Innovative financing mechanisms to reduce the cost of international remittances: Summary of Dalberg Global Development Advisors findings and recommendations

Background and motivation

International remittances, defined as financial transfers from a migrant to his or her country of origin, are instrumental to sustaining development in migrants' home countries.[1] Remittances represent a stable and significant source of capital for the developing world, subject to less volatility than other financial inflows. Despite global economic shocks, remittance flows in recent years have steadily grown at more than 10% per year, and today provide nearly three times the Official Development Assistance (ODA) flows sent to developing countries.[2] By 2014, migrant diaspora workers will send an estimated $441 billion to developing countries, representing a nearly 25% increase over funds sent in 2011.[3]. Remittances are used to pay for a variety of basic needs ranging from short-term household expenses to longer-term investments in housing, land and education. Therefore, in addition to improving day-to-day income security, remittances can also have a "positive and significant effect on economic development along a number of dimensions, including poverty alleviation, education, entrepreneurship, infant mortality, and financial development."[4]

High remittance fees, however, prevent developing countries from fully reaping the benefits of remittance flows. At 6.8% of the amount transacted, the global weighted average price of remitting funds to developing countries remains high. While remittance flows to developing countries have increased by more than 30% since 2009, weighted average prices have fallen by a modest 11% over the same period, largely driven by price declines in select corridors. Reducing the global weighted average price of remittances to developing countries by 1% point can directly increase remittance flows by $3.7 billion annually.[5] While addressing high remittance prices will require a global approach, analyses of pricing data suggest that factors in the country of origination of the remittance usually play a larger role in determining price than factors specific to the recipient country. Furthermore, global remittance outflows are relatively concentrated; the top ten sending countries account for nearly 60% of remittances sent to developing countries.[6]

While remittance outflows are concentrated among ten countries, average prices for sending remittances from these countries vary significantly across those countries. For example, while Germany and the United States are both top remitters, average prices from Germany (13.44% of amount remitted) are more than twice those from the United States (5.98%).[7] The relative significance of funding flows from top sending countries implies that interventions targeting high-volume, high-price countries could significantly impact global average remittance prices. For example, reducing remittance prices in just four of the top ten sending countries to US levels could reduce global weighted average prices from 6.8% to 6.2%, facilitating $2 billion in additional remittance flows to developing countries – comparable to increasing Canada's total aid budget by nearly 40%.[8]

The findings of this study suggest that while operating costs (driven in part by regulatory conditions) play a role in remittance pricing, poor competitive dynamics are overwhelmingly responsible for sustaining high prices globally. Furthermore, the effects of reductions in regulatory barriers or operating costs will only reach customers if markets are appropriately competitive. Dalberg Global Development Advisors, in partnership with Canada and Australia, therefore developed three innovative financing mechanisms to spur competition in the global remittance market: 1) a **limbo prize** to see how low remittance service providers (RSPs) will go on price; 2) a **networking prize** that makes it much easier for RSPs to connect with disbursing agents; and 3) a **price transparency prize** to increase consumer awareness and choice. Each of the three mechanisms seeks to reduce barriers to market entry and scale at different steps of the remittance value chain, spurring entry by new RSPs and enabling existing RSPs to improve their competitiveness.

Coordinated implementation of all three mechanisms in six target sending countries (Australia, Canada, France, Italy, United Kingdom, United States) at a one-time cost of $ 210 million could result in cumulative price reductions of up to $3.5 billion over five years, disproportionately affecting those corridors that to date have seen the least significant price declines.[9] The savings thereafter is estimated at $1.1 billion every subsequent year. This implies an incremental reduction in weighted average prices from target sending countries of 0.7% points, in turn accounting for a 0.3% point reduction in global weighted average

[1] For the purposes of this study, we consider only international remittances sent from developed to developing countries via formal channels.
[2] World Bank, "Migration and Remittances." http://go.worldbank.org/RR8SDPEHO0; updated April 2013, accessed June 2013.
[3] Mohapatra, Sankey, Dilip Ratha and Ani Silwal. "Outlook for Remittance Flows 2012-14." World Bank, 2011.
[4] Beck, Thorsten and Maria Soledad Martinez Peria. *What Explains the Cost of Remittances? An examination across 119 Country Corridors.* World Bank, 2009.
[5] Dalberg analysis based on data from the World Bank Remittance Prices Worldwide Database
[6] Top ten sending countries include the US, Saudi Arabia, UAE, Hong Kong, Canada, UK, Spain, France, Australia, and Germany.
[7] World Bank Remittances Prices Worldwide Database. http://remittanceprices.worldbank.org/; accessed May 2013.
[8] Weighted average price measured for 220 corridors for which price data is available. Global (simple) average price is 9.1%, indicating the addition of other, low volume corridors to the analysis may further increase the global weighted average. Averages do not include remittance products not involving currency exchange.
[9] For flows to major developing recipient countries from 6 sending countries (Canada, US, UK, France, Italy, Australia), including estimated indirect benefits at 3 times that of direct benefits.

remittance prices at the end of five years as a result of these mechanisms.[10] Adding the effect of the mechanisms to the existing long-term trend of global prices declining by 0.2% a year means that in five years' time we expect weighted global remittance prices to be 5.5%.[11]

The proposed mechanisms

Limbo prize: Market barriers, including high operating costs and the tendency of consumers to view price as a signal of credibility, discourage RSPs from offering their services at lower prices. Therefore, a fundamental shift in industry norms is required to encourage RSPs to compete on price and consumers to respond accordingly. A **limbo prize** could directly incentivize RSPs to offer low-priced services by seeing "how low they can go." It would award funds to one RSP per corridor / set of corridors reporting the highest volume of transactions served below a pre-set price ceiling for three years. This results-based prize offers a way to lower prices without prescribing an approach, incentivizing RSPs to find creative ways to acquire customers at lower price points.

Networking prize: Since internal operating systems (including those for messaging, clearance and settlement) differ across remittance market players, adding new distribution partners requires significant upfront investment, a particularly daunting hurdle for small RSPs. After choosing a potential partner, an RSP must build a technology interface enabling the RSP and partner to work together, resulting in complex, costly network infrastructure. This limits the number of disbursement channels that an RSP can partner with. An interoperability hub could offer RSPs a single platform facilitating multiple partnerships using a common operating platform, simplifying use and reducing costs. Membership in a hub therefore improves RSP access to and technical compatibility with disbursing agents across the globe, helping RSPs to expand their networks without incurring the significant upfront investment of time and capital that is now required to first identify potential partners for disbursement and then to ensure technical compatibility with the partner. A **networking prize** would reward up to five private sector players for creating such hubs, each after facilitating at least 12 partnerships with sending and receiving partners. Ultimately, adoption of an interoperability hub would reduce RSPs' fixed costs, facilitating RSP entry into new markets and increasing the ability of small RSPs to compete with dominant players.

Price transparency prize: Due to poor market transparency, individuals seeking to send remittances home experience difficulty in comparing the prices of different RSP services. Since reliability and trust are the most important factors in choosing an RSP – thereby favoring incumbent providers – consumers are often unaware of how much money they could save by moving to another provider. If price information were more accessible and easily comparable, consumers would likely switch to lower-price (but still reliable) providers, increasing competition and encouraging dominant RSPs to reduce prices. To facilitate consumer comparison of RSP prices, a **price transparency prize** could offer a reward to third-party technology players who create regional price transparency platforms (e.g. websites, mobile apps, etc.) by awarding funds to the platform with the most unique users at the end of three years. Because the prize rewards results, competition participants would have an incentive to promote high consumer uptake, thereby increasing the impact of each transparency platform.

The way forward

Each of the three mechanisms outlined above offers flexibility for implementation in individual countries and/or corridors. However, the success of each mechanism is contingent upon its careful design, calibration, and implementation. Donors should therefore work collaboratively to assess how to maximize benefits and mitigate risks before moving forward with one or more mechanism(s).

As immediate next steps, we therefore recommend the following:

a) Launch limbo prize in select corridors originating in G20 countries;
b) Conduct additional research on potential benefit of global interoperability hub and generate wide interest;
c) Conduct research among existing, corridor-specific RSPs to understand barriers to entering new markets;
d) Conduct market research to better understand consumer choice and decision-making in sender markets;
e) Consider launching a price transparency prize on a country-by-country basis, recognizing that some G20 countries are already active in this area.

While overall trends suggest that average remittance prices will continue to fall over time, natural improvements are likely to be disparate and only occur in certain corridors. Pursuing the proposed mechanisms, as well as engaging in further research, can help to kick-start efforts to improve competitive dynamics and lower prices, particularly in corridors where prices remain stubbornly high. By accelerating competition in the international remittance market, the G20 can help to reduce prices and unlock billions of dollars that go directly into the hands of some of the neediest households in the world.

[10] Ibid.
[11] Analysis of forward price trends based on historical data from World Bank Remittances Prices Worldwide Database. http://remittanceprices.worldbank.org/; accessed May 2013.