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Remittances for Financial Access: Lessons from Latin American Microfinance

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The potential of migrant remittances to foster access to financial services for low-income households has been largely unexplored. Comparing three Latin American countries – the Dominican Republic, El Salvador and Mexico – this inter-disciplinary study links research on remittances and microfinance with multi-actor governance approaches. While the context of high remittance-dependence provides similar challenges in all cases, it finds remarkable variety both in the structure of the remittances market and the actors involved in microfinance and in the role governments play. It explains the diverging success of MFIs in remittance markets by pointing to the interplay of for-profit, non-profit and state actors embedded within the specific market structures of each country.

Key words: Remittances, financial access, microfinance, governance

1 Introduction

The worldwide growth of remittances – the money migrants send home, usually to family members who have stayed behind – has raised the interest of academics and policy-makers alike concerning the impact of remittances on economic development. Migrants are increasingly thought of as being development actors who contribute to the economy of their countries of origin, amongst others, through the sending of remittances, and are praised by the World Bank and other international organisations for being an important and stable source of external finance for developing countries (Ratha, 2003).

While most of the research in this field has addressed the effects of remittances on poverty and inequality (Acosta et al., 2008; Adams and Page, 2003; Jones, 1998; Koechlin and León, 2006), macroeconomic effects (Acosta et al., 2007; Amuedo-Dorantes and Pozo, 2004; Buch and Kuckulenz, 2010; Sayan, 2006), and the use of these transfers by receiving households (Adams and Cuecuecha, 2010; Cox Edwards and Ureta, 2003; Massey and Parrado, 1998; Woodruff and Zenteno, 2007; Yang, 2005), the present article takes a different approach and focuses on a topic that only recently gained salience: the effect of

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remittances on access to financial services amongst low-income or geographically isolated households that are typically not serviced by the commercial banking sector.

The exclusion of migrant households from financial services occurs on both sides of the border. On the sending side, a lack of legal resident status and other access barriers may prevent many immigrants from using formal financial services. Thus, most migrants use cash-based transfer systems offered by money-transfer operators (MTOs) that do not require bank accounts. On the receiving end, many households belong to lower-income groups that are often not attended by traditional banks or live in rural areas that are not covered by the traditional banking sector. Savings from remittances are therefore often kept outside financial institutions, while the income from remittances is, in general, not taken into account in the evaluation of creditworthiness or as a means of gaining access to other financial services by mainstream financial institutions.

Efforts to improve financial access for the receivers of remittances build upon the assumption that linking remittances with financial services potentially increases their developmental impact. Access to adequate financial services can improve the living conditions of migrant families by providing them with additional tools of risk management and asset accumulation. Moreover, the savings from remittances can be channelled towards demand for credit elsewhere and thus benefit those who do not receive remittances themselves, potentially contributing to a more equal distribution of their benefits. While a number of policy papers and reports have highlighted the fact that linking remittances with additional financial services increases their development potential (i.e. Carling, 2004, 2005; GCIM, 2005; GMG/IOM, 2010; Orozco and Fedewa, 2006; Orozco, 2006; Terry, 2005; World Bank, 2006), scholarly research on this topic has been scant.

Microfinance institutions (MFIs), compared with traditional banks, are socially and geographically closer to the ‘typical’ receivers of remittances, and are therefore in a strategic position to provide additional financial services to them. At the same time, they often lack the technical, financial or organisational skills for entering the remittance markets. Our research question is motivated by the observation that the involvement of MFIs in remittance markets differs strongly across countries. Departing from this observation, we ask the following: under which conditions do MFIs enter remittance transfer markets, eventually providing additional financial services to receivers of remittances in the lower-income segment?

The article proceeds as follows. In Section 2 we discuss the two key strands of scholarly debate joined in this article, including research on the impact of remittances on the financial sector of receiving countries and on the governance of microfinance. Section 3 provides in-depth empirical case studies of three Latin American countries: El Salvador, Mexico and the Dominican Republic. All three countries are marked by high out-migration and dependence on remittances, mainly from relatively low-skilled migrants in the United States. At the same time, these countries differ with respect to the structure of their financial markets, the role of governments and other non-market actors, and the involvement of MFIs in remittance markets. In addition to reviewing documents, statistics, reports and secondary literature, the empirical case studies rely on interviews with staff from various initiatives linking remittances and microfinance, relevant actors in the respective remittance and microfinance markets, as well as experts from academia and international co-operation agencies, conducted in 2008 and 2009.

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Section 4 systematically compares different patterns of MFI involvement in each of the three countries and generates hypotheses on the conditions under which MFIs are able to enter remittance markets. We conclude that remittances are potentially a catalyst for providing better access to financial services for receivers of remittances via MFIs. However, as a comparison of the three cases shows, whether MFIs are able to play a prominent role in remittance markets depends on specific country contexts and market structures, on the one hand, and strong co-ordinating actors that are able to bridge the typically local focus of MFIs with access to global payment systems, on the other hand. With respect to the latter, a co-ordinating function may be taken by the state, as in the Mexican case, or by strong nationally organised federations of MFIs, as in the Salvadoran case. In general, it is not the result of a purely market-led process.

2 Remittances and the governance of microfinance: linking two research fields

The exclusion of low-income households from financial services has been widely acknowledged to be an obstacle to growth and poverty reduction in developing countries (Beck et al., 2007; Jalilian and Kirkpatrick, 2002). Policies aiming at financial access have been diverse and have responded to changing development paradigms, from state-led strategies including credit subsidies and directed finance to strategic groups during the post-war period (see, amongst others, Adams and Vogel, 1986; Vogel and Adams, 1997) to policies of financial liberalisation in the context of a general turn towards more market-oriented policies and the implementation of structural adjustment programmes by the 1980s and ’90s. Yet, both the state-led paradigm as well as the market-led paradigm towards finance had limited success in providing low-income households with access to reliable and affordable financial services. Critiques of ‘financial repression’ (McKinnon, 1973; Shaw, 1973; see also World Bank, 2001) argued that market distortions through government interventions did not always benefit the poor (Adams et al., 1984; Gonzalez-Vega, 1984). Moreover, the dominant role of development banks was partly made out to be responsible for the underdevelopment of microfinance sectors, especially in large countries with omnipresent governments where institutions had to compete with subsidised public loans (Conger, 2001). On the other hand, financial liberalisation and the abolition of market distortions that were blamed for misallocations did not have the expected positive effect on financial access either (Beck and Demirgüç-Kunt, 2008; Detragiache et al., 2008).

In this context, microfinance has experienced a rise on the agenda since the 1990s, pushed, amongst other things, by the success of Yunus’ Grameen Bank in Bangladesh. By applying lending techniques that take into account the lack of collateral and low individual sums, MFIs are often better prepared than commercial banks to overcome the high transaction costs and information asymmetries (Stiglitz and Weiss, 1981) that prevent the poor from having access to credit (Armendáriz and Morduch, 2005). While several empirical studies have found that microfinance had positive overall effects on poverty reduction (Imai et al., 2010; Khandker, 2005), the more critical assessments by Duflo et al. (2013) and others have brought the high hopes that had been put into microcredit in the 1990s back to earth, making it clear that microfinance cannot be seen as a solution to all of the problems of economic development. By the 2000s, the focus shifted away from microcredit towards a more integral approach, including savings and insurance (Matin et al., 2002). This perspective emphasises

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that access to adequate financial instruments like credit, insurance and savings accounts is an important complement of the risk-management and asset-building strategies of poor households (Collins et al., 2009; Matin et al., 2002; Rutherford, 2000).

The 'discovery' of microfinance raises new questions with respect to the governance of financial markets and puts an analytical framework that builds on a clear distinction between public and private for-profit actors into doubt. First, an increasing number of commercial institutions that focus on low-income segments were often subsidised with public funds from official development co-operation, at least during their 'start-up' phase (Schmidt, 2005). In addition, we find a large variety of non-commercial or non-profit-maximising financial institutions in developing countries offering micro-financial services to low-income groups (Ambrosius and Stiegler, 2011). Some institutions developed out of non-governmental organisations (NGOs); in many cases their shareholders still maintain social goals after having transformed from NGOs into regulated banks. Credit unions, although with a need to be financially sustainable in the long run, are owned by their members who receive the income generated by the association. Rather than trusting the expansion of financial services towards the poor through commercial institutions or providing direct credit as under the state-led paradigm, governments now often take indirect roles and support MFIs through subsidies, technical support, or second-tier banking. These new and indirect roles of states, often complemented by support from international donors, could be described as a third stage of financial-market paradigms in the post-liberalisation period (Richter et al., 2006; de la Torre et al., 2006).

In this article, we relate research on the governance of microfinance to research on remittances. A number of studies in recent years have argued that remittances have a positive effect on the financial development of receiving countries. Agarwal et al. (2010) and Demirgüç-Kunt et al. (2011), for example, claim that remittances create a demand for financial services on the part of the receivers because the transfers are sent periodically and receivers need a safe place to store their savings. Moreover, they argue that banks operating as transfer providers and previously unbanked remittance receivers 'get to know each other' through remittances. Finally, banks can earn income from remittance fees, which creates an incentive for locating bank branches near remittance receivers. Other authors have claimed that, in some cases, remittances might be accepted by financial institutions as a substitute for a lack of formal income and a collateral for loans, paving the way for further financial services (Orozco and Fedewa, 2006).

Several empirical studies have shown a positive impact of remittances on the development of the formal financial sector of receiving countries. According to Agarwal et al. (2010), remittances have contributed to deeper financial sectors measured in domestic savings and, albeit to a minor degree, domestic credit relative to gross domestic product (GDP) in a cross-country panel of 99 developing countries. These results are also confirmed by Martinez Peria et al. (2008) for Latin America and by Gupta et al. (2009) for sub-Saharan Africa. In a case study on Mexico, Demirgüç-Kunt et al. (2011) add evidence to the picture of remittances having a positive impact on deposits (and partly on credit) on a *meso* (municipal) level, and also find a positive impact on financial access.[1]

1. While all studies find a strong correlation between remittances and savings accounts, the effect of remittances on credit is ambiguous. As several studies have pointed out, remittances function as an insurance mechanism in case of negative events (for example, Agarwal and Horowitz, 2002; Gubert, 2002; Yang and Choi, 2007; Yang,

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The aforementioned empirical studies focus on the effects of remittances on the traditional banking sector as covered by official data and do not in general include information on MFIs, in spite of their being, on average, both socially and geographically 'closer' to receivers than traditional banks. MFIs have considerable experience serving low-income clients who have similar characteristics to remittance receivers, and they are often located in rural areas where traditional banks are not present. Policy reports and recommendations therefore highlight linking remittances with microfinance services and products as being especially promising (Hastings, 2006; Orozco and Hamilton, 2005; Orozco, 2008). In a case study based on Mexican household data, Ambrosius (2012) finds a strong positive correlation between remittances and the ownership of savings accounts with MFIs, but not with commercial banks.

In spite of their potential, MFIs face several obstacles in linking remittances with financial services. For example, MFIs typically have a local focus and are usually not integrated into national, let alone global, payment systems. Although MFIs match the socio-economic profile of remittance receivers better than traditional banks, they often do not have the institutional capacities for complex cross-border transfers in terms of liquidity-management and information-management systems, amongst others. In addition, there can be regulatory constraints regarding activities in foreign currencies or restrictions in offering certain financial services (Sander, 2008). Linking remittance transfers with financial services in developing countries thus requires connecting MFIs in the receiving country with collecting institutions on the sending side, creating access to global networks for MFIs that typically have a local focus.

3 Remittance markets, microfinance sectors and governance initiatives in three Latin American cases

In this Section we focus on three Latin American countries characterised by high levels of remittances and comparably low access to finance: the Dominican Republic, El Salvador and Mexico. Considerable portions of the population emigrated during the last few decades in each of the three countries. Approximately 10% of the Dominican and the Mexican population, and 20% of the Salvadoran population live outside their national territory, mainly in the United States, where these three nationalities rank among the largest Hispanic groups (Pew Hispanic Center, 2013). All three countries, although to varying degrees, are strongly dependent on remittances, as shown by their absolute sums and relative weight in Table 1. Whereas, in absolute terms, Mexico is one of the world's leading receivers with more than US$23 billion in 2012, the picture changes when looking at this sum's relative weight. In El Salvador, remittances account for 16% of GDP, while in the Dominican Republic the figure is close to 7%; in Mexico, remittances accounted for only 2% of GDP in 2011. However, while remittances in Mexico are less significant in relative terms at the national level compared with the Dominican Republic and El Salvador, it is worth noting that the relative size of remittances is considerably higher for those States where most of Mexico's emigrants come from. The Mexican States with the highest emigration rates,

2005). In this way, they could compete with formal financial services, possibly reducing the demand for credit and other financial products like insurance. There is empirical evidence that migrants' transfers function as a substitute for credit and play an important role in financing productive investments (Giuliano and Ruiz-Arranz, 2009; Woodruff and Zenteno, 2007) or emergency expenditures (Ambrosius and Cuecuecha, 2013).

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Michoacán and Oaxaca, have an income of remittances to GDP of almost 9% and slightly over 8%, respectively.[2] As far as access to finance is concerned, the share of adults using formal financial services lies at less than a third in all three countries (Honohan, 2008).

Table 1: Remittances and financial access in selected countries

	Dominican Republic	El Salvador	Mexico
Remittances (US$bn 2012)	3.5	4.0	23.2
Remittances/GDP (2011)	6.6%	15.9%	2.0%
Financial access (share of adults using formal financial services)	29.0%	26.0%	25.0%

Sources: World Bank (2013) for remittances and GDP data and Honohan (2008) for data on financial access.

While all three are characterised by large diasporas, a strong dependence on remittances and a relatively low level of financial access, the structures of financial and remittance markets differ across the country sample. In the following sub-sections we give a brief overview of the involvement of financial intermediaries in remittance markets and the structure of the microfinance markets for each country, before presenting existing initiatives to link remittances with microfinance.[3]

3.1 Dominican Republic: powerful MTO and nascent MF initiatives

Remittance transfer and microfinance market structures. The striking characteristic of the remittance market in the Dominican Republic is the strong dominance of (national) MTOs and the limited role for commercial banks and MFIs (Gutierrez, 2006; Suki, 2004). According to CEMLA (2010), 73% of all transfers to the Dominican Republic are transferred and paid by MTOs, of which six cover almost the entire market (93%), whereas only 11% of remittances are transferred and paid off by banks. The rest – an estimated 16% – is carried personally by Dominicans travelling to their country (ibid.). Remittances therefore hardly generate direct contact between receivers and deposit-taking financial institutions. MTOs in the Dominican Republic are mostly national companies (Remesas Vimenca, Caribe Express,

2. Own calculations based on: remittance data on the federal level 'Remesas', Banco de México (http://www.banxico.org.mx), and 'PIB y Cuentas Nacionales de México', Instituto Nacional de Estadística y Geografía (http://www.inegi.org.mx/sistemas/olap/proyectos/bd/) (last accessed 17 January 2012).
3. Indications about remittance market shares suffer from a scarcity of data. The most recent and comparable information for the Dominican Republic and El Salvador was provided by CEMLA (2009, 2010), which offer, to our knowledge, the most reliable and comparable information in that respect. However, such an overview was not found for Mexico. We therefore rely on different sources such as Bendixen & Associates and IDB(2007) and Orozco (2006), and partly on Hernández-Coss (2005) for Mexico. These differences in the data sources can, amongst other factors, be explained by the fact that transfers cannot always be clearly classified as 'MTO' or as 'banking-transfer', such as when banks and MFIs act as paying agents for an MTO, for example. However, even if exact numbers from different data sources are partly contradictory, all sources point towards similar patterns. If not indicated otherwise, the data on market participants in the respective microfinance markets are from: 'Mix Market Database', Mix Market, last accessed on 22 October 2013, http://www.mixmarket.org/, and the websites of the various countries' financial regulatory agencies.

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Remesas Dominicanas (ReD), Quisqueyana, etc.). The strong role of Dominican MTOs is also manifested in their own representation of interests *Asociación Dominicana de Empresas Remesadoras de Divisas* (ADEREDI). Setting reference exchange rates for their members that are widely adopted by the different MTOs, their actions can also be interpreted as a quasi price cartel (Suki, 2004). Another particularity of the Dominican case is that MTOs offer home delivery of remittances, optionally in US dollars, a factor that potentially reduces the propensity of recipients to save remittances in bank accounts. In fact, according to CEMLA (2010: 33), only an estimated 6% of all remittances to the Dominican Republic are not paid in cash (i.e. partly transferred to bank accounts), while 12% are paid in cash at financial institutions and 80% are delivered directly to the individual's home.

The Dominican microfinance sector is comparably poorly developed. According to the estimation of a study published by the Inter-American Development Bank (IDB), only 15.6% of potential clients are covered (Pedroza and Navajas, 2010: 7).[4] The largest players in the market, considering the credit portfolio, are some savings and credit associations (Popular, Cibao, La Nacional), ADEMI (a private development bank with a focus on small clients), AIRAC (the largest national association of credit unions) and ADOPEM (a micro bank with a special focus on women that was born out of an NGO). Amongst these players, only the last two, whose initiatives we shall discuss in the following paragraphs, offer remittance services.

Initiatives linking remittances and microfinance. Efforts to link remittances with micro-financial services can be considered as still in their initial stage in the Dominican Republic, and have only recently become more dynamic. Some members of a co-operative, the association of credit unions *Asociación de Instituciones Rurales de Ahorro y Crédito* (AIRAC), started channelling remittances in 2000 (Bocchio, 2010). In 2010, however, only four of its members offered remittance pay-out services via 26 branches, even if AIRAC's network, covering almost all (27 of 32) of the country's provinces with their almost ninety branches,[5] is strategically well-located for remittance-transfer services (ibid.). AIRAC's co-operatives offer remittances as sub-agents for two Dominican MTOs that in turn work as agents for a variety of US money-transfer firms.[6] AIRAC does not therefore negotiate agreements with MTOs centrally for all co-operatives, but seeks individual agreements with the money-transfer companies. This is because of the bad experiences the association had with its initial co-operation partner and the fact that AIRAC is not a federation of co-operatives, but is legally functioning as a NGO. This, however, reduces AIRAC's ability to profit from its negotiating potential as a large network and achieve better deals in terms of transfer prices (Bocchio, 2010). AIRAC received support from an IDB/Multilateral Investment Fund (MIF) project between 2004 and 2010, with the specific objective of facilitating access to financial services for the population in areas with a high migration density.

The development of AIRAC's remittance service, in terms of coverage and the volume of transfers, was comparably slow because of the failure of the first MTO partner and, according to the management, the regulation constraints that do not permit co-operatives to participate directly in the remittance business (Bocchio, 2010; interviews 2

4. The so-called coverage or 'penetration rate' of a microfinance sector as used by the IDB is defined as the share of microfinance clients among the working population (ibid.).
5. see www.airac.org, last accessed 12 October 2010.
6. AIRAC, e-mail to the authors, 11 October 2010.

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and 3). Thus, despite the network's potential, the overall volume of remittance transfers has been rather limited and AIRAC's participation in the Dominican remittance market still lies below 1% (0.27%).[7] As far as the supply of financial services is concerned, if remittance receivers join one of the co-operatives, they have access to the institution's general product portfolio; in some co-operatives it is also possible to have the remittances directly transferred to a savings account (interviews 2 and 3). Beyond that, however, the initiative has not developed any specific products linked to remittances.

The second Dominican initiative in the microfinance market is the remittance service from the credit and savings bank *Banco de Ahorro y Crédito* ((ADOPEM), an upgraded NGO that has been operating since 2004 as a regulated MFI and is owned by a NGO with the same name, together with national banks and international donors. ADOPEM had over 30 branches in 2009, located in roughly two-thirds of the country's provinces; all of them offered remittance services. The MFI started to pay out remittances in 2006 as a sub-agent of a Dominican MTO (interview 1). Between 2006 and 2010 ADOPEM's remittance initiative was also supported by an IDB/MIF project aimed at deepening the Dominican financial system and bringing remittance recipients into the formal banking system.

In terms of remittance transfers, even if ADOPEM has increased this activity in its first years of operation, its market participation is lower than that of AIRAC and still amounted to only 0.08% in 2009. However, it has been quite active in the promotion of linking remittances with additional financial services: The microfinance bank offers a range of financial services to its clients that are also available for remittance receivers. In the context of the IDB/MIF remittance project, additional products have been developed such as a micro life insurance and a credit programme for the start of new businesses (Bocchio, 2010). The project's final report also indicates a 'bancarisation rate' of remittances between 6% and 9% at the end of the project, though it does not indicate the methodology applied (ibid.).

3.2 El Salvador: a strong role for banks and pioneering credit unions

Remittance transfer and microfinance market structures. Financial intermediaries play a remarkably prominent role in the transfer business in El Salvador. According to CEMLA (2009), about 74% of all formal remittance transfers are paid through the four major commercial banks, which either have their own transfer institutions or co-operate with US MTOs. Only one MTO acts as a paying agent in El Salvador, as the other players in the market are credit unions or couriers. A particularity of the Salvadoran case is the fact that banks have been present on both the sending and receiving sides since the 1980s. The then state-owned Salvadoran banks opened branches in the US in order to fight the black market in foreign currency and to capture remittances for the local banking system (Magaña, 2006). Still today, Salvadoran financial institutions show a strong interest in serving both remittance senders and receivers (CEMLA, 2009), and empirical studies have found a strong correlation between remittances and the ownership of savings accounts (Ambrosius, 2011; Anzoategui et al., 2011). However, even if financial intermediaries offer direct payment of remittances on accounts, the scarcely available data from some institutions

7. The data about market shares of the initiatives presented here were calculated with information from the respective institutions and remittance data from World Bank (2013).

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indicate that the share of remittances directly deposited into accounts, instead of through cash transfers, still remains only around 15% (ibid.).

According to the IDB, 36% of the potential clients in El Salvador have access to microfinance services (Pedroza and Navajas, 2010), implying that the market coverage by microfinance actors is considerably higher than in the other two countries. The largest institutions concerning the credit portfolio are FEDECRÉDITO (a federation of workers' banks and credit unions), ProCredit (a commercial microfinance bank), FEDECACES (*Federación de Asociaciones Co-operativas de Ahorro y Crédito de El Salvador*, a federation of credit unions) and Apoyo Integral (a former NGO upgraded to a commercial MFI). All of these financial institutions are also active in the remittance market. In the following paragraphs we present the two most important initiatives in terms of market participation, both of which are from the not-for-profit co-operative sector.

Initiatives linking remittances and microfinance. El Salvador can be considered a pioneering country in linking remittances and microfinance. One early mover in the field, the federation of credit unions FEDECACES, has offered remittance services to its clients since 1998. FEDECACES came up with the idea of channelling remittances in order to foster financial access as early as 1992, long before the topic emerged on the international co-operation agenda. In the meantime, the initiative has considerably increased its outreach. In 2010 the federation co-operated with 18 MTOs, banks and credit unions abroad in order to channel money transfers,[8] and covered all 14 departments of the country with 32 affiliated co-operatives (and almost 60 points of service), all of which offer remittances. In order to push the development of the remittance service and its contribution to financial access, FEDECACES was supported by the IDB through its MIF between 2002 and 2009 (Keil, 2009).

This support was reflected in FEDECACES' remittance transfers, which grew permanently from the start of the initiative, although with even more intensity since 2002, up to channelling more than 3% of the remittance flows to El Salvador in 2009. Concerning the link between remittances and financial services, the initiative has been comparably ambitious. To start with, remittance receivers who join one of the co-operatives – though this is not a requisite for receiving the money – can have their remittances directly transferred to their account (interview 14). Furthermore, some of the co-operatives accept remittances as additional income and part of the financial history in the evaluation of the creditworthiness of their clients (interview 15). FEDECACES has also developed products specially designed for migrant families, such as a repatriation insurance, which covers the repatriation of a deceased family member and secures remittance payments for the family for a certain period after the death of the relative. A peculiarity of FEDECACES amongst the microfinance initiatives is that, in line with its strong identification with the aim of financial access, this institution was the first – and one of the few – to keep a systemic record of the conversion rate of remittance recipients (Orozco, 2008).[9] According to the institution's data, the rate remains consistently at almost 10% (Córdova, 2010).

8. FEDECACES, e-mail to the authors, 11 October 2010.
9. The conversion rate indicates how many of the remittance recipients become clients or members of the financial institution, for instance, by opening a bank account (Orozco and Hamilton, 2005; Orozco, 2008). This rate would be one suitable indicator for measuring the contribution of remittance-channelling initiatives to financial inclusion. However, very few institutions keep records of these data and/or often fail to link

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The other Salvadoran initiative, El Salvador's largest MFI network in terms of borrowers and credit portfolio, FEDECRÉDITO, has been channelling remittances since 2003/4. Between 2006 and 2008, FEDECRÉDITO received support from IDB/MIF through a loan and technical co-operation to strengthen its institutional development.[10] Co-operating with 12 MTOs, the network had 55 members with over 115 points of service in 2010 across the whole country, with all of them able to pay out remittances. Whereas the amount and growth rate of channelled remittances is larger than in the case of FEDECACES – between 2007 and 2009 it expanded its market share from under 3% to over 5% – the linking of remittances and other financial services in the case of FEDECRÉDITO is in an earlier stage. Even if it offers special financial products for remittance recipients, such as a remittance account and a housing product, these are not yet available in all the member institutions. Remittances are also taken into account for credit scoring, and, depending on the MTO, the money can be transferred directly to bank accounts. Likewise, FEDECRÉDITO started to register the conversion rate of remittance clients; as it is not yet fully automated for all the member entities, however, no data are available yet (interview 16).

3.3 Mexico: a segmented microfinance sector with diverse MF initiatives

Remittance transfer and microfinance market structure. The remittance-transfer market in Mexico shows a more mixed picture compared with the other two countries, with MTOs and banks both playing important roles in the transfer business. While the market share of banks on the paying side is estimated to be between 33% (Bendixen & Associates and IDB, 2007) and 55% (Orozco, 2006), most of the rest, according to these sources, is paid via MTO agents (estimated at 47% by Bendixen & Associates and IDB and 40% by Orozco) or other transfer channels (MFIs, personal transfers, or the postal service). In contrast to these data, the largest paying institution, Bank BBVA Bancomer, which operates its own transfer service company – Bancomer Transfer Services (BTS) – in the US, has stated that it covers almost 60% of the remittances paid in the Mexican market. Other important players are Banamex/Citibank and *Banco Azteca*, which is also a relevant actor in the microfinance market, each with around 10% according to Hernández-Coss (2005).[11]

Based on IDB estimations (Pedroza and Navajas, 2010), the Mexican microfinance sector is comparable in size to that of the Dominican Republic, with around 17% of potential client coverage. The institutional diversity of the Mexican microfinance sector, however, is larger than in the other two countries, and the sector is far more regionally segregated. *Banco Azteca* is the largest player in terms of credit portfolio, followed by *Caja Popular Mexicana* (CPM). The third, according to this criterion, *Banco Compartamos*, however, serves (one of) the largest number of active borrowers. These three institutions have branches almost all over the country; in addition, there are many smaller regional and local institutions (Stiegler, 2012: 87f).

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information about their remittance receivers and clients demanding other services. Moreover, the methodologies applied differ considerably between institutions so that they are hardly comparable.

10. IDB, 'ES-M1015: Promoting Financial Democracy by Supporting FEDECREDITO', last accessed, 18 October 2010, www.iadb.org.
11. See also the press notices 'BBVA Bancomer sigue incrementando su participación en el pago de remesas en México', 14 July 2009, http://www.bancomer.com.mx/salaprensa/, and Román Pineda, Romina, 17 January 2006, 'Amplía Elektra negocio de remesas en México', http://www.eluniversal.com.mx, (both accessed 13 December 2010).

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Initiatives linking remittances and microfinance. Corresponding to the diversified and fragmented microfinance market structure, the range of participating and supporting actors in remittance initiatives is also broader in Mexico than in the other two countries. Accordingly, the three most important initiatives in the market are from a NGO, a financial co-operative and a national development bank. The NGO *Asociación Mexicana de Uniones de Crédito del Sector Social* (AMUCSS) is a civil-society actor with long experience in the field of rural microfinance. AMUCSS created its own network of so-called '*microbancos'* with the aim of offering financial services in marginalised rural areas with a special orientation towards indigenous communities and other groups traditionally excluded from the financial system. The first *microbanco* started to offer remittance services in 2001, while others joined in 2004 on the basis of an agreement with a Mexican MTO. After temporarily participating in the '*Red de la Gente*', a government-supported MFI network offering remittances (see below), AMUCSS founded a socially-oriented company with its own distribution platform, called '*Envíos Confianza*', in 2008 which now transfers remittances through a variety of different MFIs. In terms of coverage, *Envíos Confianza* negotiated agreements at the end of 2010 with ten US-based money-transfer providers, while in Mexico it had over 140 service points in ten States, although with a focus on five in the centre-south of the country (Guerrero, Morelos, Oaxaca, Puebla and Veracruz).[12] For the strengthening of its remittance service, AMUCSS also received support from an IDB/MIF project between 2006 and 2009 and from various international foundations (interview 4).

AMUCSS explicitly stresses the social mission of its remittance service in rural and marginalised areas. It has faced severe difficulties, however, due to incidents of theft and weak financial sustainability of its institutions, resulting in the closure of some of the *microbancos* (interviews 4, 5, and 7). These problems, together with the smaller geographical coverage, may explain the comparably small participation of AMUCSS/*Envíos Confianza* in the Mexican remittance market, which serviced around 0.02% of the market as of 2009 (Stiegler, 2012: 130). Nevertheless, the initiative has been ambitious in linking remittances with additional financial services (savings for education, credit for agriculture, housing and productive investments and micro life insurance for migrants). The supply of these products, however, varies between the different institutions and some are (still) in a pilot phase (Ramírez Martínez, 2009 and interviews 4-7). MFIs occasionally take remittances into account for credit scoring (interview 7).

The second interesting case of an MFI channelling remittances in Mexico is, because of its potential for outreach, CPM, the country's largest credit union in terms of financial assets, branches and members, with a network of over 400 branches in 22 Mexican States.[13] CPM started paying remittances in 2003 with the declared aim of amplifying services to existing members and attracting new clients (interview 12). During the initial phase of its remittance service, CPM was supported by a grant from an international development agency through the World Council of Credit Unions (WOCCU), which helped to strengthen the financial institution and improve its software, and helped with the purchase of technical equipment used for the money transfers (Orozco, 2008: 8). Furthermore, WOCCU helped to establish the first contacts with US-based MTOs (interview 13). As far as remittance

12. AMUCSS, e-mail to the authors, 26 July 2010.

13. *Comisión Nacional Bancaria y de Valores* (CNBV), http://www.cnbv.gob.mx (last accessed, 13 December 2010), and *Caja Popular Mexicana*, e-mail to the authors, 25 June 2010.

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transfers and fostering financial access are concerned, considering its large network and client base, CPM seems to be lagging behind its potential, as the institution channels only around 0.5% of Mexican remittances. In terms of linking remittances with other financial services, remittance receivers have access to all the products offered by CPM upon becoming members of the credit union.

The last Mexican case presented here, the governmental initiative, is interesting not only because of its potential outreach, but also because of its innovative approach to linking remittances with microfinance. The so-called '*Red de la Gente*' (People's Network, RdG) was initiated by the Mexican state development bank *Banco de Ahorro Nacional y Servicios Financieros* (BANSEFI) in 2002 and integrates different kinds of microfinance institutions (credit unions, savings banks, specialised MFIs, etc.) that are partly branches of BANSEFI itself. An explicit goal of the RdG is to provide financial services to people without access to traditional financial tools, especially in areas that are not covered by commercial banks (interviews 9 and 11). In 2010, the network offered remittance-transfer services co-operating with more than 50 US-based money-transfer operators and two banks, and was the only initiative operating nationwide, being present in all 32 Mexican States with over 2,000 paying points. The RdG is therefore the largest banking network in Mexico in terms of branches and presence in municipalities, clearly outnumbering even the largest commercial bank network. Even if RdG was not supported by a specific remittance project, BANSEFI co-operated with the IDB and the MIF in a project called 'Strengthening Savings and Credit Unions'. One of the project's special focuses was the development of a network for remittance transfers by supporting BANSEFI via the implementation of a technological platform that is also used by the network.

In terms of remittance transfers, BANSEFI channels the largest amount of the three Mexican cases. In the light of its larger negotiating potential, its huge network in both Mexico and the US, its ability to promote the service through the Mexican consular network in the US, as well as its larger financial scope, its participation in the remittance market with little more than 2% of the market also seems to be lagging behind the initiative's potential. The initiative has experimented with new services as well as offering various regular financial services by linking remittances and microfinance (interview 9). With the aim of fostering the banking of the remittance senders and receivers, the network offers account-to-account transfers through the government's '*Directo a México*' service. One related initiative is the so-called 'Beneficiary Account Registration' mechanism, through which a remittance sender in the US can open a bank account in the name of a recipient family member in a branch of the RdG in Mexico. The receiver then formalises the account personally when receiving the remittances.[14] One particularity of this network is that only non-BANSEFI branch members offer credit because the governmental development bank is not legally authorised to do so because of its governing statutes (interview 10). In general, not all financial services are offered by all of RdG's member MFIs, as they represent a variety of different independent institutions. This fact also complicates the attempts to measure the conversion rate in the case of BANSEFI's initiative, as data on financial-service provision are administered by the affiliated MFIs autonomously (interviews 8, 9, and 10).

14. '*Directo a México*', L' Red de la Gente, http://www.directoamexico.com/en/lared.html (last accessed, 31 July 2010).

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4 Comparing country experiences: under which conditions are MFIs able to enter remittance markets?

The role of MFIs in remittance markets varies largely across the three countries, ranging from very modest levels (less than 1%) in the Dominican Republic to over 3% in Mexico and up to almost 10% in El Salvador. We argue that this variation is the result of two conditions that are both necessary, but not individually sufficient, in order to explain the success of MFIs in entering remittance markets. The first condition is related to the structure of transfer markets; it seems to be particularly difficult for MFIs to enter remittance markets whose paying institutions are dominated by MTOs. The second condition for determining whether MFIs will be successful in entering remittance markets is the existence of strong co-ordinating actors that are able to bridge the MFI's typically local focus with access to global payment systems.

4.1 The structure of remittance markets

While an MTO's core business lies in the money-transfer service and in gains from transmission fees, deposit-taking institutions are, in general, not interested in the transaction as such.[15] For them, remittances are primarily a tool in order to achieve the objective of gaining clients amongst remittance receivers and capturing their deposits. This means that deposit-taking institutions have to compete with money-transfer operators in a field that is not their core business and where they have a competitive disadvantage compared to MTOs. This is particularly challenging for MFIs which possess fewer financial and organisational resources than banks.

In addition, building up networks in both the sending and the receiving countries has significant start-up costs that generate economies of scale in transfer markets and provide competitive advantages to market pioneers. In most countries, such as the Dominican Republic, specialised MTOs entered the remittance markets first. El Salvador provides an exception in this respect. Here, state-owned banks entered remittance markets before MTOs, with the explicit aim of fighting the black market in foreign currency and of capturing remittances for the domestic banking system. This provided commercial banks in El Salvador with an initial advantage. Even after the privatisation of banks in the 1990s, commercial banks maintained a dominant market position in Salvadoran remittance markets, exploiting scale effects in transfer markets as market leaders.

Historical legacies and path dependences matter for MFIs that usually enter remittance markets later and have to break into existing market structures. We argue that a structure of transfer markets that enables MFIs to compete in remittance markets as deposit-taking institutions geared towards lower-income groups is a necessary, but not sufficient, condition for linking MFIs and remittances. In El Salvador, a relatively strong and consolidated microfinance sector found itself in a better initial condition for breaking into transfer markets compared with the other two countries. MTOs played a minor role in the Salvadoran transfer markets, where MFIs had to compete mainly with other deposit-taking institutions. Under such conditions, it was easier for MFIs to play out their competitive advantage of being both socially and geographically closer to remittance receivers. In the Dominican Republic,

15. In some cases banks run a separate transfer business, such as BTS in Mexico (see above). These are, however, functionally separated from their banking activities.

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microfinance sectors were not only smaller in relative size compared with El Salvador, but were also institutionally less consolidated than comparable institutions in El Salvador. MFIs also had to break into a market that was dominated by MTOs, and had to compete with institutions that had an important competitive advantage in the transfer business and that attended to the same segments of the population. In addition, home-delivery of remittances lowered the demand for savings accounts, undermining the specific comparative advantage MFIs had (being able to offer additional financial services to lower-income households). In the Dominican context, entering transfer markets therefore proved to be particularly difficult.

Mexico, representing the largest remittance corridor from the US in the world in absolute terms, seems to offer room for a broader range of market actors, with both MTOs and banks playing important roles in transfer markets, as well as a greater variety of MFIs playing a role in the remittance markets. Thus, the Mexican panorama concerning the link between remittances and microfinance is more fragmented and diversified than in the other two countries.

4.2 Actors in microfinance

The specific challenge for MFIs in remittance markets lies in bridging their typically local focus with access to global payment systems. In all the cases where MFIs entered remittance markets, we observed a key actor that organised member institutions, led negotiations with MTOs in the sending country, channelled remittances via their networks and received external support. All the co-ordinating institutions we observed are not-for-profit actors that work as functional equivalents in organising local institutions and providing them with access to global payment systems via co-operation with MTOs in the sending countries. We come to the conclusion that the existence of such an actor is a necessary (although not sufficient) condition for MFIs to enter remittance markets. The large institutional variety of these co-ordinating actors reflects the diversity of microfinance sectors within the three countries. Nascent initiatives in the Dominican Republic were implemented by an association of credit unions (AIRAC) and a NGO that turned into a microfinance bank (ADOPEM). In El Salvador, two federations of credit unions (and of workers' banks) were the key actors in negotiations with the sending side and in channelling remittances through their networks. Of the three countries, Mexico shows the greatest institutional diversity of initiatives: In one case, the role of leading negotiations with the MTOs on the sending side and of channelling remittances to local institutions was taken by the largest credit union with national coverage (CPM). In the case of AMUCSS, it was a NGO that founded its own social company that functioned as a bridge between a number of small and rural institutions and institutions on the sending side. Finally, we also find a governmental initiative where a development bank (BANSEFI) unified local institutions under one umbrella, the RdG, and organised transfers to members of the network.

The strength of these actors and their ability to create strategic networks of cross-border transfers differ between cases. While the development bank BANSEFI is backed by financial resources from the Mexican government to support the microfinance sector, the associations of credit unions and savings banks in El Salvador and Mexico are able to rely on a relatively centralised organisational structure, and, in contrast to MFIs in the Dominican Republic, represent a large number of local institutions. This enables them to negotiate directly with MTOs in the US and to influence partnerships on the other side of the border. In the Dominican case, MFIs do not co-operate directly with MTOs in the US, but only work as sub-agents for Dominican MTOs. In addition, the bigger of the two

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initiatives in the Dominican case, AIRAC, is not able to use its leverage capacity in co-ordinating all its members with MTOs because it is legally constituted as a NGO and not as a federation. This limits its negotiating potential and adds additional costs to the service.

The fact that all initiatives have received some kind of external support suggests that financial or technical support at least in the kick-off phase seems to be a *conditio sine qua non* for linking remittances and microfinance, but does not explain the difference in terms of MFIs' success in entering remittance markets. While in some cases this support was substantial and the initiatives are still unable to work in a financially sustainable manner without support, in others it was limited to the setting up of remittance payments in the initial stages.

Table 2: Overview of transfer market structures, actors in microfinance and their share in remittance markets

	Dominican Republic	El Salvador	Mexico
Structure of transfer markets	Dominated by MTOs that do home delivery	Dominated by commercial banks	Mixed market, both banks & MTOs
Actors in microfinance	NGO & co-operatives with relatively weak negotiating power	Strong networks of co-operatives	Institutional diversity (NGOs, large co-operatives, development banks) with varying strength
Share of MFI in remittance markets	< 1%	~ 9%	~ 3%

5 Conclusion

This article has addressed the question of the conditions under which MFIs include remittances in their product portfolio as a means of providing additional financial services to remittance-receiving households that are usually not serviced by commercial banks. This builds upon the assumption that linking remittances with further financial services increases their developmental impact because access to savings accounts and borrowing options enables receiving households to pursue more efficient risk-management and asset-building strategies. On this premise, and based on a large number of interviews with actors involved, we compared the experience of linking remittances with microfinance in three Latin American countries, all characterised by long-standing emigration, especially to the US, and with relatively high inflows of remittances.

Considering the limitations of both the state-led and the market-led approaches in providing poor households with access to adequate and affordable financial services, we departed from a paradigm of financial-market development that goes beyond a strict dichotomy of states and markets. This view allowed us to take into account the multitude of public, non-profit and for-profit actors in financial markets, and to capture the institutional diversity of governance arrangements for linking remittances with microfinance, which are embedded in the institutional settings of each country.

We conclude from a comparison of the three countries that two conditions are necessary but not individually sufficient in order to explain whether MFIs are able to

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include remittances in their product portfolio. First, we find that market structures matter. Our case studies showed that it is difficult for MFIs to enter transfer markets that are heavily dominated by MTOs, where it seems to be difficult to compensate for the scale effects in the transfers-only business. This may at least partly explain the poorer performance of the Dominican MFIs, which had to compete in a market where home-delivery of remittances worked against the institutional advantage of deposit-taking institutions. In contrast, Salvadoran transfer markets were historically dominated by commercial banks, which allowed Salvadoran MFIs to play out their comparative advantage in serving lower-income groups and those in rural areas.

Yet, market structures alone cannot explain the divergent success of MFIs in remittance markets. In all the cases where MFIs entered remittance markets, we found key actors that organised member institutions, led negotiations with MTOs in the sending country, channelled remittances via their networks and received external financial or technical support from official development assistance (ODA). The financial and organisational strength of these co-ordinating actors proved to be a crucial factor in explaining the entrance of MFIs in transfer markets.

A strong role for MFIs in remittance markets is thus not a purely market-led process, but, amongst other things, is shaped by non-market actions that have an influence on both structural and actor-related conditions. Beyond key co-ordinating actors, governments also played a role in shaping remittance markets, as illustrated by the legacy of formerly state-owned banks in the Salvadoran remittance markets (and the absence of the Dominican government beyond the supervision and regulation of a privately owned system of banks and MTOs). At the level of the individual initiatives, the Mexican government took a direct role in co-ordinating a variety of local MFIs through the development bank BANSEFI and organised transfers to members of the network. Second, we found a broad variety of private not-for-profit institutions within the microfinance sector. And third, all institutions received some sort of support from international ODA.

For MFIs, entering remittance markets is usually not an end in itself, but rather a tool for approaching new clients. This study has demonstrated that a broad variety of MFI initiatives have the potential to foster financial access via remittances and that the realisation of that potential depends on the institutional strength of actors within different contexts. Because only part of the initiatives we studied explicitly tracks the link between remittances and savings deposits or credit, we are not able to assess the degree to which a stronger role on the part of MFIs in transfer markets actually translated into better access to financial services among lower-income households or those living in rural areas. But the cursory information provided by institutions did point to a positive correlation. Up to now, this effect is still relatively small in size, but is growing.

While the empirical case studies obviously do not allow for generalisations, this article aimed at generating hypotheses and adding empirical insights to a field that has been under-researched. Linking remittances with microfinance is a new issue on the development-policy agenda and much more so on the agenda of systematic and multi-disciplinary research.

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Appendix

Table A1: List of Interviews

Interview	Date
Interview 1	ADOPEM 1, 14.03.2008, Santo Domingo
Interview 2	AIRAC 1, 21.1.2009, Santo Domingo
Interview 3	AIRAC 2, 3.2.2009, Santo Domingo
Interview 4	AMUCSS 1, 1.12.2008, México D.F.
Interview 5	AMUCSS 2, 3.12.2008, México D.F.
Interview 6	AMUCSS 3, 22.12.2008, México D.F.
Interview 7	AMUCSS 4, 16.04.2009, Washington D.C.
Interview 8	BANSEFI 1, 15.12.2008, México D.F.
Interview 9	BANSEFI 2, 22.12.2009, México D.F.
Interview 10	BANSEFI 3, 30.03.2009, México D.F.
Interview 11	BANSEFI 6, 11.02.2008, México D.F.
Interview 12	Caja Popular Mexicana 1, León, 18.12.2008
Interview 13	Caja Popular Mexicana 2, León, 03.10.2011
Interview 14	FEDECACES 1, 29.02.2008, San Salvador
Interview 15	FEDECACES 2, 26.02.2009, San Salvador
Interview 16	FEDECRÉDITO 1, 10.03.2009, San Salvador

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