banks and postal systems. The strategy may work better for large to medium MFIs that may be able to attract the requisite volume of transfers and clients. The competitive leadership strategy also can work when competitors are large institutions that are highly inefficient with bureaucratic procedures, inconvenient hours, and repeat visits required for simple transactions. MFIs may not be able to control the cost of a transfer payment, especially if acting as an agent for an MTC. However, an MFI may be able to achieve a cost advantage by minimizing waiting time and other expenses for customers by providing efficient procedures, extended hours, and convenient locations.

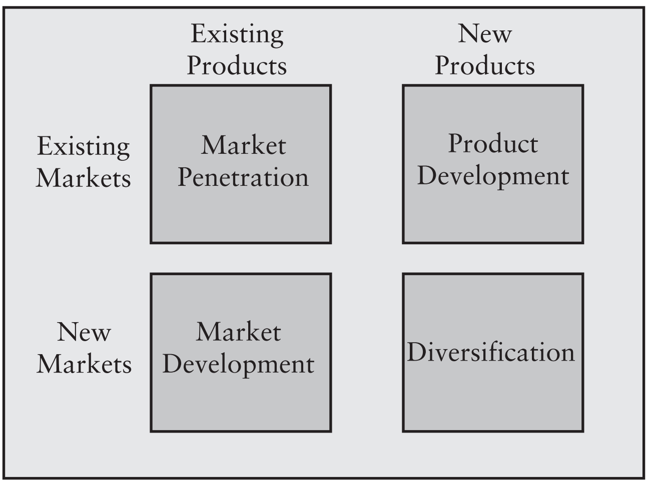
An MFI may be able to achieve a cost advantage by minimizing waiting time and other expenses for customers by providing efficient procedures, extended hours, and convenient locations.

A **focus strategy** targets a specific market segment of clients. For example, the MFI may decide to launch services with a narrowly defined target group, such as a particular geographic area or socioeconomic group, perhaps focusing on underserved clients.

The Right Product and the Right Market

Next, the MFI must determine its strategic direction for achieving growth-oriented goals. The direction an institution takes in its strategy depends on whether it markets new or existing products in new or existing markets.

Figure 8: Product-market matrix*



*Adapted from Ansoff 1957.

A **market penetration strategy** is a business-as-usual strategy, where the MFI focuses on achieving growth by selling existing products in existing markets. This can be done through more competitive pricing strategies, increased promotional activities, and more liberal terms and conditions. For example, the MFI may develop strategic alliances to begin selling an existing money transfer product in its market. The MFI can achieve growth by cross-selling more services to existing customers, creating deeper relationships, increasing retention, and attracting customers from competitors.

A **market development strategy** aims to sell existing products in new client markets. This generally involves expanding the MFI's geographic operations or approaching new customer segments. It could also encompass adding new delivery channels, such as new branches, or direct channels, such as telephone, ATMs, or mobile banking. Like the market penetration strategy, this approach may rely on alliances, correspondents, and agency relationships to broaden product offerings in new markets. Typically in a strategic alliance, revenue is shared between the MFI and its business partner.

The **product development strategy** seeks to maximize profitability by producing and distributing a variety of money transfer products in existing markets, under the MFI's own brand. This strategy may require developing new competencies and making significant changes in organizational structure, systems, and personnel.

Several MFIs have entered into money transfers with the expectation that it would be a major source of fee income only to learn that fees and commissions often just cover the cost of service.

A **diversification strategy** simultaneously markets new products in new markets. An unlicensed MFI that was becoming a licensed institution and offering a full range of deposit accounts and account-based payment instruments could be said to be embarking on a diversification strategy. The customers who will use these new products may be from the same socioeconomic group as the MFI's existing clients, but in new geographic areas. Or, the MFI may focus on a new socioeconomic client group. Combining this with a new product offering is complex and inherently risky. Under a diversification strategy, the institution is moving into markets and products where it has little or no experience, and the execution will likely require considerable management effort, human resources, financial resources, and changes to systems and institutional structure.

An MFI's motives to enter the money transfer market will determine its operational strategy. Is it increasing profits, advancing its core mission, providing a one-stop service to retain clients, or attracting new clients for other financial services? Several MFIs have entered into money transfers with the expectation that it would be a major source of fee income only to learn that fees and commissions often just cover the cost of the service. In many cases, the real net benefit to the MFI is in acquisition of new clients and in deepening relationships with existing clients. Motivation affects whether an MFI offers domestic or international transfers, choice of an international partner, clients to target, and products.

Overall, the MFI must have a clear idea about what it expects to gain from money transfers and undertake an honest assessment of the risks. Once the strategy is complete and approved by the MFI's board, it is time to draft the implementation plan.

Box 13: ARB/Ghana

The Association of Rural Banks (ARB) launched ARB Apex Bank, a central treasury for the rural banks of Ghana, a network of more than 122 banks representing over 560 agencies or points of service, some in villages as small as 500 people. Market studies in rural areas served by these banks revealed that ARB clients were having difficulty accessing transfers from urban areas in Ghana. Crime made it especially difficult for traders, who carried large sums of cash for business. At the same time, rural banks were looking for new revenue sources and ways to attract more customers. In response to this dual need, Apex Bank developed ApexLink domestic money transfer. The service uses proprietary software to manage money transfers between rural banks using coded messages sent by phone, fax, or express mail. Turnaround time is between 15 minutes and 24 hours, and transfers can be made from an account or in cash, making the service accessible to customers and noncustomers alike. ApexLink has drastically reduced the practice of sending funds through commercial drivers, which often resulted in the loss of funds.

Transfer fees are paid by the sender on a sliding scale, depending on the amount transferred (usually 0.5 percent of the transfer amount for customers and 0.75 percent for noncustomers). If a recipient lacks the government-issued identification card or passport normally required for identification purposes, he may come to the bank accompanied by a "locally known person" who acts as a witness to the transfer.

ApexLink is often used as the "last mile" in an international funds transfer. Apex Bank has partnerships with four local commercial banks and two nonbank financial institutions that are licensed to handle foreign exchange. The local banks and the financial institutions deposit funds from abroad into Apex Bank's central account in local currency. Apex Bank then transfers the funds to the rural bank for final payment to the receiving client using ApexLink.

Apex Bank has also entered into direct agreement with foreign companies for direct remittances from the United States and the Netherlands to beneficiaries in the rural areas. From the launch in June 2003 to September 2006, the system has made 167,190 transfers totaling over US$68 million.

Source: Emmanuel Yaw Sarpong (Apex Link Manager, Apex Bank), June 2004. Information updated by ARB Apex Bank, October 2006.

DEVELOPING TRANSFER PRODUCTS

Given the complexity of launching money transfers, developing an implementation plan is critical to an MFI's success. An implementation plan includes detailed actions for each market segment, product, and delivery channel, as well as the actions required of other MFI stakeholders, and a system for monitoring their implementation.

Create loyal, satisfied customers through superior understanding of their needs.

Customers play a central role in driving the MFI's product development and marketing activities. An institution should acquire an in-depth understanding of customer needs and markets and their potential profitability. Based on this analysis, the MFI can design products and services for targeted customer groups. This vision involves maximizing customer profitability—financial and social—by creating loyal, satisfied customers, through superior understanding of their needs. Marketing also involves designing, developing, and enhancing products; setting prices; communicating product features; and getting customers to use the products.

During the strategic planning process, various decisions are made about the customer groups the MFI will serve and the products it will offer. The **product manager** should ensure the product is designed to satisfy customers and contribute to the MFI's financial and social goals. The MFI should have a product manager for each product in its product portfolio. In small institutions, product managers may spend only part of their time on such functions.

An MFI with a limited product portfolio, such as short-term loans, can probably manage its products more readily, and changes may be easier to implement.

However, that is not possible with money transfer and deposit products, where every aspect of production and delivery affects operations across the MFI.

Product Development

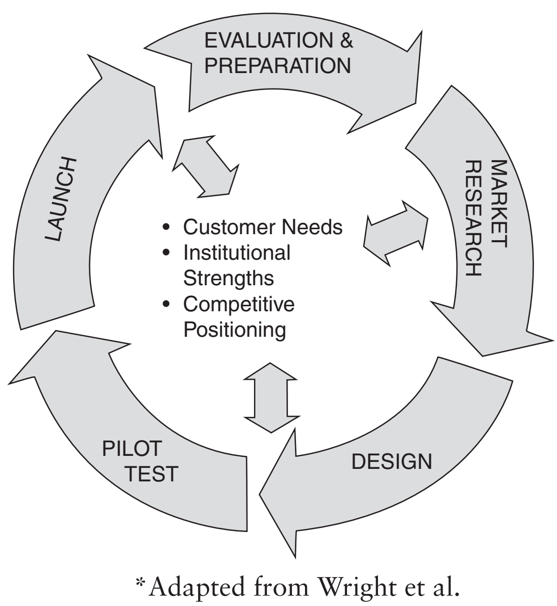
Product development is usually driven by the MFI's overall strategic plan, although ideas for new products may come from anywhere in the institution, or even from clients themselves. The product manager should screen concepts to ensure they are consistent with the institution's image, abilities, and marketing strategy; they appeal to particular segments; and their cost and profitability implications are reasonable. Of course, the product must be within the MFI's capacity and performance ability.

The MFI should take a systematic approach to product development and proceed carefully.

Product development involves marketing, operational, and technological activities. When launching an existing product, such as becoming a payout agent for an established international MTC, the product development process can be carried out more quickly. Nonetheless, the MFI should take a systematic approach and proceed carefully.

When introducing a completely new product involving major infrastructure and technological changes, a comprehensive development effort is needed.

Figure 9: Systematic product development process*



*Adapted from Wright et al.

As seen in Figure 9, product development usually consists of five major steps:

Step 1. Evaluation and Preparation. Decide on what product to develop and what infrastructure needs to be in place to support it.

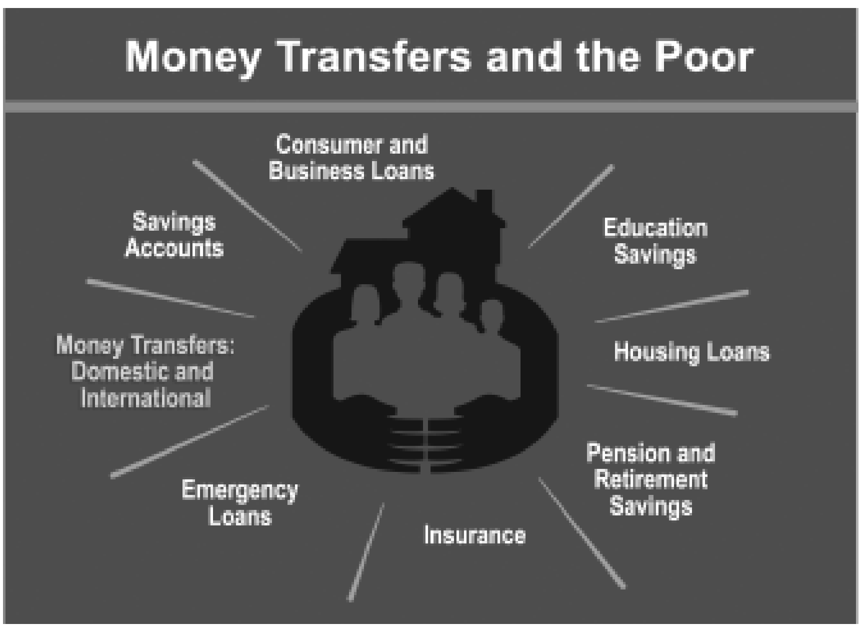
Step 2. Market Research. Perform research to determine whether the market is appropriate for the product being considered.

Step 3. Concept/Prototype Design. Determine how the product works and how it will be marketed to customers.

Step 4. Pilot Testing. Test the product in a small sample (e.g., at one branch), to determine viability, actual costs, and customer interest.

Step 5. Product Launch and Roll Out. Formally introduce product to customers along with promotional campaign.

Thus far, few MFIs have adopted this systematic, market-driven approach to product development. Typically, if the product development manager decides that a particular idea merits development, he or she will design the product and launch it to the public (following steps 1, 3, and 5). Market research and organized pilot testing (steps 2 and 4) are rarely included in the development process. Unfortunately, skipping these vital steps can lead to disaster.



Client Preferences

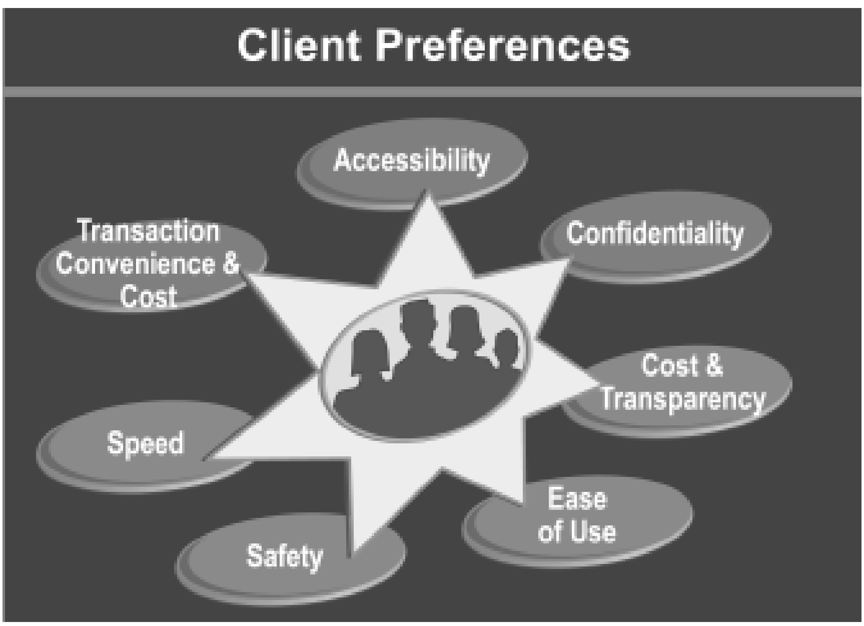
The MFI should study both the sending and receiving clients.

The MFI should study both the sending and receiving clients, because client characteristics have consequences for product design. These factors include the socioeconomic profile of target client groups, geographic patterns and seasonality of the transfer flows, and the size and characteristics of money transfers from both international and domestic sources.

By fully understanding its target clients, the MFI greatly increases its chances of designing a successful product. Table 1 shows generally observed customer preferences vis-à-vis money transfer services. The attributes considered in the table form the core of money transfer product design and can guide the MFI in product design.

When designing a new money transfer product, the MFI should carefully consider each of these client preferences as well as competition from both formal and informal money transfer services. The client-friendly features of informal systems could serve as a model when designing offerings.[13]

Once the MFI understands client preferences, the next step is to develop a product the MFI can deliver successfully. The MFI should take a hard look at its own institutional capacity to deliver the product. If current capacity is not adequate, then the MFI will need to either strengthen itself where needed or choose another product. This idea is addressed in the section "Creating Institutional Capacity."



[13] See "Annex 2: Formality of Financial Channels" for more information on informal channels.

Table 1: Client preferences in money transfer services[12]

Attributes Sought	Key Issues
Accessibility	Many migrants, especially undocumented workers, prefer few or no identity requirements, but most formal money transfer operators must comply with some type of identity stipulation. Financial institutions can also set other requirements (e.g., opening a bank account or maintaining a minimum balance) that impede the access of poor people to transfer services.
Confidentiality	Some clients prefer to keep their receipt of money transfers confidential (either to reduce claims within the family or to minimize the risk of theft) and may favor using providers like specialized MTCs that may have less stringent identity documentation requirements than multi-service financial institutions.
Cost and transparency	Most people seek transfer services that offer —low fees, —attractive exchange rates, and —transparency on fees and exchange rates at both the sending and receiving ends.
Ease of use	People prefer limited paperwork to send or collect funds, especially if they are not literate. Some people prefer interacting with a sales agent for reasons of ease and personal service. Others prefer the convenience and anonymity of ATMs or POS devices.
Safety	Transfer operators must earn the trust of migrants and their families. —Clients may be reluctant to seek services from banks or formal financial institutions because of mistrust or past experiences in their home or adopted country. —Many people prefer to send money transfers through institutions that have a track record in handling transfers and other financial services, and/or belong to a larger, well-known international network.
Speed	Many people prefer "real-time" transfers, regardless of the cost or urgency of the transfer.
Transaction convenience and cost	Both senders and recipients want to transfer funds at nearby locations and reduce other transaction costs, such as travel time, travel expenses, and bribes paid for better service.

[12] Compiled from Isern, Deshpande, and Van Doorn 2005; Jaramillo 2004; Barro and Sander no date; Cross 2003; ILO 2001; Marx unpublished; Siddiqui and Abrar 2003; and Thieme 2003.

Pricing

Typically, the MFI should set pricing to cover costs and a profit margin. However, pricing also can be used to exploit market opportunities, such as offering a low-cost money transfer option to attract clients for other services. Pricing also contributes to a product's image, where higher priced products may convey more security and safety than the cheapest product available. For example, Banco Solidario in Bolivia offers free remittances from Spain when the recipient opens a Banco Solidario account. Its goal is to sell other financial services to the receiving client.

The MFI should take a hard look at its own institutional capacity to deliver the product.

Unfortunately, the MFI may have little room to adjust prices. Pricing for money transfers is becoming much more competitive. Further, an MFI serving as the payout agent may be obligated to set prices and receive commissions based on rates established by the MTC. Typically, the institution originating the transfer sets the price, and the receiving institution is obligated to accept it. If these terms are not acceptable, the MFI could try to renegotiate or seek another partner.

If the MFI does have flexibility on pricing, it should factor in the following:

- Costs of producing and delivering a product
- Cost of capital
- Risk associated with the product
- Desired profit margin
- Customer willingness to pay
- Prices offered by competitors

If the MFI already has some money transfers experience, it would be useful to analyze the costs of the existing services to design and price new products. This type of analysis can be simple or sophisticated, depending on the MFI's systems and available information. Once a product's costs are determined, the MFI can determine the impact of costs, how to make the product more efficient, and how the product contributes (or does not) to the overall profitability of the MFI.[14]

The MFI may also want to estimate potential revenue at various prices to determine its break-even point for offering the new product. Developing these scenarios helps the MFI understand how demand for a product, costs, and potential revenues depend on many factors. Of course, projecting demand is not an exact science. It involves analyzing and forecasting all the aspects of a product that influence the demand for it, including economic data, market research, and data from central

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[14] For more information on costing, see CGAP Technical Tool No. 6, Product Costing Tool, Helms & Grace, Washington, 2004.

banks, national banker associations, and competitors in the money transfer business. Demand can be affected by a range of issues, including political and economic conditions, natural disasters, government policy changes, and changes in the number, marketing, or reputation of an MFI's competitors. In addition, the MFI's marketing efforts may lead to stronger (or weaker) demand than anticipated.

Promoting Products

The role of promotion encompasses all aspects of an institution's image.

Promotion is how the MFI communicates with its current and potential customers, employees, and other interest groups, primarily through advertising (including branding and merchandising) and public relations. Traditionally, promotional efforts focus on advertising the benefits of specific products to raise awareness, stimulate interest, and encourage purchases. The role of promotion is much broader today, encompassing all aspects of an institution's image and the way it is presented to various interest groups.

Although there is some differentiation, many institutions generally offer the same basic money transfer services. The remaining competition is based on price, speed, convenience, reputation, and perceptions of security. These competitive factors must be communicated to the client for the MFI to succeed.

Money transfers pose a special marketing challenge: How can the institution target the right clients? A promotional program launched by an MFI primarily positioned as a receiver of transfers may have little effect when the main decision makers are the senders in an urban area or another country. Accordingly, most of the advertising budgets of MTCs are spent in countries and/or areas on the sending side. Of course, recipients may have some influence on senders' decisions about how to send money. That factor—in addition to the educational value of a money transfer promotional program—argues in favor of balancing promotional efforts between sending and receiving markets.

Communicating effectively requires a thorough, systematic approach. When promoting financial products to low-income clients, the MFI must be mindful of its clients' financial literacy. Likewise, the MFI should be aware of how low-income clients use informal financial services that compete with the MFI's services. The MFI should ensure that its promotional messages clearly communicate why its products are important and how they meet customers' needs. Likewise, customers must understand how to use financial products, the charges they will pay, and their rights to privacy, redress, and unfair practices.

Linking services to transfers can attract clients, keep them loyal, and generate additional revenue. Access to other financial services may also deepen the develop-mental impact of transfers. Initially, recipients may not trust an MFI to hold their money, preferring instead to receive cash immediately. Over time, however, a client may consider banking some of the transferred funds in a linked savings or checking account, if such options are available (Isern, Deshpande, and van Doorn 2005).

When promoting financial products to low-income clients, the MFI must be mindful of their financial literacy.

Depending on the competitive context, money transfers may not be a highly profitable product for the MFI. However, by offering money transfers, the MFI may be able to attract new clients who receive money transfers and who would be interested in other financial services. For example, migrants sending remittances and their receiving families may be interested in specific products, such as deposit accounts for multiusers in the family, health insurance for family members, life insurance, repatriation benefits for the migrant, mortgages, savings plans for travel or education expenses, credit cards, and other products.

The same possibility exists on the sending end. Migrants may gradually begin to use other financial services if the MFI offers them. For example, Banco Solidario in Ecuador has developed products in conjunction with banks in Spain that allow Ecuadoran migrants working in Spain to access and repay short-term credit, save for their return home, buy real estate in Ecuador, or create savings accounts in Ecuador to which they can control access by family members (Isern, Deshpande, and van Doorn 2005).

As MFIs deepen their experience with money transfers, more are having success **cross-selling** other financial services. ACLEDA Bank in Cambodia reports that most remittance receivers hold an account in the bank and use their other services. Kasabank in Kosovo offers free incoming transfer services because receiving clients generate so much other business. Nuevo Siglo credit union in El Salvador reports that some clients open 60-day fixed-term deposits with portions of their remittances (Evans and Klaehn 2004, 5–6). Fonkoze in Haiti earns significant income from remittance clients who decide to change their U.S. dollar transfers into gourdes (Hastings forthcoming). Several MFIs have reported that it takes as many as three years to establish credibility with clients before they would consider using other financial services, such as deposits or loans. Other MFIs have been more successful, and clients have opened a deposit account after three or four transactions.

An effective sales process, based in branch offices and including field agents, is crucial to acquiring new customers and deepening relationships. Advertising and promotion can build awareness and reinforce images, but a salesperson is usually required to answer questions, overcome concerns, and discuss different ways of meeting customer needs.

Box 14: SMEP provides banking services to Kenyans through mobile phones

Use of mobile phones is growing rapidly, especially in Africa. Kenyans are increasingly turning to them for personal and business solutions. Of the approximately 10 million Kenyan mobile phone users, estimates suggest that half could use them to access banking services. Small and Micro Enterprise Programme (SMEP) believes that mobile phones can be a mechanism for serving the unbanked (currently determined to be about 38 percent of Kenyans), providing a convenient way of sending money for savings deposits and loan repayments as well as being a method of loan disbursement. SMEP is a nonprofit microfinance organization with the objective of improving the performance of low-income entrepreneurs in the informal sector of the national economy through financial and nonfinancial assistance. SMEP currently has 17 branches located in all provinces except North Province. As of October 2007, SMEP served 29,000 clients and managed a loan portfolio of US$9.1 million.

SMEP has joined with Mobile Micro-finance, Ltd. (United Kingdom) and Safaricom Company, Ltd., to develop a mobile money transfer project (MPESA). MPESA is currently in the "live pilot" phase and using real e-money in SMEP and MPESA live environments. To date, errors are within acceptable ranges and are largely the result of clients' limited technical and financial literacy. Some training and more easy-to-use interfaces are being developed to address these issues.

Source: Phyllis Mbungu (CEO, SMEP), November 2007. Also adapted from Lonie 2005; Small and Micro Enterprise Programme 2007. See also the MPESA Web site at http://www.safaricom.co.ke/m-pesa/

CREATING INSTITUTIONAL CAPACITY

Developing a Money Transfer Policy

Clear, well-defined policies and procedures are essential for effective governance and control of the MFI and its transfer services.

To be successful, the MFI should develop a policy on money transfers and, once approved by its board, communicate it to all personnel. Having a clear road map will help ensure that transfers are executed properly, whether the MFI is sending or receiving them. Clear, well-defined policies and procedures are essential for effective governance and control of the MFI and its transfer activities.

For international transfers, the MFI is likely to have influence over just one end of the transaction. Accordingly, MFIs should try to ensure that their partners' policies are consistent with their own or that the MFI's policy can be easily adapted to conform. The MFI may have more control over domestic transfers, although it must consider the policies of any correspondent bank or other business partner.

The depth and coverage of policies depends on institution size and complexity. Small, noncomplex institutions may create one central guiding document, while larger, more complex institutions may need to develop specific policies for each money transfer product. Policies that are clear and specific increase the probability of compliance, efficiency of operations, and overall success with money transfers. In addition, policies and procedures establish accountability, provide controls for risk management, define expectations, and serve as training tools.

Procedures should be reviewed and updated regularly, and especially whenever the MFI makes any major changes to its money transfer operations.

An effective money transfer policy does the following:

- Defines acceptable types of transfers
- Specifies the steps required for each transfer
- Provides measures to safeguard each transaction
- Explains pricing policies
- Sets approval authority
- Sets staff responsibilities

In addition, the policy should address data security, money laundering, client privacy, and client disclosure.

By establishing secure data procedures and ensuring compliance, the MFI will have an audit trail that helps identify any errors or potential fraud in their operations.

Data security is often overlooked, but it is an area of considerable risk for money transfers. The MFI must protect its data and the security of payment instructions, because this can attract both internal and external fraud. Given the volume and value of money transfers, data should be secure, encrypted if possible, and levels of security should be established so that a limited number of people have access to the information and can make changes to any payment instruction. Further, any change to payment instructions should be documented to note the person making the change, the date, and the reason. By establishing secure data procedures and ensuring compliance, the MFI will have an audit trail that helps identify any errors or potential fraud in its operations.

Increasingly, countries are adopting more stringent requirements for AML/CFT, and this will have broad-reaching implications for MFIs, other financial institutions, and many others. Money transfers are considered one of the riskier financial services, and national and international authorities focusing on AML/CFT are giving special attention to institutions that offer money transfers. The MFI should inform itself of national and international AML/CFT requirements (Isern, et al. 2005). Typically, these requirements include the following:

- Establishing a compliance officer
- Creating internal controls
- Maintaining accurate record keeping
- Monitoring for suspicious transactions
- Reporting to national authorities[15]

The MFI may work across two or more countries or be allied to an MTC that works regionally or globally. In these cases, the MFI should clarify which standard of AML/CFT compliance applies to its operations.

Box 15: An established MFI's experience with AML/CFT compliance

Financiera Compartamos, a specialized MFI, began operations in Mexico as a nongovernmental organization in 1990 and transformed to a regulated financial institution in 2000. Financiera Compartamos is legally registered as a *sociedad financieras de objeto limitado*, a nonbank regulated financial institution, and it served over 300,000 clients as of 2005. When it implemented the new AML/CFT regime for Mexican nonbanks in 2004, Compartamos benefited from already being a regulated institution. This meant that compliance systems, staff, and procedures were already in place. Furthermore, part of the Compartamos loan methodology included weekly visits to clients by loan officers, who knew their clients well. To comply with the new AML/CFT requirements, Compartamos instituted the following procedures:

- It maintains transaction records for 10 years.
- It monitors all transactions using customized software that identifies any unusual, complex, or large transactions by clients. It must also

[15] See Isern, et al. 2005 for additional information on AML/CFT issues.

report any client transaction larger than US$10,000 to the Mexican banking authority.

- It appointed a formal AML/CFT compliance officer, the risk manager. In compliance with regulation, a special AML/CFT committee was appointed consisting of the general manager, the risk manager, the internal auditor, and legal officer.*

*Carlos LaBarthe Costas (Compartamos general manager) and Lizette Escamilla Miranda (Compartamos risk manager) from a CGAP–World Bank survey questionnaire answered in January 2005 and summarized in Isern, et al. 2005.

Privacy measures should clarify whether and how the information is disclosed to third parties.

The transfers policy and, more broadly, the MFI's other financial services should include a **privacy policy** that describes for clients what information the MFI collects and how it is used. Privacy measures include what client information is collected and stored, and how the information is kept secure. The MFI also should specify how clients can have access to that information, correct any mistakes, and set limits on how the information is used. Finally, the privacy measures should clarify whether and how the information is disclosed to third parties.

It is vital that MFIs commit to full **disclosure** of all costs, terms, and conditions before transactions are initiated, so that customers can make informed decisions. Similarly, money transfer agreements should spell out information about the following:

- Transfer types and fees
- Policies on refunds
- Resolution of errors
- Liability for unauthorized transactions, loss, and theft
- Any other issues of customer concern

The extent to which laws and regulations cover payment systems and money transfers varies widely by country. In some countries, laws and regulations are highly specific; in others, the rights and responsibilities of parties to payment transactions are governed by contracts between service providers and users. Interpretation of these contracts is up to the judicial system. Regardless of the extent of laws, the MFI should make every possible effort to ensure that its contracts protect both itself and its customers.

Establishing Delivery Channels

Customers all over the world cite convenience as one of the most important reasons for choosing a financial institution.

To send or receive money, customers must have access to a delivery channel of a money transfer provider. In developing delivery channels, the MFI must balance customer needs for convenience with its own need to serve the market at a reasonable cost. Because decisions about delivery channels can determine an institution's market share, they have a major impact on its profitability and long-term success.

Offering transfers without adequate delivery capacity is a quick way to suffer financial losses and reputation damage. Establishing a relationship with an MTC can substantially lower the infrastructure investment, but the MFI will have less control over operations and lower revenues from shared commissions. These considerations should be factored into decision making about service delivery.

Although financial services can be delivered in a variety of ways—including by ATM, telephone, and online—most MFIs will probably launch face-to-face services from branch offices, at least in the short term. Other delivery channels may be feasible, depending on the size and complexity of the MFI, type of money transfer services, and pace of development of the country's financial infrastructure.

Face-to-face services may be offered from the MFI's branch offices or by agents who deliver money transfers to recipients. Customers all over the world cite convenience as one of the most important reasons for choosing a financial institution. Such convenience is determined by an institution's location, hours, and services. Establishing location-based delivery networks requires addressing each of these factors cost effectively.

Money transfer volumes rise and fall, typically with cyclical peaks. The MFI should plan staffing, liquidity, and security, among other things, to prepare for high-volume periods for money transfers around peak times of the day when clients are more likely to make transactions. The same planning is needed for peak days, such as common paydays (e.g., end of month or every two weeks), holidays, Monday mornings (or first day of business week in the country), and other seasonal periods, depending on the country context.

The MFI must evaluate its delivery network and determine what, if any, reengineering is needed. For example, if the institution offers group lending through a network of field officers and does not have an accessible branch network, it may need to establish one. This may be especially challenging if some (or all) of the MFI's clients live in rural areas with dispersed populations and limited access to roads, telecommunications, or other infrastructure required for efficient delivery of financial services. An institution with a convenient branch network will need to evaluate its capacity to implement the very different workflows, internal controls, and liquidity requirements involved in processing money transfers. If the MFI will serve as a payout agent for a larger company, the volume of transfers may not generate sufficient revenue to pay any extensive reengineering of the delivery network or infrastructure.

MFIs already manage risks, but they may not be familiar with the specific risks associated with money transfers.

Establishing and operating a location-based delivery network is expensive, but it usually increases revenue. The MFI should keep in mind that money transfers also can be delivered through indirect channels, using third-party intermediaries, such as merchants, mobile phone companies, and other partnerships. However, the MFI has less control over these channels, and service quality depends on the party operating the delivery network.

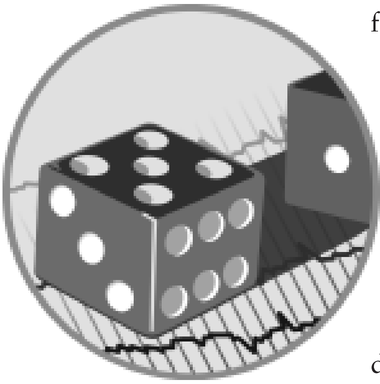
Box 16: Shared branching: Expanding points of service

Independent financial institutions can link their systems in such a way that they allow clients from other financial institutions to make loan payments, withdrawals, bill payments, and domestic money transfers among the participating institutions instead of just at the client's "home" institution. This "shared branching" leverages the combined physical network of multiple institutions to provide clients with greater access and convenience. For example, a credit union movement in Central America links 22 credit unions and their combined 128 points of service to offer a national network. The network processes 8,000 to 9,000 transactions per month among the 22 credit unions.

Source: Dave Grace (WOCCU), November 2007. For additional information on shared branching, see http://www.woccu.org/pubs/cu_world/cuw_index.php?mag_id=43

MANAGING THE RISKS

With any new endeavor, the MFI will face risks and challenges. These need not deter the MFI from entering the money transfer business, but they should be considered carefully and, where appropriate, a response plan



should be developed. Risk management includes identifying, measuring, monitoring, and mitigating risks. MFIs already manage risks associated with their existing products, but they may not be familiar with the specific risks associated with money transfers.[16]

Money Management Challenges

An MFI delivering only credit or a small volume of deposit services may operate its cash functions somewhat informally, obtaining cash as needed to meet loan demands and recycling cash received to meet liquidity needs. Estimating cash requirements is fairly straightforward in a credit-only MFI, because of the greater predictability of customer demand and loan disbursements.

But money transfers add a new dimension to management of cash transactions, because cash must be available consistently, and transfers may be seasonal or correspond to patterns that differ from cash needs for loan and deposit services. Take, for example, a WOCCU member in Central America that routinely pays over US$1 million per day in remittances and hits peaks that double and triple this amount on Monday mornings, near holidays, and following bank holiday weekends.

Handling cash increases operational risk for an MFI. Although the average transaction value may be small, processes must be formalized and carefully executed. There are many risks for employee error or fraud that can generate serious operating losses for the MFI. In addition, the MFI increases its risk of theft and burglary, especially once people know the institution has cash on hand. 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 (Evans and Klaehn 2004).

[16] This section is a summary of the main risks specifically related to money transfers. Additional information on risk management can be found on the Microfinance Gateway (http://www.microfinancegateway.org).

Box 17: Physical security in rural areas: AMUCSS´ experience

The Mexican Association of Credit Unions from the Social Sector (AMUCSS) is a network of rural MFIs: the microbanks. These financial intermediaries have been paying remittances in remote indigenous rural areas in Mexico since 2001. One of the characteristics of rural areas that limits the availability of remittances payments is physical security. Before microbanks started paying remittances, the volume of activity related to credit and savings was small, so security issues were not a priority. However, since 2006, the volume of transfers has increased steadily. In Pahuatlán, with 30,000 inhabitants, a microbank in Sierra Norte de Puebla experienced a large increase in the number of remittances paid from 100 in January 2006 to about 1,600 in June 2007 (totaling more than US$600,000). Suddenly, the microbank needed six times more cash than before. This required some changes in money management, including moving large amounts of cash from a bank at the nearest city to the rural area where the microbank pays money transfers. AMUCSS pursued two options: (*a*) securing the funds through signing an integral insurance policy for the microbanks and (*b*) contracting security companies specialized in armored trucks to transport funds. Neither option was feasible, because companies either were asking for high premiums and fees or would not work in such remote areas.

Faced with these limitations, AMUCSS tried more creative avenues, such as mitigating risk through risk dispersion and continuously changing routines. For example, different employees would go to different cities to get money in different types of transportation. Despite these preventive measures, an employee was robbed. The immediate response was to hire armored trucks to transport funds, despite their high cost. Suddenly people started to realize there was a large amount of money in the microbank. After a couple months, Pahuatlán's microbank was robbed at night. After this event, the institution was forced to stop remittance payments. Remittance beneficiaries had to travel two hours by bus to the nearest bank. Clients offered to pay a special fee to get their money transfers paid in the microbank again, thus demonstrating the importance of this service for rural communities. Pahuatlan's microbank started remittance payments service again in October 2007, after installing proper branch security, which had to be subsidized because of its high cost.

Paying or receiving remittances in remote rural areas comes at a high price either for the beneficiary or for the MFI paying it. In rural areas especially, commissions hardly cover the operational costs, let alone the security costs.

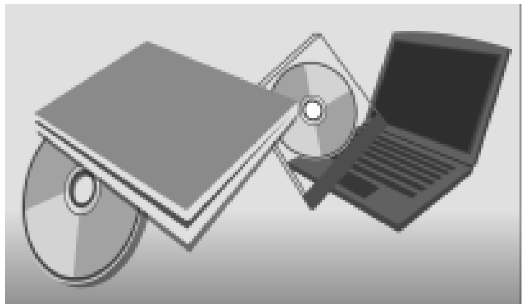
Source: Alexandre Berthaud (executive director of Envíos Confianza), November 2007.

MFIs must maintain an inventory of currency sufficient to meet the daily demands of customers.

Every institution paying and receiving cash should maintain an inventory of currency sufficient to meet the daily demands of customers at cashier windows, ATMs, or other points of service. Inadequate cash availability can lead to customer dissatisfaction and loss of goodwill. Maintaining a cash inventory sufficient for all possible demands is costly in terms of handling and opportunity costs. To address these issues, the MFI should maintain complete records of its daily cash movements, so that it can analyze its cash flows over time. Using that analysis, it can develop a cash management plan. Cash management software is also available.

Some MFIs may be able to offer payments in foreign currency, although this adds complexity to branch and headquarter operations. Many countries have laws regulating the import and export of the national currency, and the MFI must understand applicable currency laws and regulations. Institutions dealing in foreign currencies should maintain records and an account for each currency for which there is likely to be reasonable customer demand. To do so, MFIs often maintain foreign currency bank accounts at major domestic banks active in foreign exchange markets, in addition to foreign currency held as part of their inventory of cash. An institution may also have exposure to foreign currency through international loans, deposits in foreign currency, or other reasons. An MFI should set limits for the amount of foreign currency in its accounts, as well as for customer transactions, and both types of limits should be reassessed periodically. An MFI can then buy or sell foreign currency as needed. Exchange rates are determined by the foreign exchange market and can be obtained from the central bank or the institution's correspondent bank. These rates, along with fees and rules for foreign currency transactions, should be prominently displayed for customers.

Information Management Challenges



The MFI's information systems must be capable of managing the volume of transfer orders and ensuring transaction security.[17] The IT system must also be able to link with business partners, such as international MTCs and correspondent banks, and to generate reports required by national authorities. For example, when BancoSol in Bolivia decided to end it's relationship as a subagent to Western Union, it developed business alliances with small and medium-sized remittance companies. To make this shift, BancoSol needed to develop a database to receive and integrate transaction information from its new MTCs. Many international MTCs have their own software or database that helps their partner firms manage transactions. However, these systems are not foolproof. For example, Financiera El Comercio in Paraguay, which operates as an agent of Western Union, has not yet been able to download transaction information and integrate the information within its own IT system (Hastings forthcoming). The MFI will need a high-performance information system that is well integrated with its accounting systems, especially as transaction volumes increase.

Within the MFI and its business partners, data should be secure with appropriate limits, passwords, and audit trails on who can access and change data. Client data should be protected to ensure privacy and minimize the risk of identify theft, fraud, or other abuse of client information.

Data should be secure with appropriate limits on who can access and change data.

Client Service Challenges

There are inherent client challenges in money transfers, especially person-to-person retail transfers. The MFI must earn the trust of its clients as a secure and convenient provider of transfer services. For domestic transfers, the MFI may need to manage both the sender and receiver sides of the transaction. Marketing, providing customer service, and maintaining client databases are more complex when clients are in different towns, regions, or countries.

For MFIs working with international partners, the focus is typically only on

[17] For more background, see the CGAP Information Systems Resource Center at http://www.microfinancegateway. org/resource_centers/technology

receiving clients. However, the MFI must coordinate any client service problems with its partner MTC and ensure issues are properly resolved.

The MFI must also manage clients who attempt fraudulent or illegal activities. For example, clients may alter payment information, people may impersonate others to obtain their payments, or clients may try to launder funds. The MFI must comply with AML/CFT measures, as discussed in "Compliance Challenges."

Depending on the country context, MFIs may need to help clients who are unfamiliar with money transfers, especially when new transfer products or means of payment are introduced.

Clients are very concerned about their money, and in a competitive environment, the successful MFI is the one that actively keeps its customers informed.

The MFI also should establish a mechanism for informing recipients when their transfer has arrived. Many MFIs use a call center or assign this responsibility to platform officers in branches. Clients are very concerned about their money and, in a competitive market, successful MFIs actively keep their customers informed. Likewise, a call to a customer typically prevents numerous calls from the customer.

Waiting time while in an MFI's office is also a consideration. If transfers are sent with any pattern or seasonality (e.g., beginning or end of the month, holidays, beginning of school season, etc.), the MFI should consider the additional volume of operations when planning staffing, liquidity needs, and security. In addition, an MFI may find it useful to make a separate line for transfer clients to avoid client frustration, especially if many other clients are making account deposits/withdrawals or loan repayments.

In some countries, delivering payments to a client is essential to remain competitive. However, delivery adds costs and risks.

Box 18: G-Cash and SMART Money

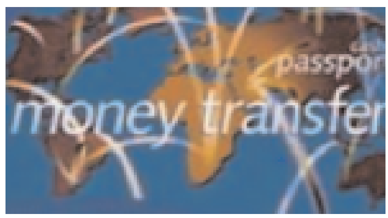
Filipinos send an estimated 200 million text messages a day. Short message service (SMS) technology is particularly popular because of low-cost mobile phones, the low cost of sending an SMS, the limited availability of landlines, and government policies that support the expansion of the telecommunications sector. Text-a-payment (TAP) services, which allow money to be transferred via text messages, are especially promising for low-income clients. Clients can use their mobile phones to make loan payments, which saves them time and money in travel, and banks can increase their rural outreach without significant cost. There are two primary TAP services in the Philippines: G-Cash and SMART.

Globe Telecom launched G-Cash in 2004. G-Cash offers payments, phone-to-phone fund transfer, domestic money transfer, and international remittance all via SMS. Globe partnered with various companies and banks, including rural banks, for money transfers and remittances with merchant stores nationwide. As of March 2006, there are approximately 1.3 million G-Cash registered users. The system handles about US$100 million per day through a distribution network of 700,000 airtime loading retailers.

SMART launched SMART Money in 2000. SMART Money links a user's phone to a cash account at Banco de Oro (a large commercial bank in the Philippines). SMART Money has features similar to those of G-Cash, but it also offers SMART Padala ("send"), which allows Filipino overseas workers to transfer money to their relatives in the Philippines. SMART currently has about 3 million SMART Money subscribers.

Despite these successes, these systems face the challenge of acceptance: customers are slow to adopt new methods for payment, and retailers are wary of (or have no incentive to use) alternative forms of payment (Owens and Bantug-Herrera 2006).

Payment Medium Challenges



The MFI seeking to offer its customers payment cards or wishing to leverage local merchants as delivery points faces several obstacles. Without membership in a bank card association or the possibility of gaining membership, the only short-term alternative is to seek sponsorship by an existing member. The first step is to build a business case for issuing cards, then to find an association member bank or card processor willing to extend sponsorship. In the medium or long term, the MFI can lobby lawmakers and regulators to eliminate these anticompetitive practices.

MFIs that are allowed to collect deposits could consider debit cards as part of their deposit and money transfers strategy. However, large national banks may be reluctant to sponsor debit card programs because of the potential competition for their customers. Because the principal member assumes financial responsibility for the sponsored member, the MFI needs a strong balance sheet to be considered.

Among prepaid cards, the open, universal prepaid card has the most potential for an MFI.

Credit cards may be a promising option for MFIs pursuing growth and new types of services. However, before issuing any cards, the MFI should have adequate information available to predict a client's ability and willingness to repay the obligations incurred. A credit card is essentially a revolving credit line, and such a product can be more profitable over the life of the MFI's client relationship than a microloan that ends when repaid. Critical issues include establishing risk-return models that ensure losses remain at predicted levels; establishing pricing that covers risks and earns profits; and creating control mechanisms that track and provide timely feedback on the performance of credit card portfolios.

Issuing prepaid cards may be the simplest route for MFIs, if cards are viable in the MFI's market. With prepaid cards, there is no requirement to establish deposit accounts for cardholders, and the cards can be issued through third-party card processors that deal with issues related to card association sponsorship. In addition, in some countries MFIs can band together and seek direct participation in card associations. While there are many types of prepaid cards, the one with the most potential for an MFI is the open, universal prepaid card, which can be used at any credit or debit card-accepting location, including over remote channels.[18] Such cards display the acceptance marks of one of the major card schemes, such as Visa or MasterCard, and often one of the major EFT networks. The issuing rules of card schemes vary, but in general the authority to issue a prepaid card is limited to members of the card associations (i.e., usually banks that are members of the Visa or MasterCard associations), and these members can issue cards only in the country where they have association membership.

Box 19: Alianza's prepaid debit card and "open" remittance delivery network

Alianza International provides very low-cost prepaid debit and remittance-enabling services (along with bill payment and long distance phone services) to immigrants and unbanked people. Working with national bank partner Central National Bank & Trust Company, Alianza provides debit cards that can be used for a range of transactions, including money transfers.

Alianza International's AlianzaNet is an "open" remittance delivery network that includes a range of institutions in its delivery channel: retail

[18] Currently, PIN-based prepaid cards cannot be used over remote channels.

distributors, nonprofit organizations, financial institutions, credit unions, MFIs, and businesses.

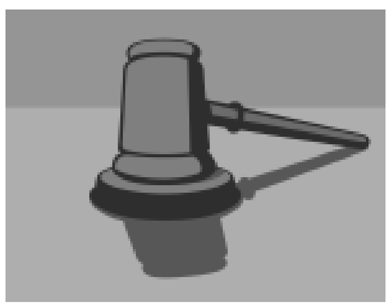
AlianzaNet reroutes existing cash-based remittance flows through card-based and account-based channels. AlianzaNet offers a "turn-key solution," providing the operations, technology, and settlement platform. Alianza International does not collect or settle monies, it only operates the system that effects transaction instruction, origination, and delivery, and it maintains records of monies requiring collection and monies requiring distribution. Alianza also offers support with "know your customer," OFAC, BSA, and other compliance requirements. Funds collection from remittance originators and settlement with remittance distributors is performed by national bank partners and foreign exchange providers.

AlianzaNet provides a mechanism for using all forms of remittance instruments, including cash-to-cash, cash-to-card, cash-to-account, card-to-cash, card-to-card, card-to-account, account-to-cash, account-to-account, and account-to-card. Alianza International provides a remittance origination network that supports remittance origination from sources that include Internet, branch teller, proprietary networks, SWIFT, ACH, and card processing networks. Alianza International is one of the few providers who currently offer money transfers as a home banking service (Alianza International 2007).

As with credit cards, third parties must obtain a license or sponsorship from a member bank in the country of issue that will be responsible for regulatory compliance and financial settlement. Because a prepaid card program involves much less counterparty credit risk than does a credit card program, it may be easier for the MFI to secure such sponsorship. Nonetheless, the MFI must still manage the operational risk involved with a prepaid card and money transfer operations.

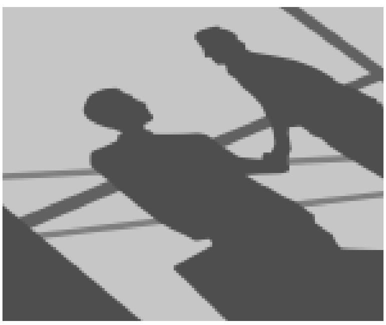
Compliance Challenges

Any institution offering money transfers should ensure compliance with existing laws and regulations. Compliance includes seeking licenses in each country of operation and reporting to authorities supervising money transfers. For institutions involved in multicurrency operations, additional licensing and reporting are usually required.



A growing number of countries are adopting more stringent requirements for AML/CFT. One of the most challenging aspects of standard AML/CFT compliance is identifying clients according to international standards. In developing and middle-income economies, for example, it is difficult for many clients to comply with certain "customer due diligence" identification requirements, such as national identity numbers or third-party verification of physical home address. As a case in point, while these requirements are already part of customer due diligence regulations in South Africa, financial institutions there are experiencing problems adhering to them because at least one-third of South African households do not have a formal address (Isern, et al. 2005).

Given the growing importance of money transfers and the rising profile of international remittances, the Committee for Payments and Settlement Systems (CPSS) of the Bank for International Settlements and the World Bank developed *General Principles for International Remittance Services*. These principles aim to achieve safe and efficient services in markets that are contestable, transparent, accessible, and sound. As countries adopt these general principles, MFIs and other institutions will be required to comply.[19]



Partnership Challenges

MTC partnerships entail several risks that need to be managed. The larger the MTC and the more dominant it is in that country's market, the more likely that it will attempt to impose exclusive relationships on its agents. An institution should ensure that all contracts with partners are legal and comply with existing laws and regulations. In addition, contracts should be reviewed by a lawyer to ensure they adequately protect the MFI's interests.

Even large MTCs cannot always generate adequate transaction volumes.

Even large MTCs cannot always generate adequate transaction volumes for institutions in receiving countries, particularly if they have not sufficiently penetrated the relevant immigrant communities in sending countries. For example, one of the first foreign MTCs that JCCUL partnered with was hardly used by Jamaicans in the United States—even though it is widely used by Latin American immigrants. Because it had refused to become an exclusive agent, JCCUL was able to bolster disappointing transfer volumes by adding other MTC partners (Isern, Deshpande, and van

[19] See "Annex 3: General Principles."

Doorn 2005). Box 20 describes other risks of MTC relationships and how institutions have dealt with them.

Box 20: Managing Risks

One way to manage the risk of launching money transfer services is to introduce the services in phases. This can be done geographically, for example, by initially rolling out MTC services only in certain branches.* XAC Bank in Mongolia took this approach. For the first few months, it limited its international MTC service to the head office. As volume builds, branches must be able to process transfer clients quickly and smoothly, a lesson XAC Bank had already learned from its domestic transfer products. By introducing international MTC transfers to its branches in phases, the bank learned how to minimize operational costs before opening up the network to larger volumes of transfers.

Gradually increasing the intensity of the relationship with an MTC is another way to manage risk. XAC Bank chose to become a sub-agent—that is, its MTC transfers are routed through another commercial bank that acts as the MTC's primary agent in Mongolia. Although this arrangement requires XAC to share over half of the revenue from each transfer with the primary agent, XAC avoids paying the cash security deposit that full agency status requires. If transfer volumes generate sufficient revenue to justify becoming a full agent, XAC has the option to upgrade its relationship with the MTC.

* Some MFIs prefer to launch transfers in all locations to ensure full coverage within their network. In these cases, MFIs have noted that client demand often builds slowly as the product becomes better known.

Source: Jim Anderson and G. Tuul, both of XAC Bank, 7 June 2004.

Because partnerships can be challenging, MFI managers suggest focusing on fostering a good reputation for a limited type of money transfers service rather than quickly developing a full suite of services. One way to begin building client trust and a good reputation is to link with established MTCs that can provide a turn-key solution for international transfers. For small to medium-size MFIs interested in domestic transfers, partnering with a bank that has transfer experience and good national coverage may be a good strategy for entering the money transfers market.

MFI managers advise focusing on fostering a good reputation for a limited type of money transfer service rather than quickly developing a full suite of services.

Partner negotiations also can take a long time, especially for MFIs that are inexperienced with money transfers. In addition, a partnership may limit an MFI's ability to offer flexible products and systems, because in many cases the MFI is essentially purchasing them "off the shelf" from the MTC. As a result, the MFI may have trouble integrating the service with its other operations and so may not be able to take full advantage of cross-selling other financial services. To protect the MFI, it may be advisable to negotiate an initial contract for a pilot period, such as one year, and ensure that any contract revisions must have the consent of the MFI (Jaramillo 2006). Additional guidance on negotiating alliances is provided in "Chapter 5: Negotiating Partnerships."

Any money transfer service will require sufficient liquidity, security, and possible investment in additional systems, staff, and infrastructure.

MFIs should bear in mind the costs involved in partnerships. Money transfers entail real costs for both an MFI and its clients. Any money transfer service will require sufficient liquidity (and thus opportunity costs for cash), security, and possible investment in additional systems, staff, and infrastructure. More sophisticated systems or more complex business models will likely require further investment. For MFI clients, many of the products offered by international MTCs may be relatively expensive and may be difficult to sell.

Costs must be measured against potential profitability. When contemplating a partnership, an MFI should determine the amount, method of calculation, and timing for payment of all fees and commissions associated with money transfers. An important consideration is whether the MFI will be an agent or a subagent of an MTC. If a subagent, the MFI will receive less revenue for each transaction; this is an important determinant of potential profits. In some countries, only commercial banks or postal networks are allowed to be direct agents of an MTC. Further, most MTCs have fixed commission rates for agents, and typically, a subagent receives the smallest amount of commission on each money transfer. As a result, there may be little room to negotiate a fee-sharing agreement.[20] When projecting profitability, the MFI also should consider potential foreign exchange gain if working in multiple currencies. In addition, the MFI should estimate potential revenue from cross-selling other services, such as savings, loans, etc. Over time, the MFI should track fees and commissions plus these other sources of revenue to make an informed decision on the overall profitability of money transfer operations.

[20] Costing analysis is addressed in more detail in "Developing Transfer Products: Pricing." For more extensive information on costing, see CGAP Technical Tool No. 6, *Product Costing Tool,* Helms & Grace, Washington, D.C., 2004.

5

Negotiating Partnerships

Partnerships are an excellent option for MFIs seeking to enter the money transfer business. With the right partnership, the MFI can grow its business and better serve its clients. But entering into a partnership requires careful consideration and planning. This chapter presents information an MFI should know when entering a partnership and tips to negotiating the best partnership agreement.

THE TWO SIDES OF THE TABLE

Typically, the courtship between the MFI and an MTC is mutual: the MFI wants to develop a new line of business, and the MTC wants to expand its network of payment agents. However, each side of the table has unique concerns. This chapter focuses on business alliances with MTCs; however, the guidance also can be applied to other types of partnerships, such as with commercial banks, shared branch networks, or other institutions offering money transfers.

The Money Transfer Company's Perspective

The MTC wants sound agents and subagents, and its choices are often limited because many countries regulate which institutions can partner with an MTC (it is often limited to commercial banks, postal networks, and foreign exchange bureaus). The MTC wants to expand its reach (so the extent of the MFI's branch network is often the most valuable bargaining chip in negotiations). The MTC wants an agent who understands the environment. MFIs have established client relationships and are usually culturally and geographically close to their clients. Large MFIs with extensive branch networks (especially rural branches) are especially attractive to MTCs.

The extent of the MFI's branch network is often the most valuable bargaining chip in negotiations.

What the MTC Looks for in a Partner

In short, the MTC values the following criteria when considering partners:

- Multiple locations in the country, especially in areas not already covered by other payment agents: branch offices in urban and rural areas, ATMs, and fixed and mobile points of service

- Well-established branch infrastructure and good communications with the institution's headquarters
- Use of a call center
- Good reputation in the country or region, especially known for good customer service
- Local knowledge from existing large client base
- Demonstrated financial performance with audited financial statements
- Experienced, friendly, and knowledgeable staff
- Secure, fully licensed operations (including cash management) that comply with national laws and regulations
- Experience with money transfers and the ability to add money transfers clients, especially to increase the volume of transactions

An MTC will also consider other criteria, such as the MFI's operating hours, financial soundness, and liquidity availability to advance customer payments before reimbursement by the MTC. Because verifying these criteria for many agents can be cumbersome, MTCs usually contract with a few primary agents in each country, often banks. Depending on local regulations, the banks may then sign subagent relationships with MFIs and other institutions. In this case, the MTC's relationship is really with the primary agent (i.e., the bank), and the primary agent is responsible for due diligence on its subagents and negotiating the subagent relationship (Jaramillo 2006).

Box 21: AMUCSS-Envíos Confianza: A grassroots consortium for rural MFIs

Many rural Mexican MFIs are too small to negotiate with MTCs, and as a result, their clients were unable to receive remittances within their community. AMUCSS, which focuses on providing broader access to financial services in rural areas, recognized the need for greater leverage. Joining together mission-driven rural MFIs, it created a consortium called Envíos Confianza. Envíos Confianza has a large network of service points in an underserved specific niche—rural areas, where 45 percent of Mexican immigrants come from—and deals directly with MTCs, giving it significant leverage in negotiations. Envíos Confianza operates the money transfer business in a centralized way and deals directly with four international MTCs.

Adapting to the needs of the MFIs has been the basis for its success. MFIs are the main stockholders and can decide on policies and pricing. A remittance payment software geared to the specific needs of rural areas was developed, using the MFIs' field experience as leverage.

Source: Alexandre Berthaud (executive director of Envíos Confianza) November 2007.

The MFI's Perspective

The MFI wants a relationship based on trust and transparency. The MFI must select partners carefully, especially as more operators enter the money transfer market. When delivering a transfer payment to a client, the MFI assumes credit risk, because it often has not yet received the actual funds from its international partner. It needs to know that the funds will arrive soon. Likewise, the sending partner relies on the receiving partner to make sure transfers are delivered to recipients. Information on both the sending and receiving side can be difficult to obtain. Receiving institutions may not be able to easily compare different money transfer partners. Likewise, send-side institutions often don't know which partners are reliable and offer good client service in a specific country.

Thorough due diligence on potential partners is crucial.

Thorough due diligence on potential partners, including reference checks, verification of legal status, and analysis of their financial viability, is crucial (Isern, Deshpande, and van Doorn 2005).

What the MFI Should Know About a Partner

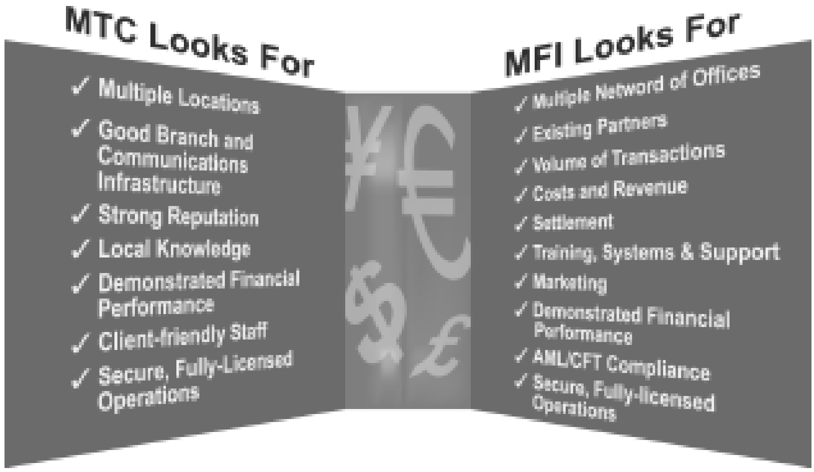
Compatibility. The MFI needs to consider how compatible a potential partner is. Compatibility often begins with sharing a similar philosophy. MFIs should ensure that the MTC fits with their mission and overall strategy. Likewise, the MFI should determine the MTC's success—or lack of success—in managing other relationships (with partners or clients). Understanding the MTC's operations, systems, and products is essential to deciding whether it is compatible with the MFI's own operations. Additionally, the MFI should determine whether the MTC is properly licensed and regulated and how it meets—or expects the MFI to meet—compliance measures.

Business. The MFI should understand the nature of the MTC's business. Is it large with many branches, points of service, and partners? What kind of volume does it handle? Where does it do business? How does the MTC's network of offices in the sending country or region relate to the MFI's target market?

Assistance. Setting up a money transfer operation is a major challenge, and any assistance the MTC can provide will be vital. Some MTCs provide the MFI training, software or hardware systems for processing transactions, assistance with information systems, and/or assistance with marketing.

Operations. Ultimately, day-to-day operations must be compatible for the partnership to work. Each MTC has its own unique way of (and schedule for) originating transactions, clearing and settling transactions, charging for transfers, determining exchange rates, determining and paying commissions and fees, and selling additional products. The MFI should ensure the MTC's practices are acceptable and practical.

"Annex 5: Partner Evaluation: Quick Reference Guide" provides further details and questions an MFI may want to consider.



STAGE ONE: Gather Information and Rank Potential MTC Partners[21]

First, the MFI should gather information on potential MTCs to identify and prioritize those that are potential ideal partners. Contacts and negotiations can then be focused on those companies with more potential for the MFI. In some cases, this information may not be publicly available. The MFI may need to seek information by posing as a client seeking information or by making direct contact with the MTC.

[21] Adapted from Jaramillo 2006.

The MFI should ensure that it has the following information from the MTC and use it to prioritize potential partners:

- **Business model.** Identify whether the MTC works with its own network of offices in the sending country or with subagent contracts. A proprietary network of offices presents more opportunities for cross-selling complementary financial services that the MFI can offer to senders and recipients.
- **Current alliances.** Does the MTC already work with banks in the MFI's country? Identify MTCs that have not already established a large network of banks as paying agents or ones that work mostly with retail companies. An MFI will be more strongly positioned if it can help expand an MTC's network of financial institutions as paying agents.
- **Direct deposit service.** Does the MTC already offer direct deposits into bank accounts? If the MFI offers this service, or could rapidly develop this capacity, it can strengthen its negotiation position.
- **Coverage in the sending country.** Does the MTC have strong coverage in the areas were there is a high concentration of immigrants from the MFI's country? If not, does it plan to expand to these areas in the near future?
- **Coverage in recipient country.** Identify the coverage the MTC has in the recipient country. Determine whether the MFI's branch network complements the MTC's existing network.
- **Cost of service.** How does the cost of the service the MTC offers compare with that of other players in the market? The MFI should determine whether its customer base would be likely to use this MTC given its price structure.
- **Relationship with banks.** Has the MTC had problems with banks in the sending country closing their bank accounts?
- **Legal compliance.** The MTC should be able to show evidence of compliance with money laundering rules and other legal restrictions.
- **Presence in other countries.** Is the MTC expanding its coverage in the MFI's region?
- **Current software and networks in use.** Does the MTC require partners to purchase or acquire specific software? The costs of new software acquisition, staff training, and software maintenance must be part of the assessment of working with an MTC.

Once the MFI has gathered this information, it should rank the MTCs that might make good business partners and begin contacting them to determine their interest in partnering.

STAGE TWO: Contact Potential Partners and Perform Due Diligence[22]

The MFI should contact those prioritized MTCs to determine whether there is potential for a partnership. Once interest is established between potential partners, a process of due diligence begins. Performing **due diligence** involves compiling all the appropriate and necessary information about the potential partner to ensure the partner has a sound business operation and a relationship is in each party's best interests. At this stage, the MFI should consider contacting a lawyer to help negotiate the eventual contract.

Often, before sharing such information, the MTC may request that the MFI sign a legally binding agreement called a **nondisclosure agreement (NDA)** that restricts the MFI from sharing the disclosed information with other parties. Typically, such agreements apply to both parties, but if not, the MFI may request that the MTC also sign an NDA.

Requesting additional information from the MTC

The MFI should ask if the MTC requires an exclusive agreement, because this is an important point that the MFI needs to evaluate.

The MFI should ask the MTC to supply all the information outlined above that was not possible to gather from public sources. Additionally, the MFI should ask whether the MTC requires exclusivity agreements because this is an important point the MFI needs to evaluate before continuing discussions.

The MFI also should ask the MTC if it is interested in linking remittances to other financial services or products. For some products, such as direct deposit of transfers, the support of the MTC will be needed.

Provide Information

The MTC will also want information on the MFI. The MFI should be prepared to supply the following information to strengthen its negotiations with the MTC.

- Information on money transfers experience, current products, alliances, and volume of transfers paid out per month
- Financial performance of the institution
- Estimated percentage of clients that receive remittances as potential market to the MTC (if available)

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[22] Adapted from Jaramillo 2006.

- Coverage of MFI network. Present how the MFI's network of branches complement the existing branch network of other MTC partners in the region; highlight presence in urban peripheral neighborhoods and rural areas where traditional bank networks are not present
- Payment instruments. Present the services and products the MFI can use to pay out money transfers, such as payments in cash, direct deposit into a bank account, use of debit or prepaid cards to recipients
- Customer service. Present the services the MFI can offer to support a good customer service, such as use of a call center to notify recipients of transfers or use of dedicated tellers for remittances during high-peak transfer periods
- Cash management. Provide liquidity and cash management policies; explain how the MFI will ensure that its branch network will be able to handle service and cash demands during peak transfer periods
- Range of financial products the MFI can offer recipients. Market these products as bringing added value to senders and recipients and therefore helping to create loyalty for the MTC
- Licensing to do money transfers (if required)
- Evidence of compliance with money-laundering rules
- Technology platform, including current software and payment networks

This stage should establish interest in working together and (potentially) an agreement to move forward.

STAGE THREE: Negotiate Contract[23]

Negotiations can take time, especially for MFIs just entering the money transfer business. The MFI should be prepared for delays, requests for more information, and multiple meetings.

Negotiations with an MTC can take time.

The following sections describe areas of negotiation. Stronger MFIs will likely be able to push for more favorable terms, but even small MFIs should be mindful of these terms, because if they are not favorable, it may signal that the partnership is not in the MFI's best interests. In addition, the MFI should work closely with informed legal counsel that is experienced in contract issues. Legal counsel can help ensure the contract protects the interests of the MFI and can provide advice throughout the negotiations.

Before entering negotiations, the MFI should have in mind the minimum requirements it can afford to accept, specifically in regard to commissions,

[22] Adapted from Jaramillo 2006 and negotiation guidelines recommended by Dave Grace, October 2006.

Negotiations should benefit both partners. It is important to remind the potential partner of the MFI's strengths.

settlement terms, and exclusivity agreements. Negotiations should benefit both partners, and if the MFI will not benefit from the relationship, it should be willing to walk away from the table. Similarly, the MFI need not renew unfavorable partnerships.

Box 22: Protecting the MFI's interests by analyzing the full costs

Partnering with an MTC can offer an MFI a complete package of services and infrastructure necessary to process money transfers. However, entering into an agency agreement with an MTC does not fit the needs of all institutions. One MFI with rural branches in the Philippines found that domestic long-distance charges for dialing into servers of its MTC partner rendered the entire relationship unprofitable, even though initial training and software had been free. In addition to dial-up charges, transfers incur other costs, such as cashier services, management attention, and office space. MFIs must be particularly careful in assessing the full cost of an agent or subagent arrangement.

Source: Chairman, Philippine MFI (name withheld), 23 June 2004.

Discuss Strengths

It is important to remind the potential partner of the MFI's strengths. Although the MTC will have performed its own due diligence, accentuating the MFI's strengths can add leverage to negotiations.

Negotiate Commission Terms

Determine how the MFI will make money. Consider the following terms:

- **Status Type.** The MFI needs to determine whether it will be an agent or subagent, correspondent bank, or member (in the case of an alliance). If acting as an agent, the MFI should define the terms for marketing and expansion of its network of subagents. If acting as a subagent, the MFI must negotiate with the primary agent to decide how commissions and operations will be divided among the MTC, the agent, and the MFI (subagent).
- **Commissions.** Commissions vary according to the MTC, the volume it manages into the region, and the number of partners it already works with in the region. Some MTCs offer a fixed commission for each remittance paid; others establish a percentage of the amount of the transfer sent as a

commission. It is common to establish commissions based on the volume the MFI will pay out. It is often an effective strategy to hear the MTC's offer first. Likewise, the MFI can use the commission agreements that it has been able to establish with other MTCs to strengthen its position.

- **Settlement.** The MTC should provide next-business-day settlement for all money transfers and commissions due the MFI. Inability to accommodate this policy may be indicative of the MTC's financial problems. If the MTC does not settle quickly, it may be generating additional income on float at the MFI's expense. The longer the duration between payment and settlement, the greater the credit risk for the MFI. The MFI should make sure it can fund the payments for whatever timeframe is negotiated. To compensate for time between payment and settlement, the MTC should be willing to prefund between 10 and 25 percent of the highest daily payout by placing a security deposit with the MFI or the MFI's financial institution.

Negotiate Other Terms

In addition to money matters, there are multiple benefits the MFI can look for in a partnership:

- **Access to networks.** Many MTCs have access to payment networks (such as SWIFT or their own proprietary networks) that require an annual license fee. The MFI should determine what access it will be granted and what, if any, fees are required.
- **Access to data.** The MFI will want access to the MTC's customer data to understand the profile of recipients and to determine strategies for cross-selling financial products.
- **Access to technology.** To smooth communications or transfer information, it may be necessary to share software or communications equipment. The MFI should ensure that cost outlays on infrastructure are fair. It may be that the MFI can share software licenses or hardware. The MFI should make sure the technology teams of both institutions meet so that the feasibility of all the technological implications is evaluated.
- **Exclusivity.** The MFI should seek nonexclusive relationships so that it has greater flexibility in partnering with others.
- **Competition restrictions.** The MFI should seek to limit its competition with other agents of the MTC. Sometimes this means expanding regional territories.

The MFI should seek non-exclusive relationships so that it has greater flexibility in partnering with others.

- **Duration of partnership.** Typically, partnerships are established for one year, with the option to renew annually (pending agreement by both parties). Such a duration not only limits the MFI's liability if the relationship turns out badly, but it also allows the MFI to negotiate better terms if its position in the market has become stronger. In addition, the MFI should ensure that either party can cancel the contract immediately with written notice for noncompliance or with 180 days advance written notice for any reason.
- **Marketing.** The MFI should establish the expected action and financial contributions from each side to promote the product. The MTC should agree to pay for most of the sales materials or at least share costs. It is also important to negotiate with the MTC a campaign to help launch the service with the MFI, including support to make the name and brand of the MFI recognized as a paying agent for the MTC.
- **Logo use.** Logos represent institutions and are powerful marketing tools. The MFI should negotiate the use of the MTC's logo and ensure that its own logo is fairly represented on marketing materials.
- **Foreign exchange.** Foreign exchange revenue is a significant component of the overall revenue in international money transfers. In addition to the fee per transaction, the MFI is entitled to a percentage of the foreign exchange revenue. Some MTCs may resist sharing foreign exchange revenues or suggest that it is too complicated to calculate given the floating rates. MFIs should know their rights and learn the practices of other institutions in the country or region.
- **Jurisdictional court.** Most contracts clarify the jurisdiction where disputes and legal issues will be settled. The MFI should aim to settle disputes in its home jurisdiction, where possible. Further, it may be more effective to use arbitration courts as the first option to resolve a legal dispute.

Concluding Thoughts

The money transfer market offers tantalizing opportunities for the MFI, but the risks can be high. The MFI should proceed with caution in evaluating the potential for such services. It should learn from the experience of institutions that have already launched them.

Beginning a money transfer business can be difficult and daunting, but the rewards of a successful operation could be significant.

The considerations discussed in this guide, while often cautionary, are meant to aid the serious MFI in a thoughtful and well-planned undertaking. Beginning a money transfer business can be difficult and daunting, but the rewards of a successful operation can be significant. As migration expands within developing countries and globally, and as financial sectors develop, the demand for money transfer products will continue to increase. In addition, clients, governments, and businesses are increasingly adopting card-based transactions and EFTs. Satisfying this growing demand will aid the MFI's bottom line, attract potential new clients, and help serve low-income clients by creating the essential services they need.

Annex 1: The Building Blocks of Retail Money Transfers: Payment Systems and Payment Instruments

TRANSFERRING FUNDS

People of all economic backgrounds engage in money transfers with other individuals, households, and businesses. They transfer money to meet everyday financial obligations, like bill payments. They also transfer money for less common reasons like providing money to children away at school, sending money to family members living elsewhere, or transferring partial earnings to other parties.

These **fund transfers** take many forms. Some people use formal services provided by banks or other financial institutions. People without bank accounts or without access to formal services typically use less formal channels.[24] They often face greater risks and higher costs as a result.

Payment systems are the institutions, networks, people, rules, and technologies that make the exchange of payments possible. The **Committee on Payment and Settlement Systems** (**CPSS**) of the Bank of International Settlements defines a payment system as consisting of a set of instruments, banking procedures, and typically, interbank funds transfer systems that ensure the circulation of money.[25] This infrastructure provides a crucial economic function by facilitating movements of money from payers to payees domestically and internationally.

Payment instruments are the mechanisms that people, businesses, and governments use to transfer money in the settlement of exchange transactions. These instruments take many forms and have many uses (see Table 2). A businesswoman may use cash to settle an exchange of goods in a local market; a merchant may use a credit card to pay for services; some businesses pay their wages by check or through direct deposit to their employees' bank accounts; and many people use EFTs to pay utility bills, taxes, and other bills.

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[24] See Annex 2 for a more detailed description of formal, semi-formal, and informal money transfer systems.

[25] CPSS Glossary of terms used in payments and settlement systems. http://www.bis.org/publ/cpss00b.htm

Table 2: Uses of fund transfers

From: \ To:	Customer	Business	Financial Service Provider	Government
Consumer	-Gifts -Reimbursements -Purchases -Loans -Rents	-Purchases -Bill payments	-Service fees and charges -Securities purchase -Insurance premiums -Loan repayment	-Taxes -License fees
Business	-Salaries -Expenses -Dividends	-Purchases -Bill payments -Rents	-Service fees and charges -Securities purchase -Insurance premium -Investment -Loan repayment	-Taxes -Withholdings -License fees
Financial Service Provider	-Dividends -Redemptions -Insurance claims -Interest	-Purchases -Bill payments	-Securities transfer -Purchase of services	-Taxes
Government	-Benefit transfers -Tax refunds -Salaries	-Purchases -Vendor payments -Tax refunds	-Tax refunds -Purchase of services -Loan repayment	-National to local governments and interdepartmental transfers

Payment instruments have evolved over time from barter to commodity-based schemes, to coins and currency, to card-based methods, and more recently, to other electronic instruments. Each of these developments has reduced the costs and risks of commerce and trade. This process continues today as technological innovations, such as the Internet and mobile telephones, new institutions, and regulatory changes stimulate new payment methods that allow money to move more easily and quickly, and at ever lower transaction costs.

Except for cash and some stored-value devices, every payment instrument is based on the transfer of money from one institution to another or from one bank account to another. Accordingly, bank accounts are an integral part of the payment infrastructure. Thus, people who do not have bank accounts—whether by choice or because of exclusion—have limited choices of payment systems and instruments. By offering money transfer services, MFIs may be able to increase options for unbanked clients.

FUND TRANSFER TYPES

Money transfers fall into three broad categories: occasional transfers, regular transfers, and remittances.

Occasional transfers occur when people need to transfer money quickly in response to a particular situation, such as someone facing an emergency, or to place a deposit on the purchase of an asset. Such transfers are typically one-time events and of moderate to high value.

Regular transfers include ongoing, regular payments between people, businesses, and/or government agencies. Examples include salary payments to employees, savings, monthly rent payments, pension payments from government or business to individuals, and monthly or quarterly school or utility fees.

Remittances are transfers from workers living elsewhere (nationally or internationally) to family, friends, and communities back home. Worker remittances generally involve small amounts—typically US$100 to US$1,000, with an average of US$200 (Sander 2003)—transferred to lower income individuals or households. **Domestic remittances** are fund transfers within a region, typically from urban to rural areas. **International remittances** are cross-border person-to-person payments of relatively low value. In practice, transfers are typically recurrent payments by migrant workers.

A large share of remittances is originated and disbursed in cash through retail outlets of MTCs. Payment cards and electronic networks are increasingly being used as mechanisms for remittances.

To be used effectively, each of these money transfer types requires an adequate infrastructure. Money transfer networks must have convenient locations for sending and receiving transfers, but around the world, rural areas typically have fewer numbers of financial service providers, and the formal financial infrastructure is often weak or nonexistent. Even when they are accessible, financial service providers may be unwilling or unable to cash national checks or foreign money orders or receive international transfers.

Whatever the reasons, limited access can have severe effects on families whose sustenance depends on timely receipt of transfers. To be effective, money transfer systems must ensure access for clients on both sides of the transaction—senders and recipients. Because the MFI typically has a good understanding of its country environment and clients, it can play an important role in its country's money transfer market.

RETAIL PAYMENT SYSTEMS

Payment systems are often classified as retail or wholesale.[26] The **retail sector** (sometimes called the consumer sector) is made up of institutions and service providers that focus on serving individuals, households, and small businesses. Within the retail sector, payment systems can be broadly classified by the money type used in the settlement of payment (cash or account-based) and/or by the medium used for payment (currency, paper, card, or electronic). **Wholesale** payments are provided, for the most part, to financial institutions.[27]

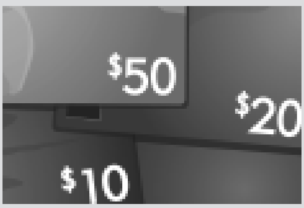
Cash payments always involve an immediate transfer of value directly from payer to payee, such as a consumer purchasing food at a store with cash.

Account-based payments usually involve exchange instructions that order a transfer of value between accounts held at financial institutions. They require that one or both of the counterparties have a banking relationship at their respective institutions. People with no access to bank accounts are excluded from account-based payments.

[26] Retail payments differ from other types in several ways. First, retail payments are typically made in large numbers of transactions and usually involve purchases of goods and services in both the consumer and business sectors—rather than, for example, wholesale settlements of transactions between financial institutions. Second, retail payments are made using a much wider range of payment instruments than larger value wholesale payments and in more varied contexts, including payments made in person at a POS as well as remote consumer and commercial transactions. Third, retail payment markets make extensive use of private systems for the transaction process and for clearing.

[27] In some countries (e.g., Turkey, Brazil, Mexico, etc.), consumers also have access to large-value payment systems.

Table 3: Payment media and their corresponding money type

	Money Type	
Payment media	**Cash**	**Account-based**
Currency 	-Banknotes and coins -Hawala	
Paper 	-Checks and drafts -Promissory notes -Money orders -Travelers checks -Bills of exchange	-Checks -Credit transfers (paper giro)
Card 	-Prepaid cards -Stored-value cards	-Debit cards -Credit cards -Charge cards -Card to card
Electronic 	-Digital cash	-Account transfers (intrabank and interbank) -Money transmission operations -Automated clearing house (ACH) debits and credits -Domestic wire (bank and private EFTs) -International wire (SWIFT, Telex) -Other Internet and mobile forms, such as mobile phone platforms -Electronic bill payments -Person-to-person payments

PAYMENT INSTRUMENTS

In all developed economies and increasingly in emerging ones, there is more variety of available payment systems and instruments. A payment system can be as simple as handing cash to a merchant in exchange for some goods or as complex as an international, multibank transfer of electronic funds.

An MFI creates money transfer **products** by packaging a specific payment instrument with the institution's terms and conditions of service. Although institutions often will promote their products in interesting ways and include various enticing features, every product can be simplified to a particular type of payment instrument.

The following sections discuss the use of various instruments in the money transfers industry, especially in developing countries.

Cash-based Payments and Transfers

Cash is the simplest type of retail payment instrument. A cash payment is the exchange of currency and coins with a face value established by the government and where final settlement occurs simultaneously with the cash handover. In developed countries, cash is the payment medium for 50 to 80 percent of retail payment transactions in terms of volume but less than 5 percent in terms of value (Donges 2003). In many developing countries, cash is still used extensively for paying wages, conducting most retail transactions, and settling many business transactions.

For low-income households, especially in developing countries, nearly all transactions are in cash. Despite efforts to move money into bank accounts, where it can be multiplied into loans to fuel investment, use of cash remains a significant part of many economies. Wage payments in cash are common, particularly among microenterprises, agricultural businesses, and companies in rural areas with limited access to banking facilities. Even when wages are required to be paid by check or directly into bank accounts, most lower income workers immediately convert the checks into cash or withdraw their pay from the accounts.

Many small enterprises and microenterprises operate solely on a cash basis, receiving cash from customers and paying it to employees and suppliers. Cash can be more expensive than other forms of payment for retailers—particularly in the small values typical of cash transactions at the **point of sale (POS)**—because it requires additional processing that can be time-consuming and costly, including tendering the cash register, balancing cash received to sales, preparing cash deposits, and managing store cash. In small stores and markets, cash received for goods and services seldom goes to banks. Some merchants prefer to deal in cash to avoid registering sales and collecting and reporting taxes based on them.

Hand-carried cash remittances and those transmitted through informal channels are difficult to estimate, and they differ greatly by country, reflecting the severity of foreign exchange control systems, effectiveness of taxation systems, mobility of migrants, the state of the payment systems infrastructure, and the structure of incentives for remitting funds. Nevertheless, the use of cash will likely remain the biggest competitor to other types of payment instruments.

Transfers can be made on a cash-to-cash basis through the purchase of paper, card, or EFT instruments. The sender pays in cash, and the funds move to the recipient for payout in cash (at banks, postal branches, check cashers, currency exchanges, retail stores, and nonbank check cashing firms).

The cashless society predicted over the past three decades is a long way off. In developed countries, card payments have reduced the use of cash, especially for purchases. But cash and checks remain prevalent, and in developing countries, cash will remain the dominant payment instrument until countries adapt and develop the needed financial infrastructure. As a result, the use of cash will likely remain the biggest competitor to other types of payment instruments.

Paper-based Payments and Transfers

Paper documents have been used to transmit money since the 14th century. Paper-based payments contain only the instructions to move the money from the payer to the payee. The actual flow of money occurs in the transfer of monetary balances between accounts in intermediary financial institutions. Paper-based payments include bank checks, drafts, money orders, traveler's checks, international payment orders, and some giro transfers.

A **check** is a demand draft drawn on a bank, payable to a designated payee, and transferable to another person by endorsement. Checks are widely used by individuals and businesses in several developed countries (e.g., Australia, Canada, France, United Kingdom, United States) to settle financial obligations. In many other countries, including most developing ones, checks are not actively used by retail customers and are only in limited use for commercial and interbank purposes. Use of checks as retail payment instruments is declining rapidly everywhere as cards and electronic payments gain favor.

The writing of a check by the payer and the **acceptance of a check** by the payee does not constitute final payment. The check must first be deposited in the payee's bank, then sent to the bank on which it is drawn for posting to the payer's account. The funds are transferred to the payee's account only after sufficient time has passed for the paying bank to dishonor the check. This process is called **check clearing** and, even in a well-developed check clearing network, it may take from overnight to several days—while in a country with low clearing automation, settlement may take several weeks.

In countries where they are common, checks are widely used by businesses to pay salaries, pay dividends to shareholders, make trade payments (to suppliers of goods and services), and conduct various other payments. In active check countries, check cashing outlets allow people to cash payroll, government, and personal checks for a fee, usually a percentage of the check amount. In addition, many large retailers, such as supermarkets, are willing to cash payroll checks from well-known companies as a service for customers. These businesses usually provide other services, including money orders, money transmission services, and bill payment. Sometimes they also offer payday loans. In active check countries, checks are also used as a payment instrument at stores and service establishments and for remote bill payments—though the risk of fraudulent presentation and the possible return of unpaid checks sometimes limit the willingness of businesses to accept checks. To limit the number of returned checks, steps have been taken by banks (by imposing heavy penalty fees on accounts until checks are paid) and businesses (by using check verification services).

Checks are a convenient, low-cost instrument for transferring funds—except for recipients without bank accounts or for cross-border transfers. If the recipient is in the same country and the check is drawn on a national bank with local branch offices, cashing the check is usually not a problem. But if there are no nearby branches and the check must be cashed at another bank, the collecting bank may charge a fee, and clearing can take up to six weeks. In some countries, foreign exchange restrictions may apply. Issuing checks and bank drafts is generally limited by law to regulated financial institutions, such as banks and most credit unions. Check transfers also depend on postal reliability, which is often lacking in developing countries, so clients risk losing checks and drafts in the mail. Even in the best cases, recipient must wait for a check to arrive and then for the funds to clear the banking system (Isern, Deshpande, and van Doorn 2005).

Official checks and foreign drafts are instruments banks issue to send money to payees domestically or abroad. Both are drawn on a bank and signed by a bank officer. An official check is in the national currency, and it is typically used to make a domestic payment. A foreign draft is in national or foreign currency and is payable through a partner bank in the destination country. Official checks are mainly used to pay taxes, make high-value purchases, or make payments through the mail. Foreign currency drafts are often used to send money in the recipient's currency or to pay for purchases overseas. A business may attach a foreign draft to an invoice to pay a foreign bill, making it easier for the recipient to apply the funds to the correct account. Businesses also may use them when other forms of payment are not feasible. Banks offer such checks to both clients and nonclients, usually for a fee. Because the transaction relies on paper from end to end, it is by far the slowest means of payment and carries relatively high risks of loss and delay. Many banks are increasing their fees for official checks and drafts to steer clients toward more automated and efficient electronic products.

A **money order** is a limited amount payment instrument that provides an order from the issuer to the remitter to pay a sum of money to the person (payee or beneficiary) named in the money order. Money orders are purchased for their face value plus a service charge of US$1 to US$10 (or a percentage of the total amount) from banks, post offices, and other nonbank outlets. Money orders give people without bank accounts a paper-based means of transferring funds. The issuer serves as a depository for the funds from the time of a money order's sale to its encashment. The float on these funds is the main source of revenue for money order issuers.

Commercial issuers like First Data Corporation (which issues money orders under the American Express and the Western Union brand names) and Viad Corporation (which issues them under Travelers Express) account for most money order revenues and outlets. Some banks issue money orders under their own names or through firms, such as Western Union. Post offices operate through their own network of offices and agents both nationally and internationally. Third-party money order issuers usually operate through their own branches and through agents, such as check-cashing outlets, convenience stores, grocery stores, supermarkets, and other retailers.

Money orders traditionally have been paper-based instruments, but unlike checks, they can be issued by and redeemed at a variety of places. Major issuers of money orders include postal financial institutions and MTCs, such as Western Union and MoneyGram. Money orders do not require a bank account; a recipient receives cash upon presenting the money order to an authorized paying agent (a bank branch, a post office, money transfer agent, etc.). This process also reduces the time a recipient must wait to access the transferred funds, compared to checks or bank drafts. However, given the need for money orders to be physically delivered to a recipient, they are subject to some of the same risks of delay and theft. Postal money orders are now estimated to provide only 1 percent of formal international money transfers. In contrast, postal networks play a very important role in domestic transfer markets in many countries. China Post, for example, manages 90 percent of cash-based transfers within the country. In Bulgaria, the post office processes three times more cash payments than do all commercial banks together. Although the volume of these transactions is large, their value is estimated at only 2 percent of the value of cash payments processed by banks—a trend visible in the majority of countries of Eastern Europe and Central Asia (Boon and Greathouse forthcoming).

Card-based Payments and Transfers

Using cards to make money transfers has become routine for many people around the world. In most developed countries, large portions of the population have one or more debit or credit cards and almost everywhere these people shop (in retail outlets, by telephone, on the Internet), their cards are readily accepted as payment.[28] However, many developing countries have fewer cardholders and acceptance places. Since their introduction in the late 1950s, payment cards have been provided by two main suppliers: commercial banks that make up bank card associations (Visa and MasterCard) and third-party issuers (American Express, Diners Club, Discover, JCB). Visa and MasterCard are one of the factors driving the extraordinary growth of the payment card market in developed countries.

The use of payment cards for money transfers is fairly new, and there are some constraints because credit card clearing and settlement systems are

[28] For more background on technology for financial services, see Ivatury 2006.

designed primarily to facilitate merchandise purchases. However, credit card issuers are finding ways to extend their usefulness and to expand the number of places where cards can be used. These initiatives have produced innovative ways to send money (see Box 23). There is little doubt that payment cards will continue to displace cash and checks and to capture a growing share of consumer spending.

Box 23: Enabling affordable, card-based international remittances

Card-to-card-based fund transfers are a recent development in international remittances. The service was introduced to provide European banks with a low-cost cross-border money transfer scheme. The service is limited to cards issued in Europe, but it is likely to expand elsewhere in the future. Visa offers the service under the name Visa Direct, and MasterCard under the name MoneySend. The two services work in similar ways. To use MoneySend, both cardholders must be registered with their financial institutions. On the Internet, the sender enters a user name, password, and the email address of the recipient. By telephone, the sender uses an interactive voice response system, entering the mobile phone number of the recipient. The recipient then takes his or her card to an ATM to withdraw the money. Because both the sender and receiver must be registered, use of the service is limited to people with credit card accounts or deposit accounts accessible with debit cards. In addition, Visa has an alliance with Eurogiro that allows for transfers to be sent to any institution affiliated with the Eurogiro scheme.

Credit cards are unique among payment products in that they are both payment instruments and credit instruments. Consumers use credit cards as a substitute for cash and checks when buying goods and services at retail outlets or by mail, telephone, or the Internet. Credit cards are increasingly used to make periodic preauthorized payments and to transfer funds. The credit card business, although concentrated in some markets, is rapidly expanding globally, highly competitive, and innovative. One of the main benefits of credit cards is the convenience they offer in allowing cardholders to arrange their spending independent of the availability of cash in their wallets or bank accounts. However, credit cards require an account with the issuing institution. Many low-income clients do not have access to credit cards, especially in developing countries.

Debit cards play a vital role in providing access to bank products and accounts. A bank card is considered a debit card when its main role is to access an account classified as a liability on the books of the card issuer. To use a debit card, a customer must hold an account with a depository institution. Debits may be cash withdrawals at ATMs or branch offices, payments to merchants for goods and services, and Internet transactions. MFIs that are allowed to collect deposits could consider debit cards as one element for their money transfers strategy.

Debit cards can be online debit cards or deferred debit cards. **Online cards** are linked to bank deposit accounts and can be used only at merchants with POS terminals or at other automated banking terminals. Purchase transactions are transmitted to the issuer through private EFT networks or card authorization networks; the amounts are then debited from the available balance in the account linked to the card. Because the account is checked each time it is used, the cardholder cannot inadvertently become overdrawn. Thus there is no credit risk associated with the issuance of such cards, and any legal party to a deposit account can be issued a card. Such cards are well-suited to the banking systems of developing countries.

Deferred (offline) debit cards are linked to bank deposits and can be used on a voucher or electronic basis. The cards—usually standard embossed cards that bear the acceptance marks of Visa or MasterCard—are sometimes called check cards because their deferred clearing cycle simulates that of a check float. All transactions initiated on deferred debit cards are first sent to the acquirer, then through the credit card clearing system to the issuer for posting to the linked deposit account within a day or two of the purchase. Although most transactions are authorized online and captured electronically, they also can be originated by manual merchants.

In many countries banks use debit cards as part of their card-based commercial payroll services for corporate clients. On payday, the employer deposits employees' pay in the bank, the bank distributes the wages to employee accounts, and employees go to ATMs to retrieve their money. Such services are often loss-making or subsidized by the corporate client, because most employees withdraw their pay immediately.

Debit cards are also useful for international (or national) remittances. The remittance sender opens an account at a bank in the guest country and receives one or two debit cards. The remittance sender provides one of the debit cards and security code (e.g., personal identification number [PIN]) to his or her family in the home country. The family member can withdraw cash from an ATM or use the debit card at any authorized **POS** ("point of sale" or "point of service"). The sender controls how much he or she deposits into the account, and funds can then be withdrawn, usually with limited charges, such as ATM fees.

ATMs accessible with debit cards have begun to play a major role in money transfers, particularly in substituting electronic transfers for money orders. ATMs have long been used for account-to-account transfers, but only recently has that capability been extended to third-party and international transfers. Although the density of ATMs is growing around the world, they are still not ubiquitous in every part of every country.

Visa Giro is a cost-effective alternative to banks and businesses. Visa Giro is a Visa debit card that is accepted in most places that accept Visa in Latin America. Remitters add value to the card at an MTC in the United States. An allied bank in Latin America distributes a card, which contains the money credited, to the recipient. Because the transfer is electronic, sending costs are reduced substantially. Visa Giro is currently working in alliances between Latin American banks and money transfer businesses. Examples include Banco Uno and Gigante Express and Banco Cuscatlan and its MTC, Corfinge, in Central America. In Mexico, HSBC (formerly Banco Bital) has an alliance with Quisqueyana, and in the Dominican Republic, Quisqueyana has an alliance with Banco Mercantil, using a product known as Cashpin (Orozco 2003b).

Since its inception in the 1990s, the **prepaid card** has become the fastest growing payment product in the financial services industry, with an estimated US$160 billion in volume in 2004 (Donges, unpublished). Most of this activity has taken place in the United States where the cards first found widespread application as gift and payroll cards, but their use is rapidly extending into Europe and Asia. Prepaid cards offer a great deal of flexibility for financial institutions to develop card products and target cash-based consumers who cannot or do not access more formal financial channels. The cards look and work like debit cards, but no transaction account is involved, and many types of institutions and vendors can sell prepaid cards. Clients can buy prepaid cards with cash or other money instruments in standard amounts predetermined by the issuer, or in tailored amounts determined by the client. A prefunded value is stored on a remote database accessed using the same magnetic-stripe card and card acceptance device infrastructure as debit and credit cards. After the value loaded to a card account has been spent, the cardholder can add value by depositing cash or other money instruments at a branch office of the issuer, an ATM operated by the issuer, or another authorized location.

Several money transfer schemes have been developed based on open, universal prepaid cards. This builds on the growing customer acceptance of prepaid cards that are used with cellular telephones in many countries. One prevalent use of prepaid cards is to facilitate the transfer of funds by migrant workers to their home countries. The bank or nonbank service provider issues one card for the sender and one for the recipient, who can use the card to withdraw cash from an ATM or to make purchases wherever the card is accepted. Access to a broad network of affiliated ATMs and merchants is an essential part of this service—and it is a challenge in many developing countries. An example of such a program is Citibank's Money Card, limited to transfers between the United States and Mexico. Money Card charges US$7.95 per wire transfer, plus a US$5 monthly maintenance fee (Orozco 2003a).

Table 4: Credit, debit, and prepaid cards: a comparison

	Customer	Benefits	Challenges
Credit Cards	Payment and credit insruments	Convenience: cardholders can arrange their spending independent of the availability of cash in their wallets or bank accounts.	Potential cardholders need to have reasonably stable incomes. Not accessible for many low-income clients. The MFI offering this service must have membership in a bank card association or create an alliance with a bank.

	Customer	Benefits	Challenges
Debit Cards	Main purpose is access to an account classified as a liability on the books of the card issuer.	Vital role in providing access to banking services. Useful for international (or national) remittances.	Low density of ATMs in developing countries. The MFI offering this service must have membership in a bank card association or create an alliance with a bank.
Prepaid Cards	Look and work like debit cards, but no transaction account is involved. A prefunded value stored on a remote database.	Convenience: Universal prepaid card can be used at any location that accepts credit or debit cards; a prepaid card program involves much less counterparty credit risk than a credit card program.	Low density of ATMs in developing countries. The MFI typically must ally with a card issuer to launch and maintain this service.

Electronic Payments and Transfers

EFTs use computers and telecommunications to transfer money between accounts in the same or different institutions. Most EFT schemes directly or indirectly involve a financial institution in initiation, clearing, or settlement of transfers.[29] Such transfers are mainly used for low- to medium-value payments. These transfers provide a reasonably timely, reliable method of ensuring money is received by beneficiaries. The range of EFT products and services is extensive and constantly growing as participants find new ways to apply technology in the process. However, because EFTs typically require both sender and receiver to have a bank account, such transfers remain beyond the reach of many lower income clients. Types of EFTs are summarized below.

[29] To date, a majority of cell phone banking programs are linked to banks. However, given the growth in banking using cell phone platforms, a few money transfer programs are being piloted by mobile phone operators without a link to a bank.

Intrabank account money transfers occur between accounts held at the same institution. Such transfers allow people to move money from one account to another to make the best use of available funds, for example to make loan payments, pay on a credit card balance, shift funds from term deposits to checking accounts, etc. Another example is a cross-account transfer that moves funds between two different clients' accounts. Some banks allow for intrabank transfers to designated noncustomers or named beneficiaries; they hold the funds until the beneficiaries claim them in person at the bank. If the bank has international branches, it may provide for international fund transfers on an account-to-account basis.

Account transfers are initiated by the account holder or set up on a recurring basis. The origination may be in person or by ATM, telephone, or Internet. Some large banks offer account-based money transfers to recipients with accounts at overseas branches or partner banks. Financial institutions charge little or nothing for account-to-account transfers. For example, Bank of America now offers free intrabank account transfers between the United States and Mexico.

Direct debits are a type of ETF in which the payer authorizes the payee to debit the payer's account for a specific amount. This instrument is mainly used for consumer bills—both for frequent, recurring payments of fixed amounts, such as life insurance premiums, and for variable amounts, such as telephone, utility, credit card, and other bills. Direct debits are widely used for bill payments in Europe, and much less so in the United States and many developing countries. The costs of direct debits are usually borne by the payee. Direct debiting requires a bank account from which automatic debits are preauthorized by the account holder.

Wire transfers are the fastest, safest way to send money domestically or internationally through the banking system. Banks and credit unions offer a variety of EFT systems for use in retail interbank transfers, ranging from corporate systems for high-value transfers to specialized offerings for worker remittances.

Wire transfers usually require both the sender and receiver to have bank accounts. Even though a wire transfer may be received within minutes of its transmission, it may take two to three days (or longer, especially among small banks in developing countries) for the beneficiary to receive the funds. Many of the costs in wire transfers are fixed costs independent of the value of the transfer; thus, small-value transfers may appear expensive. The costs of wire transfers are borne by the beneficiary, the remitter, or both and vary by bank and whether the transfer is sent domestically or internationally.

Automated clearinghouse (**ACH**) and **large-value funds transfer system** (**LVTS**) allow member financial institutions to exchange payment instructions and settle obligations electronically. ACH is a batch-process settlement system, where transactions are typically settled overnight, which incurs lower costs than a real-time gross settlement system. LVTS is a settlement system typically used by large corporations, currency dealers, and others for the immediate and real-time transfer of funds. Examples of LVTSs include the U.S. FEDWIRE, U.K. CHAPS, Turkey EFT, and the Eurozone TARGET. In many but not all cases, the transfer involves an immediate debit and credit to the sending and receiving banks' clearing accounts at the central bank. Other transfers settle on a queuing basis or with a net settlement. ACHs play a critical role in payments and money transfers in both developed and developing countries. ACHs can move payments from an originating institution to a receiving institution reliably and at low cost. They serve as the primary means of distributing wages, paying bills, funding prepaid cards, and conducting person-to-person payments. ACHs also play a role in the settlement of payments between participants in EFT networks as well as between agents and MTCs. An ACH may be owned and operated by the central bank, bank associations, commercial interests, or a combination of these.

All developed and many developing countries have at least one ACH. Some ACHs operate only on an interbank basis, with direct participation limited to licensed deposit-taking institutions, while others allow for broader participation by all types of financial institutions. An MFI may not have direct access to the clearinghouse and may be required to pass through another financial institution to process transactions.

At the international level, the most commonly used system for facilitating EFTs is operated by the **Society for Worldwide Inter-bank Financial Telecommunication** (**SWIFT**), an industry-owned cooperative that provides real-time payment messaging services to member institutions. Messages routed over SWIFT are simply instructions to transfer funds; the actual exchange or settlement of the funds takes place subsequently through a payment system or correspondent banking relationships. SWIFT is often the cheapest option for high-value commercial transactions between financial institutions, but it can be expensive for small transfers. For this reason, most payments processed by SWIFT are not individual person-to-person transfers, but larger payments between businesses or between businesses and consumers, such as university tuition. Banks may bundle and send a batch of person-to-person transfers via SWIFT (Isern, Deshpande, and van Doorn 2005).

SWIFT is not really a money transfer system as popularly thought but a interbank messaging system that carries payment orders from an originating SWIFT member bank through the SWIFT network to a receiving SWIFT member bank. The actual transfer of funds follows a different path through the correspondent bank accounts the various banks involved in the transfer hold with each other.

Like most bank technology, wire transfers are undergoing rapid changes as more institutions take advantage of the increasing security available to protect financial transactions over the Internet and as traditional high-value networks (such as SWIFT) broaden their services to include domestic retail payments and lower value transactions.

MFIs and other nonbank institutions may not have access to wire transfer networks. Although some credit unions have direct access to such systems or access through a national federation, most nonbank institutions are restricted by law from becoming part of a domestic payment system. The institution's technical capacity can represent another hurdle to accessing payment networks. The cost, information technology, and staff capacity required to connect with EFT systems can be significant. Although financial service providers can often link to EFT systems through alliances with banks, the resulting transaction entails a certain loss of competitive privacy, because the intermediary bank necessarily obtains information about the institution's money transfer business. The cost of joining SWIFT is a major obstacle for smaller institutions. In addition to buying shares, SWIFT members pay a one-time membership fee of several thousand euros, plus a yearly fee of over €1,000 per routing code. The number of codes an institution buys usually depends on the number of its branches or divisions that are linked to SWIFT.

Giro is the term used for the electronic cross-border payments offered by post offices in more than 40 countries. This system enables holders of a postal bank account to send money—domestically or overseas—to another postal account, a bank account, or a post office for cash payment. It generally takes two to four days to receive a giro transfer. The international service is often used by small entrepreneurs for import and export payments. Although sending a giro requires a postal bank account, these banks tend to have more widespread locations than commercial banks. Postal giros tend to be cheaper than bank transfers for small amounts. Barriers to access for poor clients, therefore, tend to be lower than for checks or commercial bank transfers. To cite a regional example, postal networks in North Africa provide account-based giro services that are highly popular with students and low- and middle-income groups who find it difficult to open checking accounts at commercial banks (Boon and Greathouse, forthcoming).

Internet funds transfers are growing rapidly with the increasing popularity of **e-commerce** and considerable innovations in retail payments. Internet funds transfer systems can be used to enter instructions into a Web site to initiate the movement of funds from account to account. In most of the schemes to date, the Internet serves primarily as a channel of communication between the payer and payee, with the remainder of the payment process carried out using traditional debit and credit cards or EFT mechanisms. Many of these methods use security mechanisms that address the issues of privacy and risk inherent in the use of public networks, such as encryption, digital signatures, public key infrastructure, etc. Internet-based transfers require two prerequisites that may block lower income people from using the service: (a) access to the Internet and (b) access to an account to send or receive funds.

Mobile payments involve the use of a mobile communication device, such as a mobile phone, personal digital assistant, wireless tablet, or mobile computer. First launched in 1983, mobile phone use has grown to more than 3 billion subscribers worldwide—a number expected to grow to 4 billion by 2010 (GSM Association 2007). In many developing countries, wireless networks have become the primary means of voice and data communication. The use of mobile telephones in applications involving the transmission of money between parties is growing rapidly (see Box 24).

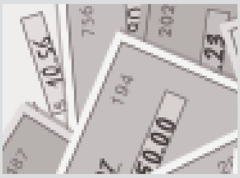
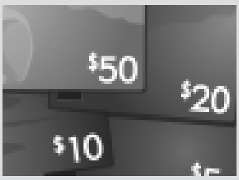
Box 24: G-Cash in the Philippines

Globe Telecom, the largest cell phone company in the Philippines, recently launched a phone-based remittance service called G-Cash that allows Filipinos working abroad to send money home more quickly and at a lower cost than through MTCs. The potential market is huge: 8 million Filipinos working abroad sent US$7.6 billion home in 2005, and about 30 percent of the country's 84 million people use cell phones.

Mobile phone subscribers register for G-Cash by keying in personal information, including their mother's maiden name, for identification purposes. Within the Philippines, cash can be credited to the phone account by visiting an authorized outlet, filling in a form, and presenting identification. The fee for this is 1 percent of the transferred amount, or a minimum of 10 pesos (US$0.20). The money can be transferred to another phone by keying in the sender's PIN, a simple code, and the recipient's phone number. The cost is the same as sending a text message, 1 peso (US$0.02). The recipient receives a text message confirming the transfer and then withdraws the cash by visiting any authorized G-Cash agent. Outlets include Globe Telecom centers; selected retailers, such as 7-Eleven; and pawnshops.

Globe Telecom is creating a network of overseas outlets where migrants can deposit cash. At present, coverage is provided in Hong Kong, Italy, Singapore, Taiwan, and the United Kingdom. The worker abroad goes to any of the phone company's remittance partners in 17 countries and pays to preload the phone. He or she then sends a text message, advising the recipient in the Philippines of the transfer. The money is instantly credited to the recipient's account with the phone company and to a "smart" debit card that enables the recipient to withdrawal the money at ATMs around the country, using a PIN to guard against fraud. Sending a payment from the United Kingdom costs £7 (US$13). The service offers an innovative, low-cost means of making cash-to-cash transfers. Neither party is required to have a bank account (G-cash presentation 2005).

Table 5: Summary: Advantages and disadvantages of money transfer mechanisms for customers and financial service partners[30]

	Customer	Financial Service Providers (FSPs)	Restrictions to Access by FSPs
Paper-based payments and transfers 	Slow; subject to loss/theft; must be physically delivered; require bank accounts to send (not necessarily to receive)	Incur relatively high processing costs	Depends on local regulation; access often limited to regulated financial institutions only
Card-based payments and transfers 	Fast, easy to use; debit cards require bank account; client must apply for card in advance; developing countries have fewer cardholders and acceptance places, such as ATMs and retail points.	Prepaid cards have fewer restrictions and may be logical first step for clients without bank accounts or institutions that cannot issue debit or credit cards.	Debit and credit cards usually require membership in a bank card association and/or access to the payments system
EFT 	Faster than paper-based instruments; usually requires bank accounts to send and receive[31]; cheaper than MTC transfers	Lower labor costs than checks, but requires link to network and infrastructure; fees lower than for MTC transfers	Can be accessed by many FSPs through financial institutions with which they conduct business
Giro 	Requires a postal account for sending, but generally cheaper and more accessible than bank-based EFTs	Requires a postal account for sending, but generally cheaper and more accessible than bank-based EFTs	Requires a postal account for sending, but generally cheaper and more accessible than bank-based EFTs

[30] Adapted from Isern, Deshpande, and van Doorn 2005.
[31] As noted, some mobile phone operators are piloting money transfer products without linking to banks. In these cases, a bank account is not required. However, a majority of current mobile phone banking operations are linked to bank accounts.

Annex 2: Formality of Financial Channels

A **financial channel** is any means by which money is transferred. Channels range from formal to semiformal to informal. Customers typically select their financial service provider based on perceptions of trust, convenience, service quality, and price. However, people without access to bank accounts typically cannot use formal channels.

FORMAL FINANCIAL CHANNELS

A country's formal financial channels are comprised of institutions that participate in some type of financial intermediation under the supervision of designated financial authorities, such as a central bank. Formal financial channels include commercial banks, saving banks, credit unions, development banks, agricultural banks, and regulated MFIs. The main driver behind the use of formal financial channels is their ability to meet the range of financial service needs of households and small enterprises: to save, borrow, make timely payments, and insure against the risk of loss. However, formal channels have their limitations. Many formal transfer channels serve limited regions within a country, such as only urban areas and larger towns. A sender may prefer the security of a particular formal provider, but the destination country may not have adequate coverage of locations for the recipient to conveniently collect the money.

SEMIFORMAL FINANCIAL CHANNELS

Semiformal or nonbank financial institutions provide many financial services, such as loans and money transfers, but they are not licensed to gather deposits. Most of these institutions are not supervised by the same authorities, and they may operate under different laws and regulations than banks and other formal institutions. A semiformal provider may have a large global agent network with an outlet near the recipient but charge a higher fee for the service, especially in countries where there is little competition.

This sector includes finance companies, some post offices, MTCs, unlicensed MFIs, retailers, and telecommunications companies. Many credit-only MFIs qualify as a semiformal financial channel.

The range of organizations and the scope of services offered by semiformal financial service firms are extensive and growing rapidly. Some specialize in specific services, lending to particular groups of borrowers, or offer specialized financial arrangements, such as leasing, securitized lending, and financial derivative operations. Some operate at the wholesale level, providing payment services to other financial services and merchants. Others are involved in the production of financial services, such as money transfers, that are offered to consumers directly or indirectly through alliances. Much of the growth in semiformal institutions has been driven by new technologies and deregulation of financial services in many countries.

Nonbank financial service firms are increasingly leveraging electronic distribution channels, information technology, and innovative marketing to offer payment services that function in a manner similar to those offered by licensed deposit-taking banks. In some cases, they employ shadow or suspense accounts to temporarily hold money until it is needed to affect a transfer. In many countries, the money held in these accounts is coming under scrutiny as to whether it should be considered as e-money or even a bank account. Through these accounts, clients without conventional bank accounts still can receive money, pay bills, and transfer money through nonbank institutions. Consumers expect the same value, safety, soundness, and protection from nonbanks as from more established financial institutions. Whether they are covered under the same consumer protection measures that apply to bank deposits is still a question in many countries.

While MTCs are dominant players in the industry, the volume of domestic and international payments through other types of nonbank institutions is small but growing.

INFORMAL CHANNELS

Where financial instruments or institutions are not widely available, people find other ways to fulfill their financial service needs. Informal funds transfer systems vary tremendously in structure and complexity.[32] Carrying cash by hand, usually by migrants themselves or by family and friends, is the most basic system, and it is especially common in situations of seasonal or circular migration, where migrants frequently return to their place of origin (Fagen and Bump, forthcoming). In some countries, the physical transfer of cash is also done by couriers

[32] For descriptions of particular systems, see Kabbucho, Sander, and Mukwana 2003; Jaramillo 2004; Mellyn 2003; and Genesis Analytics 2003.

(internationally) or by bus companies and taxi drivers (nationally or sometimes regionally). Other systems involve only the virtual movement of funds.

Use of informal channels may offer intangible benefits that a more formal system cannot. For example, senders who are undocumented workers may fear the use of formal systems, and so the anonymity provided by the use of some informal channels is a compelling feature.

Sophisticated informal systems exist under different names around the world, including hundi (South Asia), fei-chen (China), hui kwan (Hong Kong), padala (Philippines), phei kwan (Thailand), and hawala (Middle East).[33] Many of these systems, such as those common in African mineral-exporting countries like Angola, evolved as mechanisms for trade financing and net funds transfers against the movement of goods (Barro and Sander, n.d.).

Box 25: Hawalas: A sophisticated, informal channel

The hawala system used in the greater Middle East is representative of how informal channels work. Typically, a migrant makes a payment to an agent (hawaladar) in the country where he works and lives, and the hawaladar gives him a code to authenticate the transaction. The hawaladar requests his counterpart at the receiving end to make the payment to a beneficiary upon submission of the code. After the transfer, hawaladars settle accounts through payment in cash or in goods and services. They are remunerated by senders through a fee or an exchange rate spread. Hawaladars often use fluctuations in demand for different currencies, which enables them to offer customers better rates than those offered by banks (most of which will conduct transactions only at authorized rates of exchange). Because many hawaladars also are involved in businesses where money transfers are necessary, such as commodity trading, remittance services fit well into their existing activities. Remittances and business transfers are processed through the same bank accounts, and few, if any, additional operational costs are incurred (Jost and Sandhu 2000).

Afghanistan does not have a functional financial sector. More than 20 years of conflict has completely disrupted the domestic and international payments systems. In this vacuum, a large and vibrant informal market has developed. Hawaladars offer a well-organized, convenient,

[33] For more information on the hawala system, see El Qorchi 2002.

and cost-effective way to make domestic and international payments. The hawala system is estimated to have channeled at least US$200 million in emergency, relief, and development funding. Large transactions of more than US$500,000 are common, and international aid institutions and NGOs have made individual transactions equaling twice that amount (Maimbo 2003).

Experts estimate the total value of money transfers made through informal channels is somewhere between 40 and 100 percent of the volume of global formal transfers.[34] Recent studies estimate, for example, that over half of the money transfers from France to Mali and Senegal are made via informal channels, as are 85 percent of total transfers made to Sudan. Informal money transfer systems in Asia and the Middle East may manage two-and-a-half times the value of transfers processed by formal systems in these regions (Bezard 2003).

Such evidence indicates that informal systems are competing successfully with even the largest players in the formal money transfers market. In large part, their popularity is because of certain client-friendly features. Regardless of the actual mechanism used, informal transfer systems are usually fast and discreet and involve a minimum of paperwork. They are generally less expensive than formal transfer mechanisms, which are subject to regulation and taxation, and they are often available in areas where no formal sector providers exist. From a client perspective, informal systems may seem more familiar and trusted than formal services, despite the risk of possible theft. For clients who lack identity or residence documentation, informal systems may be easier to use in the short term. Given the benefits of formal systems and government concerns about informal systems, many are working to help clients move from informal to formal service providers. Nonetheless, the client-friendly features could serve as a model for financial service providers when designing appropriate money transfer products (Isern, Deshpande, and van Doorn 2005).

[34] Ratha and Bezard both estimate the size of the informal market to be approximately 40 percent of the formal market, but some private industry actors interviewed by the authors estimate it to be as large as the formal market.

Annex 3: Summary: General Principles for International Remittance Service

***Consultative Report*, March 2006 by the World Bank and Bank for International Settlements** [35]

This report provides an analysis of payment system issues related to remittances, and it sets out general principles designed to assist countries that want to improve their market for remittance services. The report was prepared for the Committee on Payment and Settlement Systems (CPSS) and the World Bank by a task force consisting of representatives from international financial institutions involved in remittances as well as representatives from central banks in both remittance-sending and remittance-receiving countries.

The task force defined the following public policy objectives for the provision of international remittance services[36]: International remittance services should be safe and efficient. To this end, the markets for the services should be contestable, transparent, accessible, and sound. In order to achieve the public policy objectives, the task force has identified principles covering five key areas: (1) transparency and consumer protection; (2) payment system infrastructure; (3) the legal and regulatory environment; (4) market structure and competition; and (5) governance and risk management. The five principles correspond to the five areas of possible market weaknesses. Their purpose is to help remove those weaknesses in order to create a safe and efficient market. They do not aim to set specific service-level standards for remittance transfers since, beyond a certain basic level of service and in normal circumstances, low price may be more important than a high level of service for most end users. The general principles are aimed at all remittance services except those based on purely physical transfers of cash.

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[35] The report presents a consultation document circulated in March 2006 that can be found at http://www.bis.org/publ/cpss76.pdf

[36] The report considers only international remittance transfers and international remittance services, not domestic ones. For simplicity it usually refers to these as "remittance transfers" and "remittance services"— i.e., it is assumed they are international. For the purposes of the report, remittance transfers are defined as *cross-border person-to-person payments of relatively low value.*

THE GENERAL PRINCIPLES

General Principle 1. The market for remittance services should be transparent and have adequate consumer protection.

In any market, full information is important, because it enables individuals to make informed decisions about which services to use, and it helps to make the market as a whole more efficient. Transparency in the market for remittances is particularly important because the price to the consumer depends on two elements: the exchange rate used and any fees charged; and combining these to calculate which service is cheapest is difficult for most consumers. Transparency and adequate consumer protection are important because, as low-income migrants in a foreign country, many senders may have difficulties understanding the local language or providing adequate identification to open a bank account, or they may lack the time and financial literacy to search out and compare different remittance services.

Remittance service providers should be encouraged to provide relevant information about their own services in easily accessible and understandable forms. Authorities or other organizations may want to provide comparative price information. They may also wish to undertake educational campaigns to give senders and receivers sufficient background knowledge to be able to understand the information being provided.

General Principle 2. Improvements to payment system infrastructure that have the potential to increase the efficiency of remittance services should be encouraged.

The infrastructure needed to support remittance services is sometimes inadequate. Many services require remittance service providers to cooperate in order to create a network of access points. It may not always be easy for potential remittance service providers to identify suitable partners, particularly in other countries. Moreover, under-development of the domestic financial infrastructure, particularly in receiving countries, may mean that transferring funds to the access points is slow and unreliable; in some cases, non-cash payment services may only be available in urban locations. Another important aspect of the infrastructure is correspondent banking, which is widely used for cross-border transfers of funds but which can be expensive for small-value payments such as remittances. The safety and efficiency of remittance services can be affected by payment systems in the relevant markets and the way that these systems are accessed and used by remittance service providers or by banks acting on their behalf. Remittance services may be improved by initiatives aimed at facilitating greater interoperability of systems and straight-through processing.

General Principle 3. Remittance services should be supported by a sound, predictable, non-discriminatory, and proportionate legal and regulatory framework in relevant jurisdictions.
The remittance industry is likely to flourish best under appropriate laws and regulations. Remittances may be regulated for various reasons including the prevention of their misuse for purposes such as money laundering. However, as with all laws and regulations, there is the possibility that those for remittances are badly designed with unintended side effects, that they are disproportionate to the problem they are designed to tackle, or that they continue to be applied even when no longer useful. Moreover, regulating remittances solely by type of entity, as is sometimes the case (e.g., when the regulations are applied only to the services provided by licensed institutions such as banks), may make regulation less effective (by creating loopholes that can be exploited for illegal activities) and distort markets (by enabling some remittance service providers to inappropriately avoid the costs of regulation and thus offer artificially cheaper services). National regulations should aim to create a level playing field between equivalent remittance services.

General Principle 4. Competitive market conditions, including appropriate access to domestic payments infrastructures, should be fostered in the remittance industry.
The efficiency of remittance services depends on there being a competitive business environment. Competition can be assisted by various steps such as discouraging exclusivity conditions, where a remittance service provider allows its agents or others to offer its remittance service only on condition that they do not offer any other competing service. It is important that remittance service providers without direct access to the domestic payments infrastructure should be able to use, on an equitable basis, the payment services provided by institutions that do have direct access.

General Principle 5. Remittance services should be supported by appropriate governance and risk management practices.

The relatively small values involved in remittance transfers mean that it is unlikely that there will be systemic risk involved. However, remittance service providers face financial, legal, operational, fraud, and reputation risks. Governance and risk-management practices can improve the safety and soundness of international remittance services and help protect consumers. These practices should be appropriate to the size and type of a remittance service provider's business and the level of risks.

* * *

Although these principles are designed to be generally applicable, some countries may decide that the size of their particular remittance market does not justify significant action. In addition, the principles are likely to be applied at one end of the transaction irrespective of application at the other end. Nevertheless, authorities may want to prioritize their efforts on the most important bilateral corridors.

Annex 4: Taking Stock Checklist

ENVIRONMENT
Country
What is the socioeconomic profile of your country (or region of countries)?
Analyze both the sending country/region and the receiving country/region. If you are performing domestic money transfers, then the sending and receiving regions may both be your region.
What is the level of migration? Are migrants dispersed broadly, or do they tend to concentrate in a few countries (or regions within a country)?
Several economic factors affect a client's demand for services, and they include GDP, inflation rates, employment levels, average household income, savings rates, etc. What are the relevant economic factors for both the sending and receiving clients?
Payment System and Regulatory Context
What is the structure of the payment system? Who has access to the payments system?
What laws and regulations are relevant for money transfers—international and/or domestic?
Does your institution need to be registered or request a license to make money transfers? If so, what are the qualifications, and does your institution meet those criteria? What is the cost of registering or applying for a license?
Will there be additional reporting costs associated with transfers?
If you will serve only as a payout agent, what are the responsibilities of your institution in complying with national regulations and laws (customer contracts, reporting, consumer protection, anti-money laundering and combating the financing of terrorism [AML/CFT] measures, etc.)? What are the potential compliance costs?
Some money transfer operators require their partners to sign exclusive agreements. Is this legal in your country? Do antitrust rules apply?
Are there regulations associated with the use of trademarks, logos, or other brand requirements?

Market
Who are your current clients?
What is your clients' socioeconomic profile: income, assets, literacy, occupation, age, gender, etc.?
What financial services do your clients use? What is the frequency, average loan (and/or savings) balance, etc.?
Are they already using money transfer services? If so, are they international or domestic?
—How many clients send transfers, and what is the average frequency and amount per month?
—How many clients receive transfers, and what is the average frequency and amount per month?
Who are your potential clients?
Do people (nonclients) within your institution's geographic area already have access to financial services?
What is their socioeconomic profile: income, assets, literacy, occupation, age, gender, etc.?
Do they send or receive money transfers—both international and domestic?
How many people send transfers, and what is the average frequency and amount per month?
How many people receive transfers, and what is the average frequency and amount per month?
Are these potential clients already customers of another institution? If so, what services do they use? If not, are they using informal financial services? What makes those informal services attractive?
What are the trends on domestic and international money transfers?
Consider the following types of money transfers: international remittances, national urban to rural remittances, bill payments, salary payments, pension, or social payments.
Over the past 3–5 years, what is the overall value and number of money transfers?
What is the average per transaction?
Who are your competitors?
Which institutions are currently involved in money transfers—international and/or domestic? Consider both formal money transfers and informal money transfers.

What are their services?
—What are their prices, speed, and methods of delivery? How would you (or their current clients) rate their services?
—Do they have international or national alliances?
—Do they have linked services, such as savings, loans, or other financial services,
Transfer Patterns
Where do money flows originate, and where and when are they delivered?
Do sending clients work or live in concentrated areas, or do they participate in hometown or community associations?
How often do your clients typically send or receive transfers?
How large are these transfers?
What is the likelihood that migration patterns might be disrupted or changed by political or natural events?
How have transfer patterns evolved over time? And what are the effects of long-term changes in the volume or frequency of transactions?
INTERNAL ASSESSMENT Institution
How is your institution's overall financial and operational performance? Is the institution stable or shrinking operations? Is it in steady, managed growth? Is it growing rapidly and straining its systems?
What impact would transfers have on the institution as a whole?
Will your institution be perceived as creditworthy by potential partners?
HR
Who is available and knowledgeable about money transfers?
Who could lead the money transfers operations? Who should be involved in designing the money transfers services—which departments and geographic areas?
What training or additional experience is needed?
Capacity
Does your institution have the capacity to manage increased cash flow from money transfers?
Could liquidity be a problem for the institution? What additional measures are needed to ensure adequate cash management and physical security of locations?

If considering international transfers, does your institution have access to foreign exchange?
As an agent, will your institution be involved in the settlement process?
Systems
Are your institution's accounting practices adequate? Can the institution accurately report financial statements at regular, reliable periods?
Is the accounting, portfolio management, and client information managed with a manual system? Automated? Can the system be easily changed to incorporate money transfers? Software?
Are communication and management information systems adequate to manage money transfers—international or domestic?
Will serving transfers clients require changing the institution's branches, cashier stations, or other infrastructure (e.g., access to ATMs, internet, phone, mobile offices, etc)? If so, what will it cost?
Money Management
What is your institution's capacity to manage transfers effectively (number of transactions, volume of clients to serve, value of payments to distribute)? Can the scale of the service be expanded?
How will money transfers affect your institution's revenue? Does your institution have the ability to project potential revenue from money transfer services?
Will your institution need to cross-sell other products to transfer clients to achieve its goals? If so, what is reasonable demand for other services? How would this affect existing operations?
Risk Management
What are the business risks and key risk mitigation measures associated with money transfers? How do these differ from those for existing services (loans, deposits, other)?
Does your institution have sufficient risk management controls in place to undertake a new business model?
Marketing
Are current services well known in the target market? Is your institution trusted and credible in the target market?

How skilled is your institution in developing new marketing campaigns?
If it will offer international transfers, is your institution prepared to market to clients in sending countries?
What unique aspect does your institution offer that will allow it to capture volume from existing players and/or serve a niche that is not currently served?

Annex 5: Selecting a Partner: Quick Reference

What an MTC Looks for in a Partner
Multiple locations in the country, especially in areas not already covered by other payment agents
Branch offices in urban and rural areas
ATMs
Fixed and mobile points of service
Well-established branch infrastructure
Good communications with the institution's headquarters
Use of a call center
Good reputation in the country or region, especially good customer service
Local knowledge of the country or region, including political, socioeconomic, and regulatory context
Existing large client base
Demonstrated financial performance with audited financial statements
Experienced, friendly, and knowledgeable staff
Secure, fully licensed operations (including cash management) that are compliant with national laws and regulations
Experience with money transfers and the ability to add money transfers clients, especially to increase the volume of transactions

What an MFI Should Know about an MTC as a Potential Partner
What is the MTC's network of offices in the sending country or region? How does the MTC's network (locations) relate to your target market?
Does the MTC offer other services (call center, travel agency, employment services, retail products, etc.)?
How many partners does the MTC already have in your country or region? Consider all partners including banks, MFIs, retail shops, postal offices, and others. How would the MTC split money transfers among the other partners and with your institution?
How many branches and other points of service are already linked to the MTC in the sending location?
What is the cost of sending a transfer with the MTC (as a percentage of the amount sent)? Include any foreign exchange transaction and all fees on both the sending and receiving side of the transaction.
What will the MTC pay to the MFI in commissions, fees, etc.? What are other revenues, such as float on money in transit?
For each transfer, how long will it take for the MTC to settle the transaction and send you the funds and revenue earned? How frequently is this paid (monthly, weekly, etc.)? Does the MTC have any insurance or other guarantees to cover any potential risk of loss of settlement for the MFI?
What is the potential for cross-selling other products with the MTC's existing client base?
Does the MTC fit with your mission or does its practices/pricing take advantage of the people you are trying to help?
Does the MTC provide any training for the MFI to launch or improve money transfer services?
Does the MTC provide assistance with information technology? For example, does the MTC provide complimentary software and hardware for processing remittance transactions?
Is the MTC properly licensed and regulated in the sending country (or countries) and, as relevant, in the receiving country (or countries)?
Who is responsible for marketing on both the sending and receiving side of the transaction? How extensive are the MTC's marketing efforts? Does the MTC provide any marketing materials or assistance to the MFI to adapt marketing messages to the local country context?

Who is responsible for AML/CFT compliance and other regulatory and legal compliance? Who will report to the central bank or other regulatory agency?
Who will manage the payment settlement, including any foreign exchange transaction? What is the MTC's relationship with banks in both the sending and receiving location?
What is the financial condition of the MTC? (This information is vital to know because you will extend credit to the MTC until the MTC makes settlement. Analyst reports may be available on the Internet or from rating agencies.)
Does the MTC have any significant customer complaints reported to public centers (e.g., business bureaus), pending court cases, or past or pending compliance violations?

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DFID, Sending Money Home, http://www.sendmoneyhome.org/

Fonkoze, http://www.fonkoze.org

IAD, http://www.thedialogue.org/programs/policy/trade/remittances/default.asp

IADB, Multilateral Investment Fund program on remittances: http://www.iadb.org/mif/v2/remittances.html

IFAD, http://www.ifad.org/events/remittances/index.htm

IRNet of WOCCU, http://www.woccu.org/prod_serv/irnet/index.php

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Making Money Transfers Work for Microfinance Institutions: A Technical Guide to Developing and Delivering Money Transfers is available for download from the CGAP Web site (http://www.cgap.org/) publications page.

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Acknowledgments

Jennifer Isern (CGAP) led the development of this technical guide on money transfers. The authors are Isern, William Donges, and Jeremy Smith. Jasmina Glisovic-Mezieres (CGAP) provided useful research assistance. The technical guide was edited by Chris Jarzombek and Paul Holtz.

Launched in October 2005, the advisory group for this initiative advised on the initial concept and reviewed annotated outlines of the manual. Advisory Group members included Vanessa Vizcarra Bianchi (MFIC), Massimo Cirasino (World Bank), Anna Cora Evans (WOCCU), José Antonio Garcia Luna (World Bank), Dave Grace (WOCCU), Gautam Ivatury (CGAP), Tom Jahnes (Western Union), Tim Lyman (CGAP), Manuel Orozco (Inter-American Dialogue), Doug Pearce (DFID), Valsa Shah (DFID), and Gregory Watson (Inter-American Development Bank).

Isern, Grace, and Glisovic-Mezieres designed the CGAP e-conference on money transfers in March 2006. Grace facilitated this five-day conference,which addressed operational issues for MFIs offering money transfer services. The e-conference was co-sponsored by CGAP, the World Council of Credit Unions (WOCCU), the International Fund for Agricultural Development (IFAD), and the Inter-American Development Bank (IADB)/Multilateral Investment Fund (MIF).

A draft of this document was released in December 2006 for public comment. Maria Jaramillo (ACCION), Grace (WOCCU), Anne Hastings (Fonkozé/Haiti), Antonio Garcia Luna (World Bank), Massimo Cirasino (World Bank), Vizcarra Bianchi (MFIC), and Ignacio Mas (CGAP) provided detailed comments to the technical guide. In addition, the authors are grateful for helpful comments and contributions of text boxes from Alex Berthauud (AMUCSS/Mexico), Peter Van Roosmalen (Inclusion Group), Phyllis Mbungu (SMEP/Kenya), Randy Gutierrez (Alianza International), Julio Vega (Foreign Ministry of Peru), Ben Knoll (Grupo Express), Arun Kashyap (UNDP), Tom Jahnes (Western Union), and Martin Alsop (DFID).

Foreword

The Consultative Group to Assist the Poor (CGAP) produced *Making Money Transfers Work for Microfinance Institutions* to help financial service providers determine whether offering money transfer services is in their interests. And if so, to help them determine what strategy, products, and institutional structure are needed to support a successful money transfer operation.

CGAP welcomes comments or questions on this publication (mailing address: 1818 H Street N.W., Washington, DC 20433, USA; fax 202-522-3744).

Elizabeth Littlefield
Chief Executive Officer
Consultative Group to Assist the Poor

Executive Summary

Money transfers, including international remittances, are a growing global market. In 2006, formally recorded international remittances exceeded US$300 billion. And it is believed that informal remittances (those that are untracked or that go through nonlicensed institutions) may be as high as an additional $150 billion.

Because of the growing market and potential for profit, companies of all types are entering the money transfer market. Given the necessary infrastructure, this includes not only formal banking institutions, but also telecoms, software and hardware companies, and governments that recognize the need for regulation as well as an opportunity to extend public services.

Likewise, this market presents a unique opportunity for MFIs to grow and extend not only their business, but also their mission. MFIs that already serve low-income clients are well placed to expand their services; many MFIs are located in areas where few others offer money transfers. If designed well, money transfers can be a valuable financial service for clients, and they can bring additional revenue for the MFI.

However, a poorly designed or poorly implemented transfer service can overwhelm the MFI with problems and can become unprofitable. An MFI should not simply decide to offer a transfer product, it must first understand the mechanics of transfers (such as how funds move from sender to settler to receiver) and the environment in which it hopes to offer the product.

The money transfer market is complicated. It is constantly changing and growing as new players enter. The MFI must undergo critical self-examination to determine whether it is ready to handle the impact of the new service. Offering money transfers requires significant development in all areas of business, including human resources, internal systems, customer service, marketing, regulation, and risk management. Indeed, providing a money transfer service can radically alter the way an MFI operates.

Partnering with a more established money transfer company (MTC) is often the best course of action, because a partnership can offer the MFI a tested blueprint and help dealing with obstacles. But partnerships come with their own risks, and no relationship is guaranteed to be successful.

Despite significant challenges, MFIs of all shapes and sizes have entered the market and created a multifaceted environment. From one-on-one relationships to large consortia, MFIs have found numerous ways to leverage weaknesses into strengths. From banking by phone to virtual banks, MFIs are offering new and more creative products and services all the time. Well-informed MFIs that have entered the money transfer business thoughtfully have discovered that the risks are worth the rewards, both to their bottom line and to the lives of their clients.

This Guide

The purpose of this Technical Guide is to help financial service providers determine what strategy, products, and institutional structure are needed to support a successful money transfer operation.

Although the money transfers market offers tantalizing opportunities for financial service providers, the risks can be high. The purpose of *Making Money Transfers Work for Microfinance Institutions* is to help financial service providers determine whether offering money transfer services is in their interests. And if so, to help them determine what strategy, products, and institutional structure are needed to support a successful money transfer operation.

This guide is primarily written for use by financial service providers, such as MFIs and other institutions that serve low-income clients. MFIs are defined as financial cooperatives, nongovernmental organizations (NGOs), specialized financial institutions, nonbank financial institutions, savings and postal banks, and others. The guide seeks to help senior managers and directors launch new money transfer services or improve existing ones. However, policy makers, regulators, funders, and others involved in the money transfers market may also benefit from this guide.

This guide is organized into five chapters, with the first half of the guide being informative (*what is the money transfer business?*) and the second half being directive (*starting a money transfer business*).

"Chapter 1: Opportunities in the Money Transfer Market" provides an overview of the market, with particular emphasis on recent trends in financial remittances.

Formal money transfers involve a complex process from sender to receiver. **"Chapter 2: How Money Transfers Work"** explains the process in detail.

MFIs can choose from a variety of business models. **"Chapter 3: Business Models for Money Transfers"** describes the basic business models for MFIs involved in money transfers and examines their advantages and disadvantages.

Beginning a successful money transfer business involves rethinking current practices or creating new ones. **"Chapter 4: Developing a Money Transfer Business"** provides a guideline for setting strategic goals, a process for evaluating the MFI's preparedness for entering the market, and an outline for developing an appropriate infrastructure.

Alliances that allow MFIs to offer money transfer services may be the best approach for new market entrants. The customer base, location, and existing distribution infrastructure of MFIs can make them attractive partners for international money transfer operators. The international operator's network, foreign exchange access, and risk management expertise can, in turn, reduce both the cost and risk of an MFI's market entry. "**Chapter 5: Negotiating Partnerships**" provides explicit instructions on crafting favorable alliances.

These chapters are supplemented with material on the concepts discussed in this guide. "**Annex 1: The Building Blocks of Retail Money Transfers: Payment Services and Instruments**" serves as a primer on money transfers. Readers who are unfamiliar with money transfers are strongly encouraged to review Annex 1 before reading the main chapters, because it provides definitions and background on terminology used in this guide. "**Annex 2: Formality of Financial Channels**" offers a comparison, along with examples, of formal, semi-formal, and informal financial channels. "**Annex 3: Summary: General Principles for International Remittance**" provides guidelines for creating better markets for financial remittances developed by the World Bank and the Bank for International Settlements Committee on Payments and Settlement Systems. "**Annex 4: Taking Stock Checklist**" is a tool MFIs can use to evaluate their strengths and weaknesses before entering the money transfer market. Similarly, "**Annex 5: Selecting a Partner: Quick Reference Guide**" provides a simple checklist of information to consider when evaluating a partner.

The field of money transfers is broad and changing rapidly.

While this guide strives for completeness, the field of money transfers is broad and rapidly evolving. Each MFI should compare the information presented herein with the realities of its own markets.

1

Opportunities in the Money Transfer Market

Financial service providers that cater to the poor have been drawn to the money transfer market because it offers them the opportunity to fulfill their financial goals and their social objectives. As a fee-based product, money transfers can generate revenues and bolster the bottom line. Because microfinance institutions (MFIs) often serve low-income clients and clients in underserved geographic areas, money transfers help MFIs meet their social goals by delivering an additional service demanded by low-income customers—often at a cost lower than that of mainstream providers (Isern, Deshpande, and van Doorn 2005).

Banking access rates are still quite low globally and lowest in Africa, where only one in five people has access to a bank account. In a recent survey of Latin America, only one-third of money transfer recipients use a bank account (Orozco 2006). Given such low levels of bank use among money transfers clients and MFI penetration into unbanked markets, MFIs are uniquely situated to capitalize on the market for money transfers.

THE MONEY TRANSFER MARKET

The money transfer market offers the opportunity to fulfill financial goals as well as social objectives.

The money transfer industry comprises a vast array of players for both international and domestic payments. In 2001, worldwide cross-border payments exceeded US$330 trillion; this is projected to grow to $604 trillion by 2011. As of 2001, domestic payments worldwide were estimated at $1,447 trillion. They are expected to increase to $2,417 trillion by 2011 (Boston Consulting Group 2003). The flows of international transfers from migrants, or international remittances, historically have been uncounted and even ignored in official statistics. In 2006, officially recorded statistics from central banks estimated that international migrant remittances reached $206 billion. However, it is widely recognized that the actual flows might be undercounted by 50 percent. A 2007 independent study by the multidonor Financing Facility for Remittances (FFR)[1] estimates that in 2006 the overall international remittance flows (both formal and informal) to developing countries reached $300 billion, suggesting more than 1.5 billion transactions of $100, $200, or $300 at a time. By all accounts, available data indicate a very large market.

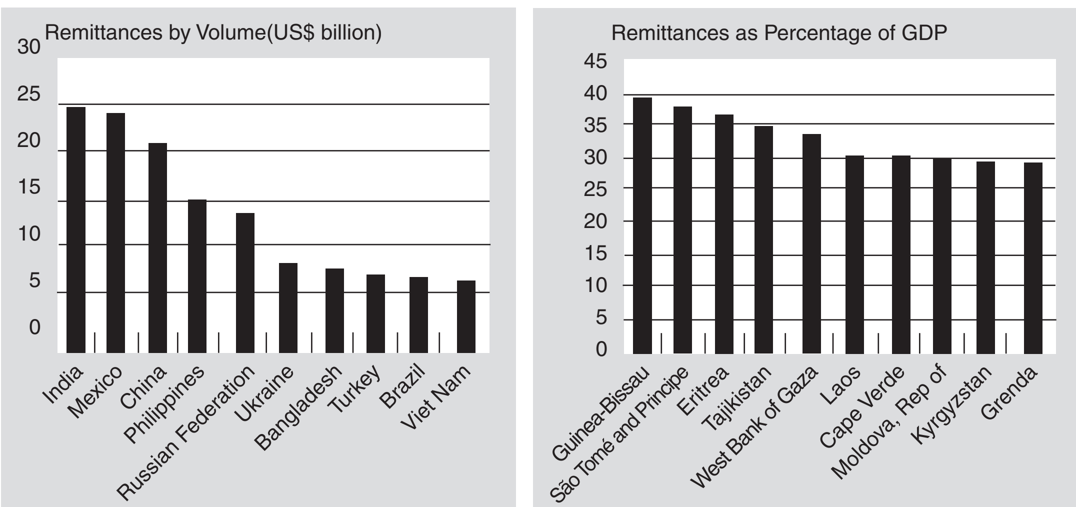
[1] FFR is a multidonor fund composed of the International Fund for Agricultural Development, CGAP, the European Union, the MIF of the Inter-American Development Bank, UNCDF, the Government of Spain, and the Government of Luxembourg. FFR is housed at IFAD headquarters in Rome. For more information, see http://www.ifad.org/events/remittances/index.htm.

Remittances constitute one of the largest sources of external funding for developing countries, in most cases dwarfing the amount of official development assistance (ODA). Figures for 2006 show that international remittances to Africa totaled US$38 billion, the equivalent of all foreign direct investment (FDI) to Africa. Remittances were the equivalent of 80 percent of all FDI flows to developing countries in Eastern Europe. Likewise, remittances were a significant portion of GDP for Asia ($114 billion), LAC ($68 billion), and the developing economies of the Near East ($28 billion).[2]

Money transfers are attracting increasing attention from the private sector, governments, and development agencies.

Such staggering global volumes, remittances, and other types of money transfers are attracting increasing attention from the private sector, governments, and development agencies. The money transfers market includes all types of customers, including individuals, businesses, and governments. For both international and domestic money transfers, clients from all levels of society use a variety of services, including formal, highly regulated channels and informal, unregulated ones (Isern, Deshpande, and van Doorn 2005). Money transfers are used by people for many purposes: from everyday bill payment, to one-time-only money needs, to delivering money from people in more-developed countries to families back home (**remittances**).

Figure 1: Large countries receive more remittances in raw volume, but small countries receive the most in remittances with respect to their GDP.*



*Adapted from Funding Facility for Remittances 2007.

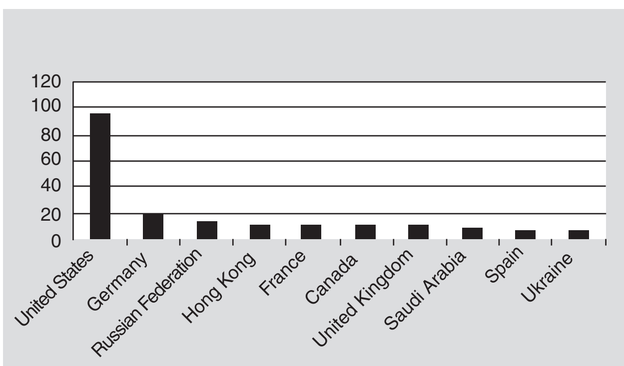
[2] OECD estimates US$103.9 billion in aid in 2006 from the world's major donors to developing countries worldwide (OECD 2006).

Among money transfer products, international remittances have received the most attention. The top three recipients of international remittances in 2006 were India (US$24,504 million), Mexico ($24,354 million), and China ($21,075 million). But smaller countries top the list when comparing remittances to national GDP: Guinea-Bissau (48.7% of GDP), Sao Tome and Principe (39%), Eritrea (37.9%), and Tajikistan (36.7%). Based on new data developed by FFR, a majority of countries in most developing regions show annual remittance inflows of more than $1 billion: Asia and Oceania (17 countries), LAC (13 countries), Europe (12 countries), and the Near East (9 countries). A further 18 African countries received more than $500 million in formally documented international remittances (Funding Facility for Remittances 2007).

Wealthy countries and economies in transition are the main source of remittances to developing countries, as seen in Figure 2. The United States is by far the largest source, with approximately US$95 billion in outward flows, followed by Germany and the Russian Federation. It is conventionally believed that migration flows are from south to north and that remittance flows are from north to south. However, south-south migration is actually estimated to be *at least* as large as south-north migration, and south-south remittances account for 30 to 45 percent of the remittances received in the south (Ratha 2005). Further, migration within countries, especially from rural to urban areas, is growing globally. As one example, approximately 100 million people were recorded officially as domestic labor migrants in China in 2005 (Cheng and Xu 2005).

South-south remittances account for 30 to 40 percent of the remittances received in the South.

Figure 2: Rich countries are the largest sources of remittance to developing countries in dollar terms*



*Adapted from Funding Facility for Remittances 2007.

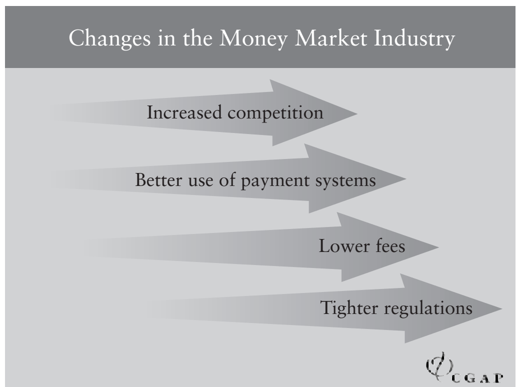
Remittances benefit low-income people directly—and on demand.

International remittances are qualitatively different from other sources of development finance. They are both relatively stable and countercyclical in nature, because migrants tend to remit more during periods of economic downturn in their home countries. Because remittances represent private money sent person to person, they benefit low-income people directly—and on demand. International MTCs have long dominated the global market, but smaller regional and national providers are beginning to explore the market potential (Isern, Deshpande, and van Doorn 2005).

While international remittances and other transfers represent a sizeable market, the potential for money transfers is even broader when domestic money transfers are considered. In many countries, domestic money transfers are growing rapidly as more countries develop national electronic payment infrastructure. For most MFIs, offering domestic money transfers represents a significant opportunity that may have fewer hurdles than international transfers (Isern, Deshpande, and van Doorn 2005).

The money transfers industry is changing rapidly.

Some of the most important changes over the past five years include the following:



- **Increased competition** among formally licensed MTCs as new firms have entered the international, regional, and national markets.
- **Better use of existing payment instruments,** such as card, phone, and Internet-based payments.
- **Lower fees** for money transfers as a result of increased competition. For example, in Latin America, the cost of sending US$200 internationally is estimated to have dropped from over 15 percent to less than 5.6 percent from 2001 to 2005 (Orozco 2006).[3] Other international and national markets are also beginning to see price reductions, and this has implications for MFIs that seek to enter the market.

[3] The actual price decrease varies considerably and depends on the number of MTCs and the level of competition in both the sending and receiving countries.

- **Tighter regulations** from national and international authorities on anti-money laundering and combating the financing of terrorism (AML/CFT). In many countries, MFIs are excluded from making currency operations and cannot access the payment system. However, some countries are starting to open their payment systems to larger, regulated MFIs.

The money transfer market offers tantalizing opportunities for MFIs to attract new clients, increase existing client loyalty, and earn additional revenue. However, MFIs must proceed with caution in evaluating the potential for money transfers. They should learn from the experience of institutions that have already launched them.

The money transfer market offers tantalizing opportunities for MFIs to attract new clients, increase existing client loyalty, and earn additional revenue.

Forming an alliance with a proven MTC may be the best approach for MFIs just entering the market, especially for international money transfers. MFIs' customer base, location, and existing distribution infrastructure can make them attractive partners for MTCs. In return, the international payment networks, foreign exchange access, and risk management expertise of MTCs can reduce both the cost and risk of MFIs' entry into the market.

The domestic money transfers market is a prime market for MFIs. The industry is just starting to grapple with more reliable information on international money transfers, but very little information is available on domestic transfers. Nonetheless, it is clear that the volume of domestic money transfers, including person-to-person remittances, is multiple times larger. Institutions with nationwide coverage are well placed to offer domestic transfers. While many of the same challenges apply, domestic transfers can be considerably easier to launch and manage than international transfers.

2

How Money Transfers Work

By ensuring each step of the value chain is efficient and effective, the MFI can generate superior value for the client and overall success with its money transfer product.

PAYMENT INSTRUMENTS

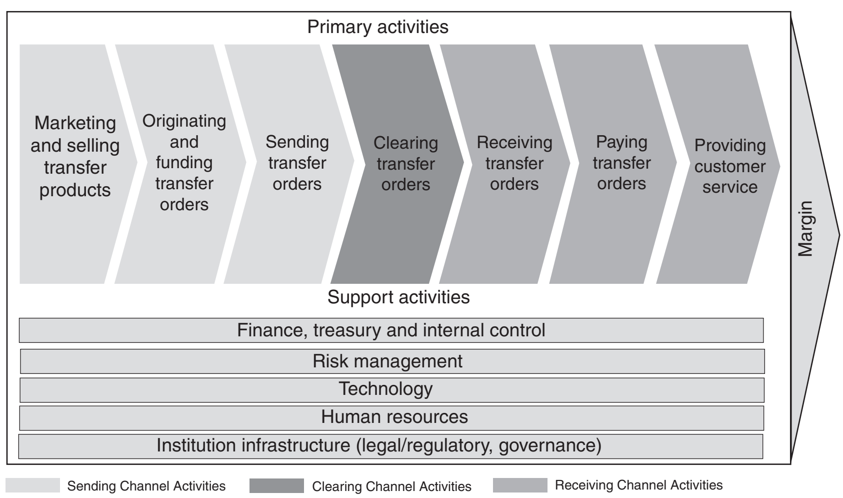
Fund transfers and instruments take many forms. Transfers may be formal and use an established banking channel, or they can be informal and use a hawaladar. Funds may be transferred using a low-tech paper medium or a high-tech electronic one that requires an extensive network of settlement centers and clearing houses. This chapter examines the money transfer process as it relates to formal, more sophisticated channels. It provides an overview of each stage of the process to give MFIs a better understanding of the mechanics behind money transfer products.

See "Annex 1: The Building Blocks of Retail Money Transfers" for more detail on payment instruments.

MONEY TRANSFER VALUE CHAIN

Each step in a money transfer transaction comes together in a value chain, as shown in Figure 3. By ensuring that each step of the value chain is efficient and effective, MFIs can generate superior value for clients and overall success with their money transfer product. While MFIs may not have full control over each step in the value chain—especially if they develop a business alliance with an MTC—it is nevertheless important for MFIs to understand the full process involved in money transfers.

Figure 3: Value chain for the money transfer business



Marketing and Selling Transfers Products

Marketing is instrumental for introducing the new services to clients.

Marketing is especially challenging for money transfers because both the sending and receiving client need to be considered.[4] One of the most promising strategies available to MFIs is marketing that is targeted at specific client segments (e.g., ethnic communities for remittances, salaried workers for regular monthly payments, parents with children for school fees, etc.).

In markets where there are many transfer options available, marketing information can be confusing for clients, and the information provided is often superficial. Successful institutions identify their product advantage (speed, convenience, price, etc.) and highlight these features in their marketing. In environments with few transfer services, marketing is instrumental for introducing the new service to clients. In all cases, continuous targeted marketing is the key to attracting clients.

Many recipient institutions overlook the crucial role that send-side marketing plays in generating transfers. One of the chief ways leading MTCs maintain their dominant market share is through well-funded media campaigns. MFIs that partner with such companies will benefit from their marketing efforts. MFIs that choose other options, however, must compensate for the lack of an established marketing machine (Isern, Deshpande, and van Doorn 2005).

Box 1: Send-side marketing by Fonkoze in Haiti

Send-side marketing is crucial to the success of money transfer services in recipient countries, but it can be easily overlooked. The Haitian MFI Fonkoze learned this lesson when it launched its own, low-cost money transfer service in cooperation with a commercial bank in the United States. Although it negotiated attractive terms with the bank and generated a break-even transaction volume, the new transfer product did not produce sufficient profits to invest in improving the service.

Consequently, Fonkoze formulated a send-side marketing campaign targeted at the Haitian community living in the United States. At first, Fonkoze planned to produce public service announcements, purchase targeted radio

[4] For more background on marketing, the Microsave initiative is an excellent resource (http://www.microsave.org). Additional guidance on marketing can be found on the Microfinance Gateway (http://www.microfinancegateway.org).

and print advertisements, and conduct radio interviews in U.S. cities with large Haitian populations. However, the MFI quickly realized that this type of expensive marketing was better at producing market awareness than at changing client behavior. Because Fonkoze's original money transfer service worked quite differently than a typical MTC (a customer mails a check to the U.S. bank partner of Fonkoze, which then sends the funds to the Haitian MFI), it needed a marketing campaign that could convince potential clients to do things differently, rather than simply change service providers.

The MFI also needed to overcome the image of unreliability that small institutions offering low-cost services often suffer from among many Haitians abroad. The result was an innovative campaign of "family days" at Fonkoze branches in Haiti, during which the institution rented out cyber cafés and gave customers a free five-minute phone call to the United States. Fonkoze also gave nonclients free phone calls, provided they took the money they would have spent on a call and opened an account with the MFI. Using this technique, the first event generated 100 new accounts in a single day. The MFI controlled costs by not paying for individual calls, but by purchasing them in bulk at a deep discount by paying the cyber café's daily rate. During the calls, grateful clients almost invariably mentioned Fonkoze to their relatives, producing a referral from a trusted source—the best kind of publicity the institution could generate.

The institution must attract a high volume of money transfers to break even and eventually generate profits.

The calls also produced a targeted list of clients who already send money to Fonkoze clients regularly, representing an ideal market for its money transfer service. The MFI concluded that this focused strategy yielded better customer conversion rates than the expensive, untargeted media placements used in the past.

Source: Anne Hastings (Fonkoze director), November 2007; Isern, Deshpande, and van Doorn 2005.

To support growth, an MFI must build a broad, active customer base—and to do that, it must offer customers a valued product. At the retail level, money transfers are usually a lower value transaction, especially for the typical customer base of an MFI. As a result, the institution must attract a high volume of money transfers to break even and eventually generate profits. For example, Anelik RU Co., Ltd., in Russia experienced rapid growth in its money transfer business from 400,000 transactions and US$155 million in payment volume in 2001 to over 1.8 million transactions and $830 million in payment volume in 2005 (Veronina 2006).

If an MFI is allied with a money transfers firm, especially as a payout agent, it may not have much control over the volume of money transfers. However, if the MFI is able to attract clients who send transfers, either domestically or internationally, the MFI must have a good process in place to originate and initiate transfers.

Originating and Funding

Selecting the Transfer Mechanism

The originating institution decides on the best transfer mechanism, depending on the client's preferences and the institution's available options and its contract with the client. Typically the following criteria affect the choice of transfer mechanism:

- Is it a cash-to-cash transfer, account-to-account transfer, or a mix of cash and account?
- Is it one time or recurring (monthly, quarterly)?
- Is it urgent (requiring same-day availability of funds to the recipient)?
- Is it high value or low value?
- Is it local or long distance?
- Is it domestic or international?
- How accessible is the transfer channel to the sender and recipient?
- How much will it cost the two parties?
- What risks are involved?

Funding the Money Transfer

Money transfer transactions must be funded before their execution. Clients typically use cash, check, card, or transfer of funds from an account in their name. In addition to the value of the transfer, clients must pay for the cost of making the transfer. Typically, sending clients pay the full cost of the transfer, although there may be other fees (formal or not) that receiving clients pay. Often, there is little transparency in pricing across money transfer channels, making it difficult for senders to compare options before making a decision.

There is little transparency in pricing across money transfer channels, and MFIs should aim for greater transparency with their clients.

For example, some services convert the transaction in U.S. dollars, regardless of where they operate, and thereby generate foreign exchange revenue for receiving as well as paying out—causing a double foreign exchange cost for clients. The currency may be determined by a national currency exchange control. MFIs should be aware of relevant regulations and currency restrictions.

Cost factors for clients include direct costs and indirect fees. **Direct costs** encompass the following:

- Minimum fees
- Sender or recipient fees
- Authorization fees
- Commissions
- Currency exchange fees

Indirect costs include the following:

- Getting to and from the point of service
- A phone call to tell the recipient of the transaction
- Low or unfavorable foreign exchange rates often used by banks and MTCs
- Maintaining a minimum balance or account

Originating the Transfer

The transaction is originated with the sending client.

Once the channel has been chosen and the transfer is funded, the next step is the origination of the payment or transfer order. Currently, origination may be done in the office of the sending institution.This is the most common method for retail money transfers. The transaction is originated with a form, either manual or digital, completed by the client, usually with the assistance of a sales agent. The agent then initiates the transfer using the institution's established procedures, which vary by institution size and complexity. If an MFI is working with another institution, such as a bank or MTC, the MFI may have little flexibility in procedures to originate the transfer.

While this is currently the most common method for origination, technology is changing rapidly, and as new forms of money transfers emerge, origination methods will also likely change.

Sending, Clearing, and Settlement of Transfer Orders

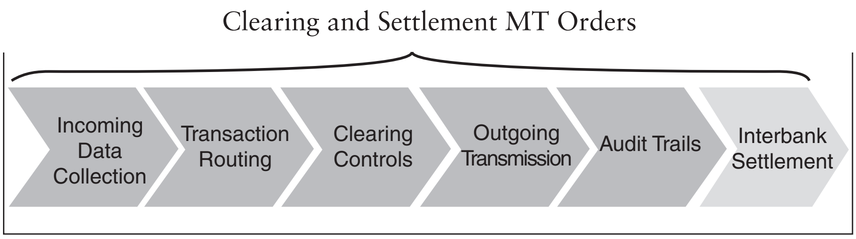
The way the transfer moves between the sender and recipient is determined by the payment instrument and the transfer mechanism.

Clearing is a critical part of the money transfer value chain. In countries with centralized banking systems dominated by a few institutions, many transfer senders and recipients hold accounts with the same institution, making interbank operations unnecessary. But it is far more common for senders and recipients to deal with different institutions, which requires interbank clearing and settlement.

Clearing is the process of transmitting, reconciling, and in some cases, confirming transfer transactions before their final settlement (see Figure 4). During clearing, the sending and receiving financial institutions exchange information about the payment, and the amount of funds to be settled by those institutions is calculated. The outcome is a fully processed payment transaction between sender and recipient as well as a valid financial claim by the receiving institution to receive funds from the sending institution.

Clearing is the process of transmitting, reconciling, and in some cases, confirming transfer transactions before their final settlement.

Figure 4: Clearing and settlement of money transfers



Settlement is the process of discharging the claims of the institutions involved in a transfer. This involves a payment from the sending institution to the receiving institution. The steps include collecting and checking the integrity of the claims to be settled, ensuring the availability of funds for settlement, settling the claims between the two institutions, recording the settlement, and communicating the final settlement.

Many of the activities in the clearing process are not transparent to users, because they happen behind the scenes. Nevertheless, the importance of understanding the clearing and settlement process cannot be overstated—regardless of an institution's direct involvement in the process. Problems arising at the transaction originators or receivers, or within the clearing process, can result in significant operating losses. A routine ACH transaction in the United States costs less than $0.01 to process, but isolating and correcting even a minor error in a transaction can cost more than $30.[5] A small error

[5] Source: Bill Donges, based on various sources. Pheonix Hecht, the U.S. bank price research firm, reports the average price of an ACH origination is US$0.12 and includes originator and originating institution transaction costs, plus the originator's margin. Also, various Federal Reserve Bank studies have shown that ACH processing costs are between $0.01 and $0.02. Costs in other countries will vary considerably depending on context.

during origination of many small transactions, for example, can create a larger discrepancy and place all stakeholders at risk. Thus it is vital that MFIs understand the clearing process even if they are not direct participants.

Four types of institutional arrangements are used to clear payment instructions:

- **On-us clearing arrangements** where the accounts to be debited or credited are held by the same financial institution. Accordingly, the exchange of information and calculation of balances in the clearing process are performed by the same institution.
- **Bilateral clearing arrangements** where two financial institutions maintain agreements about the exchange of information and transfer of funds between accounts.
- **Third-party clearing arrangements** where financial institutions employ a common third party (a separate financial institution known as a **correspondent**) for clearing, with one or more institutions forwarding payment instructions to the correspondent for sorting and processing.
- **Multilateral clearing arrangements** where financial institutions exchange information and, in some cases, funds with other financial institutions through organizations, such as clearinghouses, that operate central clearing facilities and may also act as a central counterparty in the settlement of payment obligations under a multilateral netting arrangement.

Multilateral arrangements offer more efficient coordination of the exchange of payment instructions among multiple institutions as well as greater economies of scale in operating communication networks and providing processing services. The number of clearing transactions and financial institutions involved are the main factors determining the effectiveness of the various types of clearing arrangements.

Receiving a Money Transfer Order

Getting money into the hands of recipients is one of the most important phases in money transfers.

Getting money into the hands of recipients is one of the most important phases in money transfers. While senders may have a variety of choices among money transfer systems, many domestic and international transfers flow into less-developed areas with limited options for receiving funds.

For international remittances, an MFI's main role, at least initially, will most likely be on the receiving end. For domestic transfers, the MFI may be involved on both the sending and receiving side.

The receiving channel for a money transfer depends on the type of transfer instrument and clearing system involved. These channels can be broadly categorized as physical or electronic.

Physical channels used to transport payment instructions include personal transportation and mail. Money transfer instruments that can be transmitted by physical channels include currency, checks, money orders, traveler's checks, debit cards, credit cards, and prepaid cards.

Electronic channels involve the receipt of electronic files of transfer transactions from clearing facilities, by phone, and by Internet. The receiving institution may be a commercial bank, an MFI, a savings bank, a postal bank, or other financial service provider. In most cases, these files contain only the funds transfer instructions; the actual money flows through separate settlement channels. The timing of these two flows may differ by several days to a week or more. During this interval, the receiving institution has a settlement risk, because it may pay out a transfer order before receiving credit for the funds. Given this risk, the institution must carefully reconcile incoming transactions and the settlement of those transactions.

Ideally, an institution that executes money transfers should be able to inform customers when the transfer arrives, whether as a standard or additional service. Indeed, it is good practice to contact transfer recipients, because the cost of such a message is usually less than the cost of interruptions caused when recipients contact the MFI several times to find out if a transfer was received. Such messages can be delivered by phone or by using automated calling systems, email, and text messages. When working as a payer for some MTCs, however, the institution may not receive information on the recipient client. In these cases, the institution may not know the customer until the customer walks in the door with the code to receive a money transfer.

An institution should be able to inform customers when the transfer arrives, as a standard or additional service.

Box 2: Fonkoze offers stored-value cards

Fonkoze, Haiti's largest MFI, is developing a partnership with Central National Bank and Trust Company (CNB), located in Oklahoma, and Alianza International to offer a payroll stored-value card to Haitians living in the United States and Canada. The product allows employers to directly deposit payroll compensation to the card at no charge to either the employer or employee. The card can be used like a debit card, although the employee does not need to have a bank account. Card holders can store funds on the card, make point-of-sale purchases, and withdraw funds from automated teller machines (ATMs) internationally. The cost savings to remitters will be significant: any amount up to US$2,500 can be transferred to Haiti for deposit into the client's Fonkoze account or for cash withdrawal for a flat fee of $6. Transfers can be made by calling a toll-free phone number or by accessing a Web site. In addition, card owners will be able to make low-cost phone calls. The cost savings to the unbanked of no longer having to pay fees to cash their payroll checks combined with the low cost of money transfers and telephone calls to Haiti are expected to make the card very popular in the Haitian diaspora.

CNB is the contracting party and primary prepaid card processor, while Alianza is providing CNB with program/marketing support and driving channel distribution and customer adoption. Alianza is also responsible for developing the remittance delivery network for connecting nontraditional endpoints, such as MFIs and credit unions, for remittance origination and delivery. Fonkoze is responsible for marketing the card in Haitian communities and with employers of Haitians.

Source: Anne Hastings (Fonkoze director), November 2007.

Paying a Money Transfer Order

Disbursement of funds against an authenticated money transfer can occur using local currency, foreign currency (if regulations permit), check, or credit to an account at the MFI. Funds can be disbursed at a branch of the receiving institution, by special delivery to the client's home, at a retail agent, though an ATM, or by credit to an account. The options available for paying out a money transfer depend on the MFI's branch network, systems, and business alliances. Currently, most transfers are paid through cash, foreign currency, or deposit to the account of the receiving client. MFIs must give careful attention to paying money transfer orders. The costs of establishing and maintaining the paying capability are significant and include factors such as office locations, cash management, hours of operation, staffing, ATMs, accounting, and internal controls.[6]

Effective customer service generates customer confidence, trust, loyalty, and repeat business.

Customer Service

Customer service is the final stage in the value chain of money transfer activities. Activities include answering client questions, providing information on transfer

[6] See "Chapter 4: Creating Institutional Capacity: Establishing Delivery Channels" for additional considerations.

services and other available financial services, authorizing exceptional events, maintaining accounts, and resolving problems. Effective customer service—for both senders and recipients—is crucial to the success of a money transfer program because it generates customer confidence, trust, loyalty, and repeat business.[7]

For example, Fonkoze in Haiti discovered just how difficult customer service can be. Fonkoze's management worked hard to ensure that staff would confirm payouts and problems on a regular basis to its partner MTC (Hastings forthcoming). Keeping its partner firm and clients satisfied with its service was a constant and ongoing challenge.

Consumer satisfaction levels reflect positive attitudes toward the industry on the part of remittance senders. A survey of 2,800 remitters from Latin America and the Caribbean showed that over 80 percent of consumers feel satisfied or very satisfied with their MTC (Orozco 2006).

MFIs already have a relationship with their clients; this is a strong asset in launching new products. When offering money transfers, MFIs will need to adjust their client approach. Money transfer services are a different kind of relationship: for money transfers—as with savings—MFIs must win the trust of clients, whereas for lending, clients must win the trust of the MFI.

Perceptions of service quality are affected by many factors, including the following:

- Attitude of staff when delivering services
- Hours of operation
- Convenience of location of offices and their appearance
- Average time required to deliver a transfer, which includes receiving information from the sending agent about the money transfer and waiting time for a client to pick up a payment (or have a payment delivered to his/her location, if that service is available)
- Form and manner of communication with customers
- How problems are addressed and the speed of resolution
- Whether the MFI consistently has sufficient liquidity to make payments on demand

Customer service is effective when people are dealt with promptly, honestly, and knowledgeably.

Customer service is effective when people are dealt with promptly, honestly, and knowledgeably.

[7] For more background on customer service, the Microsave initiative is an excellent resource (http://www. microsave.org). Additional guidance on customer service can be found on the Microfinance Gateway (http://www.microfinancegateway.org).

3

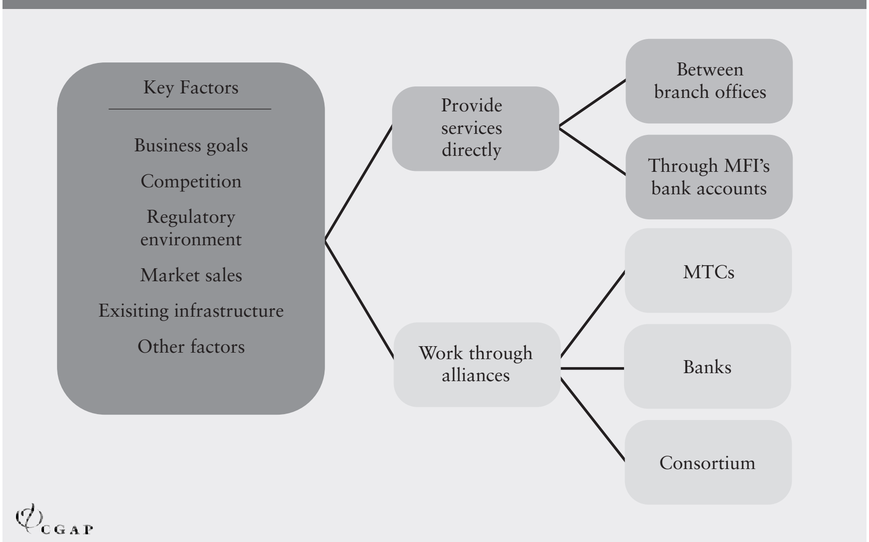
Business Models for Money Transfers

This chapter describes the basic business models for MFIs involved in money transfers.

Readers who are new to the business of money transfers are encouraged to review "Annex 1: The Building Blocks of Retail Money Transfers" for more background on the concepts discussed in this chapter.

This chapter examines models from several regions in order to capture the diverse ways MFIs offer transfer services. However, the models described here are not exhaustive. Many noteworthy experiences are not covered, and as more financial institutions—large and small—enter the industry, the field will continue to evolve.

Different MFIs, Different Approaches



An institution is not limited to one business model. Many financial institutions use a mix of business models.

MFIs may decide to provide services directly or to work through alliances with MTCs, banks, or consortia. It is important to note that an institution is not limited to one business model. Many financial institutions use a mix of business models. For example, a commercial bank might offer its own direct service while also acting as an agent for Western Union, MoneyGram, or other MTCs.

Box 3: Pursuing several models: Guatemala's Banrural

Commercial banks are important players in the Guatemalan transfers market. However, Banrural is the only bank that does not operate as an exclusive agent of an MTC. Banrural is a large commercial bank, with good negotiating clout. Banrural transfers funds through branches in the United States as well as through agreements with more than 80 money transfer operators, some of which manage a very small volume of transfers. Banrural distributes more than 150,000 transfers a month—evidence that it has developed a unique, successful model (Orozco and Hamilton 2005).

Deciding on a business model can be challenging for MFIs.

An MFI's choice of business models is usually limited by **country regulations** and market realities. In many countries, an MFI without a banking license can act only as an agent or subagent of an MTC or establish a correspondent relationship with a commercial bank or other licensed financial institution.

Options also vary depending on the market niche the MFI pursues (whether domestic transfers, international transfers, or both). For example, if the MFI will be mainly on the "receive" side of international transfers and will be making payments to clients who collect their money transfers, the MFI may want to establish an alliance with a specialized company with extensive operations on the "send" side. Alternatively, if the MFI plans to offer money transfers within the country, it may be able to operate independently.

Market structure will also affect an MFI's choice of business model. In some countries one firm—typically a large international MTC—dominates the remittance market. In Latin America for example, MoneyGram and Western Union are dominant players, with more than 35 percent of the market, but new entrants include regional or country-specific MTCs, more than 100 credit unions, and several large Latin American banks that see the large U.S. immigrant population as a growth market (Williams 2006).

Depending on the country context, specialized MTCs may be major players as they target a niche market of migrants, business people, or others with a large volume of transfers for a specific set of countries. Examples of regional or country-specific MTCs include Ria Envia, Dolex, Siguue, Vigo, Delgado, Intermex, Nexar, GroupEx, Money Express, Telepay, and hundreds of others. In other countries, such as Turkey, India, and Mali, one or more commercial banks are the market leaders. As the flow of remittances and other money transfers continues to expand rapidly, many markets are becoming more competitive, creating more opportunities for MFIs.

Deciding on a business model can be challenging for MFIs. Many lack sufficient resources to ascertain their competitive position in their local markets, so they do not have a clear sense of whether there are niches that might be filled or what added value they could offer to potential partners. Similarly, relatively few MFIs have the capacity to conduct proper due diligence on potential partners and thus might not clearly understand the costs and benefits associated with a given business model. Moreover, few have experience working with partners or working as agents. Even large MFIs can be at a disadvantage when negotiating with huge MTCs.

Many MFIs act as payment agents for MTCs.

MFIs can choose from a variety of business models. Some MFIs offer transfer services directly, using in-house systems that range from basic systems built around their core accounting package to more sophisticated systems based on specific electronic funds transfer (EFT) systems. Other MFIs partner with one or more MTCs, such as Western Union or MoneyGram. Such partnerships are far more common, and they take many forms. Many MFIs act as payment agents for MTCs, while others gain access to proprietary networks (such as SWIFT) by working with banks or other financial institutions; some do both.

These options are not mutually exclusive. An MFI could offer paper-based money orders for use in occasional domestic money transfers or bill payment; operate as an agency of one of the MTCs for simple, low-value domestic or international transfers; and establish a correspondent relationship with a bank for higher value, higher reliability international transfers. MFIs can also form alliances with similar institutions to enhance their negotiating leverage with specialized MTCs. Examples of alliances or consortia include networks of state banks and savings or postal banks, credit union federations, and other national or international microfinance networks. [8]

Box 4: Postal networks offer a variety of money transfer options

Around the globe, post offices historically have been one of the most common ways to transfer funds. They have, by far, the largest network of outlets, with more than 660,000 worldwide, and a dense presence in rural areas. There are two kinds of postal service providers: postal operators and

[8] For more information on microfinance networks, including consortia of state development banks and savings and postal institutions, see Isern and Cook 2004.

postal banks. Operators offer traditional postal services. Banks are licensed financial institutions regulated by central banks or other government agencies. Both provide money transfer services, some direct and others indirect.

Direct services offered by postal operators can be used to send cash or checks by mail or to purchase postal money orders (also sent by mail) or telegraphic money orders. Domestic transfers through postal operators vary by country. In the United States, unbanked people often use postal money orders for bill payments and other transfers. For international transfers, however, postal networks account for less than 1 percent of the global market. In some regions, especially Latin America, this decline in use is attributable to a lack of client trust in postal operators. Moreover, postal networks are competing against new technologies that have eroded their traditional business. Postal operators also operate as agents of MTCs, and more than half the world's postal networks have agreements with Western Union or MoneyGram.

The market is much larger for domestic transfers, and competition is typically less intense.

Postal banks offer a full range of financial services. But, like postal operators, they have not established a significant presence in the global money transfer market—despite similar advantages in terms of access to huge branch networks and a strong historical position in the industry.

Recognizing the weaknesses of current services, some postal banks are developing new payment products. Several have introduced debit cards linked to accounts. In South Africa, for example, Postbank introduced a Flexi Card that can be used at post office counters and bank ATMs. Others, such as Brazil's Caixa Economica Federal, offer cards linked to government payment services and a broad range of ATMs. For remittances, both domestic and international, many postal banks are looking to improve products and services by working with payment networks such as Eurogiro.

The Universal Postal Union (UPU), together with Eurogiro, has developed a new product: the TeleMoneyOrder, a two-day money transfer that can be easily traced. UPU has also introduced another electronic product, called the International Financial Network. However, these products have yet to make a significant dent in the market. According to one observer, that is because postal networks have not developed a truly strategic approach to money transfers—one that takes advantage of their competitive strengths. Recently, the

Financing Facility for Remittances initiative began a program with UPU to promote the use of post offices for remittances in West Africa.

Source: Isabelle Segni (World Bank) and Hans Boon (ING), January 2006. See also World Savings Bank Institute 2004 and Boon 2005.

DIRECT APPROACH

MFIs may offer money transfers directly, without a business alliance. Because MFIs may face fewer regulatory and licensing hurdles for domestic transfers, a direct approach is probably more feasible. In addition, the market is much larger for domestic transfers, and competition is typically less intense.[9]

Box 5: Direct payment system in the Philippines and El Salvador

Banks have direct access to payment systems and can make transfers directly within their international branch offices and through international networks, such as SWIFT. The first universal bank in the Philippines to offer international remittances, the Philippine National Bank, began offering transfers in the 1970s through its network of foreign branch offices. Several other major banks followed suit in the 1980s, including the Bank of the Philippine Islands and the Allied Banking Corporation. More recently, four Salvadoran banks—Bancomercio, Banagricola, Banco Salvadoreño, and Banco Cuscatlan—introduced direct payment systems by opening offices in U.S. cities with large Salvadoran immigrant populations, such as Los Angeles, Houston, and Washington, D.C. These banks operate in the United States as MTCs, not as fully licensed banks. Such models are relatively sophisticated, offering rapid and reliable services designed to compete with established MTCs.

MFIs may set up direct money transfer operations using several different options:

- **Transfer funds between branch offices.** The MFI moves funds between its own locations. In Pakistan, First Micro Finance Bank Limited Pakistan, a former NGO that has banking license, offers an electronic interbranch transfer service to its clients throughout Pakistan (USAID 2005).

[9] Competition for domestic transfers may be less intense from formally licensed firms, but informal money transfers may be thriving. The MFI should analyze all potential competitors. In East and Southern Africa, for example, courier services, taxis, and bus companies successfully offer money transfer services. The bus companies and taxis travel routes that have booking offices at specific stops where money is received or paid out to clients.

- **Transfer funds using the MFI's bank.** The MFI routes funds through its bank account, but it does not formally set up an alliance with its bank. In Mexico, Associacion Mexicana de Uniones de Credito del Sector Social (AMUCSS) is a network of savings-led MFIs, known locally as *microbancos,* that offers transfers using basic technology. One microbanco, Xuu Ñuu Ndavi (XNN), opened dual bank accounts in California and Mexico and offered transfer services to clients who deposited funds directly into the MFI's account. The MFI transferred funds between its two bank accounts and delivered the payment to the recipient client (Fertziger 2004).

If done on a small scale, the direct approach may be relatively quick and inexpensive to launch as a pilot.

Box 6: National Microfinance Bank of Tanzania: The dominant player in the domestic transfer market

The National Microfinance Bank of Tanzania, a recently privatized commercial bank, is the country's main provider of domestic money transfers. The bank is large, with more than 130,000 clients, a tremendous savings base (over US$370 million), and a network with 108 points of service as of September 2003. The bank offers transfers by Internet, phone, fax, and mail, with varying speeds of delivery. To transfer funds, the sender or the recipient must have an account with the bank. Instead of remittances, a major portion of the bank's domestic business involves managing payments for the government (salaries and pensions), as well as for large agribusinesses and mining companies. The bank has earned a reputation for timely, safe delivery of funds—a key element of its success.*

*Sander, Mukwana, and Millinga 2001; see also the bank's Web site (http://www.nmbtz.com), Development Alternatives Inc. (http://www.dai.com), and Tanzania Presidential Parastatal Sector Reform Commission (http://www.psrctz.com).

There are several **advantages** to offering a direct transfer service:

- The MFI **captures the entire fee**, as opposed to sharing it with one or more partners.
- The MFI may be well suited for certain **niche markets**—especially rural markets—where there may be less competition.
- If an MFI already provides financial services in rural areas, it may have **well-established relationships** and client trust that would be a useful base on which to build money transfers services. In the case of AMUCSS, for

example, some of its clients from Santa Cruz de Mixtepec (in the Mexican state of Oaxaca) migrated for work to Santa Maria, California, and AMUCSS maintained its strong client links.

A direct approach typically has relatively high maintenance costs.

- If done on a small scale, the direct approach may be relatively **quick and inexpensive** to launch as a pilot.

There are also **disadvantages** of taking a direct approach:

- Domestic and international money transfers are fundamentally businesses of scale, and there is generally a correlation between more points of service for clients and greater volume of money transfers. Absent a large infrastructure of well-placed points of service, these systems typically generate **low transaction volumes.** This is not always the case with domestic transfers, as the National Microfinance Bank of Tanzania demonstrates (see Box 6).
- While the costs of launching a direct approach may be low, it typically has relatively **high maintenance costs** (on a per transaction basis). If a service does not generate high volumes of transfers, costs associated with development and expansion may become prohibitive.
- By going it alone, the MFI is fully responsible for the **marketing campaign**. Marketing is especially complex for international remittances, where successful operations usually involve a large marketing effort in the sending country.
- The MFI has the sole responsibility of informing itself of, and complying with, relevant **regulations**, including anti-money laundering laws.

Direct Approach	
Advantages	Disadvantages
MFI captures entire fee	Low transaction volumes if small infrastructure
Well-established client base	
Less competition in niche markets	High maintenance costs
Quick and inexpensive to pilot	Responsibility for marketing
	Responsibility for compliance

Despite these risks, taking the direct approach can be simply a first step to entering the money transfers business. Several MFIs that developed their own transfer systems, like Fonkoze, have since expanded their product lines through partnerships with MTCs (see Box 7).

Box 7: Fonkoze expands remittance options

Haiti received over US$1.2 billion in remittances in 2005, comprising about one-quarter of the Haitian GDP. The country's largest MFI is Fonkoze, which has over 50,000 active borrowers and a network of 32 branches that extend into rural areas. Fonkoze began offering remittances through a system it developed with City National Bank of New Jersey. Customers could transfer funds directly to a Fonkoze account, use a money order, or mail a check. Fonkoze's remittance service cost $10 a transfer for transfers under $1,000, with a sliding scale up to $50 for transfers over $5,000, which is much lower than the global average of 10–15 percent fee. The service provides clients with more convenient payout options, better exchange rates, and more financial services than traditional MTCs. Fonkoze's product was cost-competitive, but relatively slow, and it required customers to have a fairly high level of financial literacy.

Fonkoze wanted to reach massive volume and provide its clients with more than one product. At the same time, many MTCs in Haiti were looking for ways to reach rural clients. In December 2005, Fonkoze teamed up with Rapid Transfer, a licensed money transfer agent in Haiti that works on behalf of large MTCs, including UNO Money Transfer and MoneyGram. Based on this successful partnership, today Fonkoze has been able to partner with other large companies, such as Unitransfer, CAM, and Banco BHD in the Dominican Republic.

Source: Anne Hastings (Fonkoze director), November 2007; Fonkoze 2005; and USAID 2005.

PARTNERSHIPS

Working with an established partner is the fastest way to gain market presence.

Many MFIs choose to offer money transfers through partnerships with MTCs or commercial banks.[10] Working with an established partner is the fastest way to gain a presence in the market. Well-established MTCs offer reliable products with the potential to generate a large volume of transactions. Working as an agent usually requires less management attention and fewer internal systems than creating an independent in-house money transfer service. Furthermore, MTC relationships may even become a necessity for maintaining clients as the

[10] Strictly speaking, the partnerships referred to here are contractual supplier or commercial agency relationships.

MFI's competitors begin offering convenient transfer services (Isern, Deshpande, and van Doorn 2005). A growing number of MFIs have established alliances to become an agent or subagent with MTCs, such as Western Union or MoneyGram, or have linked with payment providers, such as Eurogiro.

Part of the attraction of a partnership is simplicity. Many companies offer **turnkey packages** to their agents, providing a preset package of well-tested products, a technology platform, limited training, and marketing materials for the MFI to begin operations. Agents benefit from an established agent network and existing marketing campaigns in other countries, both of which help to generate a larger volume of transfers. Some MTCs provide training, technical assistance, or call center support to guide the MFI, especially when initially launching operations.

Some MTCs provide training, technical assistance, or call center support to the MFI.

In reality, however, few packages are truly turnkey, and the MFI usually needs to adapt to its partner's systems and operations. Often, the MFI must decide the best approach for distributing a payment through its network, integrating payment data from the MTC into its existing accounting systems, providing settlement among its branches, and marketing the product locally.

From an MFI's perspective, there are three general types of partnerships: single partnerships, multiple partnerships, and affiliations with a consortium or clearinghouse. None of these is mutually exclusive, and variations exist within each type.

Single Partnerships

Most MFIs begin with a single partner, such as a bank for domestic payments or an MTC for international payments.

A single partnership has several **advantages**:

- **Start slow.** Starting with one alliance makes sense from many angles, because each relationship may take time to research, negotiate, and implement.
- **Test the relationship.** A single partner may provide enough transfer business for the MFI to test the service before investing further. For example, large MTCs typically offer a significant, if not dominant, presence in the market—providing their agents with significant transaction volume and revenue.

A single partnership also has **disadvantages**:

- **Exclusivity.** A few prominent MTCs require exclusivity arrangements with their agents, so MFIs are legally prevented from seeking other partners. Exclusivity agreements can constrain an MFI's ability to expand market share (Orozco and Hamilton 2005).[11] Many MFIs try to negotiate away the exclusivity requirement (though this may not be possible), while others look for partners that do not require exclusive arrangements. Whether to sign a contract that requires exclusivity is an important issue for an MFI to consider; this aspect is addressed in "Chapter 5: Negotiating Partnerships."

- **Competition among agents.** As one of potentially many agents in its market, the MFI is competing with other agents based on the terms defined by its agreement with the MTC.
- **Relies on partner's strength.** The MFI is limited by the MTC's strength in certain markets, which may not be a good fit for the MFI's branch network. For example, an MFI whose clients receive remittances from Saudi Arabia and the United Arab Emirates may work with an MTC that has offices in only one of those countries.

Partnership (Single)	
Advantages	Disadvantages
Slow start	Exclusivity
Test the relationship	Competition between agents
	Relies on partner's strength

Multiple Partnerships

As they deepen their money transfer operations, some MFIs decide to pursue additional partners.

Multiple partners offer the potential for greater volume of transactions and clients, and thus profits. While most MFIs start with a single partner, as they deepen their money transfers operations, some decide to pursue additional partners. Some MFIs work with large global MTCs, medium-size regionally specific companies, small niche firms, commercial banks, and others.

Using multiple partners has several **advantages**:

- The MFI can gain **strong positions** in countries or regions that best fit its clients' needs.
- The MFI can **diversify its operations and commission income** among several MTCs in case one partner does not perform as expected, cancels the partnership, and/or de-emphasizes it by creating intense price competition among agents.
- The MFI has **better access** to the market in sending countries, rather than being limited by the market share of one partner.

[11] On the other hand, MTCs that require exclusivity suggest that the MFI may receive advantages, such as greater access to training, advertising support, and other agreement terms, from the exclusive arrangement.

- If the MFI has a strong negotiating position (large branch network, for example), it may benefit from an **increased share of fees and commissions**. For example, BancoSol in Bolivia initially offered remittances as a sub-agent of Western Union. It ended this relationship with Western Union in 2003 to work directly with small and medium-sized MTCs and with savings banks in Spain, such as La Caixa and La CECA, that have a strong presence in key markets with Bolivian migrants.

Multiple partnerships also have **disadvantages**:

- Multiple partnerships require **more management attention** from the MFI.
- Multiple systems, transfer products, and procedures **require good training** for the MFI staff to avoid confusing the transfer services and to provide good client service.
- The MFI may need to **develop its own system or develop an IT platform** to manage the flow of payments and to adapt to multiple partner systems.

Negotiating with multiple partners is typically most effective when the MFI already has experience in money transfers.

Negotiating with multiple partners is typically most effective when the MFI already has experience in money transfers and has a strong negotiating position, such as a large branch network.

Partnership (Multiple)	
Advantages	Disadvantages
Gain strong positions in countries that best fit the MFI's needs	Requires more management attention from MFI
Chance to diversify operations	Requires strong staff training
Better access to the market in sending countries	MFI may need to develop its own system or IT platform
Increased share of fees and commissions	

POTENTIAL PARTNERS

Money Transfer Companies

Privately owned **proprietary networks** are used by nonbank MTCs to provide low-value money transfers domestically and internationally for people who lack access to or do not wish to use bank transfers. Transfers are carried out through the companies' proprietary EFT networks, though some small operators rely on telephone, email, or fax. Each major MTC operates in a similar manner, with a central database linking all agents. After the sender pays the transfer amount and fee, the funds are immediately transferred. The sender then informs the recipient, usually by phone or text message.

Box 8: IRnet for credit unions

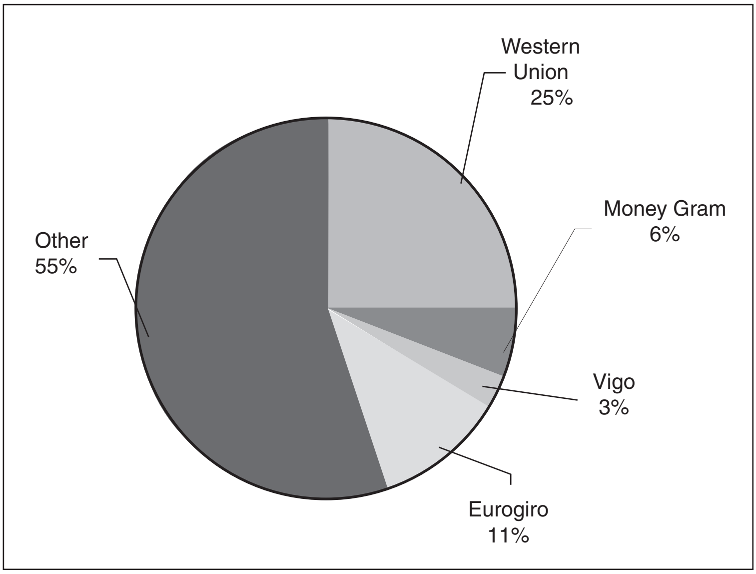
Many credit unions that offer remittances do so through an electronic platform developed by the World Council of Credit Unions (WOCCU) called the International Remittances Network (IR*net*). IR*net* provides credit unions access to the means by which they can offer remittance services. On the sending side, WOCCU has contracted with MoneyGram, Travelex, and Vigo Remittance Corporation, three well-established money transfer organizations, to serve as the transmitter of account-to-account, account-to-cash, or cash-to-cash remittances for IR*net* credit unions. A credit union that joins IR*net* can choose which money transmission services it would like to offer to its members. A choice is provided to each credit union so that remittance senders and receivers have more options for transferring and receiving funds. Remittance senders using an IR*net* credit union can send money from the United States to countries in Latin America, Asia, Africa, Europe, and Australia. IR*net* connects over 900 credit union points of service in Ecuador, Bolivia, Guatemala, Mexico, Honduras, Nicaragua, El Salvador, Jamaica, and Kenya with three vendors. Since its establishment in 1999, over US$1.3 billion has been transferred through the network.*

*World Council of Credit Unions, http://www.woccu.org/prod_serv/irnet/faq.php

Western Union, the largest MTC in the market, reported that it processed approximately 81 million transfers in 2003 (First Data Corporation 2003), which represents roughly 25 percent of the total market (Bezard 2003).

Western Union represents roughly 25 percent of market share.

Figure 5: Estimated market share of international person-to-person transfer providers, 2003*



*Adapted from Isern, Deshpande, and van Doorn 2005.

Market shares of the other major international transfer providers (see Figure 5) are estimated, using the average figure of US$300 per international transfer cited by MoneyGram (2004). These percentages are, however, indicative at best, because average transfer amounts vary widely by region. In any given country, a specialized MTC may have become a major player through targeting a niche market with a large volume of transfers.

It may be easier to negotiate with small MTCs.

MTCs provide their services through their branch offices and through extensive networks of partner banks, postal agencies, MFIs, travel agents, check cashers, change bureaus, grocery stores, convenience stores, etc. MTCs may offer several options for sending and receiving transfers:

- **Cash-to-cash.** Where the sender pays in cash at the originating outlet and the receiver is paid in cash at the receiving outlet. This is the most common form of money transmission.
- **Cash-to-account.** Where the company has partnerships with banks, postal agencies, MFIs, and other types of agencies that allow the sender to pay in cash and have the funds deposited in the recipient's bank account.
- **Internet combinations.** Some companies have Web sites where customers

can initiate a remittance, pay for the transaction with a credit card, and have the payout be received in cash at a receiving outlet.

Small Money Transfer Companies

Some MFIs choose to work with **small MTCs** focused on key countries or regions. For example, Microfinance International (MFIC) is a small company that specializes in offering money transfers through a network of MFI partners. MFIC began in 2004 as an MTC working exclusively with migrants from El Salvador through a pilot program in the Maryland, Virginia, Delaware, and Washington, D.C., in the United States.

Small companies may be eager to sign new partners to expand their network rapidly, and they may offer lower prices to clients and better terms for their agents. It may be easier to negotiate with small MTCs that do not have the massive resources or dominant positions of their larger competitors. As a result, MFIs might consider working with small MTCs as a market entry strategy, to build volume and gain experience.

Working with small MTCs requires carefully weighing costs and benefits. The main tradeoff is between price and volume. While a smaller company may provide a higher commission to its agents, it may not generate sufficient volume of money transfers to cover the MFI's investment. Further, a smaller company may not be as financially stable and could expose the MFI to greater credit and settlement risk. Location is also critical: an MFI must be certain that an MTC has locations in the sending country or region with high concentrations of migrants from regions where the MFI has a strong presence. More guidance is provided in "Chapter 5: Negotiating Partnerships."

Bank Partners

MFIs that partner with banks or other financial institutions may pursue several options. The MFI could be a **subagent** to the bank, who is the primary agent with an MTC.

The MFI could gain **access to payment networks (or card systems)**, such as SWIFT or Eurogiro, and card systems, such as Visa and Mastercard. Access is usually limited to licensed financial institutions and may have membership requirements beyond the means and capacity of most MFIs. The MFI benefits from access to the payment system without having to bear the full burden of licensing, investment, fees, and other requirements of joining the

MFIs that partner with banks benefit from access to the payment system without having to bear the full burden of licensing, investment, fees, and other requirements of joining the payment network or card system.

payment network or card system. As one example, the postal network Posta Moldova has established such a partnership with ING and Deutsche Bank to launch money transfers and develop other financial products.

Correspondent banking involves one bank providing services to another to move funds, exchange currencies, or conduct other financial transactions (see Box 9). Only MFIs with banking licenses can establish correspondent relationships. At present, correspondent banking relationships are typically more important for payment services other than international remittances. As the money transfer industry becomes increasingly competitive, however, banks and other financial institutions are using correspondent relationships to develop more competitive products.

Box 9: Cambodia's ACLEDA Bank and its correspondent banking activities

Cambodia's ACLEDA Bank has steadily expanded its payment services over the past five years. In early 2001 the bank, operating under a special banking license designed for transformed NGOs, began offering domestic money transfer services. Later that year it began offering international fund transfers as an agent of Western Union. Two years later, ACLEDA started offering domestic payment services through local correspondent banks. The final stage of its expansion occurred in 2004, when ACLEDA began offering international funds transfer through SWIFT, after receiving a full banking license in December 2003.

ACLEDA took a different approach from many MFIs. Rather than focusing on remittances, it pursued a broader strategy that provides cash management services as one of four core business areas. Cash management services include payroll services, collections, and money transfers. Clients for these services are different from those for its retail services to the general public. They include local businesses and banks, multinational firms, government, and development agencies. One reason ACLEDA has been able to pursue this strategy is its large network of 136 offices in 19 of Cambodia's 21 provinces.

The number and volume of transactions for all types of transfers have increased consistently since 2001. With US$140 million in volume, domestic transfers are far more important for ACLEDA than international transfers of $38 million in 2004. And although the bank's agreement with

SWIFT was signed more recently than its contract with Western Union, the volume of SWIFT transfers in 2004 was more than four times ($31 million vs. $7 million) that of Western Union (Sai 2005; USAID 2005).

Consortium Approach

Smaller institutions often do not have the leverage to negotiate favorable terms with larger partners. To alleviate this discrepancy, smaller financial institutions sometimes band together to form a **consortium** that becomes the primary agent of an MTC. Institutions with limited geographic coverage or IT systems find this approach especially beneficial, although consortium members typically need a minimum level of systems integration and/or a common IT platform to work together effectively.

Smaller financial institutions sometimes band together to form a consortium.

Box 10: GiroNil shared money transfer platform in Egypt

Established in 2005, GiroNil is an Egyptian–Dutch joint venture that implemented a shared money transfer platform in Egypt, where less than 10 percent of the 70 million inhabitants have a bank account. GiroNil is open to all financial institutions, including MFIs. Because of its nationwide distribution channel of bank branches and postal offices, it offers a low-cost infrastructure for bill payment and remittances.

GiroNil's current Egyptian shareholders are Banque Misr (the biggest public-sector bank), Commercial International Bank (the biggest private-sector bank), and Egypt Post (the largest distribution channel with 3,500 post offices that function as retail outlets for the banks). The Dutch shareholders are FMO (the Dutch development bank) and Inclusion Group.

GiroNil is establishing links with Eurogiro, MFIC, and other international MTCs. The next step will be to open the shared platform to facilitate mobile payments.

Inclusion Group acts as a catalyst and is managing GiroNil during the start-up phase. The group's roots are in the cost-efficient payment system of the Netherlands. It is a small, independent company focused on financial inclusion and the reduction of cash in developing countries.

Source: Peter van Roosmalen (Inclusion Group), November 2007.

The consortium usually takes a percentage of the transfer revenue.

The consortium approach has been used by several financial institution federations, including the Jamaica Cooperative Credit Union League (JCCUL), which has partnered with a local MTC to bundle four foreign MTCs into a money transfer service under its own proprietary brand. Other examples of bundling for both domestic and international transfers include Apex Bank, a network of more than 100 rural banks in Ghana; Rural Bankers Association in the Philippines; and L@ Red de la Gente in Mexico (see Box 11).

Box 11: Bansefi: A network for MFIs

Bansefi, the Mexican government's national savings bank, was created in 2001 to provide financial services to the country's vast unbanked population. In January 2003, Bansefi formed L@ Red de la Gente (the People's Network), a network that includes Bansefi and MFIs that provide remittances from the United States and other financial services.

MFIs that wish to join L@ Red pay US$1,000 to Bansefi for membership. In return, L@ Red provides its members with several advantages. Members benefit from existing agreements with multiple MTCs and government institutions. MFIs are able to provide their clients with access to remittances from a group of nine domestic and international MTCs (Fertziger 2004).*

*See also http://www.bansefi.gob.mx and http://www.lareddelagente.com.mx

Networks or consortium approaches do have their **disadvantages**:

- The MFI **depends on the consortium's ability to negotiate** terms and conditions with MTCs. Negotiations may be difficult, because member institutions must first agree amongst themselves.
- Some consortium members may receive more transfer payment volume than others. **Uneven benefits** to members may cause tension within the consortium, and terms and conditions may need to be renegotiated.
- The **consortium usually takes a percentage** of the transfer revenue.

4

Developing a Money Transfer Business

Sending money transfers across a city, country, or the world demands careful attention to ensure transfers arrive properly and can be quickly paid to the intended beneficiaries. For MFIs without experience in payment systems, the introduction of money transfers can be a considerable challenge.

Many MFIs have struggled to be profitable with money transfers. One MFI that started on its own using a direct approach offered money transfers for seven years before the service became profitable. Others have been profitable in as little as two to three months when working as an agent for an MTC in a region with a high volume of transfers. While many MFIs report significant and rapid growth in the number and volume of transfers they process, this increase does not necessarily mean greater profits for the MFI. Clearly, careful consideration should be taken before embarking on a money transfer business.

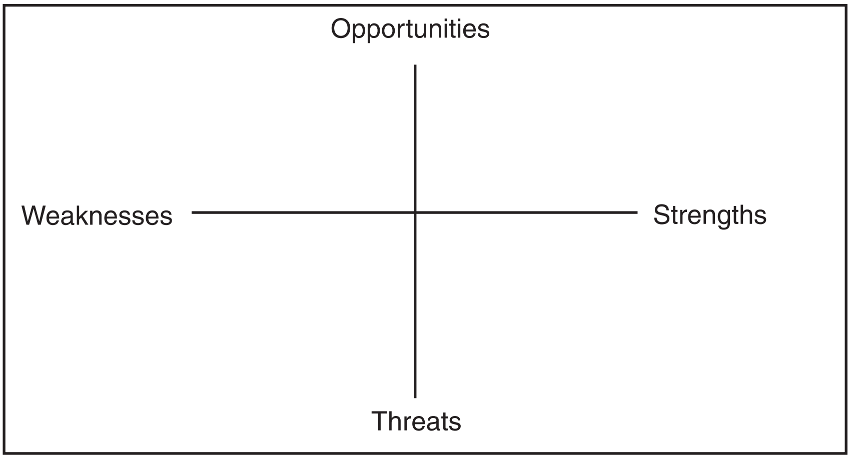
This chapter catalogs many of the challenges and risks that are the initial and ongoing concerns for MFIs in the money transfer business. It provides a survey of the kinds of questions MFIs should ask *before* embarking on a money transfer business. Considering these issues is the first—and crucial—step of entering the money transfers business. In addition to this chapter, "Annex 4 and Annex 5" provide detailed checklists for MFIs to use in their consideration.

SWOT analysis encourages management to think ahead, forces the institution to sharpen its goals and policies, and creates a fit between the institution's objectives, abilities, and market environment.

TAKING STOCK

The MFI must determine if offering money transfers is in its best interests by taking stock of the environment (the market for money transfers) and its own internal capacity. Some refer to this process as a **SWOT analysis: strengths, weaknesses, opportunities, and threats**. Analyzing both internal capacity and external realities will help MFIs systematically decide whether and how to launch money transfers. Such analysis encourages management to think ahead, forces the institution to sharpen its goals and policies, and helps create a fit among the institution's objectives, abilities, and market environment.

Figure 6: SWOT Matrix



Environment

Expansion into a new market demands careful analysis of an MFI's existing and potential customers.

The MFI should understand the business environment of its market. It should survey the broad forces—including financial markets, economic trends, legal and regulatory issues, social and demographic patterns, and technological advances—that will determine the current and future shape of the market for transfer services and its role in it.

An analysis of the environment could include examining the following:

- Socioeconomic profile of the country/countries (or region within a single country)
- Structure of the payment system and who has access to it
- Relevant laws and regulations (international and domestic) for money transfers

Expanding into a new market demands careful analysis of an MFI's existing and potential customers (both recipients and senders), markets, marketing, service delivery channels, and competition. The MFI should examine the following:

- Current clients
- Trends on domestic and international money transfers
- Competitors

The MFI should map the geographic patterns of the transfer flows of interest to it and examine where flows originate and terminate and whether sending clients work or live in concentrated areas.

If clients work or live in concentrated areas, then targeted marketing and clustered points of service are more feasible. If sending clients are dispersed, marketing will be more challenging, and the number of transactions per branch office may be lower, reducing economies of scale. If receiving clients are dispersed, the MFI must tackle the challenges of infrastructure, client outreach, cash management, and security. These factors may vary between urban and rural areas (Isern, Deshpande, and van Doorn 2005).

It is vital to understand the size and characteristics of money transfers from both international and domestic sources. MFIs should examine the following:

- Who receives and sends transfers, based on available market research
- How often their existing clients send or receive transfers
- Size of the transfers

It is important to note the difference between average and modal transfer amounts, because averages can be skewed upward by a few large transfers, while the most frequent transfer amounts may be much smaller. This information is vital for pricing and revenue projections because fees usually depend on the amount transferred.

Patterns of seasonality in remittances can influence marketing efforts, financial projections, and the design of complementary financial products. The MFI should examine the following:

- Likelihood that migration patterns might be disrupted or changed by political or natural events
- Evolution of transfer patterns over time
- Effects of long-term changes in the volume or frequency of transactions

In the case of remittances, research indicates that migrants take some time after immigration to establish regular money transfer patterns and that remittances may taper off after immigrants have spent significant time in the host country. The effect of broad labor movements on money transfers may thus not be felt for several years (Frumkin 2004). Alternatively, there are cases where people migrate specifically to work and send money home, and money transfers may begin much more quickly.

Internal Assessment

The MFI should make an objective self-assessment of its capabilities and constraints for money transfers. Internal analysis includes examining past performance, human resources, financial resources, and technological and organizational capabilities. In addition to thinking about the new money transfers service, the MFI should consider other services and operations that may be strained or affected when introducing any new services.

An internal assessment should include examining the following:

- Overall financial and operational performance (stable, growing, shrinking)
- Available human resources, and their knowledge of money transfers
- Capacity to manage the increased cash flow from money transfers
- Resilience of the MFI's systems and overall capacity for growth in transactions and number of clients
- Capacity for managing transfers effectively (number of transactions, volume of clients to serve, value of payments to distribute)
- How money transfers will affect the MFI's revenue
- Business risks and key risk mitigation measures associated with money transfers
- Marketing capacity

In addition to thinking about the new money transfer service, the MFI should consider other services and operations that may be strained or affected.

Ultimately, where an MFI positions itself in the transfer market partly depends on its current stage of development and its future goals. Smaller or younger MFIs may enter the market with limited participation in remittance services, and later—if growth is the goal—offer additional money transfers, such as domestic payments, salary transfers, etc. Larger or more well-established MFIs may decide to launch several transfer services.

SETTING STRATEGY

Once the MFI has a solid understanding of the environment and its own strengths and weaknesses, and it has determined that entering the money transfer business is in its best interests, the next step is to develop the strategy for launching money transfers.

Strategic planning should be aligned with the scale of the MFI. A comprehensive planning initiative can be a major undertaking, requiring significant managerial and financial resources. Many of the activities involved demand strong analytical skills that may not exist in every MFI and are expensive to contract from external consultants. A small MFI can engage in informal strategic planning using internal resources. A larger MFI may wish to conduct strategic and market planning more formally, perhaps with outside help.

Goal Setting

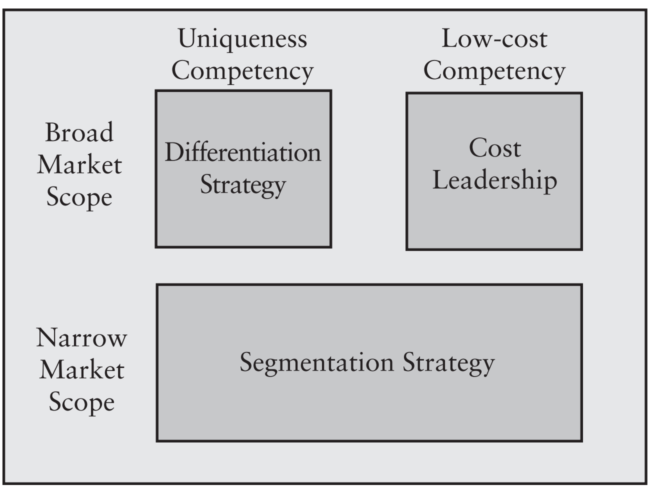
In general, MFIs aspire either to healthy financial returns from the services they deliver or to strong benefits for the low-income clients they serve, or to both. For MFIs launching money transfer services, the typical goals include generating more revenue from the service and/or using money transfers to increase their customer base. For the MFI just entering the money transfer business, it may be difficult to set realistic goals. Indeed, goals set early on may mostly be a wish list until more detailed assessments are complete. For that reason, the MFI should revisit and reassess its goals regularly—as often as quarterly—as it learns of and addresses new challenges. The MFI's goals for the money transfer business should build on those assessments and should be specific, measurable, achievable, relevant, and set with a timeframe in mind.

The MFI should revisit its goals regularly as it learns of and addresses new challenges.

Determining Competitive Advantage

The MFI's strategy should aim to achieve a competitive advantage. In this regard, classic business strategies developed by Michael Porter may be useful to consider. Porter suggested three broad categories of strategy: delivering cheaper services, offering different services than competitors, or focusing on particular customers or products (Porter 1989).

Figure 7: Porter's generic strategies*



*Adapted from Porter 1989.

An MFI can also provide more personalized service, as well as financial education geared toward the needs of low-income clients and microenterprises.

A **differentiation strategy** aims to provide a unique service not yet available in the market. Uniqueness in the money transfers industry may be difficult for an MFI to achieve against commercial banks—particularly with providing payment products, many of which require participating in clearing systems and associations open only to banks. Still, there are substitutes that an MFI could offer more conveniently, reliably, and respectfully. An MFI can also provide more personalized service and financial education geared toward the needs of low-income clients and microenterprises.

Box 12: WIZZIT: New possibilities, but also new challenges

WIZZIT is a "virtual bank"—it has no physical branches of its own. It operates as a division of the South African Bank of Athens and targets the 16 million people in South Africa (48 percent of adults) with limited financial access. Customers use their mobile phones or a debit cards to make payments, purchases, and money transfers. They can deposit money at any Absa Bank or Postbank branch, which effectively gives them more choices than any other bank. WIZZIT does not have a minimum balance or charge monthly fees; it uses a pay-as-you-go pricing model. In lieu of traditional marketing, WIZZIT has over 2,000 low-income young individuals who promote the service to other low-income people and receive a commission for new customers. Despite its flexibility and success, WIZZIT faces many challenges because potential customers are often wary of new technology and many lack even basic financial literacy (Ivatury and Pickens 2006).

A **cost leadership strategy** tries to leverage ways of obtaining a cost advantage. Most of the money transfer products an MFI can offer are subject to economies of scale where larger volumes of transactions will be increasingly more efficient for the MFI. Such a strategy may not be best for smaller MFIs, which typically have fewer customers and smaller volumes of lower value transactions; unit costs may be higher for smaller MFIs than for their competitors, such as banks and postal systems. The strategy may work better for large to medium MFIs that may be able to attract the requisite volume of transfers and clients. The competitive leadership strategy also can work when competitors are large institutions that are highly inefficient with bureaucratic procedures, inconvenient hours, and repeat visits required for simple transactions. MFIs may not be able to control the cost of a transfer payment, especially if acting as an agent for an MTC. However, an MFI may be able to achieve a cost advantage by minimizing waiting time and other expenses for customers by providing efficient procedures, extended hours, and convenient locations.

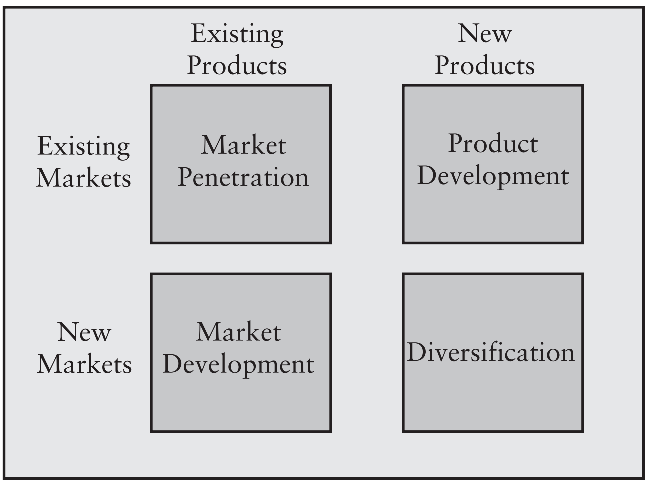
An MFI may be able to achieve a cost advantage by minimizing waiting time and other expenses for customers by providing efficient procedures, extended hours, and convenient locations.

A **focus strategy** targets a specific market segment of clients. For example, the MFI may decide to launch services with a narrowly defined target group, such as a particular geographic area or socioeconomic group, perhaps focusing on underserved clients.

The Right Product and the Right Market

Next, the MFI must determine its strategic direction for achieving growth-oriented goals. The direction an institution takes in its strategy depends on whether it markets new or existing products in new or existing markets.

Figure 8: Product-market matrix*



*Adapted from Ansoff 1957.

A **market penetration strategy** is a business-as-usual strategy, where the MFI focuses on achieving growth by selling existing products in existing markets. This can be done through more competitive pricing strategies, increased promotional activities, and more liberal terms and conditions. For example, the MFI may develop strategic alliances to begin selling an existing money transfer product in its market. The MFI can achieve growth by cross-selling more services to existing customers, creating deeper relationships, increasing retention, and attracting customers from competitors.

A **market development strategy** aims to sell existing products in new client markets. This generally involves expanding the MFI's geographic operations or approaching new customer segments. It could also encompass adding new delivery channels, such as new branches, or direct channels, such as telephone, ATMs, or mobile banking. Like the market penetration strategy, this approach may rely on alliances, correspondents, and agency relationships to broaden product offerings in new markets. Typically in a strategic alliance, revenue is shared between the MFI and its business partner.

The **product development strategy** seeks to maximize profitability by producing and distributing a variety of money transfer products in existing markets, under the MFI's own brand. This strategy may require developing new competencies and making significant changes in organizational structure, systems, and personnel.

Several MFIs have entered into money transfers with the expectation that it would be a major source of fee income only to learn that fees and commissions often just cover the cost of service.

A **diversification strategy** simultaneously markets new products in new markets. An unlicensed MFI that was becoming a licensed institution and offering a full range of deposit accounts and account-based payment instruments could be said to be embarking on a diversification strategy. The customers who will use these new products may be from the same socioeconomic group as the MFI's existing clients, but in new geographic areas. Or, the MFI may focus on a new socioeconomic client group. Combining this with a new product offering is complex and inherently risky. Under a diversification strategy, the institution is moving into markets and products where it has little or no experience, and the execution will likely require considerable management effort, human resources, financial resources, and changes to systems and institutional structure.

An MFI's motives to enter the money transfer market will determine its operational strategy. Is it increasing profits, advancing its core mission, providing a one-stop service to retain clients, or attracting new clients for other financial services? Several MFIs have entered into money transfers with the expectation that it would be a major source of fee income only to learn that fees and commissions often just cover the cost of the service. In many cases, the real net benefit to the MFI is in acquisition of new clients and in deepening relationships with existing clients. Motivation affects whether an MFI offers domestic or international transfers, choice of an international partner, clients to target, and products.

Overall, the MFI must have a clear idea about what it expects to gain from money transfers and undertake an honest assessment of the risks. Once the strategy is complete and approved by the MFI's board, it is time to draft the implementation plan.

Box 13: ARB/Ghana

The Association of Rural Banks (ARB) launched ARB Apex Bank, a central treasury for the rural banks of Ghana, a network of more than 122 banks representing over 560 agencies or points of service, some in villages as small as 500 people. Market studies in rural areas served by these banks revealed that ARB clients were having difficulty accessing transfers from urban areas in Ghana. Crime made it especially difficult for traders, who carried large sums of cash for business. At the same time, rural banks were looking for new revenue sources and ways to attract more customers. In response to this dual need, Apex Bank developed ApexLink domestic money transfer. The service uses proprietary software to manage money transfers between rural banks using coded messages sent by phone, fax, or express mail. Turnaround time is between 15 minutes and 24 hours, and transfers can be made from an account or in cash, making the service accessible to customers and noncustomers alike. ApexLink has drastically reduced the practice of sending funds through commercial drivers, which often resulted in the loss of funds.

Transfer fees are paid by the sender on a sliding scale, depending on the amount transferred (usually 0.5 percent of the transfer amount for customers and 0.75 percent for noncustomers). If a recipient lacks the government-issued identification card or passport normally required for identification purposes, he may come to the bank accompanied by a "locally known person" who acts as a witness to the transfer.

ApexLink is often used as the "last mile" in an international funds transfer. Apex Bank has partnerships with four local commercial banks and two nonbank financial institutions that are licensed to handle foreign exchange. The local banks and the financial institutions deposit funds from abroad into Apex Bank's central account in local currency. Apex Bank then transfers the funds to the rural bank for final payment to the receiving client using ApexLink.

Apex Bank has also entered into direct agreement with foreign companies for direct remittances from the United States and the Netherlands to beneficiaries in the rural areas. From the launch in June 2003 to September 2006, the system has made 167,190 transfers totaling over US$68 million.

Source: Emmanuel Yaw Sarpong (Apex Link Manager, Apex Bank), June 2004. Information updated by ARB Apex Bank, October 2006.

DEVELOPING TRANSFER PRODUCTS

Given the complexity of launching money transfers, developing an implementation plan is critical to an MFI's success. An implementation plan includes detailed actions for each market segment, product, and delivery channel, as well as the actions required of other MFI stakeholders, and a system for monitoring their implementation.

Create loyal, satisfied customers through superior understanding of their needs.

Customers play a central role in driving the MFI's product development and marketing activities. An institution should acquire an in-depth understanding of customer needs and markets and their potential profitability. Based on this analysis, the MFI can design products and services for targeted customer groups. This vision involves maximizing customer profitability—financial and social—by creating loyal, satisfied customers, through superior understanding of their needs. Marketing also involves designing, developing, and enhancing products; setting prices; communicating product features; and getting customers to use the products.

During the strategic planning process, various decisions are made about the customer groups the MFI will serve and the products it will offer. The **product manager** should ensure the product is designed to satisfy customers and contribute to the MFI's financial and social goals. The MFI should have a product manager for each product in its product portfolio. In small institutions, product managers may spend only part of their time on such functions.

An MFI with a limited product portfolio, such as short-term loans, can probably manage its products more readily, and changes may be easier to implement.

However, that is not possible with money transfer and deposit products, where every aspect of production and delivery affects operations across the MFI.

Product Development

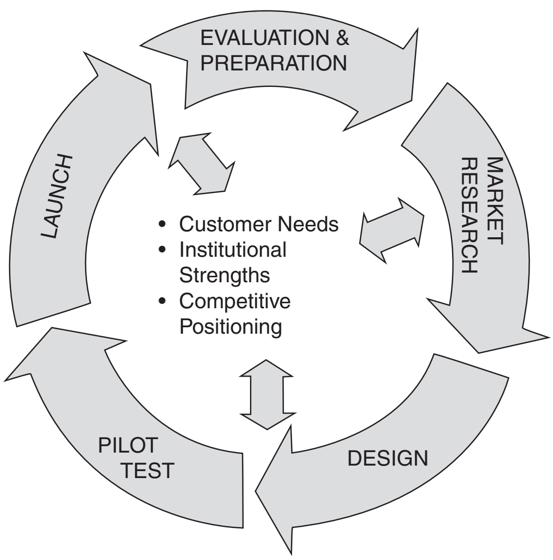
Product development is usually driven by the MFI's overall strategic plan, although ideas for new products may come from anywhere in the institution, or even from clients themselves. The product manager should screen concepts to ensure they are consistent with the institution's image, abilities, and marketing strategy; they appeal to particular segments; and their cost and profitability implications are reasonable. Of course, the product must be within the MFI's capacity and performance ability.

The MFI should take a systematic approach to product development and proceed carefully.

Product development involves marketing, operational, and technological activities. When launching an existing product, such as becoming a payout agent for an established international MTC, the product development process can be carried out more quickly. Nonetheless, the MFI should take a systematic approach and proceed carefully.

When introducing a completely new product involving major infrastructure and technological changes, a comprehensive development effort is needed.

Figure 9: Systematic product development process*



*Adapted from Wright et al.

As seen in Figure 9, product development usually consists of five major steps:

Step 1. Evaluation and Preparation. Decide on what product to develop and what infrastructure needs to be in place to support it.

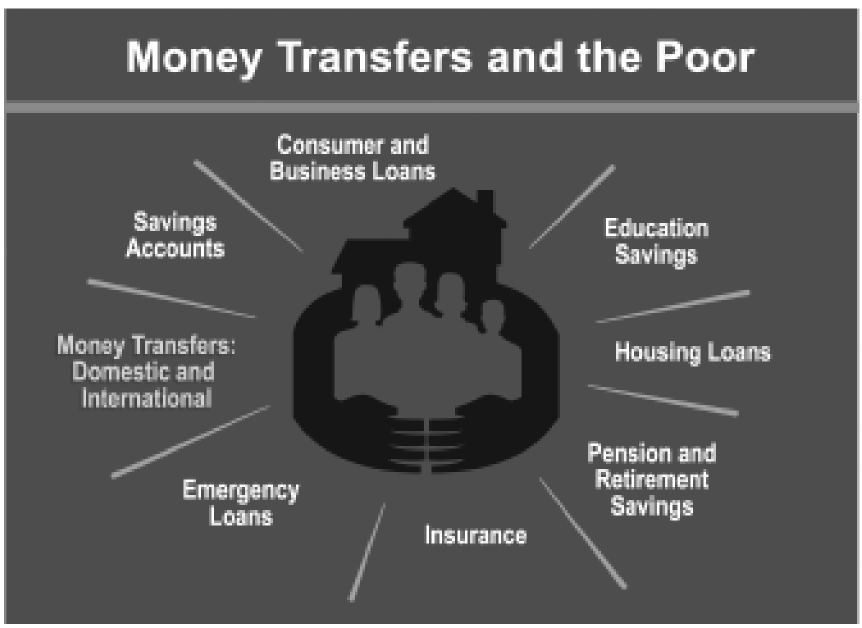
Step 2. Market Research. Perform research to determine whether the market is appropriate for the product being considered.

Step 3. Concept/Prototype Design. Determine how the product works and how it will be marketed to customers.

Step 4. Pilot Testing. Test the product in a small sample (e.g., at one branch), to determine viability, actual costs, and customer interest.

Step 5. Product Launch and Roll Out. Formally introduce product to customers along with promotional campaign.

Thus far, few MFIs have adopted this systematic, market-driven approach to product development. Typically, if the product development manager decides that a particular idea merits development, he or she will design the product and launch it to the public (following steps 1, 3, and 5). Market research and organized pilot testing (steps 2 and 4) are rarely included in the development process. Unfortunately, skipping these vital steps can lead to disaster.



The MFI should study both the sending and receiving clients.

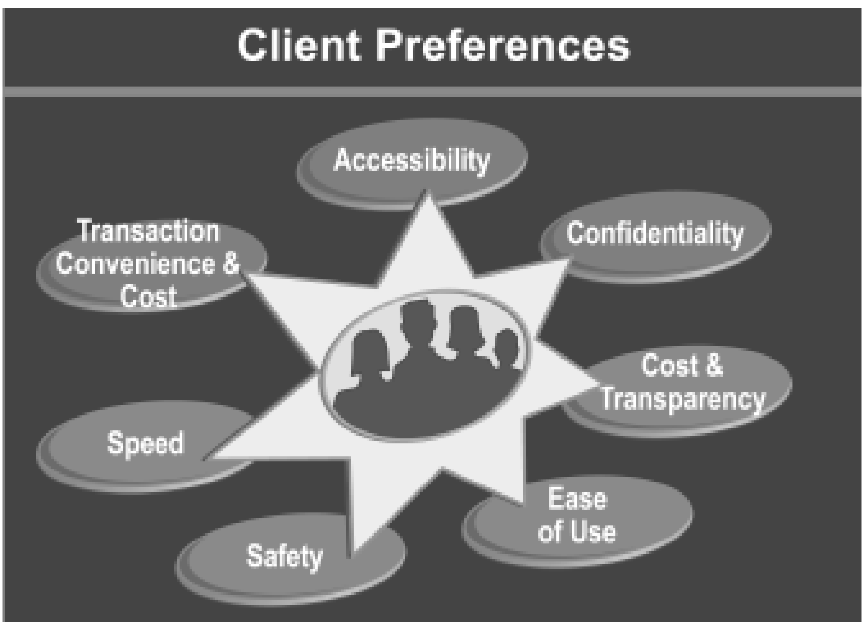
Client Preferences

The MFI should study both the sending and receiving clients, because client characteristics have consequences for product design. These factors include the socioeconomic profile of target client groups, geographic patterns and seasonality of the transfer flows, and the size and characteristics of money transfers from both international and domestic sources.

By fully understanding its target clients, the MFI greatly increases its chances of designing a successful product. Table 1 shows generally observed customer preferences vis-à-vis money transfer services. The attributes considered in the table form the core of money transfer product design and can guide the MFI in product design.

When designing a new money transfer product, the MFI should carefully consider each of these client preferences as well as competition from both formal and informal money transfer services. The client-friendly features of informal systems could serve as a model when designing offerings.[13]

Once the MFI understands client preferences, the next step is to develop a product the MFI can deliver successfully. The MFI should take a hard look at its own institutional capacity to deliver the product. If current capacity is not adequate, then the MFI will need to either strengthen itself where needed or choose another product. This idea is addressed in the section "Creating Institutional Capacity."



[13] See "Annex 2: Formality of Financial Channels" for more information on informal channels.

Table 1: Client preferences in money transfer services[12]

Attributes Sought	Key Issues
Accessibility	Many migrants, especially undocumented workers, prefer few or no identity requirements, but most formal money transfer operators must comply with some type of identity stipulation. Financial institutions can also set other requirements (e.g., opening a bank account or maintaining a minimum balance) that impede the access of poor people to transfer services.
Confidentiality	Some clients prefer to keep their receipt of money transfers confidential (either to reduce claims within the family or to minimize the risk of theft) and may favor using providers like specialized MTCs that may have less stringent identity documentation requirements than multi-service financial institutions.
Cost and transparency	Most people seek transfer services that offer —low fees, —attractive exchange rates, and —transparency on fees and exchange rates at both the sending and receiving ends.
Ease of use	People prefer limited paperwork to send or collect funds, especially if they are not literate. Some people prefer interacting with a sales agent for reasons of ease and personal service. Others prefer the convenience and anonymity of ATMs or POS devices.
Safety	Transfer operators must earn the trust of migrants and their families. —Clients may be reluctant to seek services from banks or formal financial institutions because of mistrust or past experiences in their home or adopted country. —Many people prefer to send money transfers through institutions that have a track record in handling transfers and other financial services, and/or belong to a larger, well-known international network.
Speed	Many people prefer "real-time" transfers, regardless of the cost or urgency of the transfer.
Transaction convenience and cost	Both senders and recipients want to transfer funds at nearby locations and reduce other transaction costs, such as travel time, travel expenses, and bribes paid for better service.

[12] Compiled from Isern, Deshpande, and Van Doorn 2005; Jaramillo 2004; Barro and Sander no date; Cross 2003; ILO 2001; Marx unpublished; Siddiqui and Abrar 2003; and Thieme 2003.

Pricing

Typically, the MFI should set pricing to cover costs and a profit margin. However, pricing also can be used to exploit market opportunities, such as offering a low-cost money transfer option to attract clients for other services. Pricing also contributes to a product's image, where higher priced products may convey more security and safety than the cheapest product available. For example, Banco Solidario in Bolivia offers free remittances from Spain when the recipient opens a Banco Solidario account. Its goal is to sell other financial services to the receiving client.

The MFI should take a hard look at its own institutional capacity to deliver the product.

Unfortunately, the MFI may have little room to adjust prices. Pricing for money transfers is becoming much more competitive. Further, an MFI serving as the payout agent may be obligated to set prices and receive commissions based on rates established by the MTC. Typically, the institution originating the transfer sets the price, and the receiving institution is obligated to accept it. If these terms are not acceptable, the MFI could try to renegotiate or seek another partner.

If the MFI does have flexibility on pricing, it should factor in the following:

- Costs of producing and delivering a product
- Cost of capital
- Risk associated with the product
- Desired profit margin
- Customer willingness to pay
- Prices offered by competitors

If the MFI already has some money transfers experience, it would be useful to analyze the costs of the existing services to design and price new products. This type of analysis can be simple or sophisticated, depending on the MFI's systems and available information. Once a product's costs are determined, the MFI can determine the impact of costs, how to make the product more efficient, and how the product contributes (or does not) to the overall profitability of the MFI.[14]

The MFI may also want to estimate potential revenue at various prices to determine its break-even point for offering the new product. Developing these scenarios helps the MFI understand how demand for a product, costs, and potential revenues depend on many factors. Of course, projecting demand is not an exact science. It involves analyzing and forecasting all the aspects of a product that influence the demand for it, including economic data, market research, and data from central

[14] For more information on costing, see CGAP Technical Tool No. 6, Product Costing Tool, Helms & Grace, Washington, 2004.

banks, national banker associations, and competitors in the money transfer business. Demand can be affected by a range of issues, including political and economic conditions, natural disasters, government policy changes, and changes in the number, marketing, or reputation of an MFI's competitors. In addition, the MFI's marketing efforts may lead to stronger (or weaker) demand than anticipated.

Promoting Products

The role of promotion encompasses all aspects of an institution's image.

Promotion is how the MFI communicates with its current and potential customers, employees, and other interest groups, primarily through advertising (including branding and merchandising) and public relations. Traditionally, promotional efforts focus on advertising the benefits of specific products to raise awareness, stimulate interest, and encourage purchases. The role of promotion is much broader today, encompassing all aspects of an institution's image and the way it is presented to various interest groups.

Although there is some differentiation, many institutions generally offer the same basic money transfer services. The remaining competition is based on price, speed, convenience, reputation, and perceptions of security. These competitive factors must be communicated to the client for the MFI to succeed.

Money transfers pose a special marketing challenge: How can the institution target the right clients? A promotional program launched by an MFI primarily positioned as a receiver of transfers may have little effect when the main decision makers are the senders in an urban area or another country. Accordingly, most of the advertising budgets of MTCs are spent in countries and/or areas on the sending side. Of course, recipients may have some influence on senders' decisions about how to send money. That factor—in addition to the educational value of a money transfer promotional program—argues in favor of balancing promotional efforts between sending and receiving markets.

Communicating effectively requires a thorough, systematic approach. When promoting financial products to low-income clients, the MFI must be mindful of its clients' financial literacy. Likewise, the MFI should be aware of how low-income clients use informal financial services that compete with the MFI's services. The MFI should ensure that its promotional messages clearly communicate why its products are important and how they meet customers' needs. Likewise, customers must understand how to use financial products, the charges they will pay, and their rights to privacy, redress, and unfair practices.

Linking services to transfers can attract clients, keep them loyal, and generate additional revenue. Access to other financial services may also deepen the develop-mental impact of transfers. Initially, recipients may not trust an MFI to hold their money, preferring instead to receive cash immediately. Over time, however, a client may consider banking some of the transferred funds in a linked savings or checking account, if such options are available (Isern, Deshpande, and van Doorn 2005).

When promoting financial products to low-income clients, the MFI must be mindful of their financial literacy.

Depending on the competitive context, money transfers may not be a highly profitable product for the MFI. However, by offering money transfers, the MFI may be able to attract new clients who receive money transfers and who would be interested in other financial services. For example, migrants sending remittances and their receiving families may be interested in specific products, such as deposit accounts for multiusers in the family, health insurance for family members, life insurance, repatriation benefits for the migrant, mortgages, savings plans for travel or education expenses, credit cards, and other products.

The same possibility exists on the sending end. Migrants may gradually begin to use other financial services if the MFI offers them. For example, Banco Solidario in Ecuador has developed products in conjunction with banks in Spain that allow Ecuadoran migrants working in Spain to access and repay short-term credit, save for their return home, buy real estate in Ecuador, or create savings accounts in Ecuador to which they can control access by family members (Isern, Deshpande, and van Doorn 2005).

As MFIs deepen their experience with money transfers, more are having success **cross-selling** other financial services. ACLEDA Bank in Cambodia reports that most remittance receivers hold an account in the bank and use their other services. Kasabank in Kosovo offers free incoming transfer services because receiving clients generate so much other business. Nuevo Siglo credit union in El Salvador reports that some clients open 60-day fixed-term deposits with portions of their remittances (Evans and Klaehn 2004, 5–6). Fonkoze in Haiti earns significant income from remittance clients who decide to change their U.S. dollar transfers into gourdes (Hastings forthcoming). Several MFIs have reported that it takes as many as three years to establish credibility with clients before they would consider using other financial services, such as deposits or loans. Other MFIs have been more successful, and clients have opened a deposit account after three or four transactions.

An effective sales process, based in branch offices and including field agents, is crucial to acquiring new customers and deepening relationships. Advertising and promotion can build awareness and reinforce images, but a salesperson is usually required to answer questions, overcome concerns, and discuss different ways of meeting customer needs.

Box 14: SMEP provides banking services to Kenyans through mobile phones

Use of mobile phones is growing rapidly, especially in Africa. Kenyans are increasingly turning to them for personal and business solutions. Of the approximately 10 million Kenyan mobile phone users, estimates suggest that half could use them to access banking services. Small and Micro Enterprise Programme (SMEP) believes that mobile phones can be a mechanism for serving the unbanked (currently determined to be about 38 percent of Kenyans), providing a convenient way of sending money for savings deposits and loan repayments as well as being a method of loan disbursement. SMEP is a nonprofit microfinance organization with the objective of improving the performance of low-income entrepreneurs in the informal sector of the national economy through financial and nonfinancial assistance. SMEP currently has 17 branches located in all provinces except North Province. As of October 2007, SMEP served 29,000 clients and managed a loan portfolio of US$9.1 million.

SMEP has joined with Mobile Micro-finance, Ltd. (United Kingdom) and Safaricom Company, Ltd., to develop a mobile money transfer project (MPESA). MPESA is currently in the "live pilot" phase and using real e-money in SMEP and MPESA live environments. To date, errors are within acceptable ranges and are largely the result of clients' limited technical and financial literacy. Some training and more easy-to-use interfaces are being developed to address these issues.

Source: Phyllis Mbungu (CEO, SMEP), November 2007. Also adapted from Lonie 2005; Small and Micro Enterprise Programme 2007. See also the MPESA Web site at http://www.safaricom.co.ke/m-pesa/

CREATING INSTITUTIONAL CAPACITY

Developing a Money Transfer Policy

Clear, well-defined policies and procedures are essential for effective governance and control of the MFI and its transfer services.

To be successful, the MFI should develop a policy on money transfers and, once approved by its board, communicate it to all personnel. Having a clear road map will help ensure that transfers are executed properly, whether the MFI is sending or receiving them. Clear, well-defined policies and procedures are essential for effective governance and control of the MFI and its transfer activities.

For international transfers, the MFI is likely to have influence over just one end of the transaction. Accordingly, MFIs should try to ensure that their partners' policies are consistent with their own or that the MFI's policy can be easily adapted to conform. The MFI may have more control over domestic transfers, although it must consider the policies of any correspondent bank or other business partner.

The depth and coverage of policies depends on institution size and complexity. Small, noncomplex institutions may create one central guiding document, while larger, more complex institutions may need to develop specific policies for each money transfer product. Policies that are clear and specific increase the probability of compliance, efficiency of operations, and overall success with money transfers. In addition, policies and procedures establish accountability, provide controls for risk management, define expectations, and serve as training tools.

Procedures should be reviewed and updated regularly, and especially whenever the MFI makes any major changes to its money transfer operations.

An effective money transfer policy does the following:

- Defines acceptable types of transfers
- Specifies the steps required for each transfer
- Provides measures to safeguard each transaction
- Explains pricing policies
- Sets approval authority
- Sets staff responsibilities

In addition, the policy should address data security, money laundering, client privacy, and client disclosure.

By establishing secure data procedures and ensuring compliance, the MFI will have an audit trail that helps identify any errors or potential fraud in their operations.

Data security is often overlooked, but it is an area of considerable risk for money transfers. The MFI must protect its data and the security of payment instructions, because this can attract both internal and external fraud. Given the volume and value of money transfers, data should be secure, encrypted if possible, and levels of security should be established so that a limited number of people have access to the information and can make changes to any payment instruction. Further, any change to payment instructions should be documented to note the person making the change, the date, and the reason. By establishing secure data procedures and ensuring compliance, the MFI will have an audit trail that helps identify any errors or potential fraud in its operations.

Increasingly, countries are adopting more stringent requirements for AML/CFT, and this will have broad-reaching implications for MFIs, other financial institutions, and many others. Money transfers are considered one of the riskier financial services, and national and international authorities focusing on AML/CFT are giving special attention to institutions that offer money transfers. The MFI should inform itself of national and international AML/CFT requirements (Isern, et al. 2005). Typically, these requirements include the following:

- Establishing a compliance officer
- Creating internal controls
- Maintaining accurate record keeping
- Monitoring for suspicious transactions
- Reporting to national authorities[15]

The MFI may work across two or more countries or be allied to an MTC that works regionally or globally. In these cases, the MFI should clarify which standard of AML/CFT compliance applies to its operations.

Box 15: An established MFI's experience with AML/CFT compliance

Financiera Compartamos, a specialized MFI, began operations in Mexico as a nongovernmental organization in 1990 and transformed to a regulated financial institution in 2000. Financiera Compartamos is legally registered as a *sociedad financieras de objeto limitado*, a nonbank regulated financial institution, and it served over 300,000 clients as of 2005. When it implemented the new AML/CFT regime for Mexican nonbanks in 2004, Compartamos benefited from already being a regulated institution. This meant that compliance systems, staff, and procedures were already in place. Furthermore, part of the Compartamos loan methodology included weekly visits to clients by loan officers, who knew their clients well. To comply with the new AML/CFT requirements, Compartamos instituted the following procedures:

- It maintains transaction records for 10 years.
- It monitors all transactions using customized software that identifies any unusual, complex, or large transactions by clients. It must also

[15] See Isern, et al. 2005 for additional information on AML/CFT issues.

report any client transaction larger than US$10,000 to the Mexican banking authority.

- It appointed a formal AML/CFT compliance officer, the risk manager. In compliance with regulation, a special AML/CFT committee was appointed consisting of the general manager, the risk manager, the internal auditor, and legal officer.*

*Carlos LaBarthe Costas (Compartamos general manager) and Lizette Escamilla Miranda (Compartamos risk manager) from a CGAP–World Bank survey questionnaire answered in January 2005 and summarized in Isern, et al. 2005.

Privacy measures should clarify whether and how the information is disclosed to third parties.

The transfers policy and, more broadly, the MFI's other financial services should include a **privacy policy** that describes for clients what information the MFI collects and how it is used. Privacy measures include what client information is collected and stored, and how the information is kept secure. The MFI also should specify how clients can have access to that information, correct any mistakes, and set limits on how the information is used. Finally, the privacy measures should clarify whether and how the information is disclosed to third parties.

It is vital that MFIs commit to full **disclosure** of all costs, terms, and conditions before transactions are initiated, so that customers can make informed decisions. Similarly, money transfer agreements should spell out information about the following:

- Transfer types and fees
- Policies on refunds
- Resolution of errors
- Liability for unauthorized transactions, loss, and theft
- Any other issues of customer concern

The extent to which laws and regulations cover payment systems and money transfers varies widely by country. In some countries, laws and regulations are highly specific; in others, the rights and responsibilities of parties to payment transactions are governed by contracts between service providers and users. Interpretation of these contracts is up to the judicial system. Regardless of the extent of laws, the MFI should make every possible effort to ensure that its contracts protect both itself and its customers.

Establishing Delivery Channels

Customers all over the world cite convenience as one of the most important reasons for choosing a financial institution.

To send or receive money, customers must have access to a delivery channel of a money transfer provider. In developing delivery channels, the MFI must balance customer needs for convenience with its own need to serve the market at a reasonable cost. Because decisions about delivery channels can determine an institution's market share, they have a major impact on its profitability and long-term success.

Offering transfers without adequate delivery capacity is a quick way to suffer financial losses and reputation damage. Establishing a relationship with an MTC can substantially lower the infrastructure investment, but the MFI will have less control over operations and lower revenues from shared commissions. These considerations should be factored into decision making about service delivery.

Although financial services can be delivered in a variety of ways—including by ATM, telephone, and online—most MFIs will probably launch face-to-face services from branch offices, at least in the short term. Other delivery channels may be feasible, depending on the size and complexity of the MFI, type of money transfer services, and pace of development of the country's financial infrastructure.

Face-to-face services may be offered from the MFI's branch offices or by agents who deliver money transfers to recipients. Customers all over the world cite convenience as one of the most important reasons for choosing a financial institution. Such convenience is determined by an institution's location, hours, and services. Establishing location-based delivery networks requires addressing each of these factors cost effectively.

Money transfer volumes rise and fall, typically with cyclical peaks. The MFI should plan staffing, liquidity, and security, among other things, to prepare for high-volume periods for money transfers around peak times of the day when clients are more likely to make transactions. The same planning is needed for peak days, such as common paydays (e.g., end of month or every two weeks), holidays, Monday mornings (or first day of business week in the country), and other seasonal periods, depending on the country context.

The MFI must evaluate its delivery network and determine what, if any, reengineering is needed. For example, if the institution offers group lending through a network of field officers and does not have an accessible branch network, it may need to establish one. This may be especially challenging if some (or all) of the MFI's clients live in rural areas with dispersed populations and limited access to roads, telecommunications, or other infrastructure required for efficient delivery of financial services. An institution with a convenient branch network will need to evaluate its capacity to implement the very different workflows, internal controls, and liquidity requirements involved in processing money transfers. If the MFI will serve as a payout agent for a larger company, the volume of transfers may not generate sufficient revenue to pay any extensive reengineering of the delivery network or infrastructure.

MFIs already manage risks, but they may not be familiar with the specific risks associated with money transfers.

Establishing and operating a location-based delivery network is expensive, but it usually increases revenue. The MFI should keep in mind that money transfers also can be delivered through indirect channels, using third-party intermediaries, such as merchants, mobile phone companies, and other partnerships. However, the MFI has less control over these channels, and service quality depends on the party operating the delivery network.

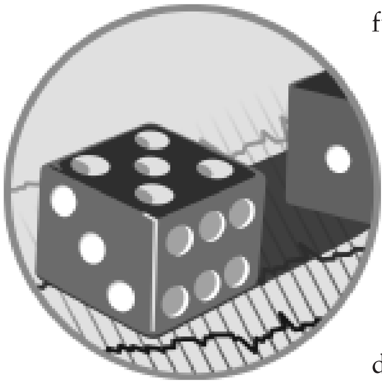
Box 16: Shared branching: Expanding points of service

Independent financial institutions can link their systems in such a way that they allow clients from other financial institutions to make loan payments, withdrawals, bill payments, and domestic money transfers among the participating institutions instead of just at the client's "home" institution. This "shared branching" leverages the combined physical network of multiple institutions to provide clients with greater access and convenience. For example, a credit union movement in Central America links 22 credit unions and their combined 128 points of service to offer a national network. The network processes 8,000 to 9,000 transactions per month among the 22 credit unions.

Source: Dave Grace (WOCCU), November 2007. For additional information on shared branching, see http://www.woccu.org/pubs/cu_world/cuw_index.php?mag_id=43

MANAGING THE RISKS

With any new endeavor, the MFI will face risks and challenges. These need not deter the MFI from entering the money transfer business, but they should be considered carefully and, where appropriate, a response plan



should be developed. Risk management includes identifying, measuring, monitoring, and mitigating risks. MFIs already manage risks associated with their existing products, but they may not be familiar with the specific risks associated with money transfers.[16]

Money Management Challenges

An MFI delivering only credit or a small volume of deposit services may operate its cash functions somewhat informally, obtaining cash as needed to meet loan demands and recycling cash received to meet liquidity needs. Estimating cash requirements is fairly straightforward in a credit-only MFI, because of the greater predictability of customer demand and loan disbursements.

But money transfers add a new dimension to management of cash transactions, because cash must be available consistently, and transfers may be seasonal or correspond to patterns that differ from cash needs for loan and deposit services. Take, for example, a WOCCU member in Central America that routinely pays over US$1 million per day in remittances and hits peaks that double and triple this amount on Monday mornings, near holidays, and following bank holiday weekends.

Handling cash increases operational risk for an MFI. Although the average transaction value may be small, processes must be formalized and carefully executed. There are many risks for employee error or fraud that can generate serious operating losses for the MFI. In addition, the MFI increases its risk of theft and burglary, especially once people know the institution has cash on hand. 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 (Evans and Klaehn 2004).

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[16] This section is a summary of the main risks specifically related to money transfers. Additional information on risk management can be found on the Microfinance Gateway (http://www.microfinancegateway.org).

Box 17: Physical security in rural areas: AMUCSS´ experience

The Mexican Association of Credit Unions from the Social Sector (AMUCSS) is a network of rural MFIs: the microbanks. These financial intermediaries have been paying remittances in remote indigenous rural areas in Mexico since 2001. One of the characteristics of rural areas that limits the availability of remittances payments is physical security. Before microbanks started paying remittances, the volume of activity related to credit and savings was small, so security issues were not a priority. However, since 2006, the volume of transfers has increased steadily. In Pahuatlán, with 30,000 inhabitants, a microbank in Sierra Norte de Puebla experienced a large increase in the number of remittances paid from 100 in January 2006 to about 1,600 in June 2007 (totaling more than US$600,000). Suddenly, the microbank needed six times more cash than before. This required some changes in money management, including moving large amounts of cash from a bank at the nearest city to the rural area where the microbank pays money transfers. AMUCSS pursued two options: (*a*) securing the funds through signing an integral insurance policy for the microbanks and (*b*) contracting security companies specialized in armored trucks to transport funds. Neither option was feasible, because companies either were asking for high premiums and fees or would not work in such remote areas.

Faced with these limitations, AMUCSS tried more creative avenues, such as mitigating risk through risk dispersion and continuously changing routines. For example, different employees would go to different cities to get money in different types of transportation. Despite these preventive measures, an employee was robbed. The immediate response was to hire armored trucks to transport funds, despite their high cost. Suddenly people started to realize there was a large amount of money in the microbank. After a couple months, Pahuatlán's microbank was robbed at night. After this event, the institution was forced to stop remittance payments. Remittance beneficiaries had to travel two hours by bus to the nearest bank. Clients offered to pay a special fee to get their money transfers paid in the microbank again, thus demonstrating the importance of this service for rural communities. Pahuatlan's microbank started remittance payments service again in October 2007, after installing proper branch security, which had to be subsidized because of its high cost.

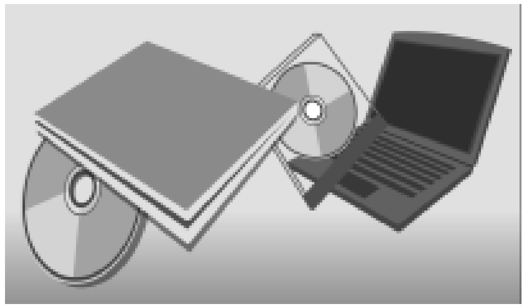
Paying or receiving remittances in remote rural areas comes at a high price either for the beneficiary or for the MFI paying it. In rural areas especially, commissions hardly cover the operational costs, let alone the security costs.

Source: Alexandre Berthaud (executive director of Envíos Confianza), November 2007.

MFIs must maintain an inventory of currency sufficient to meet the daily demands of customers.

Every institution paying and receiving cash should maintain an inventory of currency sufficient to meet the daily demands of customers at cashier windows, ATMs, or other points of service. Inadequate cash availability can lead to customer dissatisfaction and loss of goodwill. Maintaining a cash inventory sufficient for all possible demands is costly in terms of handling and opportunity costs. To address these issues, the MFI should maintain complete records of its daily cash movements, so that it can analyze its cash flows over time. Using that analysis, it can develop a cash management plan. Cash management software is also available.

Some MFIs may be able to offer payments in foreign currency, although this adds complexity to branch and headquarter operations. Many countries have laws regulating the import and export of the national currency, and the MFI must understand applicable currency laws and regulations. Institutions dealing in foreign currencies should maintain records and an account for each currency for which there is likely to be reasonable customer demand. To do so, MFIs often maintain foreign currency bank accounts at major domestic banks active in foreign exchange markets, in addition to foreign currency held as part of their inventory of cash. An institution may also have exposure to foreign currency through international loans, deposits in foreign currency, or other reasons. An MFI should set limits for the amount of foreign currency in its accounts, as well as for customer transactions, and both types of limits should be reassessed periodically. An MFI can then buy or sell foreign currency as needed. Exchange rates are determined by the foreign exchange market and can be obtained from the central bank or the institution's correspondent bank. These rates, along with fees and rules for foreign currency transactions, should be prominently displayed for customers.



Information Management Challenges

The MFI's information systems must be capable of managing the volume of transfer orders and ensuring transaction security.[17] The IT system must also be able to link with business partners, such as international MTCs and correspondent banks, and to generate reports required by national authorities. For example, when BancoSol in Bolivia decided to end it's relationship as a subagent to Western Union, it developed business alliances with small and medium-sized remittance companies. To make this shift, BancoSol needed to develop a database to receive and integrate transaction information from its new MTCs. Many international MTCs have their own software or database that helps their partner firms manage transactions. However, these systems are not foolproof. For example, Financiera El Comercio in Paraguay, which operates as an agent of Western Union, has not yet been able to download transaction information and integrate the information within its own IT system (Hastings forthcoming). The MFI will need a high-performance information system that is well integrated with its accounting systems, especially as transaction volumes increase.

Within the MFI and its business partners, data should be secure with appropriate limits, passwords, and audit trails on who can access and change data. Client data should be protected to ensure privacy and minimize the risk of identify theft, fraud, or other abuse of client information.

Data should be secure with appropriate limits on who can access and change data.

Client Service Challenges

There are inherent client challenges in money transfers, especially person-to-person retail transfers. The MFI must earn the trust of its clients as a secure and convenient provider of transfer services. For domestic transfers, the MFI may need to manage both the sender and receiver sides of the transaction. Marketing, providing customer service, and maintaining client databases are more complex when clients are in different towns, regions, or countries.

For MFIs working with international partners, the focus is typically only on

[17] For more background, see the CGAP Information Systems Resource Center at http://www.microfinancegateway. org/resource_centers/technology

receiving clients. However, the MFI must coordinate any client service problems with its partner MTC and ensure issues are properly resolved.

The MFI must also manage clients who attempt fraudulent or illegal activities. For example, clients may alter payment information, people may impersonate others to obtain their payments, or clients may try to launder funds. The MFI must comply with AML/CFT measures, as discussed in "Compliance Challenges."

Depending on the country context, MFIs may need to help clients who are unfamiliar with money transfers, especially when new transfer products or means of payment are introduced.

Clients are very concerned about their money, and in a competitive environment, the successful MFI is the one that actively keeps its customers informed.

The MFI also should establish a mechanism for informing recipients when their transfer has arrived. Many MFIs use a call center or assign this responsibility to platform officers in branches. Clients are very concerned about their money and, in a competitive market, successful MFIs actively keep their customers informed. Likewise, a call to a customer typically prevents numerous calls from the customer.

Waiting time while in an MFI's office is also a consideration. If transfers are sent with any pattern or seasonality (e.g., beginning or end of the month, holidays, beginning of school season, etc.), the MFI should consider the additional volume of operations when planning staffing, liquidity needs, and security. In addition, an MFI may find it useful to make a separate line for transfer clients to avoid client frustration, especially if many other clients are making account deposits/withdrawals or loan repayments.

In some countries, delivering payments to a client is essential to remain competitive. However, delivery adds costs and risks.

Box 18: G-Cash and SMART Money

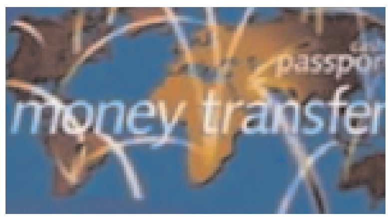
Filipinos send an estimated 200 million text messages a day. Short message service (SMS) technology is particularly popular because of low-cost mobile phones, the low cost of sending an SMS, the limited availability of landlines, and government policies that support the expansion of the telecommunications sector. Text-a-payment (TAP) services, which allow money to be transferred via text messages, are especially promising for low-income clients. Clients can use their mobile phones to make loan payments, which saves them time and money in travel, and banks can increase their rural outreach without significant cost. There are two primary TAP services in the Philippines: G-Cash and SMART.

Globe Telecom launched G-Cash in 2004. G-Cash offers payments, phone-to-phone fund transfer, domestic money transfer, and international remittance all via SMS. Globe partnered with various companies and banks, including rural banks, for money transfers and remittances with merchant stores nationwide. As of March 2006, there are approximately 1.3 million G-Cash registered users. The system handles about US$100 million per day through a distribution network of 700,000 airtime loading retailers.

SMART launched SMART Money in 2000. SMART Money links a user's phone to a cash account at Banco de Oro (a large commercial bank in the Philippines). SMART Money has features similar to those of G-Cash, but it also offers SMART Padala ("send"), which allows Filipino overseas workers to transfer money to their relatives in the Philippines. SMART currently has about 3 million SMART Money subscribers.

Despite these successes, these systems face the challenge of acceptance: customers are slow to adopt new methods for payment, and retailers are wary of (or have no incentive to use) alternative forms of payment (Owens and Bantug-Herrera 2006).

Payment Medium Challenges



The MFI seeking to offer its customers payment cards or wishing to leverage local merchants as delivery points faces several obstacles. Without membership in a bank card association or the possibility of gaining membership, the only short-term alternative is to seek sponsorship by an existing member. The first step is to build a business case for issuing cards, then to find an association member bank or card processor willing to extend sponsorship. In the medium or long term, the MFI can lobby lawmakers and regulators to eliminate these anticompetitive practices.

MFIs that are allowed to collect deposits could consider debit cards as part of their deposit and money transfers strategy. However, large national banks may be reluctant to sponsor debit card programs because of the potential competition for their customers. Because the principal member assumes financial responsibility for the sponsored member, the MFI needs a strong balance sheet to be considered.

Among prepaid cards, the open, universal prepaid card has the most potential for an MFI.

Credit cards may be a promising option for MFIs pursuing growth and new types of services. However, before issuing any cards, the MFI should have adequate information available to predict a client's ability and willingness to repay the obligations incurred. A credit card is essentially a revolving credit line, and such a product can be more profitable over the life of the MFI's client relationship than a microloan that ends when repaid. Critical issues include establishing risk-return models that ensure losses remain at predicted levels; establishing pricing that covers risks and earns profits; and creating control mechanisms that track and provide timely feedback on the performance of credit card portfolios.

Issuing prepaid cards may be the simplest route for MFIs, if cards are viable in the MFI's market. With prepaid cards, there is no requirement to establish deposit accounts for cardholders, and the cards can be issued through third-party card processors that deal with issues related to card association sponsorship. In addition, in some countries MFIs can band together and seek direct participation in card associations. While there are many types of prepaid cards, the one with the most potential for an MFI is the open, universal prepaid card, which can be used at any credit or debit card-accepting location, including over remote channels.[18] Such cards display the acceptance marks of one of the major card schemes, such as Visa or MasterCard, and often one of the major EFT networks. The issuing rules of card schemes vary, but in general the authority to issue a prepaid card is limited to members of the card associations (i.e., usually banks that are members of the Visa or MasterCard associations), and these members can issue cards only in the country where they have association membership.

Box 19: Alianza's prepaid debit card and "open" remittance delivery network

Alianza International provides very low-cost prepaid debit and remittance-enabling services (along with bill payment and long distance phone services) to immigrants and unbanked people. Working with national bank partner Central National Bank & Trust Company, Alianza provides debit cards that can be used for a range of transactions, including money transfers.

Alianza International's AlianzaNet is an "open" remittance delivery network that includes a range of institutions in its delivery channel: retail

[18] Currently, PIN-based prepaid cards cannot be used over remote channels.

distributors, nonprofit organizations, financial institutions, credit unions, MFIs, and businesses.

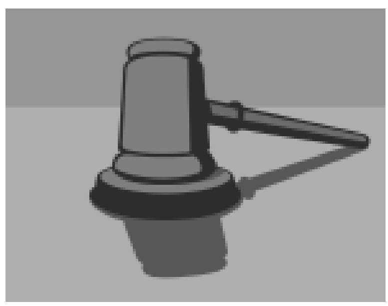
AlianzaNet reroutes existing cash-based remittance flows through card-based and account-based channels. AlianzaNet offers a "turn-key solution," providing the operations, technology, and settlement platform. Alianza International does not collect or settle monies, it only operates the system that effects transaction instruction, origination, and delivery, and it maintains records of monies requiring collection and monies requiring distribution. Alianza also offers support with "know your customer," OFAC, BSA, and other compliance requirements. Funds collection from remittance originators and settlement with remittance distributors is performed by national bank partners and foreign exchange providers.

AlianzaNet provides a mechanism for using all forms of remittance instruments, including cash-to-cash, cash-to-card, cash-to-account, card-to-cash, card-to-card, card-to-account, account-to-cash, account-to-account, and account-to-card. Alianza International provides a remittance origination network that supports remittance origination from sources that include Internet, branch teller, proprietary networks, SWIFT, ACH, and card processing networks. Alianza International is one of the few providers who currently offer money transfers as a home banking service (Alianza International 2007).

As with credit cards, third parties must obtain a license or sponsorship from a member bank in the country of issue that will be responsible for regulatory compliance and financial settlement. Because a prepaid card program involves much less counterparty credit risk than does a credit card program, it may be easier for the MFI to secure such sponsorship. Nonetheless, the MFI must still manage the operational risk involved with a prepaid card and money transfer operations.

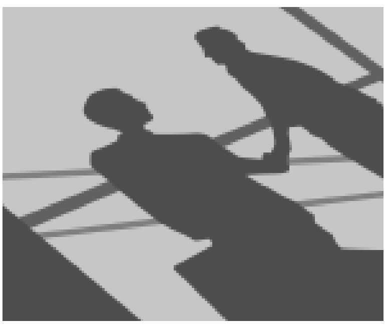
Compliance Challenges

Any institution offering money transfers should ensure compliance with existing laws and regulations. Compliance includes seeking licenses in each country of operation and reporting to authorities supervising money transfers. For institutions involved in multicurrency operations, additional licensing and reporting are usually required.



A growing number of countries are adopting more stringent requirements for AML/CFT. One of the most challenging aspects of standard AML/CFT compliance is identifying clients according to international standards. In developing and middle-income economies, for example, it is difficult for many clients to comply with certain "customer due diligence" identification requirements, such as national identity numbers or third-party verification of physical home address. As a case in point, while these requirements are already part of customer due diligence regulations in South Africa, financial institutions there are experiencing problems adhering to them because at least one-third of South African households do not have a formal address (Isern, et al. 2005).

Given the growing importance of money transfers and the rising profile of international remittances, the Committee for Payments and Settlement Systems (CPSS) of the Bank for International Settlements and the World Bank developed *General Principles for International Remittance Services*. These principles aim to achieve safe and efficient services in markets that are contestable, transparent, accessible, and sound. As countries adopt these general principles, MFIs and other institutions will be required to comply.[19]



Partnership Challenges

MTC partnerships entail several risks that need to be managed. The larger the MTC and the more dominant it is in that country's market, the more likely that it will attempt to impose exclusive relationships on its agents. An institution should ensure that all contracts with partners are legal and comply with existing laws and regulations. In addition, contracts should be reviewed by a lawyer to ensure they adequately protect the MFI's interests.

Even large MTCs cannot always generate adequate transaction volumes.

Even large MTCs cannot always generate adequate transaction volumes for institutions in receiving countries, particularly if they have not sufficiently penetrated the relevant immigrant communities in sending countries. For example, one of the first foreign MTCs that JCCUL partnered with was hardly used by Jamaicans in the United States—even though it is widely used by Latin American immigrants. Because it had refused to become an exclusive agent, JCCUL was able to bolster disappointing transfer volumes by adding other MTC partners (Isern, Deshpande, and van

[19] See "Annex 3: General Principles."

Doorn 2005). Box 20 describes other risks of MTC relationships and how institutions have dealt with them.

Box 20: Managing Risks

One way to manage the risk of launching money transfer services is to introduce the services in phases. This can be done geographically, for example, by initially rolling out MTC services only in certain branches.* XAC Bank in Mongolia took this approach. For the first few months, it limited its international MTC service to the head office. As volume builds, branches must be able to process transfer clients quickly and smoothly, a lesson XAC Bank had already learned from its domestic transfer products. By introducing international MTC transfers to its branches in phases, the bank learned how to minimize operational costs before opening up the network to larger volumes of transfers.

Gradually increasing the intensity of the relationship with an MTC is another way to manage risk. XAC Bank chose to become a sub-agent—that is, its MTC transfers are routed through another commercial bank that acts as the MTC's primary agent in Mongolia. Although this arrangement requires XAC to share over half of the revenue from each transfer with the primary agent, XAC avoids paying the cash security deposit that full agency status requires. If transfer volumes generate sufficient revenue to justify becoming a full agent, XAC has the option to upgrade its relationship with the MTC.

* Some MFIs prefer to launch transfers in all locations to ensure full coverage within their network. In these cases, MFIs have noted that client demand often builds slowly as the product becomes better known.

Source: Jim Anderson and G. Tuul, both of XAC Bank, 7 June 2004.

Because partnerships can be challenging, MFI managers suggest focusing on fostering a good reputation for a limited type of money transfers service rather than quickly developing a full suite of services. One way to begin building client trust and a good reputation is to link with established MTCs that can provide a turn-key solution for international transfers. For small to medium-size MFIs interested in domestic transfers, partnering with a bank that has transfer experience and good national coverage may be a good strategy for entering the money transfers market.

MFI managers advise focusing on fostering a good reputation for a limited type of money transfer service rather than quickly developing a full suite of services.

Partner negotiations also can take a long time, especially for MFIs that are inexperienced with money transfers. In addition, a partnership may limit an MFI's ability to offer flexible products and systems, because in many cases the MFI is essentially purchasing them "off the shelf" from the MTC. As a result, the MFI may have trouble integrating the service with its other operations and so may not be able to take full advantage of cross-selling other financial services. To protect the MFI, it may be advisable to negotiate an initial contract for a pilot period, such as one year, and ensure that any contract revisions must have the consent of the MFI (Jaramillo 2006). Additional guidance on negotiating alliances is provided in "Chapter 5: Negotiating Partnerships."

Any money transfer service will require sufficient liquidity, security, and possible investment in additional systems, staff, and infrastructure.

MFIs should bear in mind the costs involved in partnerships. Money transfers entail real costs for both an MFI and its clients. Any money transfer service will require sufficient liquidity (and thus opportunity costs for cash), security, and possible investment in additional systems, staff, and infrastructure. More sophisticated systems or more complex business models will likely require further investment. For MFI clients, many of the products offered by international MTCs may be relatively expensive and may be difficult to sell.

Costs must be measured against potential profitability. When contemplating a partnership, an MFI should determine the amount, method of calculation, and timing for payment of all fees and commissions associated with money transfers. An important consideration is whether the MFI will be an agent or a subagent of an MTC. If a subagent, the MFI will receive less revenue for each transaction; this is an important determinant of potential profits. In some countries, only commercial banks or postal networks are allowed to be direct agents of an MTC. Further, most MTCs have fixed commission rates for agents, and typically, a subagent receives the smallest amount of commission on each money transfer. As a result, there may be little room to negotiate a fee-sharing agreement.[20] When projecting profitability, the MFI also should consider potential foreign exchange gain if working in multiple currencies. In addition, the MFI should estimate potential revenue from cross-selling other services, such as savings, loans, etc. Over time, the MFI should track fees and commissions plus these other sources of revenue to make an informed decision on the overall profitability of money transfer operations.

[20] Costing analysis is addressed in more detail in "Developing Transfer Products: Pricing." For more extensive information on costing, see CGAP Technical Tool No. 6, *Product Costing Tool,* Helms & Grace, Washington, D.C., 2004.

5

Negotiating Partnerships

Partnerships are an excellent option for MFIs seeking to enter the money transfer business. With the right partnership, the MFI can grow its business and better serve its clients. But entering into a partnership requires careful consideration and planning. This chapter presents information an MFI should know when entering a partnership and tips to negotiating the best partnership agreement.

THE TWO SIDES OF THE TABLE

Typically, the courtship between the MFI and an MTC is mutual: the MFI wants to develop a new line of business, and the MTC wants to expand its network of payment agents. However, each side of the table has unique concerns. This chapter focuses on business alliances with MTCs; however, the guidance also can be applied to other types of partnerships, such as with commercial banks, shared branch networks, or other institutions offering money transfers.

The Money Transfer Company's Perspective

The MTC wants sound agents and subagents, and its choices are often limited because many countries regulate which institutions can partner with an MTC (it is often limited to commercial banks, postal networks, and foreign exchange bureaus). The MTC wants to expand its reach (so the extent of the MFI's branch network is often the most valuable bargaining chip in negotiations). The MTC wants an agent who understands the environment. MFIs have established client relationships and are usually culturally and geographically close to their clients. Large MFIs with extensive branch networks (especially rural branches) are especially attractive to MTCs.

The extent of the MFI's branch network is often the most valuable bargaining chip in negotiations.

What the MTC Looks for in a Partner

In short, the MTC values the following criteria when considering partners:

- Multiple locations in the country, especially in areas not already covered by other payment agents: branch offices in urban and rural areas, ATMs, and fixed and mobile points of service

- Well-established branch infrastructure and good communications with the institution's headquarters
- Use of a call center
- Good reputation in the country or region, especially known for good customer service
- Local knowledge from existing large client base
- Demonstrated financial performance with audited financial statements
- Experienced, friendly, and knowledgeable staff
- Secure, fully licensed operations (including cash management) that comply with national laws and regulations
- Experience with money transfers and the ability to add money transfers clients, especially to increase the volume of transactions

An MTC will also consider other criteria, such as the MFI's operating hours, financial soundness, and liquidity availability to advance customer payments before reimbursement by the MTC. Because verifying these criteria for many agents can be cumbersome, MTCs usually contract with a few primary agents in each country, often banks. Depending on local regulations, the banks may then sign subagent relationships with MFIs and other institutions. In this case, the MTC's relationship is really with the primary agent (i.e., the bank), and the primary agent is responsible for due diligence on its subagents and negotiating the subagent relationship (Jaramillo 2006).

Box 21: AMUCSS-Envíos Confianza: A grassroots consortium for rural MFIs

Many rural Mexican MFIs are too small to negotiate with MTCs, and as a result, their clients were unable to receive remittances within their community. AMUCSS, which focuses on providing broader access to financial services in rural areas, recognized the need for greater leverage. Joining together mission-driven rural MFIs, it created a consortium called Envíos Confianza. Envíos Confianza has a large network of service points in an underserved specific niche—rural areas, where 45 percent of Mexican immigrants come from—and deals directly with MTCs, giving it significant leverage in negotiations. Envíos Confianza operates the money transfer business in a centralized way and deals directly with four international MTCs.

Adapting to the needs of the MFIs has been the basis for its success. MFIs are the main stockholders and can decide on policies and pricing. A remittance payment software geared to the specific needs of rural areas was developed, using the MFIs' field experience as leverage.

Source: Alexandre Berthaud (executive director of Envíos Confianza) November 2007.

The MFI's Perspective

Thorough due diligence on potential partners is crucial.

The MFI wants a relationship based on trust and transparency. The MFI must select partners carefully, especially as more operators enter the money transfer market. When delivering a transfer payment to a client, the MFI assumes credit risk, because it often has not yet received the actual funds from its international partner. It needs to know that the funds will arrive soon. Likewise, the sending partner relies on the receiving partner to make sure transfers are delivered to recipients. Information on both the sending and receiving side can be difficult to obtain. Receiving institutions may not be able to easily compare different money transfer partners. Likewise, send-side institutions often don't know which partners are reliable and offer good client service in a specific country.

Thorough due diligence on potential partners, including reference checks, verification of legal status, and analysis of their financial viability, is crucial (Isern, Deshpande, and van Doorn 2005).

What the MFI Should Know About a Partner

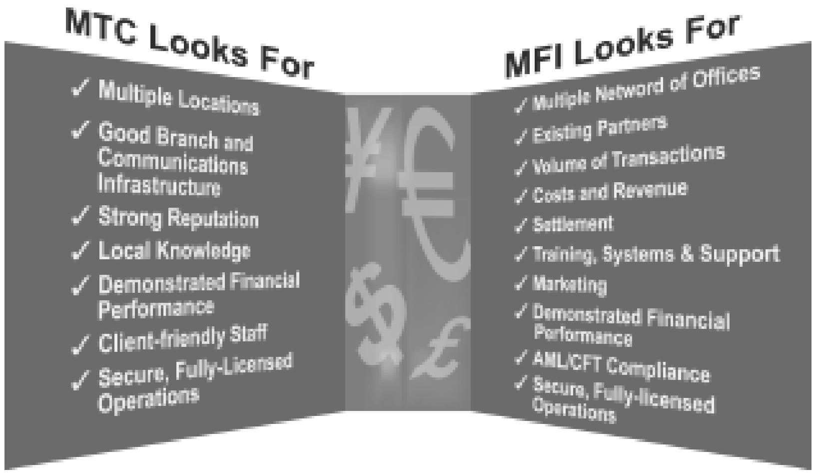
Compatibility. The MFI needs to consider how compatible a potential partner is. Compatibility often begins with sharing a similar philosophy. MFIs should ensure that the MTC fits with their mission and overall strategy. Likewise, the MFI should determine the MTC's success—or lack of success—in managing other relationships (with partners or clients). Understanding the MTC's operations, systems, and products is essential to deciding whether it is compatible with the MFI's own operations. Additionally, the MFI should determine whether the MTC is properly licensed and regulated and how it meets—or expects the MFI to meet—compliance measures.

Business. The MFI should understand the nature of the MTC's business. Is it large with many branches, points of service, and partners? What kind of volume does it handle? Where does it do business? How does the MTC's network of offices in the sending country or region relate to the MFI's target market?

Assistance. Setting up a money transfer operation is a major challenge, and any assistance the MTC can provide will be vital. Some MTCs provide the MFI training, software or hardware systems for processing transactions, assistance with information systems, and/or assistance with marketing.

Operations. Ultimately, day-to-day operations must be compatible for the partnership to work. Each MTC has its own unique way of (and schedule for) originating transactions, clearing and settling transactions, charging for transfers, determining exchange rates, determining and paying commissions and fees, and selling additional products. The MFI should ensure the MTC's practices are acceptable and practical.

"Annex 5: Partner Evaluation: Quick Reference Guide" provides further details and questions an MFI may want to consider.



STAGE ONE: Gather Information and Rank Potential MTC Partners[21]

First, the MFI should gather information on potential MTCs to identify and prioritize those that are potential ideal partners. Contacts and negotiations can then be focused on those companies with more potential for the MFI. In some cases, this information may not be publicly available. The MFI may need to seek information by posing as a client seeking information or by making direct contact with the MTC.

[21] Adapted from Jaramillo 2006.

The MFI should ensure that it has the following information from the MTC and use it to prioritize potential partners:

- **Business model.** Identify whether the MTC works with its own network of offices in the sending country or with subagent contracts. A proprietary network of offices presents more opportunities for cross-selling complementary financial services that the MFI can offer to senders and recipients.
- **Current alliances.** Does the MTC already work with banks in the MFI's country? Identify MTCs that have not already established a large network of banks as paying agents or ones that work mostly with retail companies. An MFI will be more strongly positioned if it can help expand an MTC's network of financial institutions as paying agents.
- **Direct deposit service.** Does the MTC already offer direct deposits into bank accounts? If the MFI offers this service, or could rapidly develop this capacity, it can strengthen its negotiation position.
- **Coverage in the sending country.** Does the MTC have strong coverage in the areas were there is a high concentration of immigrants from the MFI's country? If not, does it plan to expand to these areas in the near future?
- **Coverage in recipient country.** Identify the coverage the MTC has in the recipient country. Determine whether the MFI's branch network complements the MTC's existing network.
- **Cost of service.** How does the cost of the service the MTC offers compare with that of other players in the market? The MFI should determine whether its customer base would be likely to use this MTC given its price structure.
- **Relationship with banks.** Has the MTC had problems with banks in the sending country closing their bank accounts?
- **Legal compliance.** The MTC should be able to show evidence of compliance with money laundering rules and other legal restrictions.
- **Presence in other countries.** Is the MTC expanding its coverage in the MFI's region?
- **Current software and networks in use.** Does the MTC require partners to purchase or acquire specific software? The costs of new software acquisition, staff training, and software maintenance must be part of the assessment of working with an MTC.

Once the MFI has gathered this information, it should rank the MTCs that might make good business partners and begin contacting them to determine their interest in partnering.

STAGE TWO: Contact Potential Partners and Perform Due Diligence[22]

The MFI should contact those prioritized MTCs to determine whether there is potential for a partnership. Once interest is established between potential partners, a process of due diligence begins. Performing **due diligence** involves compiling all the appropriate and necessary information about the potential partner to ensure the partner has a sound business operation and a relationship is in each party's best interests. At this stage, the MFI should consider contacting a lawyer to help negotiate the eventual contract.

Often, before sharing such information, the MTC may request that the MFI sign a legally binding agreement called a **nondisclosure agreement (NDA)** that restricts the MFI from sharing the disclosed information with other parties. Typically, such agreements apply to both parties, but if not, the MFI may request that the MTC also sign an NDA.

Requesting additional information from the MTC

The MFI should ask if the MTC requires an exclusive agreement, because this is an important point that the MFI needs to evaluate.

The MFI should ask the MTC to supply all the information outlined above that was not possible to gather from public sources. Additionally, the MFI should ask whether the MTC requires exclusivity agreements because this is an important point the MFI needs to evaluate before continuing discussions.

The MFI also should ask the MTC if it is interested in linking remittances to other financial services or products. For some products, such as direct deposit of transfers, the support of the MTC will be needed.

Provide Information

The MTC will also want information on the MFI. The MFI should be prepared to supply the following information to strengthen its negotiations with the MTC.

- Information on money transfers experience, current products, alliances, and volume of transfers paid out per month
- Financial performance of the institution
- Estimated percentage of clients that receive remittances as potential market to the MTC (if available)

[22] Adapted from Jaramillo 2006.

- Coverage of MFI network. Present how the MFI's network of branches complement the existing branch network of other MTC partners in the region; highlight presence in urban peripheral neighborhoods and rural areas where traditional bank networks are not present
- Payment instruments. Present the services and products the MFI can use to pay out money transfers, such as payments in cash, direct deposit into a bank account, use of debit or prepaid cards to recipients
- Customer service. Present the services the MFI can offer to support a good customer service, such as use of a call center to notify recipients of transfers or use of dedicated tellers for remittances during high-peak transfer periods
- Cash management. Provide liquidity and cash management policies; explain how the MFI will ensure that its branch network will be able to handle service and cash demands during peak transfer periods
- Range of financial products the MFI can offer recipients. Market these products as bringing added value to senders and recipients and therefore helping to create loyalty for the MTC
- Licensing to do money transfers (if required)
- Evidence of compliance with money-laundering rules
- Technology platform, including current software and payment networks

This stage should establish interest in working together and (potentially) an agreement to move forward.

STAGE THREE: Negotiate Contract[23]

Negotiations with an MTC can take time.

Negotiations can take time, especially for MFIs just entering the money transfer business. The MFI should be prepared for delays, requests for more information, and multiple meetings.

The following sections describe areas of negotiation. Stronger MFIs will likely be able to push for more favorable terms, but even small MFIs should be mindful of these terms, because if they are not favorable, it may signal that the partnership is not in the MFI's best interests. In addition, the MFI should work closely with informed legal counsel that is experienced in contract issues. Legal counsel can help ensure the contract protects the interests of the MFI and can provide advice throughout the negotiations.

Before entering negotiations, the MFI should have in mind the minimum requirements it can afford to accept, specifically in regard to commissions,

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[22] Adapted from Jaramillo 2006 and negotiation guidelines recommended by Dave Grace, October 2006.

Negotiations should benefit both partners. It is important to remind the potential partner of the MFI's strengths.

settlement terms, and exclusivity agreements. Negotiations should benefit both partners, and if the MFI will not benefit from the relationship, it should be willing to walk away from the table. Similarly, the MFI need not renew unfavorable partnerships.

Box 22: Protecting the MFI's interests by analyzing the full costs

Partnering with an MTC can offer an MFI a complete package of services and infrastructure necessary to process money transfers. However, entering into an agency agreement with an MTC does not fit the needs of all institutions. One MFI with rural branches in the Philippines found that domestic long-distance charges for dialing into servers of its MTC partner rendered the entire relationship unprofitable, even though initial training and software had been free. In addition to dial-up charges, transfers incur other costs, such as cashier services, management attention, and office space. MFIs must be particularly careful in assessing the full cost of an agent or subagent arrangement.

Source: Chairman, Philippine MFI (name withheld), 23 June 2004.

Discuss Strengths

It is important to remind the potential partner of the MFI's strengths. Although the MTC will have performed its own due diligence, accentuating the MFI's strengths can add leverage to negotiations.

Negotiate Commission Terms

Determine how the MFI will make money. Consider the following terms:

- **Status Type.** The MFI needs to determine whether it will be an agent or subagent, correspondent bank, or member (in the case of an alliance). If acting as an agent, the MFI should define the terms for marketing and expansion of its network of subagents. If acting as a subagent, the MFI must negotiate with the primary agent to decide how commissions and operations will be divided among the MTC, the agent, and the MFI (subagent).
- **Commissions.** Commissions vary according to the MTC, the volume it manages into the region, and the number of partners it already works with in the region. Some MTCs offer a fixed commission for each remittance paid; others establish a percentage of the amount of the transfer sent as a

commission. It is common to establish commissions based on the volume the MFI will pay out. It is often an effective strategy to hear the MTC's offer first. Likewise, the MFI can use the commission agreements that it has been able to establish with other MTCs to strengthen its position.

- **Settlement.** The MTC should provide next-business-day settlement for all money transfers and commissions due the MFI. Inability to accommodate this policy may be indicative of the MTC's financial problems. If the MTC does not settle quickly, it may be generating additional income on float at the MFI's expense. The longer the duration between payment and settlement, the greater the credit risk for the MFI. The MFI should make sure it can fund the payments for whatever timeframe is negotiated. To compensate for time between payment and settlement, the MTC should be willing to prefund between 10 and 25 percent of the highest daily payout by placing a security deposit with the MFI or the MFI's financial institution.

Negotiate Other Terms

In addition to money matters, there are multiple benefits the MFI can look for in a partnership:

- **Access to networks.** Many MTCs have access to payment networks (such as SWIFT or their own proprietary networks) that require an annual license fee. The MFI should determine what access it will be granted and what, if any, fees are required.
- **Access to data.** The MFI will want access to the MTC's customer data to understand the profile of recipients and to determine strategies for cross-selling financial products.
- **Access to technology.** To smooth communications or transfer information, it may be necessary to share software or communications equipment. The MFI should ensure that cost outlays on infrastructure are fair. It may be that the MFI can share software licenses or hardware. The MFI should make sure the technology teams of both institutions meet so that the feasibility of all the technological implications is evaluated.
- **Exclusivity.** The MFI should seek nonexclusive relationships so that it has greater flexibility in partnering with others.
- **Competition restrictions.** The MFI should seek to limit its competition with other agents of the MTC. Sometimes this means expanding regional territories.

The MFI should seek non-exclusive relationships so that it has greater flexibility in partnering with others.

- **Duration of partnership.** Typically, partnerships are established for one year, with the option to renew annually (pending agreement by both parties). Such a duration not only limits the MFI's liability if the relationship turns out badly, but it also allows the MFI to negotiate better terms if its position in the market has become stronger. In addition, the MFI should ensure that either party can cancel the contract immediately with written notice for noncompliance or with 180 days advance written notice for any reason.
- **Marketing.** The MFI should establish the expected action and financial contributions from each side to promote the product. The MTC should agree to pay for most of the sales materials or at least share costs. It is also important to negotiate with the MTC a campaign to help launch the service with the MFI, including support to make the name and brand of the MFI recognized as a paying agent for the MTC.
- **Logo use.** Logos represent institutions and are powerful marketing tools. The MFI should negotiate the use of the MTC's logo and ensure that its own logo is fairly represented on marketing materials.
- **Foreign exchange.** Foreign exchange revenue is a significant component of the overall revenue in international money transfers. In addition to the fee per transaction, the MFI is entitled to a percentage of the foreign exchange revenue. Some MTCs may resist sharing foreign exchange revenues or suggest that it is too complicated to calculate given the floating rates. MFIs should know their rights and learn the practices of other institutions in the country or region.
- **Jurisdictional court.** Most contracts clarify the jurisdiction where disputes and legal issues will be settled. The MFI should aim to settle disputes in its home jurisdiction, where possible. Further, it may be more effective to use arbitration courts as the first option to resolve a legal dispute.

Concluding Thoughts

The money transfer market offers tantalizing opportunities for the MFI, but the risks can be high. The MFI should proceed with caution in evaluating the potential for such services. It should learn from the experience of institutions that have already launched them.

Beginning a money transfer business can be difficult and daunting, but the rewards of a successful operation could be significant.

The considerations discussed in this guide, while often cautionary, are meant to aid the serious MFI in a thoughtful and well-planned undertaking. Beginning a money transfer business can be difficult and daunting, but the rewards of a successful operation can be significant. As migration expands within developing countries and globally, and as financial sectors develop, the demand for money transfer products will continue to increase. In addition, clients, governments, and businesses are increasingly adopting card-based transactions and EFTs. Satisfying this growing demand will aid the MFI's bottom line, attract potential new clients, and help serve low-income clients by creating the essential services they need.

Annex 1: The Building Blocks of Retail Money Transfers: Payment Systems and Payment Instruments

TRANSFERRING FUNDS

People of all economic backgrounds engage in money transfers with other individuals, households, and businesses. They transfer money to meet everyday financial obligations, like bill payments. They also transfer money for less common reasons like providing money to children away at school, sending money to family members living elsewhere, or transferring partial earnings to other parties.

These **fund transfers** take many forms. Some people use formal services provided by banks or other financial institutions. People without bank accounts or without access to formal services typically use less formal channels.[24] They often face greater risks and higher costs as a result.

Payment systems are the institutions, networks, people, rules, and technologies that make the exchange of payments possible. The **Committee on Payment and Settlement Systems (CPSS)** of the Bank of International Settlements defines a payment system as consisting of a set of instruments, banking procedures, and typically, interbank funds transfer systems that ensure the circulation of money.[25] This infrastructure provides a crucial economic function by facilitating movements of money from payers to payees domestically and internationally.

Payment instruments are the mechanisms that people, businesses, and governments use to transfer money in the settlement of exchange transactions. These instruments take many forms and have many uses (see Table 2). A businesswoman may use cash to settle an exchange of goods in a local market; a merchant may use a credit card to pay for services; some businesses pay their wages by check or through direct deposit to their employees' bank accounts; and many people use EFTs to pay utility bills, taxes, and other bills.

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[24] See Annex 2 for a more detailed description of formal, semi-formal, and informal money transfer systems.

[25] CPSS Glossary of terms used in payments and settlement systems. http://www.bis.org/publ/cpss00b.htm

Table 2: Uses of fund transfers

To: / From:	Customer	Business	Financial Service Provider	Government
Consumer	-Gifts -Reimbursements -Purchases -Loans -Rents	-Purchases -Bill payments	-Service fees and charges -Securities purchase -Insurance premiums -Loan repayment	-Taxes -License fees
Business	-Salaries -Expenses -Dividends	-Purchases -Bill payments -Rents	-Service fees and charges -Securities purchase -Insurance premium -Investment -Loan repayment	-Taxes -Withholdings -License fees
Financial Service Provider	-Dividends -Redemptions -Insurance claims -Interest	-Purchases -Bill payments	-Securities transfer -Purchase of services	-Taxes
Government	-Benefit transfers -Tax refunds -Salaries	-Purchases -Vendor payments -Tax refunds	-Tax refunds -Purchase of services -Loan repayment	-National to local governments and interdepartmental transfers

Payment instruments have evolved over time from barter to commodity-based schemes, to coins and currency, to card-based methods, and more recently, to other electronic instruments. Each of these developments has reduced the costs and risks of commerce and trade. This process continues today as technological innovations, such as the Internet and mobile telephones, new institutions, and regulatory changes stimulate new payment methods that allow money to move more easily and quickly, and at ever lower transaction costs.

Except for cash and some stored-value devices, every payment instrument is based on the transfer of money from one institution to another or from one bank account to another. Accordingly, bank accounts are an integral part of the payment infrastructure. Thus, people who do not have bank accounts—whether by choice or because of exclusion—have limited choices of payment systems and instruments. By offering money transfer services, MFIs may be able to increase options for unbanked clients.

FUND TRANSFER TYPES

Money transfers fall into three broad categories: occasional transfers, regular transfers, and remittances.

Occasional transfers occur when people need to transfer money quickly in response to a particular situation, such as someone facing an emergency, or to place a deposit on the purchase of an asset. Such transfers are typically one-time events and of moderate to high value.

Regular transfers include ongoing, regular payments between people, businesses, and/or government agencies. Examples include salary payments to employees, savings, monthly rent payments, pension payments from government or business to individuals, and monthly or quarterly school or utility fees.

Remittances are transfers from workers living elsewhere (nationally or internationally) to family, friends, and communities back home. Worker remittances generally involve small amounts—typically US$100 to US$1,000, with an average of US$200 (Sander 2003)—transferred to lower income individuals or households. **Domestic remittances** are fund transfers within a region, typically from urban to rural areas. **International remittances** are cross-border person-to-person payments of relatively low value. In practice, transfers are typically recurrent payments by migrant workers.

A large share of remittances is originated and disbursed in cash through retail outlets of MTCs. Payment cards and electronic networks are increasingly being used as mechanisms for remittances.

To be used effectively, each of these money transfer types requires an adequate infrastructure. Money transfer networks must have convenient locations for sending and receiving transfers, but around the world, rural areas typically have fewer numbers of financial service providers, and the formal financial infrastructure is often weak or nonexistent. Even when they are accessible, financial service providers may be unwilling or unable to cash national checks or foreign money orders or receive international transfers.

Whatever the reasons, limited access can have severe effects on families whose sustenance depends on timely receipt of transfers. To be effective, money transfer systems must ensure access for clients on both sides of the transaction—senders and recipients. Because the MFI typically has a good understanding of its country environment and clients, it can play an important role in its country's money transfer market.

RETAIL PAYMENT SYSTEMS

Payment systems are often classified as retail or wholesale.[26] The **retail sector** (sometimes called the consumer sector) is made up of institutions and service providers that focus on serving individuals, households, and small businesses. Within the retail sector, payment systems can be broadly classified by the money type used in the settlement of payment (cash or account-based) and/or by the medium used for payment (currency, paper, card, or electronic). **Wholesale** payments are provided, for the most part, to financial institutions.[27]

Cash payments always involve an immediate transfer of value directly from payer to payee, such as a consumer purchasing food at a store with cash.

Account-based payments usually involve exchange instructions that order a transfer of value between accounts held at financial institutions. They require that one or both of the counterparties have a banking relationship at their respective institutions. People with no access to bank accounts are excluded from account-based payments.

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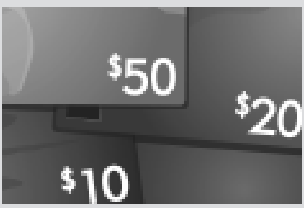
[26] Retail payments differ from other types in several ways. First, retail payments are typically made in large numbers of transactions and usually involve purchases of goods and services in both the consumer and business sectors—rather than, for example, wholesale settlements of transactions between financial institutions. Second, retail payments are made using a much wider range of payment instruments than larger value wholesale payments and in more varied contexts, including payments made in person at a POS as well as remote consumer and commercial transactions. Third, retail payment markets make extensive use of private systems for the transaction process and for clearing.

[27] In some countries (e.g., Turkey, Brazil, Mexico, etc.), consumers also have access to large-value payment systems.

Table 3: Payment media and their corresponding money type

	Money Type	
Payment media	**Cash**	**Account-based**
Currency 	-Banknotes and coins -Hawala	
Paper 	-Checks and drafts -Promissory notes -Money orders -Travelers checks -Bills of exchange	-Checks -Credit transfers (paper giro)
Card 	-Prepaid cards -Stored-value cards	-Debit cards -Credit cards -Charge cards -Card to card
Electronic 	-Digital cash	-Account transfers (intrabank and interbank) -Money transmission operations -Automated clearing house (ACH) debits and credits -Domestic wire (bank and private EFTs) -International wire (SWIFT, Telex) -Other Internet and mobile forms, such as mobile phone platforms -Electronic bill payments -Person-to-person payments

PAYMENT INSTRUMENTS

In all developed economies and increasingly in emerging ones, there is more variety of available payment systems and instruments. A payment system can be as simple as handing cash to a merchant in exchange for some goods or as complex as an international, multibank transfer of electronic funds.

An MFI creates money transfer **products** by packaging a specific payment instrument with the institution's terms and conditions of service. Although institutions often will promote their products in interesting ways and include various enticing features, every product can be simplified to a particular type of payment instrument.

The following sections discuss the use of various instruments in the money transfers industry, especially in developing countries.

Cash-based Payments and Transfers

Cash is the simplest type of retail payment instrument. A cash payment is the exchange of currency and coins with a face value established by the government and where final settlement occurs simultaneously with the cash handover. In developed countries, cash is the payment medium for 50 to 80 percent of retail payment transactions in terms of volume but less than 5 percent in terms of value (Donges 2003). In many developing countries, cash is still used extensively for paying wages, conducting most retail transactions, and settling many business transactions.

For low-income households, especially in developing countries, nearly all transactions are in cash. Despite efforts to move money into bank accounts, where it can be multiplied into loans to fuel investment, use of cash remains a significant part of many economies. Wage payments in cash are common, particularly among microenterprises, agricultural businesses, and companies in rural areas with limited access to banking facilities. Even when wages are required to be paid by check or directly into bank accounts, most lower income workers immediately convert the checks into cash or withdraw their pay from the accounts.

Many small enterprises and microenterprises operate solely on a cash basis, receiving cash from customers and paying it to employees and suppliers. Cash can be more expensive than other forms of payment for retailers—particularly in the small values typical of cash transactions at the **point of sale** (**POS**)—because it requires additional processing that can be time-consuming and costly, including tendering the cash register, balancing cash received to sales, preparing cash deposits, and managing store cash. In small stores and markets, cash received for goods and services seldom goes to banks. Some merchants prefer to deal in cash to avoid registering sales and collecting and reporting taxes based on them.

Hand-carried cash remittances and those transmitted through informal channels are difficult to estimate, and they differ greatly by country, reflecting the severity of foreign exchange control systems, effectiveness of taxation systems, mobility of migrants, the state of the payment systems infrastructure, and the structure of incentives for remitting funds. Nevertheless, the use of cash will likely remain the biggest competitor to other types of payment instruments.

Transfers can be made on a cash-to-cash basis through the purchase of paper, card, or EFT instruments. The sender pays in cash, and the funds move to the recipient for payout in cash (at banks, postal branches, check cashers, currency exchanges, retail stores, and nonbank check cashing firms).

The cashless society predicted over the past three decades is a long way off. In developed countries, card payments have reduced the use of cash, especially for purchases. But cash and checks remain prevalent, and in developing countries, cash will remain the dominant payment instrument until countries adapt and develop the needed financial infrastructure. As a result, the use of cash will likely remain the biggest competitor to other types of payment instruments.

Paper-based Payments and Transfers

Paper documents have been used to transmit money since the 14th century. Paper-based payments contain only the instructions to move the money from the payer to the payee. The actual flow of money occurs in the transfer of monetary balances between accounts in intermediary financial institutions. Paper-based payments include bank checks, drafts, money orders, traveler's checks, international payment orders, and some giro transfers.

A **check** is a demand draft drawn on a bank, payable to a designated payee, and transferable to another person by endorsement. Checks are widely used by individuals and businesses in several developed countries (e.g., Australia, Canada, France, United Kingdom, United States) to settle financial obligations. In many other countries, including most developing ones, checks are not actively used by retail customers and are only in limited use for commercial and interbank purposes. Use of checks as retail payment instruments is declining rapidly everywhere as cards and electronic payments gain favor.

The writing of a check by the payer and the **acceptance of a check** by the payee does not constitute final payment. The check must first be deposited in the payee's bank, then sent to the bank on which it is drawn for posting to the payer's account. The funds are transferred to the payee's account only after sufficient time has passed for the paying bank to dishonor the check. This process is called **check clearing** and, even in a well-developed check clearing network, it may take from overnight to several days—while in a country with low clearing automation, settlement may take several weeks.

In countries where they are common, checks are widely used by businesses to pay salaries, pay dividends to shareholders, make trade payments (to suppliers of goods and services), and conduct various other payments. In active check countries, check cashing outlets allow people to cash payroll, government, and personal checks for a fee, usually a percentage of the check amount. In addition, many large retailers, such as supermarkets, are willing to cash payroll checks from well-known companies as a service for customers. These businesses usually provide other services, including money orders, money transmission services, and bill payment. Sometimes they also offer payday loans. In active check countries, checks are also used as a payment instrument at stores and service establishments and for remote bill payments—though the risk of fraudulent presentation and the possible return of unpaid checks sometimes limit the willingness of businesses to accept checks. To limit the number of returned checks, steps have been taken by banks (by imposing heavy penalty fees on accounts until checks are paid) and businesses (by using check verification services).

Checks are a convenient, low-cost instrument for transferring funds—except for recipients without bank accounts or for cross-border transfers. If the recipient is in the same country and the check is drawn on a national bank with local branch offices, cashing the check is usually not a problem. But if there are no nearby branches and the check must be cashed at another bank, the collecting bank may charge a fee, and clearing can take up to six weeks. In some countries, foreign exchange restrictions may apply. Issuing checks and bank drafts is generally limited by law to regulated financial institutions, such as banks and most credit unions. Check transfers also depend on postal reliability, which is often lacking in developing countries, so clients risk losing checks and drafts in the mail. Even in the best cases, recipient must wait for a check to arrive and then for the funds to clear the banking system (Isern, Deshpande, and van Doorn 2005).

Official checks and foreign drafts are instruments banks issue to send money to payees domestically or abroad. Both are drawn on a bank and signed by a bank officer. An official check is in the national currency, and it is typically used to make a domestic payment. A foreign draft is in national or foreign currency and is payable through a partner bank in the destination country. Official checks are mainly used to pay taxes, make high-value purchases, or make payments through the mail. Foreign currency drafts are often used to send money in the recipient's currency or to pay for purchases overseas. A business may attach a foreign draft to an invoice to pay a foreign bill, making it easier for the recipient to apply the funds to the correct account. Businesses also may use them when other forms of payment are not feasible. Banks offer such checks to both clients and nonclients, usually for a fee. Because the transaction relies on paper from end to end, it is by far the slowest means of payment and carries relatively high risks of loss and delay. Many banks are increasing their fees for official checks and drafts to steer clients toward more automated and efficient electronic products.

A **money order** is a limited amount payment instrument that provides an order from the issuer to the remitter to pay a sum of money to the person (payee or beneficiary) named in the money order. Money orders are purchased for their face value plus a service charge of US$1 to US$10 (or a percentage of the total amount) from banks, post offices, and other nonbank outlets. Money orders give people without bank accounts a paper-based means of transferring funds. The issuer serves as a depository for the funds from the time of a money order's sale to its encashment. The float on these funds is the main source of revenue for money order issuers.

Commercial issuers like First Data Corporation (which issues money orders under the American Express and the Western Union brand names) and Viad Corporation (which issues them under Travelers Express) account for most money order revenues and outlets. Some banks issue money orders under their own names or through firms, such as Western Union. Post offices operate through their own network of offices and agents both nationally and internationally. Third-party money order issuers usually operate through their own branches and through agents, such as check-cashing outlets, convenience stores, grocery stores, supermarkets, and other retailers.

Money orders traditionally have been paper-based instruments, but unlike checks, they can be issued by and redeemed at a variety of places. Major issuers of money orders include postal financial institutions and MTCs, such as Western Union and MoneyGram. Money orders do not require a bank account; a recipient receives cash upon presenting the money order to an authorized paying agent (a bank branch, a post office, money transfer agent, etc.). This process also reduces the time a recipient must wait to access the transferred funds, compared to checks or bank drafts. However, given the need for money orders to be physically delivered to a recipient, they are subject to some of the same risks of delay and theft. Postal money orders are now estimated to provide only 1 percent of formal international money transfers. In contrast, postal networks play a very important role in domestic transfer markets in many countries. China Post, for example, manages 90 percent of cash-based transfers within the country. In Bulgaria, the post office processes three times more cash payments than do all commercial banks together. Although the volume of these transactions is large, their value is estimated at only 2 percent of the value of cash payments processed by banks—a trend visible in the majority of countries of Eastern Europe and Central Asia (Boon and Greathouse forthcoming).

Card-based Payments and Transfers

Using cards to make money transfers has become routine for many people around the world. In most developed countries, large portions of the population have one or more debit or credit cards and almost everywhere these people shop (in retail outlets, by telephone, on the Internet), their cards are readily accepted as payment.[28] However, many developing countries have fewer cardholders and acceptance places. Since their introduction in the late 1950s, payment cards have been provided by two main suppliers: commercial banks that make up bank card associations (Visa and MasterCard) and third-party issuers (American Express, Diners Club, Discover, JCB). Visa and MasterCard are one of the factors driving the extraordinary growth of the payment card market in developed countries.

The use of payment cards for money transfers is fairly new, and there are some constraints because credit card clearing and settlement systems are

[28] For more background on technology for financial services, see Ivatury 2006.

designed primarily to facilitate merchandise purchases. However, credit card issuers are finding ways to extend their usefulness and to expand the number of places where cards can be used. These initiatives have produced innovative ways to send money (see Box 23). There is little doubt that payment cards will continue to displace cash and checks and to capture a growing share of consumer spending.

Box 23: Enabling affordable, card-based international remittances

Card-to-card-based fund transfers are a recent development in international remittances. The service was introduced to provide European banks with a low-cost cross-border money transfer scheme. The service is limited to cards issued in Europe, but it is likely to expand elsewhere in the future. Visa offers the service under the name Visa Direct, and MasterCard under the name MoneySend. The two services work in similar ways. To use MoneySend, both cardholders must be registered with their financial institutions. On the Internet, the sender enters a user name, password, and the email address of the recipient. By telephone, the sender uses an interactive voice response system, entering the mobile phone number of the recipient. The recipient then takes his or her card to an ATM to withdraw the money. Because both the sender and receiver must be registered, use of the service is limited to people with credit card accounts or deposit accounts accessible with debit cards. In addition, Visa has an alliance with Eurogiro that allows for transfers to be sent to any institution affiliated with the Eurogiro scheme.

Credit cards are unique among payment products in that they are both payment instruments and credit instruments. Consumers use credit cards as a substitute for cash and checks when buying goods and services at retail outlets or by mail, telephone, or the Internet. Credit cards are increasingly used to make periodic preauthorized payments and to transfer funds. The credit card business, although concentrated in some markets, is rapidly expanding globally, highly competitive, and innovative. One of the main benefits of credit cards is the convenience they offer in allowing cardholders to arrange their spending independent of the availability of cash in their wallets or bank accounts. However, credit cards require an account with the issuing institution. Many low-income clients do not have access to credit cards, especially in developing countries.

Debit cards play a vital role in providing access to bank products and accounts. A bank card is considered a debit card when its main role is to access an account classified as a liability on the books of the card issuer. To use a debit card, a customer must hold an account with a depository institution. Debits may be cash withdrawals at ATMs or branch offices, payments to merchants for goods and services, and Internet transactions. MFIs that are allowed to collect deposits could consider debit cards as one element for their money transfers strategy.

Debit cards can be online debit cards or deferred debit cards. **Online cards** are linked to bank deposit accounts and can be used only at merchants with POS terminals or at other automated banking terminals. Purchase transactions are transmitted to the issuer through private EFT networks or card authorization networks; the amounts are then debited from the available balance in the account linked to the card. Because the account is checked each time it is used, the cardholder cannot inadvertently become overdrawn. Thus there is no credit risk associated with the issuance of such cards, and any legal party to a deposit account can be issued a card. Such cards are well-suited to the banking systems of developing countries.

Deferred (offline) debit cards are linked to bank deposits and can be used on a voucher or electronic basis. The cards—usually standard embossed cards that bear the acceptance marks of Visa or MasterCard—are sometimes called check cards because their deferred clearing cycle simulates that of a check float. All transactions initiated on deferred debit cards are first sent to the acquirer, then through the credit card clearing system to the issuer for posting to the linked deposit account within a day or two of the purchase. Although most transactions are authorized online and captured electronically, they also can be originated by manual merchants.

In many countries banks use debit cards as part of their card-based commercial payroll services for corporate clients. On payday, the employer deposits employees' pay in the bank, the bank distributes the wages to employee accounts, and employees go to ATMs to retrieve their money. Such services are often loss-making or subsidized by the corporate client, because most employees withdraw their pay immediately.

Debit cards are also useful for international (or national) remittances. The remittance sender opens an account at a bank in the guest country and receives one or two debit cards. The remittance sender provides one of the debit cards and security code (e.g., personal identification number [PIN]) to his or her family in the home country. The family member can withdraw cash from an ATM or use the debit card at any authorized **POS** ("point of sale" or "point of service"). The sender controls how much he or she deposits into the account, and funds can then be withdrawn, usually with limited charges, such as ATM fees.

ATMs accessible with debit cards have begun to play a major role in money transfers, particularly in substituting electronic transfers for money orders. ATMs have long been used for account-to-account transfers, but only recently has that capability been extended to third-party and international transfers. Although the density of ATMs is growing around the world, they are still not ubiquitous in every part of every country.

Visa Giro is a cost-effective alternative to banks and businesses. Visa Giro is a Visa debit card that is accepted in most places that accept Visa in Latin America. Remitters add value to the card at an MTC in the United States. An allied bank in Latin America distributes a card, which contains the money credited, to the recipient. Because the transfer is electronic, sending costs are reduced substantially. Visa Giro is currently working in alliances between Latin American banks and money transfer businesses. Examples include Banco Uno and Gigante Express and Banco Cuscatlan and its MTC, Corfinge, in Central America. In Mexico, HSBC (formerly Banco Bital) has an alliance with Quisqueyana, and in the Dominican Republic, Quisqueyana has an alliance with Banco Mercantil, using a product known as Cashpin (Orozco 2003b).

Since its inception in the 1990s, the **prepaid card** has become the fastest growing payment product in the financial services industry, with an estimated US$160 billion in volume in 2004 (Donges, unpublished). Most of this activity has taken place in the United States where the cards first found widespread application as gift and payroll cards, but their use is rapidly extending into Europe and Asia. Prepaid cards offer a great deal of flexibility for financial institutions to develop card products and target cash-based consumers who cannot or do not access more formal financial channels. The cards look and work like debit cards, but no transaction account is involved, and many types of institutions and vendors can sell prepaid cards. Clients can buy prepaid cards with cash or other money instruments in standard amounts predetermined by the issuer, or in tailored amounts determined by the client. A prefunded value is stored on a remote database accessed using the same magnetic-stripe card and card acceptance device infrastructure as debit and credit cards. After the value loaded to a card account has been spent, the cardholder can add value by depositing cash or other money instruments at a branch office of the issuer, an ATM operated by the issuer, or another authorized location.

Several money transfer schemes have been developed based on open, universal prepaid cards. This builds on the growing customer acceptance of prepaid cards that are used with cellular telephones in many countries. One prevalent use of prepaid cards is to facilitate the transfer of funds by migrant workers to their home countries. The bank or nonbank service provider issues one card for the sender and one for the recipient, who can use the card to withdraw cash from an ATM or to make purchases wherever the card is accepted. Access to a broad network of affiliated ATMs and merchants is an essential part of this service—and it is a challenge in many developing countries. An example of such a program is Citibank's Money Card, limited to transfers between the United States and Mexico. Money Card charges US$7.95 per wire transfer, plus a US$5 monthly maintenance fee (Orozco 2003a).

Table 4: Credit, debit, and prepaid cards: a comparison

	Customer	Benefits	Challenges
Credit Cards	Payment and credit insruments	Convenience: cardholders can arrange their spending independent of the availability of cash in their wallets or bank accounts.	Potential cardholders need to have reasonably stable incomes. Not accessible for many low-income clients. The MFI offering this service must have membership in a bank card association or create an alliance with a bank.

	Customer	Benefits	Challenges
Debit Cards	Main purpose is access to an account classified as a liability on the books of the card issuer.	Vital role in providing access to banking services. Useful for international (or national) remittances.	Low density of ATMs in developing countries. The MFI offering this service must have membership in a bank card association or create an alliance with a bank.
Prepaid Cards	Look and work like debit cards, but no transaction account is involved. A pre-funded value stored on a remote database.	Convenience: Universal prepaid card can be used at any location that accepts credit or debit cards; a prepaid card program involves much less counterparty credit risk than a credit card program.	Low density of ATMs in developing countries. The MFI typically must ally with a card issuer to launch and maintain this service.

Electronic Payments and Transfers

EFTs use computers and telecommunications to transfer money between accounts in the same or different institutions. Most EFT schemes directly or indirectly involve a financial institution in initiation, clearing, or settlement of transfers.[29] Such transfers are mainly used for low- to medium-value payments. These transfers provide a reasonably timely, reliable method of ensuring money is received by beneficiaries. The range of EFT products and services is extensive and constantly growing as participants find new ways to apply technology in the process. However, because EFTs typically require both sender and receiver to have a bank account, such transfers remain beyond the reach of many lower income clients. Types of EFTs are summarized below.

[29] To date, a majority of cell phone banking programs are linked to banks. However, given the growth in banking using cell phone platforms, a few money transfer programs are being piloted by mobile phone operators without a link to a bank.

Intrabank account money transfers occur between accounts held at the same institution. Such transfers allow people to move money from one account to another to make the best use of available funds, for example to make loan payments, pay on a credit card balance, shift funds from term deposits to checking accounts, etc. Another example is a cross-account transfer that moves funds between two different clients' accounts. Some banks allow for intrabank transfers to designated noncustomers or named beneficiaries; they hold the funds until the beneficiaries claim them in person at the bank. If the bank has international branches, it may provide for international fund transfers on an account-to-account basis.

Account transfers are initiated by the account holder or set up on a recurring basis. The origination may be in person or by ATM, telephone, or Internet. Some large banks offer account-based money transfers to recipients with accounts at overseas branches or partner banks. Financial institutions charge little or nothing for account-to-account transfers. For example, Bank of America now offers free intrabank account transfers between the United States and Mexico.

Direct debits are a type of ETF in which the payer authorizes the payee to debit the payer's account for a specific amount. This instrument is mainly used for consumer bills—both for frequent, recurring payments of fixed amounts, such as life insurance premiums, and for variable amounts, such as telephone, utility, credit card, and other bills. Direct debits are widely used for bill payments in Europe, and much less so in the United States and many developing countries. The costs of direct debits are usually borne by the payee. Direct debiting requires a bank account from which automatic debits are preauthorized by the account holder.

Wire transfers are the fastest, safest way to send money domestically or internationally through the banking system. Banks and credit unions offer a variety of EFT systems for use in retail interbank transfers, ranging from corporate systems for high-value transfers to specialized offerings for worker remittances.

Wire transfers usually require both the sender and receiver to have bank accounts. Even though a wire transfer may be received within minutes of its transmission, it may take two to three days (or longer, especially among small banks in developing countries) for the beneficiary to receive the funds. Many of the costs in wire transfers are fixed costs independent of the value of the transfer; thus, small-value transfers may appear expensive. The costs of wire transfers are borne by the beneficiary, the remitter, or both and vary by bank and whether the transfer is sent domestically or internationally.

Automated clearinghouse (ACH) and **large-value funds transfer system (LVTS)** allow member financial institutions to exchange payment instructions and settle obligations electronically. ACH is a batch-process settlement system, where transactions are typically settled overnight, which incurs lower costs than a real-time gross settlement system. LVTS is a settlement system typically used by large corporations, currency dealers, and others for the immediate and real-time transfer of funds. Examples of LVTSs include the U.S. FEDWIRE, U.K. CHAPS, Turkey EFT, and the Eurozone TARGET. In many but not all cases, the transfer involves an immediate debit and credit to the sending and receiving banks' clearing accounts at the central bank. Other transfers settle on a queuing basis or with a net settlement. ACHs play a critical role in payments and money transfers in both developed and developing countries. ACHs can move payments from an originating institution to a receiving institution reliably and at low cost. They serve as the primary means of distributing wages, paying bills, funding prepaid cards, and conducting person-to-person payments. ACHs also play a role in the settlement of payments between participants in EFT networks as well as between agents and MTCs. An ACH may be owned and operated by the central bank, bank associations, commercial interests, or a combination of these.

All developed and many developing countries have at least one ACH. Some ACHs operate only on an interbank basis, with direct participation limited to licensed deposit-taking institutions, while others allow for broader participation by all types of financial institutions. An MFI may not have direct access to the clearinghouse and may be required to pass through another financial institution to process transactions.

At the international level, the most commonly used system for facilitating EFTs is operated by the **Society for Worldwide Inter-bank Financial Telecommunication (SWIFT)**, an industry-owned cooperative that provides real-time payment messaging services to member institutions. Messages routed over SWIFT are simply instructions to transfer funds; the actual exchange or settlement of the funds takes place subsequently through a payment system or correspondent banking relationships. SWIFT is often the cheapest option for high-value commercial transactions between financial institutions, but it can be expensive for small transfers. For this reason, most payments processed by SWIFT are not individual person-to-person transfers, but larger payments between businesses or between businesses and consumers, such as university tuition. Banks may bundle and send a batch of person-to-person transfers via SWIFT (Isern, Deshpande, and van Doorn 2005).

SWIFT is not really a money transfer system as popularly thought but a interbank messaging system that carries payment orders from an originating SWIFT member bank through the SWIFT network to a receiving SWIFT member bank. The actual transfer of funds follows a different path through the correspondent bank accounts the various banks involved in the transfer hold with each other.

Like most bank technology, wire transfers are undergoing rapid changes as more institutions take advantage of the increasing security available to protect financial transactions over the Internet and as traditional high-value networks (such as SWIFT) broaden their services to include domestic retail payments and lower value transactions.

MFIs and other nonbank institutions may not have access to wire transfer networks. Although some credit unions have direct access to such systems or access through a national federation, most nonbank institutions are restricted by law from becoming part of a domestic payment system. The institution's technical capacity can represent another hurdle to accessing payment networks. The cost, information technology, and staff capacity required to connect with EFT systems can be significant. Although financial service providers can often link to EFT systems through alliances with banks, the resulting transaction entails a certain loss of competitive privacy, because the intermediary bank necessarily obtains information about the institution's money transfer business. The cost of joining SWIFT is a major obstacle for smaller institutions. In addition to buying shares, SWIFT members pay a one-time membership fee of several thousand euros, plus a yearly fee of over €1,000 per routing code. The number of codes an institution buys usually depends on the number of its branches or divisions that are linked to SWIFT.

Giro is the term used for the electronic cross-border payments offered by post offices in more than 40 countries. This system enables holders of a postal bank account to send money—domestically or overseas—to another postal account, a bank account, or a post office for cash payment. It generally takes two to four days to receive a giro transfer. The international service is often used by small entrepreneurs for import and export payments. Although sending a giro requires a postal bank account, these banks tend to have more widespread locations than commercial banks. Postal giros tend to be cheaper than bank transfers for small amounts. Barriers to access for poor clients, therefore, tend to be lower than for checks or commercial bank transfers. To cite a regional example, postal networks in North Africa provide account-based giro services that are highly popular with students and low- and middle-income groups who find it difficult to open checking accounts at commercial banks (Boon and Greathouse, forthcoming).

Internet funds transfers are growing rapidly with the increasing popularity of **e-commerce** and considerable innovations in retail payments. Internet funds transfer systems can be used to enter instructions into a Web site to initiate the movement of funds from account to account. In most of the schemes to date, the Internet serves primarily as a channel of communication between the payer and payee, with the remainder of the payment process carried out using traditional debit and credit cards or EFT mechanisms. Many of these methods use security mechanisms that address the issues of privacy and risk inherent in the use of public networks, such as encryption, digital signatures, public key infrastructure, etc. Internet-based transfers require two prerequisites that may block lower income people from using the service: (a) access to the Internet and (b) access to an account to send or receive funds.

Mobile payments involve the use of a mobile communication device, such as a mobile phone, personal digital assistant, wireless tablet, or mobile computer. First launched in 1983, mobile phone use has grown to more than 3 billion subscribers worldwide—a number expected to grow to 4 billion by 2010 (GSM Association 2007). In many developing countries, wireless networks have become the primary means of voice and data communication. The use of mobile telephones in applications involving the transmission of money between parties is growing rapidly (see Box 24).

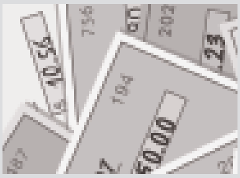
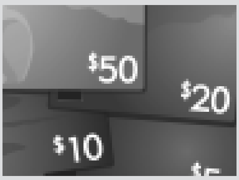
Box 24: G-Cash in the Philippines

Globe Telecom, the largest cell phone company in the Philippines, recently launched a phone-based remittance service called G-Cash that allows Filipinos working abroad to send money home more quickly and at a lower cost than through MTCs. The potential market is huge: 8 million Filipinos working abroad sent US$7.6 billion home in 2005, and about 30 percent of the country's 84 million people use cell phones.

Mobile phone subscribers register for G-Cash by keying in personal information, including their mother's maiden name, for identification purposes. Within the Philippines, cash can be credited to the phone account by visiting an authorized outlet, filling in a form, and presenting identification. The fee for this is 1 percent of the transferred amount, or a minimum of 10 pesos (US$0.20). The money can be transferred to another phone by keying in the sender's PIN, a simple code, and the recipient's phone number. The cost is the same as sending a text message, 1 peso (US$0.02). The recipient receives a text message confirming the transfer and then withdraws the cash by visiting any authorized G-Cash agent. Outlets include Globe Telecom centers; selected retailers, such as 7-Eleven; and pawnshops.

Globe Telecom is creating a network of overseas outlets where migrants can deposit cash. At present, coverage is provided in Hong Kong, Italy, Singapore, Taiwan, and the United Kingdom. The worker abroad goes to any of the phone company's remittance partners in 17 countries and pays to preload the phone. He or she then sends a text message, advising the recipient in the Philippines of the transfer. The money is instantly credited to the recipient's account with the phone company and to a "smart" debit card that enables the recipient to withdrawal the money at ATMs around the country, using a PIN to guard against fraud. Sending a payment from the United Kingdom costs £7 (US$13). The service offers an innovative, low-cost means of making cash-to-cash transfers. Neither party is required to have a bank account (G-cash presentation 2005).

Table 5: Summary: Advantages and disadvantages of money transfer mechanisms for customers and financial service partners[30]

	Customer	Financial Service Providers (FSPs)	Restrictions to Access by FSPs
Paper-based payments and transfers 	Slow; subject to loss/theft; must be physically delivered; require bank accounts to send (not necessarily to receive)	Incur relatively high processing costs	Depends on local regulation; access often limited to regulated financial institutions only
Card-based payments and transfers 	Fast, easy to use; debit cards require bank account; client must apply for card in advance; developing countries have fewer cardholders and acceptance places, such as ATMs and retail points.	Prepaid cards have fewer restrictions and may be logical first step for clients without bank accounts or institutions that cannot issue debit or credit cards.	Debit and credit cards usually require membership in a bank card association and/or access to the payments system
EFT 	Faster than paper-based instruments; usually requires bank accounts to send and receive[31]; cheaper than MTC transfers	Lower labor costs than checks, but requires link to network and infrastructure; fees lower than for MTC transfers	Can be accessed by many FSPs through financial institutions with which they conduct business
Giro 	Requires a postal account for sending, but generally cheaper and more accessible than bank-based EFTs	Requires a postal account for sending, but generally cheaper and more accessible than bank-based EFTs	Requires a postal account for sending, but generally cheaper and more accessible than bank-based EFTs

[30] Adapted from Isern, Deshpande, and van Doorn 2005.
[31] As noted, some mobile phone operators are piloting money transfer products without linking to banks. In these cases, a bank account is not required. However, a majority of current mobile phone banking operations are linked to bank accounts.

Annex 2: Formality of Financial Channels

A **financial channel** is any means by which money is transferred. Channels range from formal to semiformal to informal. Customers typically select their financial service provider based on perceptions of trust, convenience, service quality, and price. However, people without access to bank accounts typically cannot use formal channels.

FORMAL FINANCIAL CHANNELS

A country's formal financial channels are comprised of institutions that participate in some type of financial intermediation under the supervision of designated financial authorities, such as a central bank. Formal financial channels include commercial banks, saving banks, credit unions, development banks, agricultural banks, and regulated MFIs. The main driver behind the use of formal financial channels is their ability to meet the range of financial service needs of households and small enterprises: to save, borrow, make timely payments, and insure against the risk of loss. However, formal channels have their limitations. Many formal transfer channels serve limited regions within a country, such as only urban areas and larger towns. A sender may prefer the security of a particular formal provider, but the destination country may not have adequate coverage of locations for the recipient to conveniently collect the money.

SEMIFORMAL FINANCIAL CHANNELS

Semiformal or nonbank financial institutions provide many financial services, such as loans and money transfers, but they are not licensed to gather deposits. Most of these institutions are not supervised by the same authorities, and they may operate under different laws and regulations than banks and other formal institutions. A semiformal provider may have a large global agent network with an outlet near the recipient but charge a higher fee for the service, especially in countries where there is little competition.

This sector includes finance companies, some post offices, MTCs, unlicensed MFIs, retailers, and telecommunications companies. Many credit-only MFIs qualify as a semiformal financial channel.

The range of organizations and the scope of services offered by semiformal financial service firms are extensive and growing rapidly. Some specialize in specific services, lending to particular groups of borrowers, or offer specialized financial arrangements, such as leasing, securitized lending, and financial derivative operations. Some operate at the wholesale level, providing payment services to other financial services and merchants. Others are involved in the production of financial services, such as money transfers, that are offered to consumers directly or indirectly through alliances. Much of the growth in semiformal institutions has been driven by new technologies and deregulation of financial services in many countries.

Nonbank financial service firms are increasingly leveraging electronic distribution channels, information technology, and innovative marketing to offer payment services that function in a manner similar to those offered by licensed deposit-taking banks. In some cases, they employ shadow or suspense accounts to temporarily hold money until it is needed to affect a transfer. In many countries, the money held in these accounts is coming under scrutiny as to whether it should be considered as e-money or even a bank account. Through these accounts, clients without conventional bank accounts still can receive money, pay bills, and transfer money through nonbank institutions. Consumers expect the same value, safety, soundness, and protection from nonbanks as from more established financial institutions. Whether they are covered under the same consumer protection measures that apply to bank deposits is still a question in many countries.

While MTCs are dominant players in the industry, the volume of domestic and international payments through other types of nonbank institutions is small but growing.

INFORMAL CHANNELS

Where financial instruments or institutions are not widely available, people find other ways to fulfill their financial service needs. Informal funds transfer systems vary tremendously in structure and complexity.[32] Carrying cash by hand, usually by migrants themselves or by family and friends, is the most basic system, and it is especially common in situations of seasonal or circular migration, where migrants frequently return to their place of origin (Fagen and Bump, forthcoming). In some countries, the physical transfer of cash is also done by couriers

[32] For descriptions of particular systems, see Kabbucho, Sander, and Mukwana 2003; Jaramillo 2004; Mellyn 2003; and Genesis Analytics 2003.

(internationally) or by bus companies and taxi drivers (nationally or sometimes regionally). Other systems involve only the virtual movement of funds.

Use of informal channels may offer intangible benefits that a more formal system cannot. For example, senders who are undocumented workers may fear the use of formal systems, and so the anonymity provided by the use of some informal channels is a compelling feature.

Sophisticated informal systems exist under different names around the world, including hundi (South Asia), fei-chen (China), hui kwan (Hong Kong), padala (Philippines), phei kwan (Thailand), and hawala (Middle East).[33] Many of these systems, such as those common in African mineral-exporting countries like Angola, evolved as mechanisms for trade financing and net funds transfers against the movement of goods (Barro and Sander, n.d.).

Box 25: Hawalas: A sophisticated, informal channel

The hawala system used in the greater Middle East is representative of how informal channels work. Typically, a migrant makes a payment to an agent (hawaladar) in the country where he works and lives, and the hawaladar gives him a code to authenticate the transaction. The hawaladar requests his counterpart at the receiving end to make the payment to a beneficiary upon submission of the code. After the transfer, hawaladars settle accounts through payment in cash or in goods and services. They are remunerated by senders through a fee or an exchange rate spread. Hawaladars often use fluctuations in demand for different currencies, which enables them to offer customers better rates than those offered by banks (most of which will conduct transactions only at authorized rates of exchange). Because many hawaladars also are involved in businesses where money transfers are necessary, such as commodity trading, remittance services fit well into their existing activities. Remittances and business transfers are processed through the same bank accounts, and few, if any, additional operational costs are incurred (Jost and Sandhu 2000).

Afghanistan does not have a functional financial sector. More than 20 years of conflict has completely disrupted the domestic and international payments systems. In this vacuum, a large and vibrant informal market has developed. Hawaladars offer a well-organized, convenient,

[33] For more information on the hawala system, see El Qorchi 2002.

and cost-effective way to make domestic and international payments. The hawala system is estimated to have channeled at least US$200 million in emergency, relief, and development funding. Large transactions of more than US$500,000 are common, and international aid institutions and NGOs have made individual transactions equaling twice that amount (Maimbo 2003).

Experts estimate the total value of money transfers made through informal channels is somewhere between 40 and 100 percent of the volume of global formal transfers.[34] Recent studies estimate, for example, that over half of the money transfers from France to Mali and Senegal are made via informal channels, as are 85 percent of total transfers made to Sudan. Informal money transfer systems in Asia and the Middle East may manage two-and-a-half times the value of transfers processed by formal systems in these regions (Bezard 2003).

Such evidence indicates that informal systems are competing successfully with even the largest players in the formal money transfers market. In large part, their popularity is because of certain client-friendly features. Regardless of the actual mechanism used, informal transfer systems are usually fast and discreet and involve a minimum of paperwork. They are generally less expensive than formal transfer mechanisms, which are subject to regulation and taxation, and they are often available in areas where no formal sector providers exist. From a client perspective, informal systems may seem more familiar and trusted than formal services, despite the risk of possible theft. For clients who lack identity or residence documentation, informal systems may be easier to use in the short term. Given the benefits of formal systems and government concerns about informal systems, many are working to help clients move from informal to formal service providers. Nonetheless, the client-friendly features could serve as a model for financial service providers when designing appropriate money transfer products (Isern, Deshpande, and van Doorn 2005).

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[34] Ratha and Bezard both estimate the size of the informal market to be approximately 40 percent of the formal market, but some private industry actors interviewed by the authors estimate it to be as large as the formal market.

Annex 3: Summary: General Principles for International Remittance Service

***Consultative Report*, March 2006 by the World Bank and Bank for International Settlements** [35]

This report provides an analysis of payment system issues related to remittances, and it sets out general principles designed to assist countries that want to improve their market for remittance services. The report was prepared for the Committee on Payment and Settlement Systems (CPSS) and the World Bank by a task force consisting of representatives from international financial institutions involved in remittances as well as representatives from central banks in both remittance-sending and remittance-receiving countries.

The task force defined the following public policy objectives for the provision of international remittance services[36]: International remittance services should be safe and efficient. To this end, the markets for the services should be contestable, transparent, accessible, and sound. In order to achieve the public policy objectives, the task force has identified principles covering five key areas: (1) transparency and consumer protection; (2) payment system infrastructure; (3) the legal and regulatory environment; (4) market structure and competition; and (5) governance and risk management. The five principles correspond to the five areas of possible market weaknesses. Their purpose is to help remove those weaknesses in order to create a safe and efficient market. They do not aim to set specific service-level standards for remittance transfers since, beyond a certain basic level of service and in normal circumstances, low price may be more important than a high level of service for most end users. The general principles are aimed at all remittance services except those based on purely physical transfers of cash.

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[35] The report presents a consultation document circulated in March 2006 that can be found at http://www.bis.org/publ/cpss76.pdf

[36] The report considers only international remittance transfers and international remittance services, not domestic ones. For simplicity it usually refers to these as “remittance transfers” and “remittance services”— i.e., it is assumed they are international. For the purposes of the report, remittance transfers are defined as *cross-border person-to-person payments of relatively low value.*

THE GENERAL PRINCIPLES

General Principle 1. The market for remittance services should be transparent and have adequate consumer protection.
In any market, full information is important, because it enables individuals to make informed decisions about which services to use, and it helps to make the market as a whole more efficient. Transparency in the market for remittances is particularly important because the price to the consumer depends on two elements: the exchange rate used and any fees charged; and combining these to calculate which service is cheapest is difficult for most consumers. Transparency and adequate consumer protection are important because, as low-income migrants in a foreign country, many senders may have difficulties understanding the local language or providing adequate identification to open a bank account, or they may lack the time and financial literacy to search out and compare different remittance services.

Remittance service providers should be encouraged to provide relevant information about their own services in easily accessible and understandable forms. Authorities or other organizations may want to provide comparative price information. They may also wish to undertake educational campaigns to give senders and receivers sufficient background knowledge to be able to understand the information being provided.

General Principle 2. Improvements to payment system infrastructure that have the potential to increase the efficiency of remittance services should be encouraged.
The infrastructure needed to support remittance services is sometimes inadequate. Many services require remittance service providers to cooperate in order to create a network of access points. It may not always be easy for potential remittance service providers to identify suitable partners, particularly in other countries. Moreover, under-development of the domestic financial infrastructure, particularly in receiving countries, may mean that transferring funds to the access points is slow and unreliable; in some cases, non-cash payment services may only be available in urban locations. Another important aspect of the infrastructure is correspondent banking, which is widely used for cross-border transfers of funds but which can be expensive

for small-value payments such as remittances. The safety and efficiency of remittance services can be affected by payment systems in the relevant markets and the way that these systems are accessed and used by remittance service providers or by banks acting on their behalf. Remittance services may be improved by initiatives aimed at facilitating greater interoperability of systems and straight-through processing.

General Principle 3. Remittance services should be supported by a sound, predictable, non-discriminatory, and proportionate legal and regulatory framework in relevant jurisdictions.

The remittance industry is likely to flourish best under appropriate laws and regulations. Remittances may be regulated for various reasons including the prevention of their misuse for purposes such as money laundering. However, as with all laws and regulations, there is the possibility that those for remittances are badly designed with unintended side effects, that they are disproportionate to the problem they are designed to tackle, or that they continue to be applied even when no longer useful. Moreover, regulating remittances solely by type of entity, as is sometimes the case (e.g., when the regulations are applied only to the services provided by licensed institutions such as banks), may make regulation less effective (by creating loopholes that can be exploited for illegal activities) and distort markets (by enabling some remittance service providers to inappropriately avoid the costs of regulation and thus offer artificially cheaper services). National regulations should aim to create a level playing field between equivalent remittance services.

General Principle 4. Competitive market conditions, including appropriate access to domestic payments infrastructures, should be fostered in the remittance industry.

The efficiency of remittance services depends on there being a competitive business environment. Competition can be assisted by various steps such as discouraging exclusivity conditions, where a remittance service provider allows its agents or others to offer its remittance service only on condition that they do not offer any other competing service. It is important that remittance service providers without direct access to the domestic payments infrastructure should be able to use, on an equitable basis, the payment services provided by institutions that do have direct access.

General Principle 5. Remittance services should be supported by appropriate governance and risk management practices.

The relatively small values involved in remittance transfers mean that it is unlikely that there will be systemic risk involved. However, remittance service providers face financial, legal, operational, fraud, and reputation risks. Governance and risk-management practices can improve the safety and soundness of international remittance services and help protect consumers. These practices should be appropriate to the size and type of a remittance service provider's business and the level of risks.

* * *

Although these principles are designed to be generally applicable, some countries may decide that the size of their particular remittance market does not justify significant action. In addition, the principles are likely to be applied at one end of the transaction irrespective of application at the other end. Nevertheless, authorities may want to prioritize their efforts on the most important bilateral corridors.

Annex 4: Taking Stock Checklist

ENVIRONMENT
Country
What is the socioeconomic profile of your country (or region of countries)?
Analyze both the sending country/region and the receiving country/region. If you are performing domestic money transfers, then the sending and receiving regions may both be your region.
What is the level of migration? Are migrants dispersed broadly, or do they tend to concentrate in a few countries (or regions within a country)?
Several economic factors affect a client's demand for services, and they include GDP, inflation rates, employment levels, average household income, savings rates, etc. What are the relevant economic factors for both the sending and receiving clients?
Payment System and Regulatory Context
What is the structure of the payment system? Who has access to the payments system?
What laws and regulations are relevant for money transfers—international and/or domestic?
Does your institution need to be registered or request a license to make money transfers? If so, what are the qualifications, and does your institution meet those criteria? What is the cost of registering or applying for a license?
Will there be additional reporting costs associated with transfers?
If you will serve only as a payout agent, what are the responsibilities of your institution in complying with national regulations and laws (customer contracts, reporting, consumer protection, anti-money laundering and combating the financing of terrorism [AML/CFT] measures, etc.)? What are the potential compliance costs?
Some money transfer operators require their partners to sign exclusive agreements. Is this legal in your country? Do antitrust rules apply?
Are there regulations associated with the use of trademarks, logos, or other brand requirements?

Market
Who are your current clients?
What is your clients' socioeconomic profile: income, assets, literacy, occupation, age, gender, etc.?
What financial services do your clients use? What is the frequency, average loan (and/or savings) balance, etc.?
Are they already using money transfer services? If so, are they international or domestic?
—How many clients send transfers, and what is the average frequency and amount per month?
—How many clients receive transfers, and what is the average frequency and amount per month?
Who are your potential clients?
Do people (nonclients) within your institution's geographic area already have access to financial services?
What is their socioeconomic profile: income, assets, literacy, occupation, age, gender, etc.?
Do they send or receive money transfers—both international and domestic?
How many people send transfers, and what is the average frequency and amount per month?
How many people receive transfers, and what is the average frequency and amount per month?
Are these potential clients already customers of another institution? If so, what services do they use? If not, are they using informal financial services? What makes those informal services attractive?
What are the trends on domestic and international money transfers?
Consider the following types of money transfers: international remittances, national urban to rural remittances, bill payments, salary payments, pension, or social payments.
Over the past 3–5 years, what is the overall value and number of money transfers?
What is the average per transaction?
Who are your competitors?
Which institutions are currently involved in money transfers—international and/or domestic? Consider both formal money transfers and informal money transfers.

What are their services?
—What are their prices, speed, and methods of delivery? How would you (or their current clients) rate their services?
—Do they have international or national alliances?
—Do they have linked services, such as savings, loans, or other financial services,
Transfer Patterns
Where do money flows originate, and where and when are they delivered?
Do sending clients work or live in concentrated areas, or do they participate in hometown or community associations?
How often do your clients typically send or receive transfers?
How large are these transfers?
What is the likelihood that migration patterns might be disrupted or changed by political or natural events?
How have transfer patterns evolved over time? And what are the effects of long-term changes in the volume or frequency of transactions?
INTERNAL ASSESSMENT
Institution
How is your institution's overall financial and operational performance? Is the institution stable or shrinking operations? Is it in steady, managed growth? Is it growing rapidly and straining its systems?
What impact would transfers have on the institution as a whole?
Will your institution be perceived as creditworthy by potential partners?
HR
Who is available and knowledgeable about money transfers?
Who could lead the money transfers operations? Who should be involved in designing the money transfers services—which departments and geographic areas?
What training or additional experience is needed?
Capacity
Does your institution have the capacity to manage increased cash flow from money transfers?
Could liquidity be a problem for the institution? What additional measures are needed to ensure adequate cash management and physical security of locations?

If considering international transfers, does your institution have access to foreign exchange?
As an agent, will your institution be involved in the settlement process?
Systems
Are your institution's accounting practices adequate? Can the institution accurately report financial statements at regular, reliable periods?
Is the accounting, portfolio management, and client information managed with a manual system? Automated? Can the system be easily changed to incorporate money transfers? Software?
Are communication and management information systems adequate to manage money transfers—international or domestic?
Will serving transfers clients require changing the institution's branches, cashier stations, or other infrastructure (e.g., access to ATMs, internet, phone, mobile offices, etc)? If so, what will it cost?
Money Management
What is your institution's capacity to manage transfers effectively (number of transactions, volume of clients to serve, value of payments to distribute)? Can the scale of the service be expanded?
How will money transfers affect your institution's revenue? Does your institution have the ability to project potential revenue from money transfer services?
Will your institution need to cross-sell other products to transfer clients to achieve its goals? If so, what is reasonable demand for other services? How would this affect existing operations?
Risk Management
What are the business risks and key risk mitigation measures associated with money transfers? How do these differ from those for existing services (loans, deposits, other)?
Does your institution have sufficient risk management controls in place to undertake a new business model?
Marketing
Are current services well known in the target market? Is your institution trusted and credible in the target market?

How skilled is your institution in developing new marketing campaigns?
If it will offer international transfers, is your institution prepared to market to clients in sending countries?
What unique aspect does your institution offer that will allow it to capture volume from existing players and/or serve a niche that is not currently served?

Annex 5: Selecting a Partner: Quick Reference

What an MTC Looks for in a Partner
Multiple locations in the country, especially in areas not already covered by other payment agents
Branch offices in urban and rural areas
ATMs
Fixed and mobile points of service
Well-established branch infrastructure
Good communications with the institution's headquarters
Use of a call center
Good reputation in the country or region, especially good customer service
Local knowledge of the country or region, including political, socioeconomic, and regulatory context
Existing large client base
Demonstrated financial performance with audited financial statements
Experienced, friendly, and knowledgeable staff
Secure, fully licensed operations (including cash management) that are compliant with national laws and regulations
Experience with money transfers and the ability to add money transfers clients, especially to increase the volume of transactions

What an MFI Should Know about an MTC as a Potential Partner
What is the MTC's network of offices in the sending country or region? How does the MTC's network (locations) relate to your target market?
Does the MTC offer other services (call center, travel agency, employment services, retail products, etc.)?
How many partners does the MTC already have in your country or region? Consider all partners including banks, MFIs, retail shops, postal offices, and others. How would the MTC split money transfers among the other partners and with your institution?
How many branches and other points of service are already linked to the MTC in the sending location?
What is the cost of sending a transfer with the MTC (as a percentage of the amount sent)? Include any foreign exchange transaction and all fees on both the sending and receiving side of the transaction.
What will the MTC pay to the MFI in commissions, fees, etc.? What are other revenues, such as float on money in transit?
For each transfer, how long will it take for the MTC to settle the transaction and send you the funds and revenue earned? How frequently is this paid (monthly, weekly, etc.)? Does the MTC have any insurance or other guarantees to cover any potential risk of loss of settlement for the MFI?
What is the potential for cross-selling other products with the MTC's existing client base?
Does the MTC fit with your mission or does its practices/pricing take advantage of the people you are trying to help?
Does the MTC provide any training for the MFI to launch or improve money transfer services?
Does the MTC provide assistance with information technology? For example, does the MTC provide complimentary software and hardware for processing remittance transactions?
Is the MTC properly licensed and regulated in the sending country (or countries) and, as relevant, in the receiving country (or countries)?
Who is responsible for marketing on both the sending and receiving side of the transaction? How extensive are the MTC's marketing efforts? Does the MTC provide any marketing materials or assistance to the MFI to adapt marketing messages to the local country context?

Who is responsible for AML/CFT compliance and other regulatory and legal compliance? Who will report to the central bank or other regulatory agency?
Who will manage the payment settlement, including any foreign exchange transaction? What is the MTC's relationship with banks in both the sending and receiving location?
What is the financial condition of the MTC? (This information is vital to know because you will extend credit to the MTC until the MTC makes settlement. Analyst reports may be available on the Internet or from rating agencies.)
Does the MTC have any significant customer complaints reported to public centers (e.g., business bureaus), pending court cases, or past or pending compliance violations?

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CPSS (glossary of terms), http://www.bis.org/publ/cpss00b.htm

DFID, Sending Money Home, http://www.sendmoneyhome.org/

Fonkoze, http://www.fonkoze.org

IAD, http://www.thedialogue.org/programs/policy/trade/remittances/default.asp

IADB, Multilateral Investment Fund program on remittances: http://www.iadb.org/mif/v2/remittances.html

IFAD, http://www.ifad.org/events/remittances/index.htm

IRNet of WOCCU, http://www.woccu.org/prod_serv/irnet/index.php

L@ Red de la Gente, http://www.lareddelagente.com.mx

Livelihoods Connect, http://www.livelihoods.org/hot_topics/migration.html#3

Microfinance Gateway, http://www.microfinancegateway.org/

MPESA, http://www.safaricom.co.ke/m-pesa/

USAID, Newsletter on remittances: http://www.sendmoneyhome.org/Press/Migrant%20 Remittances—August %202006.pdf#search=%22remittances%20DAI%22

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World Council of Credit Unions (WOCCU), http://www.woccu.org

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