

The African Remittance Landscape - An Overview

November 20, 2006

Carole St. Laurent

ICTs for Development Consultant

FluidIT Solutions

+1 (416) 762-2245

carole@fluidITsolutions.com



Table of Contents

1	REMITTANCES TO AFRICA – AN OVERVIEW	3
2	OPPORTUNITIES TO SUPPORT REMITTANCES TO AFRICA THROUGH ICTS.....	6
3	SUMMARY	8
4	REFERENCES	10

1 Remittances to Africa – An Overview

Remittances comprise significant sources of capital for developing countries, far exceeding official development assistance (Ratha 2004). They are believed to reduce poverty, and have a direct, positive impact on the recipients, many of whom are poor. While many commonalities exist in the global remittance marketplace, this paper focuses on the needs and emerging services in Africa. African remittances are transferred through various means, including banks, large money transfer operators (MTOs) such as Western Union, indigenous MTOs such as Somali “hawalas”, and through the informal economy, including transfers carried in person by friends or traders.

In Somalia, for example, where little other financial infrastructure exists, remittances are a critical financial support to the country. Money can be sent from anywhere in the world to almost any remote Somali village within one hour through a network of agents in rural areas. In turn, these agents receive money from local importers to buy goods from abroad. The cash flow from these inputs and outputs means that agents rarely need to rely on bank transfers for currency. Settlements with MTO headquarters are periodically wired through international banking networks.

Remittances are critical sources of income in many developing economies. It is important to strengthen the sector’s self-regulation, international financial compliance, and help them implement modern software platforms that will make the financial transactions more secure. One of the motivations for this is the increased international concern over money laundering, particularly in light of the events of September 11th, 2001. For example, the MTO Al-Barakat was closed in 2001 by the United States under allegations of illegal activities, and other MTOs reported difficulties opening business bank accounts in the US at a remittance conference in December 2005.

Automating MTOs’ anti-money laundering compliance is seen as a significant advantage that ICTs can offer to both streamline operations, and to prove legal compliance. This should make it easier for MTOs to open bank accounts and conduct their businesses. With an estimated \$17 billion in annual remittances to Africa (Walker 2006), protecting this income stream is very important. The ability to reduce costs and make more money available to Africans, rather than being spent on transaction fees, is another major issue under discussion. Scott Robinson (Memo #3, n. d.) argues that fees exceeding a threshold be taxed, with the income being used to fund ICT infrastructure and other development projects. He recommends a fee cap of 2.5% (Memo #3, n. d.), however, average remittance transactions fees are 13%, and as high as 20% (Ratha 2004). The difference is viewed as money that could otherwise be channeled to remittance recipients.

Many African citizens do not hold bank accounts, so cannot receive money wires through traditional financial institutions. Most recipients use telephone calls, SMS messages, or emails to request money from relatives, or to receive notice of a transfer waiting for pickup at an MTO branch (which can be as small as one agent in rural areas). They must provide a unique transaction code, show identification, or be known to the agent to receive the funds. Many remittance senders in developed countries are unbanked as well, and make cash payments at MTO offices. Banks in Africa have few branches in rural areas, and their services are slow where they do exist (Financial Mail 2005). Therefore alternatives such as microfinance institutions (MFIs) are seen as good potential providers of remittances. *Crafting a Money Transfers Strategy: Guidance For Pro-Poor Financial Service Providers* (Isern et al. 2005) is a thorough guide which helps MFIs understand the remittance industry, and assess how to enter it, if desired.

Remittances have largely been seen as personal affairs, but their impact on gross national product, community development, and potential links with microfinance institutions is increasingly being

African Remittance Landscape

Fall 2006



recognized. Research about African remittances lags behind that of Latin America, but has recently gained more attention. Dr. Manuel Orozco, a Latin American remittance expert, was a major contributor to three reports on African remittances since 2005. In a telephone consultation in September 2006, Dr. Orozco recommended that the key research needs for African remittances are how best to enable remittance payments technically, how to offer remittances and other financial products through microfinance institutions, and regulatory reform.

In many countries, the capital and legal requirements to offer financial services are onerous, making it difficult for microfinance institutions or MTOs to expand their services to remittances or savings. This reduces options for unbanked populations, who often cannot access good alternative financial services from banks. Tightened regulations and currency exchange restrictions led Western Union to cease operations in South Africa (Orozco 2005b, p. 76). However in Uganda, the 2003 Micro Finance Deposit Taking Institutions Act enabled MFIs to take deposits (Magnette & Lock 2005, p. 7). Regulatory changes to facilitate remittances are one of the recommendations of the Committee on Payment and Settlement Systems (CPSS)/World Bank Task Force on remittances (2006).

Orozco (2005a) also recommends combining the resources of banks, microfinance institutions, and expatriate investment funds to increase loans to local businesses. Diaspora communities abroad who start hometown associations (HTAs) are one vehicle to promote investment and development in their communities of origin. In Mexico, matching government grants triple the impact of the HTA donations to development projects. Perhaps government or development partners in Africa can also offer matching grants to encourage donations for projects. ICTs could support this by enabling communication between the parties to enable cooperation, development planning, governance, and transparency. For example, a website could be developed to help the Diaspora find and join HTAs, learn about government or development partner incentives, collaborate with partners in local communities to explore needs and prioritize projects, transfer money online, and support project reporting and governance.

A study on West African remittances shows that large volumes of money cross borders between African countries. Remittance transfers between the four countries studied were estimated at US \$2 billion, and the trade settlements at US \$8 billion (Orozco 2006, p. 1). Restrictive government policies, inconvertibility of currencies, and corruption drive potentially formal economic activities into the informal economy. Small and medium sized businesses have difficulty accessing loans and bank accounts, leaving the region vastly underserved financially. Microfinance institutions meet some needs, but regulations prevent them from providing full services. Technology is recommended as one way to improve financial services to the region and increase use of formal systems by reducing costs and thereby fees, and offering more convenient services such as mobile banking – the provision of financial services through cellular phones (Orozco 2006, pp. 1, 3).

Debit or credit cards, and stored value or “smart” cards, are other technologies that facilitate remittances. A debit or credit card requires an online connection to a banking network for every transaction. A smart card has the advantage of an embedded microchip, which stores the present monetary value of the card on the card itself, which reduces the frequency that it must be connected to the online backbone (Isern et al. 2005, p. 13). The amount is reduced when a purchase or cash withdrawal is made, and some cards can be replenished and reused. The combination of cards with point of sale (POS) devices facilitate financial services in much more diverse locations than branch banking provides. Customer acceptance and harmonization of ATM and POS networks are necessary conditions for expanded card-based remittance services (Isern et al. 2005, p. 14).

“Wizzit”, a service that offers money transfers through cell phones, was launched in South Africa in 2005 (Financial Mail 2005). It transfers money onto a stored value card that can be used at ATMs



and retail outlets. Cellular-based financial services could become a significant way that unbanked populations begin to use financial services. Mobile banking is highly suited to Africa, where cell phones are much more available than computers, ATMs, or bank branches. Glo Mobile introduced mobile banking in Nigeria in August 2006, but the only transactions currently available are inquiries, transfers between accounts within one bank, and purchasing cell phone credits (Daily Sun 2006). Phone-to-phone transfers are more convenient, and are available in some regions. For example, Celpay (www.celpay.com) offers SIM and SMS based payments and transfers in Zambia and the Democratic Republic of Congo that do not require bank accounts (Migrant Remittances 2005, p.2). SMART Money in the Philippines allows remittance senders in seventeen countries to electronically transfer money to their subscribers' phone accounts and smart cards (Migrant Remittances 2005, p.2). Such services are making international and national remittances more convenient (DFID 2005).

Another relevant new technology is stored value, or "smart" cards. Rolling out the point of sale (POS) terminals to enough retail outlets to make cards useful will be a large challenge. Still, card-based transactions on the continent are gaining momentum. Wireless POS terminals and smart cards have already been piloted for microfinance transactions in rural Uganda. The Microdevelopment Finance Team (MFT), a multi-stakeholder partnership, developed a system to enable microfinance loan monitoring and payments in 2005. Their published case study (Magnette & Lock 2005) discusses the costs, returns on investment, and difficulties in introducing electronic payments in Uganda, and is a valuable resource for similar research surrounding remittances. The payment platform they developed may provide a suitable platform to expand to remittance transfers. Software developers will be interested that they recommend an "extreme programming" methodology for this context rather than a more traditional software development methodology.

Improved technologies such as smart cards, point of sale systems, and cellular phone transactions can reduce fraud, lower expenses, and thereby reduce fees (Orozco 2006, pp. 2-3). Currently, many West African remittances are sent as cash through friends or truck drivers, who charge a fee of approximately \$15 US. The average remittance is \$157 US. Few remitters have bank accounts, and only two of the thirty-five people surveyed had ever used a formal MTO (these two used Western Union).

Thamel in Nepal offers an alternative, less technology-based model for increased remittances and local commerce (Paul 2005). They accept online remittances between the US and Nepal, and recipients can receive deposits to a bank account, or pick up cash through a local agent. They also have an online store from which people can purchase goods for Kathmandu residents. This improves the local economy and provides jobs for delivery agents who distribute the goods. They offer the unique customer service of uploading photographs of each recipient with their gift. Families enjoy the photographs, and customer confidence is improved. As a spin-off benefit, the local website developers of www.thamel.com started a business providing ecommerce sites to other entrepreneurs. Thamel consults to organizations wishing to replicate their award-winning model. Africa already has online stores that accept payments from abroad to fund purchases at home. Mama Mikes (www.mamamikes.com) serves Kenya and Uganda with flowers, cellular airtime, and store vouchers. Supporting even greater remittances of goods to Africa is an exciting possibility.

Robinson (Memo #4, n. d.), focusing on Latin America, recommends that HTAs fund telecentres, which will provide ICT services to microfinance institutions. This would enable MFIs to automate and offer new electronic services. Robinson makes some assumptions that may not be transferable to Africa, including two-year timelines for telecentre sustainability based primarily on offering VOIP services. However, there are benefits that would benefit both regions. Particularly interesting is the convergence of Diaspora communities, local community services such as ICTs and microfinance, and the enabling of better governance and community development. In Ghana, and perhaps



elsewhere in Africa, some HTAs already exist. The participants at the *Accra Regional Forum on Remittances and Trade in West Africa*¹ in 2006 expressed interest in exploring better communication, collaboration and support for HTAs and local communities. This is another avenue worth considering.

2 Opportunities to Support Remittances to Africa through ICTs

It is an opportune time for remittance partners in Africa to adopt appropriate ICTs. New technologies such as mobile banking and smart cards are being rapidly improved and deployed. Access to GSM service is widely available, and access to Internet service is expanding, especially due to wireless and satellite options. The need for MFIs and MTOs to adopt computer systems to help them reduce costs, meet regulations, and better serve customers is real. However, most African MTOs and MFIs lack up-to-date software and delivery channels to meet these needs. By consolidating the efforts among stakeholders, including MTOs, MFIs, development organizations and governments, better solutions can be implemented at lower costs. At the least, research and recommendations about the most appropriate technological solutions should be shared. This would help MFIs and MTOs adopt better solutions, and help them avoid less sustainable independent solutions that are expensive to replace later.

Common transaction standards could be defined to make it easier for remittance service providers to expand their services by developing business partnerships. The definition of a common interface would reduce the cost to add interfaces to each business partner. This is one of the recommendations of the Committee on Payment and Settlement Systems (CPSS)/World Bank Task Force on remittances (2006, p. 17), and is discussed more fully in their report.

The development of a common financial transfer gateway would be even more helpful. The World Council of Credit Unions, Inc. (WOCCU) implemented a common gateway, *IRnet*[®], which facilitates remittances among its members and between credit unions and MTOs, primarily in Latin America and the Caribbean, but with plans to expand the receiving side to Africa (Evans & Klaehn, 2004, p. 16). The Inter-American Development Bank and the Consultative Group to Assist the Poor (CGAP) financially assisted the project (*ibid.*, p. 7). Credit Unions use their own software or the MTO's software to manage remittance transactions.

Migrant Remittances (2005, p. 4) recommends developing an open system that can transfer funds between multiple remittance processing institutions. Currently MTOs either develop their own closed systems, or use a vendor's system. Large remittance software vendors such as PayQuik provide this type of gateway in a proprietary fashion, and they enable their institutional customers to share sending or receiving branches with each other. An open gateway would reduce per-transaction costs and greatly expand potential network partners to its participants.

Such a system would benefit participating institutions by providing access to international money transfer systems at lower costs. One interface to the gateway system would give them access to the available settlement systems and participating remittance transfer partners' networks (if the

¹ Information about the Forum is available online at http://www.watradehub.com/index.php?option=com_content&task=view&id=314&Itemid=39



partners opted to do so), eliminating the need to establish interfaces with these parties individually. Partners could route remittances through others' distribution channels for a small fee or commission, expanding their reach without the "bricks and mortar" expenses of physical branches. MTOs that already have a software solution could interface to the gateway, expanding the capabilities of their systems and their business services. Major remittance software vendors should be encouraged to interface to the gateway and provide input to the protocol to ensure it supports their informational requirements.

Grameen Foundation's Technology Centre launched an open source management information system for the microfinance marketplace called Mifos in November 2006. It is currently being beta tested, with plans to go live in 2007 (Grameen Foundation 2006). The open source approach to financial systems is unique, challenging, and interesting. In Mifos' case, the core platform was developed by technology specialists such as employees of the Global Markets Institute at Goldman Sachs. The intention is that local software experts will be able to install the core version of Mifos and modify it for their MFI clients, contributing to the software so that others can benefit from their efforts. It is much easier to do this with a management system that supports an MFI's internal operations as Mifos does, than with a remittance system that interfaces with international money transfer networks. Financial transfers require state-of-the-art online security, and tested and secure proprietary interfaces with international money transfer systems. Anti-money laundering algorithms and compliance regulations are other critical components that only a trusted technology partner should issue new releases of, even if the open source community contributes changes such as translations. Also, MTOs would need expert help installing the system and ensuring that their Internet connections, database, and servers are secure. I have seen cases in which MTOs sent remittance transactions over unencrypted Internet connections, or emailed their customers' personal financial information in unencrypted spreadsheets, and greater security awareness is required to prevent such security breaches from being made by other MTOs. However, an open source community could support system features such as customer data, accounting, and reporting. In fact, Mifos could offer a platform on which to add remittance functionality in the future.

Truen et al. (2005) offer creative suggestions including remittances initiated on the Internet and fulfilled by money transfers, the sharing of ATM cards linked to one bank account, and enabling existing service providers such as retail stores to provide remittances. They evaluate the regulatory obstacles to each option in the Southern African Development Community (SADC), but their research and general principles are applicable to all regions.

While defining concrete proposals to better support remittances through ICTs requires the collaboration of as many stakeholders as possible, some ideas of how ICTs can better support remittances are offered below:

1. Use ICTs to support collaboration and community development among the Diaspora, Hometown Associations, local communities, governments, and development partners. For example, a website could be developed to help the Diaspora find and join HTAs, learn about government or development partner incentives, collaborate with partners in local communities to explore needs and prioritize projects, and monitor projects and budgets. Components could include photographs of project needs and implementations, community "wish lists", best practices, capacity building resources, information about matching grants, and online transactions through preferred (or customer-selected) online remittance providers. Other tools such as email lists, wikis, and voice over IP teleconferences can aid discussions, joint proposals, and knowledge sharing.
2. Help African MTOs and MFIs adopt modern remittance software that fulfills the needs for security, efficiency, compliance with anti-money laundering regulations, electronic money transfers, and reporting. The use of a common platform can enable organizations to

share distribution channels, allowing companies to send remittances to locations where they do not have their own agents.

3. Develop a hybrid open source/proprietary model for a remittance software platform. A trusted technology partner should maintain control and quality assurance of the financial interfaces. The anti-money laundering components would most likely be strongest if an interface to a third-party proprietary system was integrated. The technology partner should also develop security specifications for the implementation and deployment of the system, and provide a quality assurance certificate for each MTO using the system, stating that the MTO's implementation has been tested for security (similar to the TRUSTe program for online privacy standards², or VeriSign's seal for SSL Certificates³). Potentially, by aggregating small MTOs' transactions through a common gateway, transaction fees for third-party systems can be significantly reduced. The open source community can contribute to customer information modules, management modules, reporting, transaction information, translation, and other less risk-prone areas.
4. Research the best remittance payment platforms, and help MTOs understand, evaluate, or adopt solutions. For example, smart cards, point of sale systems, or mobile telephone banking could reduce fraud, lower expenses, and improve access to remittances. As cell phones are the most feasible platform, research alternative phone-based technologies including SMS, internal chips, WAP, J2ME, USSD, and interactive voice response (IVR) transactions.
5. Help MTOs and businesses provide online remittance services or ecommerce websites that include the remittance of goods, like www.Thamel.com and www.MamaMikes.com.
6. Provide regulatory support. This could include disseminating information on international financial legislation and procedures to help MTOs adhere to international anti-money laundering laws, or information on regulations and advocacy efforts to enable microfinance institutions to offer remittances, for example.

3 Summary

Remittances are a major source of income for many families in developing economies. At an estimated \$93 billion in 2003, they exceed more than twice the official development assistance income of developing countries (Ratha 2004). The reach of MTOs and informal money traders exceeds that of banks in rural Africa, and provides important sources of foreign currency and trade financing. MTOs are facing increased regulation and scrutiny, particularly in light of September 11th, and indigenous MTOs face barriers such as difficulty opening business bank accounts in the developing world. They must adhere to stringent international anti-money laundering regulations and reporting requirements, and face market competition. Improved management and financial transfer software would help make the industry more efficient, compliant, and transparent, and enable better customer service and lower fees.

² see www.truste.org

³ See www.verisign.com

African Remittance Landscape Fall 2006



Mobile banking and smart cards are becoming increasingly available and relevant to African and global remittances. Where cash-based transfer services are not yet available, cell phone credits are sometimes used as currency for small transactions, demonstrating the need for easy, inexpensive payment services. How best to technically enable person-to-person money transfers, software to support MTOs and international money transfers, and online marketplaces for goods as well as cash transfers, are promising areas for development and support.

Microfinance institutions are well positioned to offer remittance services where regulations allow this. Hometown associations supported by the Diaspora, and sometimes by matching government grants, are one vehicle to use remittances for community development, in addition to private transfers.

ICTs can support remittances through management software for global MTOs, anti-money laundering systems, using online banking to fund or pay out remittances, for transferring aggregate remittances at the MTO level, and through new technologies such as mobile banking, point of sale systems, smart cards and debit cards. Improved technologies will reduce fraud and transaction fees, leaving more money available for the recipients. Remittances of goods, as well as currency, is one model of development that has been highly successful in Nepal, and is gaining ground in Africa.

Sharing research into the best software alternatives for MTOs, and perhaps sharing the development of a hybrid open source/managed software platform for remittances are two ways that stakeholders can collaborate to adopt better remittance solutions that an MTO or MFI could afford individually. At the least, common transaction standards should be developed to make interfacing with third party systems less costly and time consuming. It is prohibitively expensive to develop both the interfaces and pay the fees to participate in international money transfer networks such as SWIFT, so an aggregate solution would reduce costs for the participants.

4 References

Committee on Payment and Settlement Systems (CPSS) & World Bank (2006), *General Principles for International Remittance Services: Consultative Report* [Online], Bank for International Settlements, Basel, and The World Bank, Washington DC. Available from: <<http://www.bis.org/publ/cps73.pdf>> [9 September 2006]

Department for International Development (DFID) (2005), 'Money Talks', *Developments*, Issue 31, Fall [Online], Available from: <<http://www.developments.org.uk/data/issue31/money-talks.htm>> [7 September 2006]

Evans, A. & Klaehn, J. (2004), *A Technical Guide to Remittances: The Credit Union Experience* [Online], World Council of Credit Unions, Inc., Washington, DC. Available from: <https://www.woccu.org/development/guide/remittances_techguide.pdf> [14 September 2006]

Fanawopo, S. (2006). 'Mobile Banking on the Rise', *Daily Sun*, 16 August [Online]. Available from: <<http://www.sunnewsonline.com/webpages/features/suntech/2006/aug/16/suntech-16-08-2006-001.htm>> [8 September 2006]

Financial Mail (2005). 'Waving the Wand: Cellphone Banking could Transform Financial Services in SA and the rest of the Developing World', *Financial Mail*, 25 November [Online]. Available from: <<http://www.wizzit.co.za/media/wavinghand.pdf>> [7 September 2006]

Grameen Foundation (2006), *Grameen Foundation Launches Mifos Initiative* [Online], Grameen Foundation, Washington DC. Available from: <http://www.grameenfoundation.org/resource_center/news/~story=192> [20 November 2006]

Isern, J., Deshpande, R., van Doorn, J. (2005), 'Crafting a Money Transfers Strategy: Guidance For Pro-Poor Financial Service Providers', *Occasional Papers No. 10, March 2005* [Online], The Consultative Group to Assist the Poor (CGAP), Washington, DC. Available from: <http://www.cgap.org/docs/OccasionalPaper_10.pdf> [7 September 2006]

Magnette, N. & Lock, D. (2005), *What Works: Scaling Microfinance with the Remote Transaction System* [Online], World Resources Institute, Washington DC. Available from: <<http://www.digitaldividend.org/pdf/rts.pdf>> [7 September 2006]

Migrant Remittances (2005), 'Backbone Technology: Open Platforms for Greater Outreach And Cheaper Services', *Migrant Remittances*, Vol. 2 No. 1, April [Online], Available from: <http://www.livelihoods.org/hot_topics/docs/RemitAMAP3_05.pdf> [7 September 2006]

Orozco, M. (2005a). *Diasporas, Development and Transnational Integration: Ghanaians in the US, UK and Germany* [Online], USAID, Washington DC. Available from: <<http://www.thedialogue.org/publications/2005/fall/diasporas.pdf>> [6 September 2006]

Orozco, M. (2005b). *Remittances – Global Opportunities for International Person-To-Person Money Transfers*, VRL Publishing Ltd., London.

African Remittance Landscape Fall 2006



Orozco, M. (2006). *West African Financial Flows and Opportunities for People and Small Businesses* [Online], USAID, Washington DC. Available from:

<http://www.thedialogue.org/publications/2006/spring/orozco_WAfrica.pdf> [6 September 2006]

Paul, J. (2005), *What Works: Thamel.com, Diaspora-Enabled Development* [Online], World Resources Institute, Washington DC. Available from: <<http://www.nextbillion.net/files/Thamel%20-%20Final.pdf>> [7 September 2006]

Ratha, D. (2004), *Understanding the Importance of Remittances* [Online], Migration Information Source, Washington DC. Available from:

<<http://www.migrationinformation.org/Feature/display.cfm?id=256>> [7 September 2006]

Robinson, S. (n. d.), *SSRC Memo #3* [Online]. Available from:

<http://www.ssrc.org/programs/itic/publications/knowledge_report/memos/robinsonmemo3.pdf#search=%22%22scott%20robinson%22%20ssrc%22> [7 September 2006]

Robinson, S. (n. d.), *SSRC Memo #4* [Online]. Available from:

<http://www.ssrc.org/programs/itic/publications/knowledge_report/memos/robinsonmemo4.pdf#search=%22%22scott%20robinson%22%20remittance%22> [7 September 2006]

Truen, S., Ketley, R., Bester, H., Davis, B., Hutcheson, H.-D., Kwakwa, K., Mogapi, S. (2005), *Supporting remittances in Southern Africa: Estimating market potential and assessing regulatory obstacles*, Genesis Analytics (Pty) Ltd, Johannesburg. Available from:

<http://www.microfinancegateway.com/files/27700_file_27700.pdf> [14 September 2006]

Walker, C. (2005), *'Remittances to Africa Overtakes Foreign Direct Investment'*, Nextbillion.net, 9 December [Online]. Available from: <<http://www.nextbillion.net/newsroom/2005/12/09/remittances-to-africa-overtakes-foreign-direct-investment>> [7 September 2006]