Microfinance and Remittances

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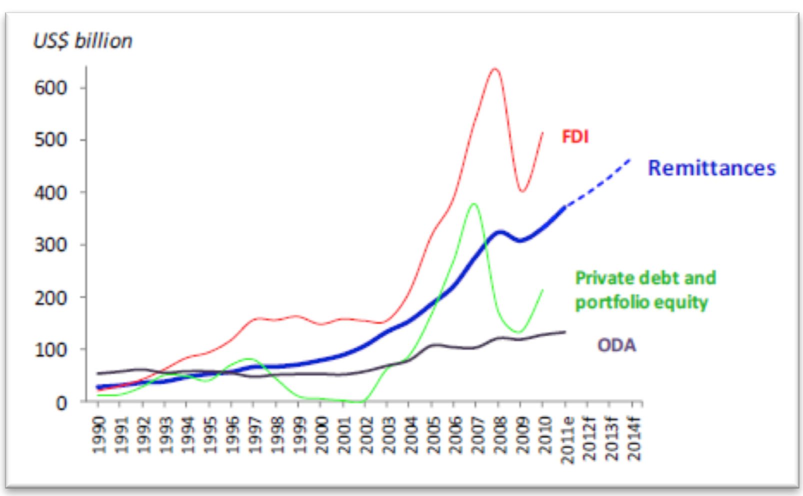
Introduction

Microfinance and remittances play a major role in the economies of many developing countries. Microfinance was developed to provide the poor with access to financial services and to support the development of small and micro-businesses. Remittances are funds sent by immigrants and migrant workers to their families back home for everything from putting food on the table to supporting new enterprises. There are many similarities between the objectives of microfinance and remittances; both are aimed at poverty reduction, both can increase a safety net for households and families, and both have the potential to promote job creation and economic development through investment in small and micro-enterprises. Many experts feel that increasing the involvement of microfinance institutions (MFIs) in the remittance transfer process is a promising way to expand financial services access to the poor, particularly in rural areas that lack access to larger commercial banks.[1]

There are significant opportunities for coordinating microfinance offerings with remittance services in Somalia. Somalia has a well-developed remittance sector, but its microfinance sector is comparatively nascent. As such, there is potential for remittance service providers to help expand microfinance in Somalia. MFIs would benefit from the knowledge possessed by remittance service providers who are experienced in bringing funds into the country and who have established relationships with potential microfinance clients. Remittance services could also be bolstered by adding microfinance products, which could help broaden the range of people served and provide greater variety in the services offered. This combination of services could help those Somalis who rely on remittances for economic subsistence to establish small businesses that could promote economic development.

Remittances and Development



Remittances across the globe are growing year by year, and they far exceed official development assistance (ODA), as shown in the graph from the World Bank's 2011 Migration and Development Brief on remittance flows.[2]
Remittances play a definitive role in economic development and have the potential to greatly influence job creation in countries such as Somalia. As stated by Abdirashid Duale, CEO of Dahabshiil, the largest

African money transfer business, "there is no doubt that remittance inflow has been an important factor in Africa's economic development."[3]

While remittances have the potential to promote development, a heavy reliance on them can cause problems for countries or communities. Coordinating with the microfinance sector could help to offset many of these risks.

One such risk is that people might become so dependent on the remittances that they cease to pursue economic activities at home and instead focus on sending ambitious young adults abroad to make money and send remittances home.[4] This would inhibit economic development in the home country and promote the "brain drain" phenomenon. It is therefore important to leverage the potential for remittances to increase job creation in recipient countries. Microfinance services can help meet this goal because they are specifically aimed at providing funds for enterprise development.

Another threat is that remittances will foster an increased disparity between the haves and the have-nots instead of helping those most in need. Given that remittances are predominately sent to family members, only those families that are successful in sending someone abroad are able to benefit from them. Unfortunately the cost of emigrating, which includes visa application fees and transportation expenses, can prohibit many people from moving abroad. As such, remittances likely would not help families that do not have a member living and working abroad. Microfinance, on the other hand, is intended to provide financial opportunities for everyone. Including microfinance in financial service offerings could extend help to those who do not have family members living and working abroad.

A 2008 *Economist* Intelligence Unit white paper sponsored by Western Union analyzed ways in which migrant worker remittances could be used for development. Their analysis focused on Asia, but the findings are more broadly relevant. The premise of the report was that remittances improve the lives of those who receive them and commonly have a positive multiplier effect on the local economy. However, there are obstacles to successfully investing remittances into micro- and small enterprises. Recipients who might otherwise be encouraged to start a small business or cottage industry are constrained by the lack of a safe place to save their remittances, the inability to leverage the remittances through a loan, and the lack of an infrastructure for participating in a market.[5] This leads to the conclusion that combining microfinance opportunities with remittances could fill in these gaps and thus improve the likelihood of building lasting and sustainable business ventures.

Somali Remittances

Remittances are a primary source of financial inflow for Somalia and its northernmost region, Somaliland. A 2009/2010 Gallup Poll revealed that 40% of people in Somaliland received remittances, which was the highest percentage in the world (no information was available for Somalia).[6] Total annual remittances to Somalia/Somaliland are estimated to be between $1 and $1.5 billion.[7] These remittances are a vital source of income for many Somalis who not only struggle with poverty and poor access to financial resources, but who must also overcome the challenges of drought, famine, and armed conflict. A 2008 survey of the UK-based members of the Somali diaspora found that nearly all remittances went to cover day-to-day needs including food, clothing, education, housing, and electricity. These remittances provide recipients with a buffer against the challenges of poverty and insecurity, which in turn provides a more secure foundation upon which to develop the human capital needed for economic development.

Remittances are predominately used to help recipients with immediate needs, but they also play an important role in business development in Somalia. While it was not possible to determine exact figures, the findings of the UK survey suggested that 5–10% of remittances were intended for business investment. A 2009 United Nations Development Program report estimated that slightly more, 12–13%, is invested.[8] This seemingly moderate proportion has a major impact. Both reports found that 80% of total investment into new entrepreneurial activities is funded through remittances.[9] It is clear that Somali business development is strongly dependent on remittances. However, the 2008 UK survey also found that remitters were dissatisfied with their investments because "only rarely do these investment efforts meet expectations or succeed at all."[10] The poor success rate may be attributed in part to the challenges presented by civil war and poor infrastructure, but is also correlated with a lack of business acumen among the recipients. This second element indicates a need for training and capacity-building among the recipients; these are services that are typically offered by microfinance institutions (MFIs).

There is potential for Somali Remittance Organizations (SROs) and remittances themselves to increase access to microfinance in Somalia. Remittances enter Somalia via money transfer systems that extend to even the most remote areas. This is facilitated by a network of SROs that have agents located throughout the country. A combination of trust and familial or clan-based relationships provides agents with the ability to locate and distribute remittances to the final recipient. Trust is similarly important for MFIs, especially in areas where microfinance is new and prospective clients are unfamiliar with the lending process. It is essential that each loan officer develops and maintains the trust of clients. As with SROs, pre-existing relationships with clans and communities can provide the foundation for this trust. While there is little information available on the other qualifications required for being an SRO agent, they have this foundational trust in place. Additionally, the familiarity the SRO agents have with the money transfer process provides a base of knowledge that, with training, could make them effective loan officers.

Opportunities and Challenges for MFIs Entering the Remittance Market

Most papers and studies evaluating microfinance and remittances discuss the ways in which already-established MFIs can include money transfer services as an additional product for their clients, rather than ways to include microfinance services in existing remittance markets. For example, the International Fund for Agricultural Development administers the Financing Facility for Remittances, which seeks to "maximize the development impact of the $125 billion remitted to rural areas every year and to create jobs that will help reduce the need to migrate" by incorporating remittance services into MFIs.[11] A 2006 report presented to the Microcredit Summit similarly emphasized that there are both social and financial opportunities for MFIs that include remittance transfer services for their clients because they provide "pro-poor clients a quality product at a lower cost that helps them build a safety net" while also "attracting new clients, cross-selling existing services, strengthening customer loyalty, increasing revenues, and mobilizing savings."[12]

There are many benefits to be found in combining microfinance and remittance services, but also an array of challenges. There are two key benefits:

- Remittances recipients lack support in terms of information or ideas about investment opportunities and lack expertise in how to run a business.[13] MFIs, which provide training and capacity-building, can help to improve the success rate of business investments from remittances.
- Remittance services can provide MFIs with a new source of income in the form of fees for transferring money.

The most commonly discussed challenges are those related to the entrance of MFIs into the money transfer market, including:

- A complex regulatory and licensing environment for money transfer services
- Developing the capacity of the institution in terms of management, staffing, systems, and marketing to provide the service
- Identifying and entering an appropriate market niche
- The costs of entry into the market
- Identifying partners with the same values and negotiating mutually advantageous partnership agreements[14]

Microfinance and Remittances in Somalia

An ongoing challenge for MFIs in Somalia is the absence of a financial sector, which complicates the process of getting money from donors to the microfinance organizations. Remittances may provide an avenue for this, as SROs have not only figured out an effective way to get money into the country, especially via foreign exchange, but they also have networks of people on the ground who have relationships with and knowledge of financial operations. Another challenge is that MFIs require a significant investment in skilled human capital. Specialized staff is needed for everything from customer relations to back-office functions.[15] Thanks to the availability of SRO agents across the country, there are well-trained people who are adept at managing financial flows and who are also well-connected through their remittance networks; these are likely to be good candidates to serve as loan officers. The CEO of Dahabshiil emphasized the importance of coordination between microfinance and remittance markets:

> Microfinance is already enabling some of the poorest Somalis to plan for the future and to be more resilient to the shocks of conflict and famine. The expertise of companies like Dahabshiil and their experience of working in such regions will be essential if these innovations are to live up to their early promise.[16]

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