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Money Transfers: Taking Advantage of the Market Opportunity[1]

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Introduction

Cross-border remittances as a source of development finance have recently been the subject of increasing public attention. Although not all such transfers are captured in official statistics, formal remittances constitute the second largest source of external funding for developing countries, ahead of both capital market flows and official development assistance.[2]

Money transfers are also a lucrative financial service. Financial service providers (FSPs) that cater to the poor have been increasingly attracted to the money transfer market because it offers them the opportunity to fulfill both financial and social goals.[3] However, relatively little information is available on how these FSPs might enter the money transfer market.

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1 This article provides an overview of the forthcoming Consultative Group to Assist the Poor (CGAP) Occasional Paper "Crafting a Money Transfers Strategy: Guidance for Pro-Poor Financial Service Providers."

2 Ratha, Dilip. "Workers' Remittances: An Important and Stable Source of External Development Finance." Chapter 7 in *Global Development Finance 2003*. Washington, DC: World Bank, 2003, p. 157.

3 Financial service providers (FSPs) that cater to the poor include not only financial institutions, but also nonfinancial institutions, such as retailers that provide financial services as part of their product mix. In this article, FSP refers to financial service providers that deliberately offer products and services to clients below the socioeconomic level normally served by mainstream commercial banks.

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Money Transfers

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To begin to address this void, this article explores some strategic and operational choices that pro-poor FSPs must consider when launching a money transfer product. The article provides an overview of the potential market opportunity that money transfers represent, describes the components of a money transfer system and how some pro-poor FSPs have combined them to take advantage of the market opportunity, and explores the factors FSPs must consider when building a money transfer strategy, including client preferences, regulation, competition, institutional capacity, financial analysis, and marketing.

Overview of the Money Transfer Market

The money transfer industry is highly complex, comprising a vast array of formal and informal players that use rapidly changing technologies and institutional infrastructure to effect transactions for diverse clients. Money transfers can be classified in various ways, for example, by type of customer (governments, businesses, individuals), type of transmission channel (formal or informal), or origin and end points. Person-to-person money transfers are probably most relevant for pro-poor FSPs, given their customer base and the inability of governments and informal sector businesses in emerging markets to make extensive use of non-cash methods for payments to individuals.

International remittances transferred through the formal sector are perhaps the best-documented type of person-to-person transfer. Based on data of the International Monetary Fund (IMF), the World Bank estimated the global volume of formal cross-border remittance transfers to be $88.1 billion in 2002 and $93 billion in 2003.[4] Experts estimate the total value of monetary transfers made through informal channels (e.g., cash transfers conducted through family, friends, or undocumented transfer channels) may add another 40% to 100% to this amount.[5]

Such evidence indicates that informal systems are competing successfully with even the largest players in the formal money transfer market. Much of their popularity is due to client-friendly features like speed, anonymity, and minimum paperwork. They are also generally less expensive than formal transfer mechanisms, and are often present in areas where no formal sector providers exist.

The formal market is dominated by large, specialized money transfer companies (MTCs) such as Western Union, Eurogiro, MoneyGram, and Vigo. By number of transfers processed, Western Union is estimated to serve 25% of the market, Eurogiro 11%, MoneyGram 6%, and Vigo 3%. The rest of the formal money transfer market is fragmented among commercial banks, post offices, foreign exchange bureaus, credit unions, and niche money transfer companies, with different players dominating specific markets. Total revenue for this industry is currently estimated between $15 billion and $18 billion, and the demand for person-to-person money transfers is expected to increase steadily in the future.[6]

Although most current research focuses on transfers from developed to developing countries, migration often occurs within the same continent. Close to half of all reported migrants live in developing countries.[7] Evidence also indicates that poorer and more rural migrants tend to move to destinations closer to home—often urban centers within the same country. They also earn and remit less money than do wealthier international migrants.[8] The amounts of domestic transactions thus tend to be smaller than international transfers, but these transfers are more numerous and flow to many more households.[9] In the People's Republic of China alone, domestic migrants sent $45 billion via formal transfer providers in 2003.[10]

Safe, affordable money transfer mechanisms are critical for processing both domestic and international transfers. Domestic transfer services serve as the final link—the "last mile"—of the international transfer process, so domestic markets must operate efficiently for international transfers to reach their intended recipients. However, money transfer networks within developing countries are often more limited than international networks due to an undeveloped payments infrastructure and/or lack of FSPs. This reality represents an opportunity for FSPs that serve the poor, especially in remote or rural areas where transfer options may be especially scarce.

The Building Blocks of a Money Transfer System

Money transfer systems have three main elements: (i) the mechanism that carries a transfer from point A to point B; (ii) the organization(s) that provide(s) the service; and (iii) the delivery approach—how the funds are collected from

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4 World Bank, *Global Development Finance 2004*. The World Bank remittance figures are calculated on the basis of the *IMF Balance of Payments Yearbook* (2001). The $93 billion figure includes worker remittances, employee compensation, and migrant transfers.

5 Ratha and Bezard estimate the size of the informal market to be approximately 40% of the formal market, but some private industry players interviewed by the authors estimate it to be as large as the formal market. See Bezard, Gwenn. *Global Money Transfers: Exploring the Remittances Gold Mine.* Boston: Celent Communications, 2003.

6 Bezard, *Global Money Transfers*, 20.

7 International Labour Organization (ILO). "Making the Best of Globalisation: Migrant Worker Remittances and Micro-Finance." Workshop report, Employment Sector, Social Finance Unit. Geneva, 2000.

8 See Fagen, Patricia Weiss, and Micah Bump. "Remittances between Developing Neighbors in Latin America." Chapter 9 in *Beyond Small Change: Making Migrants' Remittances Count.* Washington, DC: Inter-American Development Bank, forthcoming; Cross, Catherine. "Migrant Workers' Remittances and Microfinance in South Africa." Study for the ILO and Teba Bank, Social Finance Programme, Geneva, 2003. Available: www.ilo.org/public/english/employment/finance/download/cross.pdf; and Sander, Cerstin. "Capturing a Market Share? Migrant Remittances and Money Transfers as a Microfinance Service in Sub-Saharan Africa," *Small Enterprise Development* 15, no. 1 (March 2004): 20–34.

9 See Sander, "Capturing a Market Share?" In the author's words, "for instance, a study on Viet Nam showed that 7 out of 8 transactions received were domestic remittances but they constituted only 50% of the value."

10 Kynge, James. "China's Urban Workforce Fuels Rural Economy," *Financial Times.* 26 February 2004.

and/or given to the client. This section briefly describes common transfer mechanisms and the factors that often prevent pro-poor FSPs from accessing them. It then explores how FSPs have forged partnerships with other financial institutions to overcome this obstacle, as well as new delivery approaches being used to make money transfers more convenient for clients.

Transfer Mechanisms

The major transfer mechanisms in use today fall into two main categories: paper-based and electronic. Paper-based instruments include checks, bank drafts, and money orders; while electronic fund transfers occur over various networks. Automatic clearinghouses and real-time gross settlement systems link financial institutions and their clients. Postal financial institutions have their own network for the transfer of funds. Finally, MTC networks link huge numbers of agents, which can be financial institutions or retail establishments depending on local regulations.

Transfer mechanisms vary along several other dimensions of relevance to pro-poor FSPs. One important consideration is whether the mechanism requires senders and/or receivers to have accounts with a financial institution to use the service, as this can be an obstacle for low-income clients. Customers also care about the speed of the mechanism, which is faster for electronic systems, as well as convenience and price.

From the perspective of FSPs, restrictions on access to various mechanisms may be the overriding concern, although processing cost and the need for physical and information technology infrastructure are important as well. Checks and drafts are typically only issued by bank and quasi-bank financial institutions, money orders by postal financial institutions and large private operators. Access to payment systems such as clearinghouses and real-time gross settlement systems typically occurs through a bank, and giro transfers can only be originated by postal banks. Membership in MTC networks can also be restricted to certain types of institutions depending on local regulations.

Partnerships

To overcome the access restrictions mentioned above, FSPs that serve the poor have forged creative institutional partnerships. Alliances with banks, credit unions, postal networks, international money transfer companies, and retail outlets allow FSPs to leverage their strengths (proximity to clients and established quality services) to overcome their weaknesses (limited transfer expertise, restrictions on foreign exchange dealings, and/or access to a payment system). MTC relationships may even become a competitive necessity, as they did for XAC Bank in Mongolia, which found that it needed to offer the same convenient transfer services offered by its competitors to retain clients.

A growing number of FSPs have established alliances with MTCs such as Western Union, Eurogiro, MoneyGram, and Vigo. Part of the attraction is due to simplicity: MTCs often offer agents a turnkey solution for providing money transfer services, with a complete package of software and training. Agents may also benefit from existing marketing programs and an established agent network, which can generate transfer volume. These advantages have enabled MTCs to partner with a broad networks of banks, nonbank financial institutions, post offices, and retail businesses of all types.

Partnerships with MTCs also entail risks that must be managed. For example, the larger the MTC, the more likely that it will attempt to impose exclusive relationships on its agents. Yet even large MTCs cannot always generate adequate transaction volumes for institutions in receiving countries, particularly if they have not sufficiently penetrated the relevant immigrant communities in sending countries. The financial implications of partnering with an MTC must also be properly analyzed; although many of them offer free hardware and training for start-up service, operating costs such as telecommunications charges and staff time must also be considered.

On the MTCs' side, the most important factor in choosing agents is often regulatory. In some countries, access to MTC networks is limited by law to banks and occasionally credit unions and foreign exchange bureaus. A second crucial factor is the extent of an agent's branch network, which is often its most valuable bargaining chip in negotiating MTC agent or subagent status. MTCs are often attracted by the proximity of microfinance institutions to poor clients, whom they consider one of their most important target markets. Additional criteria that figure in agent selection are operating hours, financial soundness, and sufficient liquidity to advance customer payments prior to reimbursement.

Partnerships with other types of institutions are also possible. Financial institutions with bank licenses can provide money transfer services via an electronic payment network by setting up correspondence relationships with banks in other countries or regions. The relationships between FONKOZE in Haiti and City National Bank of New Jersey in the United States, and between Spanish savings banks and Banco Solidario in Ecuador, are two such examples. In both cases, money transfers are bundled by the sending institution and transmitted to an account at the recipient institution that unbundles the payments for distribution to the receiving clients. For FSPs without bank licenses, other types of relationships with banks may still be possible: the Indian nongovernment organization Adhikar is using the services of its bank to provide money transfers to domestic migrants and their families, leveraging the bank's established transfer facilities and its own proximity to poor clients.

Even if they enjoy access to one type of transfer mechanism, FSPs often establish links with other providers so that they can offer customers a more comprehensive range of transfer options. Post offices, for example, often offer postal money orders and MTC services, enabling them to process both domestic and international transfers.

Although this type of strategic alliance can be beneficial for FSPs, careful partner selection is needed, especially as more operators enter the market. When receiving institutions deliver a transfer payment to a client, they assume a credit risk, as they have often not yet received the actual funds from their international partner. Sending FSPs rely on partners in receiving countries to make sure that transfers are delivered to recipients. Since information on both

ICICI Bank: Money Transfers and Rural Outreach

ICICI Bank, an Indian commercial bank, offers a wide range of financial services including money transfers. In 2004, the bank's "Money2India" service had over 670 agent locations in India and recently extended its outreach to remote village centers via computer kiosks. Kiosk operators are independent business people, who pay for setup costs themselves, typically financed through a partial loan from ICICI Bank. Since ICICI Bank does not incur any fixed costs, the system has proven to be an inexpensive way for the bank to extend its outreach to rural areas.

From a customer perspective, the system works as follows: a sender remits money to the recipient's ICICI account, either through an ICICI branch office or a Money2India agent. As soon as the transaction takes place, the Money2India agent informs the kiosk operator, who in turn informs the recipient. The recipient can then either collect the remittance at ICICI or the kiosk, which is equipped with a low-cost automated teller machine. ICICI estimates that kiosks can be profitably placed in villages as small as 2,000 residents. This option is very attractive for rural recipients because it eliminates transaction costs involved in traveling to a larger town to visit a bank branch.

Kiosks used by ICICI Bank offer a combination of telephone, financial, educational, and other services. From an operator's perspective, the business model is only viable if multiple services are routed through a single kiosk. However, experience shows that kiosks can become profitable even without the money transfer service, which can easily be added at a later date.

Source: Interview with Bindu Ananth, Social Initiatives Manager, ICICI Bank, 15 June 2004.

sending and receiving FSPs can be difficult to obtain, thorough due diligence on potential partners is essential.

Delivery Approaches

Money transfer operators have traditionally expected customers to come to them, typically delivering transfers to customers in cash at a bank branch, post office, or MTC agent location. More recently, the spread of new technologies in developing countries is enabling clients to send and receive transfers in a wider variety of forms and locations.[11] New delivery technologies can eliminate service constraints related to branch locations and operating hours while potentially also lowering costs, especially in remote locations. The box describes how an Indian bank uses computer kiosks to deliver transfer services outside their branch network. Systems combining mobile phones and retail points-of-sale (POS), currently being developed in South Africa, Cameroon, and the Philippines, offer another alternative.

Debit and stored-value cards, in combination with POS devices, can also transmit funds in secure electronic form, enabling clients to access transfers in multiple locations. In North America, many banks have taken advantage of debit card technology to design accounts specifically for money transfers. Such accounts often come with two (or more) debit cards: one for the sender to deposit cash into the account at an automated teller machine (ATM), and one for the receiver abroad to withdraw the cash at a compatible ATM. A study of remittances to Latin America recently found that debit card withdrawals were the least expensive of any transfer method in the market.[12] However, the relatively low fees normally charged for ATM transactions also mean that this type of product is less lucrative for FSPs than transfers through other mechanisms. In some markets, customers have embraced the new technology slower than expected.

Determinants of a Money Transfer Strategy

FSPs face a problem that seems deceptively simple: how to move funds from a sender to a recipient and make a profit. Yet the choice of partners, transmission mechanisms, and delivery approaches described earlier involves a complex set of strategic considerations. These include market factors, the external environment, and the institution's own internal strengths and weaknesses.

Client preferences for money transfers are a primary factor in shaping an FSP's strategy. To determine these preferences, FSPs must collect and analyze data on key issues. First, *who are the clients*? In addition to routine demographic data, FSPs must understand clients' preexisting level of access to financial services. They must also know *where* the money is originating and where it is going in their target market. *Transfer patterns*—including size, frequency, and short- and long-term trends—are also crucial to understand, as are preferences with respect to specific *product features*. Reliability, speed, accessibility, ease of use, confidentiality, and price are generally considered core attributes of a money transfer product, but can vary in importance. Mapping the particular preferences of its clients with respect to these attributes can help a pro-poor FSP identify its market niche. Finally, understanding what *other financial* service clients want can help an FSP attract clients and keep them loyal, thereby generating additional revenue for the FSP.

The other market factor that FSPs must consider is competition. A pro-poor FSP should identify which formal and informal money transfer agents operate in its region, the transfer mechanisms they use, and the volume of transfers that they manage. It should assess competitors' strengths and weaknesses in addressing client preferences, including formal and informal operators. The competitive analysis should enable FSPs to determine whether they can offer customers a better product and thus identify their comparative advantage as a provider.

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[11] The multiplicity of delivery technologies has important implications for increasing poor clients' access to financial services because it can enable providers to reach more clients without incurring the cost of additional physical infrastructure. The costs and benefits of various cash access technologies are discussed at length in the CGAP Information Technology Innovations Series, www.cgap.org/publications/microfinance_technology.html.

[12] Orozco, Manuel. The Remittance Marketplace: Prices, Policy, and Financial Institutions. Washington, DC: Pew Hispanic Center, Annenburg School for Communication, University of Southern California, 2004. p. 1.

Among nonmarket external factors, regulation plays perhaps the most important role in shaping an FSP's money transfer strategy. The regulatory environment determines many of the options available to an FSP seeking to enter the money transfer market, including whether the service provider will have direct access to foreign exchange, the legal right to become an agent or subagent of an MTC, or access to the national payments system. Compliance with anti-money laundering regulations and payment of taxes on transfers can also affect the viability of a money transfer offering.

An FSP's own internal institutional capacity also plays a crucial role in determining this viability. Money transfer operations require a significant investment in skilled human capital, which adds to the cost of the service. Information systems must be capable of managing the volume of anticipated transfer operations, ensuring transaction security, possibly interfacing with other transfer operators, and generating reports to comply with regulations (e.g., anti-money laundering legislation). Transfer operators must also have the capacity to carefully manage liquidity and, if they receive cross-border transfers directly, foreign exchange risk.

Financial analysis of the proposed offering must pay special attention to long-term estimates of demand. Money transfers are essentially a volume business, so confidence about future volume is crucial, especially if the method chosen requires a large initial investment. As money transfers give FSPs the opportunity to acquire new and retain existing customers, the financial analysis must also estimate revenues from cross-selling other financial services, as well as potential savings generated by increased customer retention.

Effective marketing to both receiving and sending customers also underpins a successful money transfer strategy. In environments with few transfer services, marketing is instrumental for introducing the new service to clients. In markets where many transfer options are available, marketing can help introduce transparency around prices. Gaining the trust of clients is especially important for small operators going up against established giant players, whose omnipresent marketing boost their images as a reliable entity.

Conclusion

Formal and informal money transfers constitute a growing, multibillion-dollar market, reaching clients who may have previously had little access to financial services. FSPs have a potential financial interest in money transfers because the service may enable them to increase revenues, attract new clients, cross-sell existing services, and develop new linked products. Before launching any new product, but especially a highly complex one like money transfers, FSPs must give careful consideration to client preferences, competition, regulation, and their own institutional capacity.

Alliances that allow FSPs to offer money transfer services may be the best approach for new entrants to the market. The client knowledge, location, and existing distribution infrastructure of pro-poor FSPs can make them attractive partners for existing money transfer operators. The international payment networks, foreign exchange access, and risk management expertise of specialized money transfer companies and commercial banks can, in turn, reduce both the cost and risk of a pro-poor FSP's entry into the money transfer service market.

As more poor households in developing countries come to rely on income earned elsewhere, demand for these products will continue to increase. Satisfying this demand for diverse financial services is crucial to building financial systems that truly serve the poor.

SELECTED PUBLICATIONS ON MICROFINANCE

Journal Articles

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Baumann, Ted. 2004. Pro-Poor Microcredit in South Africa: Cost Efficiency and Productivity of South African Pro-Poor Microfinance Institutions. *Development Southern Africa*. 21(5): 785-798.

Daniels, Reza. 2004. Financial Intermediation, Regulation, and the Formal Microcredit Sector in South Africa. *Development Southern Africa*. 21(5): 831-849.

Egli, Dominik. 2004. Progressive Lending as an Enforcement Mechanism in Microfinance Programs. *Review of Development Economics*. 8(4): 505-520.

Elahi, Khandakar Q. and C.P. Danopoulos. 2004. Microcredit and the Third World: Perspectives from Moral and Political Philosophy. *International Journal of Social Economics*. 31(7): 643-654.

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Other Publications

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WELCOME REMARKS BY ADB PRESIDENT HARUHIKO KURODA

**Regional Conference on "Expanding the Frontiers of Commercial Microfinance"
14 March 2005, ADB**

Chairman Lohani, distinguished speakers, guests and participants: I am delighted to welcome you to this regional conference on microfinance.

We are very fortunate to have among us a number of outstanding representatives from government, academia, the private sector, and nongovernment organizations to lead today's discussions. I would like to say a special word of welcome to our keynote speakers: Ms. Marguerite Robinson and Mr. Stuart Rutherford. Both Ms. Robinson and Mr. Rutherford are internationally acclaimed for their work in the area of microfinance. We are privileged to have them here to lend us their insights and expertise.

The theme of this conference is: "Expanding the Frontiers of Commercial Microfinance."

Put simply, it means finding ways to extend access permanent access to institutional financial services to the majority of poor and low income households and their microenterprises. That is the goal of ADB's microfinance development strategy. And I know it is a goal we share with all of you who are here today.

Why is microfinance important to developing Asia and the Pacific?

Because despite remarkable progress in the fight against poverty, the Asia and Pacific region is still home to the majority of the world's poor. Nearly 700 million Asians still struggle to exist on less than a dollar a day. Nearly 2 billion survive on less than 2 dollars a day.

Microfinance is a powerful tool in the fight against poverty. Greater access to financial services has brought significant economic benefits to millions of poor and low income people here, and around the world. But millions more remain unserved or underserved. Until their needs are addressed, they will have little hope of helping themselves rise above poverty and contribute to their own economic and social well being, and that of their families and communities.

ADB has been a long standing partner in the provision of microfinance services. In recognition of industry trends, we have shifted our focus from providing support for narrowly defined microcredit programs to supporting the development of comprehensive financial systems for the poor. In addition to loan assistance totaling over $500 million at the end of 2004 we are working with a number of member developing countries to build the policy environment, financial infrastructure, viable institutions, and other elements necessary for the growth of the industry.

Using this approach, we have supported the development of new microfinance regulatory frameworks in Cambodia, Kyrgyz Republic, Nepal, Pakistan, and Tajikistan. Azerbaijan, Sri Lanka, and Viet Nam are also in the midst of such reforms. We are also helping central banks improve their capacity to supervise microfinance institutions that mobilize poor people's deposits.

We are seeing new developments in the industry, such as the successful transformation of nongovernment organizations into regulated financial institutions in a number of Asian countries. We are seeing the establishment of new microfinance institutions, such as the Khushhali Bank in Pakistan, and the growing network of savings and credit unions in the Kyrgyz Republic. And we are witnessing increasing involvement of private commercial banks. ICICI Bank, who you will hear from tomorrow, is one bank that has developed a very clear strategy to expand the provision of financial products and services to the poor in India as a profitable activity.

These are very encouraging signs, but much more remains to be done. Closing the huge gap between the demand for microfinance and its supply will take a significant scaling up of service by formal banking institutions, nonbank financial institutions, nongovernment organizations, and alternative financial institutions such as state owned rural development banks, credit unions, and postal savings banks.

It will also require a change in mindset. Despite a growing number of success stories, the significant potential of providing financial services to poor and low income households on a profitable basis has yet to be realized. Making financial systems more competitive will be key to expanding the industry while ensuring better quality services at a reasonable cost.

Over the next two days, you will have many opportunities to discuss these and other issues, to share successes, and to learn from one another's experiences. Beyond the conference, the great challenge remains of taking these experiences back to your institutions, policy makers, constituents, and partners– to inspire change, expand the frontiers of finance to include the poor, and bring hope and opportunity to more people in the Asia and Pacific region.

I wish to assure you of ADB's strong commitment to the just cause of providing microfinance to the people of the Asia and Pacific region. I look forward to hearing the results of your deliberations.

OPENING REMARKS BY G.H.P.B. VAN DER LINDEN, VICE PRESIDENT, KNOWLEDGE MANAGEMENT AND SUSTAINABLE DEVELOPMENT, ADB

Regional Conference on "Expanding the Frontiers of Commercial Microfinance"
14 March 2005, ADB

Introduction

Let me first join with President Kuroda in welcoming all of you to this conference. This is the inaugural event of ADB's Microfinance Week. Over the next few days, we will also join with our partners from the United Nations to host a regional multistakeholder dialogue on "Building Inclusive Financial Sectors for Development." And, we will hold a training session for staff at ADB and other funding agencies on the role of governments in microfinance.

As President Kuroda noted, ADB is keenly interested and active in this important area. We are encouraged by recent developments in the microfinance industry, and look forward to working with you to take our mutual efforts to the next level.

Industry has Evolved, But Challenges Remain

The evolution of microfinance has certainly been impressive. From its beginnings as a social mission driven by nongovernment organizations, the industry has rapidly diversified, both in the kinds of institutions providing service, and in the array of services it provides.

In the early 1 980s, poor and low income households in countries such as Bangladesh, Cambodia, Indonesia, and Mongolia, just to name a few, had virtually no access to formal or semiformal financial institutions.

Today, over 200,000 poor and low income Cambodian households have permanent access to financial services. In Bangladesh, microfinance giants such as the Bangladesh Rural Advancement Committee, the Association for Social Advancement and the world famous Grameen Bank provide microcredit facilities to millions of poor households. And, a number of state owned financial institutions, including the Unit Desa system of the Bank Rakyat Indonesia and the Agricultural Bank of Mongolia, have been successfully reformed and transformed into dynamic, profitable microfinance service providers. You will hear the details of some of these success stories, and the lessons that we can draw from them, over the course of the next two days.

Yet, despite this progress, most of the Asia and Pacific region remains woefully under serviced.

In India, while the microfinance industry has begun to evolve, market penetration of service providers remains extremely low. Across the region as a whole, we believe that the entire financial sector—including NGOs, rural branches of commercial banks, agricultural development banks, rural development banks, and cooperatives—reaches no more than 30% of the rural population with microcredit. Even fewer have access to "frills" such as insurance, payment services, money transfers and safe, convenient, reliable deposit services. In most Asian countries, the poorest households rely largely on social safety nets, informal markets, and self finance for their requirements.

Setting the Stage for Growth

Given the large and growing demand, the only way to sufficiently increase the supply of microfinance is through commercialization. And to do this, we must address a number of key challenges among them, establishing a climate conducive to commercialization, attracting private sector investment, and putting microfinance institutions on a more sustainable footing.

How can this be achieved? The solutions are not simple, but let me offer a few thoughts.

First, to encourage established private sector financial institutions to enter the market, financial systems must be made more competitive. ICICI's entry into microfinance has set an example in India, but most countries in Asia will need to attract many banks, not just one, to respond to the large unserved and underserved markets.

Second, governments have a critical and constructive role to play. Experience shows that financial services for the poor expand rapidly when governments develop sound policies and legal frameworks, ensure macroeconomic stability, and encourage competition in financial markets. Government

interventions through direct service provision and interest rate caps reduce the attractiveness of microfinance to the private sector and nongovernment organizations. Governments should focus instead on ensuring that the basic economic, social, and physical infrastructure is in place to allow the industry to grow. This includes services like health and education, as well as rural infrastructure to reduce both transaction costs and the financial risks of entering rural markets.

The governments of Bangladesh, Cambodia, Indonesia, and the Philippines did not impose interest rate caps. This helped tremendously in the growth of the industry in these countries. Some other countries that did impose such caps have failed to see rapid growth. This is an important lesson.

Third, donors can make an important contribution by discouraging inappropriate government interventions, and by helping countries strengthen their legal frameworks, regulatory systems, and supervisory ability. Donors can also ensure that grants for industry development are performance based, with indicators for monitoring and measuring success, and that their assistance will not discourage private sector entry into the industry. All too often in the past, donors have played a counterproductive role in the sector by creating a dependency on concessional funds. Donors need to adjust their role in response to industry changes.

Finally, many alternative financial institutions, such as state owned agricultural and rural banks, national savings banks, postal savings banks, and savings and credit unions are not harnessing their potential to serve the poor on a large scale, on a profitable basis. For those with large branch networks or service delivery points, this potential is significant, particularly in reaching rural and remote areas. But in most cases, these institutions require substantial reforms, if they are to be transformed into dynamic service providers.

Experience has shown that such reforms are feasible, even in countries with difficult operating environments. The Agricultural Bank of Mongolia, which is represented here, will no doubt provide further information on its program of reform and the results it has achieved.

Conclusion

Ladies and gentlemen, UN Secretary General Kofi Annan states that "Sustainable access to microfinance helps alleviate poverty by generating income, creating jobs, allowing children to go to school, enabling families to obtain health care, and empowering people to make the choices that best serve their needs.... The great challenge before us is to address the constraints that exclude people from full participation in the financial sector."

I couldn't agree more. A financial system that serves only a minority of a country's people is unacceptable. Inclusive financial systems that provide access for the majority should be made a central goal of every developing country.

The development community must stand together to support governments to achieve this goal. As the President outlined, ADB has supported the development of financial systems for the poor in the past and we will continue to do so in the future, in close cooperation with the other funding agencies.

Thank you, and best of luck in your deliberations.

SELECTED ADB PROJECTS ON MICROFINANCE, 2004

- Azerbaijan: an $800,000 grant approved in December 2004 to promote development and outreach of commercial banks and MFIs. The assistance aims to create an effective collateral and debt enforcement framework and improve the regulatory and supervisory frameworks for MFIs.
- People's Republic of China (PRC): a $1.0 million technical assistance (TA) grant approved in November 2004 for rural finance reforms and development of microfinance institutions (MFIs). The TA will help improve and expand financial services to the rural poor in underdeveloped areas of Guizhou and the Inner Mongolia Autonomous Region of the PRC.
- Philippines: a $250,000 TA grant approved in December 2004 to support the development of a sound and viable financial system that can provide efficient and sustainable microfinance services for the poor.
- Timor-Leste: a $500,000 TA grant approved in December 2004 to strengthen MFIs in Timor-Leste to increase its outreach to the poor, improve its sustainability, and divest its shares for whole or partial privatization.
- Tonga: a $250,000 TA grant approved in December 2004 to design a countrywide program for the development of youth microenterprises.
- Regional: a $500,000 TA grant approved in December 2004 for a regional study of Southeast Asia workers' remittances. The TA aims to identify ways to encourage large remittance flows and the effectiveness of its use, and greater use of formal remittance channels.