Remittances and microfinance in India: Opportunities and challenges for development finance

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Opportunities and Challenges for Development Finance

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Abstract

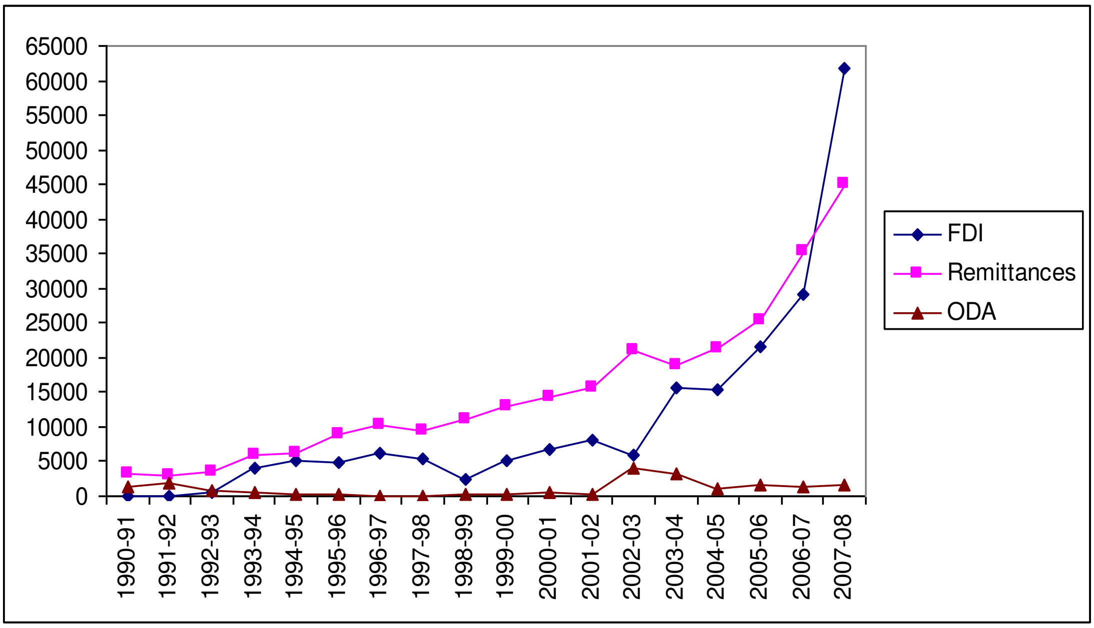
With remittances to the developing countries reaching USD 251 billion in 2007, there has been a recent surge of interest to understand the effective channelization of this flow of remittances for providing a variety of financial services desirable to the poor households in the receiving regions, especially in rural pockets. An effective solution, by way of suggestion, especially by policymakers, has been a partnership between the formal money transfer agents and Micro Finance Institutions (MFIs). The remittances and MFI nexus is seen as an important tool for development finance for the poor remittance receiving households. This paper makes an attempt to explore the various opportunities as well as challenges facing MFIs in India in this regard and recommends certain necessary steps in order to consolidate the process of linking MFIs with other conventional formal institutions. Additionally, the paper proposes two models of remittance transfer and mobilisation that could be applicable to India as well as other developing countries facing similar situation.

Key Words: *Remittances, Micro finance, Development*
JEL Classification: F24, F22, G21, O15, O19

1. Introduction

The development potential of migrant worker's remittances, both internal as well as international, is been increasingly recognized in recent times and hence, has attracted the interests of academicians and policymakers. This is evident from contemporary literature on 'migration and development' and can be attributed to the manifold increase in the flow of remittances to the developing countries of late. The past two decades has also seen phenomenal rise in migrant worker's remittances to India, making the country the highest receiver. Worker's remittances to India has risen from USD 2 billion in 1990-91 to USD 45 billion in 2007-2008. The total remittance receipts far exceeded not only Official Development Assistance (ODA) but also Foreign Direct Investment (FDI) in the country (RBI, 2008). It is evident from Figure 1 below which shows remittances for each year since 1991, that is, post liberalisation, vis-à-vis FDI and ODA in India.

Figure 1: Remittances, FDI and ODA in India



Source: Reserve Bank of India, Handbook of Statistics of Indian Economy, 2008

However, available data gives the picture of only those transfers that are through formal channels. There are huge flows through informal channels[1] as well. Puri and Ritzema (1999) cite 'convenience' as the main reason behind this 'leakage' from the formal systems of transfer. They also attribute this to inadequate banking facilities and unfavourable macroeconomic policies. However, post 9/11, high vigilance and restrictions on these informal channels (anti money laundering steps) and favourable macro situation since liberalisation in India, resulted in a greater flow of remittances through formal channels[2].

In case of internal transfers, that are those transfers that take place within the country, there are no recorded facts. But considering the huge flow of migrants within states in search of employment that is evident from census data, considerable flow of money back to the native places is obvious. The amount of remittances that flow within the country may not be comparable to the huge international flows into the country from other countries, yet their significance in the lives of the poorer section of migrants in the country cannot be ignored. This is because available evidence suggests that in case of international migration, it is not the poorest who migrate (de Haas, 2005), because they do not have the resources to finance their migration. So, the monies sent back home by the relatively poorer migrants, who do so internally, does have relative impacts for their well being.

However, be it internal or international, monies sent back home by migrants play a crucial role in the lives of the families. The rise in remittances has led to several options for money transfer as well as increased competition amongst transfer agents with technological advances playing a major role. But despite all these positive aspects, a systematic delivery mechanism of remittances to a majority of rural pockets in India, which form major migrant sending and remittance receiving regions, is either non existent or is at a very nascent stage. In rural areas along with the informal agents, new generation of financial institutions like Micro Finance Institutions (MFIs) and Business Correspondence (BCs) of Banking Institutions have expressed their interests in the business of transferring remittances. However, the outreach is insignificant. Moreover, most of the MFIs in India have been involved in savings, credit and insurance practices rather than remittance transfer. Fernando (2003) cites certain assumptions behind this, for instance, remittances, received by households, are assumed to be mainly spent on consumption for basic needs by them rather than being 'income-generating'. Hence, those remittance receivers do not belong to the target group of MFIs.

So far, remittances and its impact on macro and micro variables had been a major point of observation amongst academia and policymakers in many developing countries, especially empirical studies in Latin America, Philippines and South Asia. Last decade has seen more optimistic views on impacts of remittances, not only on the receiving countries as a whole, but on the households and communities receiving them as well. But in recent years this has gone even beyond to encompass issues pertaining to nexus between demand for financial services by remittance receivers and scope for those monies for development finance in the rural sector, of which institutions like MFIs form a 'point of intersection' (see for example Orozco, 2002). Available literature has shown successful linkages between MFIs and remittances transfer wherever they exist at the global level. There are successful cases observed especially in Latin American countries (World Council of Credit Unions -WOCCU, NAFIN in Mexico, Banco Solidario in Ecuador and PRODEM in Bolivia), certain South East Asian countries like Indonesia (Bank Rakyat Indonesia), Philippines (UNLAD and New Rural Bank of San Leonardo) and also African countries (National Micro Finance Bank in Tanzania, Uganda Microfinance Union, Centenary Rural Development Bank in Uganda and Teba Bank for mineworkers in South Africa) (ILO, 2000 and Sander, 2003b as cited in SDC, 2004).

Efforts to channelize remittances flows to and within India for development finance and savings mobilization is still at a budding stage. This owes to a variety of factors including a non-supportive regulatory framework for MFIs and other new generation financial institutions in India, improper infrastructure, technological backwardness, lack of awareness about the formal remittance services, bureaucratic nature of the formal financial institutions and financial illiteracy. With a brief exploration of existence of a link between remittances and MFIs through available evidence, this paper *firstly*, explores the various opportunities for and challenges facing MFIs in order to venture into remittance services in India with the help of evidence on both existing as well as proposed link between remittances and MFIs. *Secondly*, on the basis of those challenges, the paper makes certain recommendations in order to overcome those challenges and transform them into opportunities for developing an effective remittance delivery system. The recommendations are an attempt to further create and consolidate linkages between remittances and micro finance in India. *Thirdly*, the paper proposes two models for remittance services targeted at the rural remittance receiving households. Excerpts from formal discussions with officials of certain MFIs and BCs, in both rural and urban areas, have been included wherever found suitable for illustrations.

2. Microfinance Institutions in Remittance Services

Inclusion of the nexus between remittances and MFIs in ‘Remittances and Development’ discourse is a fairly recent phenomenon because of the very contemporary nature of the link between the two at the global level. It is said that due to their ability to reach out to the rural communities and possessing characteristics that combine both ‘formal and informal sector practices’, the MFIs have been found to be capable of handling money transfers for remote rural areas where small transactions and personal relationships with the clients matter and also providing innovative financial services to the remittance receiving clientele (Buencamino and Gorbunov, 2002). MFIs are said to have the potential of delivering positive returns on investments (ILO, 2000).

A most cited example of a successful venture is the case of IRNet which is a partnership of World Council of Credit Unions (WOCCU) with VIGO Remittance Corporation, reportedly world's third largest MTO (see Fernando, 2003 and ILO, 2000). WOCCU developed networks of credit unions by partnering with VIGO Remittance Corporation for transferring money including attractive features, for instance, disclosing the actual exchange rate at the point of sale, lower commission charges and generous refund policies in an event of delivery related problems. This partnership proved to be successful because of the favourable network of WOCCU in rural areas (WOCCU, 2004).

On the one hand we see this kind of initiatives setting examples; on the other hand we have countries where this opportunity is being explored by researchers and MFIs. For instance, in a study in Bangladesh, it was found that a large amount of remittances are transferred through informal channels. Siddiqui and Abrar (2003) have identified three types of roles that MFIs could play in attracting, transferring and administering remittances and they were, opening savings account for migrants and their families, industrial financing and other productive investments for migrant workers accounts and adequate monitoring for protection of the savings and investments of the migrants. During their interviews with leading micro finance experts, Siddiqui and Abrar (2003) found that, the major MFIs in Bangladesh did not deal with remittances. However, they mention that Bangladesh Rural Advancement Committee (BRAC) and Grameen bank see tremendous scope for gearing remittances for productive investments and savings. For example, BRAC has planned to launch a BRAC bank to curb informal flows of remittances through the *hundi* system. But certain other experts in their interviews have cautioned that until MFIs do not face a problem of funds, they would not get involved in remittance business.

However, a major impediment for MFIs in various countries to venture into remittance business, as pointed out by such country specific studies, has been the legal or regulatory framework of the apex banks in the respective countries. In Bangladesh, all MFIs are registered either under Voluntary Society's Act, Non Governmental Organisation (NGO) Act or Trust Act and hence are prohibited from making financial transactions (Siddiqui and Abrar, 2003). In Philippines, the NBFCs are not governed by the common legislation that allows for financial transfers. The power of Bangko Sentral ng Pilipinas to regulate various avenues including Overseas Filipino Worker's accounts and electronic devices overlook the fact that the migrants use of these avenues. There are regulations in money transfer market in Samoa where only limited money transfer agencies and commercial banks are allowed to participate. MFIs in Samoa are not allowed to participate in remittance transfer market. Similar situation exists in case of Indonesia, where only fully fledged commercial banks can deal with foreign exchange. NBFIs and MFIs have no permission to deal with remittances. The environment is more controlled in Indonesia due to the post Asian Financial Crisis effects in the financial sector in the country (FDC Reports, 2007).

Apart from legal restrictions of MFIs, other constraints to a successful implementation of remittance services by MFIs include various aspects like financial illiteracy of migrants and their household members and technological constraints that have been mentioned in various studies. However, a comparatively unexplored area has been the successful implementation of the technology involved. Little is known in general from existing instances regarding the viability of mobile transfers or usage of smart cards or other innovative technologies involving trigger mechanisms in case of money transfers.

According to a study by Sa-Dhan (2006), 40 to 50 per cent of MFIs in India are registered as societies or trusts, another 40 percent MFIs operate as cooperatives and rest of the MFIs are registered as NBFCs. A trend of registering MFIs as NBFCs has evolved recently as MFIs has been transformed from Poverty Lending Organisations to Profit Earning Organisations. Initially MFIs started to deliver credit and savings services. However, later on they began providing insurance services to scale up their operations. High competition among the MFIs in certain pockets in

India has resulted in innovation of new financial products for the poor. Some of the MFIs like *Basix* (Hyderabad) and *Ajiwika* (Jharkhand) have been considering remittance services as a new area of need. Apart from labour migration to other countries, due to rural-urban divide internally, migration from rural areas to cities is a common and increasing phenomenon (Census, 2001). This has created a greater need for domestic remittances transfer services. However, the formal financial market is not very active in the domestic transfer of remittances. Semi formal financial institutions like MFIs can explore remittance services as another viable financial product.

MFIs apparently, have considerable scope to play a major role in bridging this gap between the demand for quick and easy delivery services of rural households receiving remittances and supply of financial options in areas where commercial banks and other MTOs fail to deliver. In this respect a major player over the years had been Post Offices. They have greater outreach in rural areas compared to commercial banks, but they have been ineffective in case of money delivering services due to existence of corruption. There have been instances of long delays in delivery. Also, the officials often have to be bribed by the families of the poor migrants in order to receive remittances. In addition the charges of the money order of post offices are very high (5 per cent). This proves to be very high especially in case of small amounts sent by poor migrant workers.

Often in such cases these families prefer informal agents who are either informal money transfer operators or friends and relatives of the family members of the migrants. But in such cases there have been thefts and cheating, hence are unsecured means of delivery.
Ghate (2008) points out that in this case if MFIs are able to charge a fee that is cost recovering then it would be much lower than the postal charge. In a nutshell, MFIs seemingly have more economies of scope (Ghate, 2008), so they have the potential to leverage remittances for development. Moreover, remittances business can also be an important source of funds for MFIs because income from this can reduce their vulnerability (Fernando, 2007).

Moreover, in case of international remittances reaching rural families, where amounts are higher compared to internal remittances, MFIs have huge potential to take the initiative to gear the remittances for more productive purposes for these families. However, a suitable legal framework for MFIs is required to provide this service. In this regard, the next section explores the various opportunities and challenges for this intriguing relationship to develop in the Indian context.

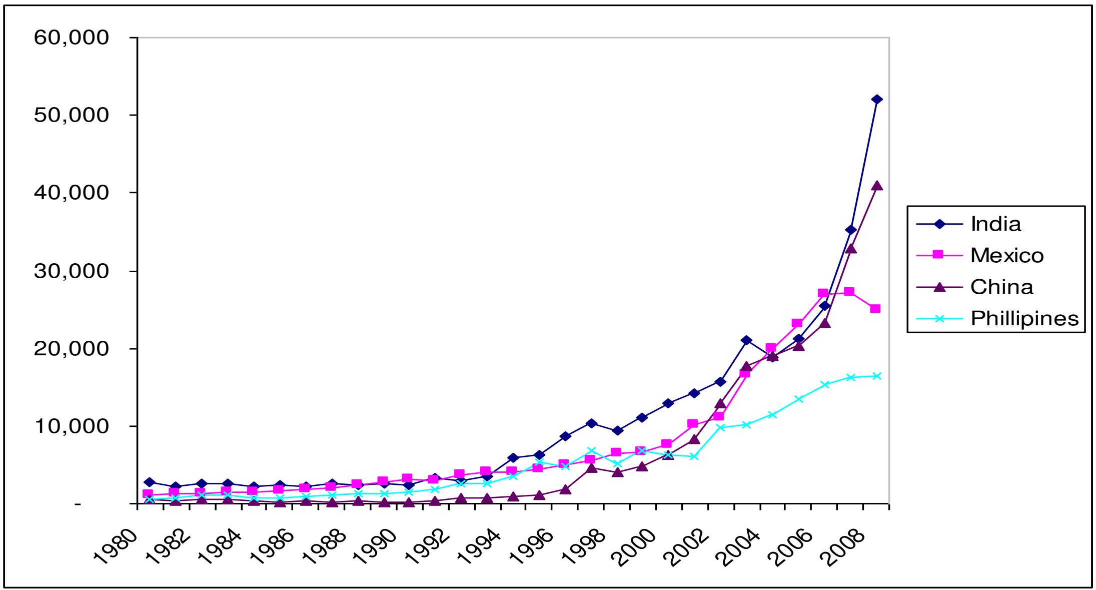
3. Opportunities and Challenges for India

3.1 The Opportunities

a. High flow of international remittances as well as internal remittances

Inward remittances to India have been a significant feature since 1980's during massive labour outflows to mainly Gulf countries. But increase in inward flows of remittances has been phenomenal post 1991 due to various macro and microeconomic factors. Amongst them are liberalized exchange rate regimes, incentives for migrants in the form of various NRI deposit schemes which also influenced greater flows of remittances through formal channels, massive outflow of skilled migrants (software personnel) to high income countries which lead to higher amounts of remittances flowing in and current account convertibility. Figure-2 below shows flow of Indian remittances in comparison to the other top remittance receiving countries (Mexico, China and Philippines) since 1980's. It shows the steady increase in remittances in India since mid 1990's till date excepting a few years (2004-06) when Mexico was the highest recipient country. Since 2006 India had again surpassed Mexico.

Figure-2: Remittances to India in Comparison with other Top Receiving Countries



Source: Plotted from IMFData, 2008, http://www.imf.org/external/data.htm

Though there is no data that captures the flow of remittances within the country, yet census figures on internal migration in the country shows significant flows. Out of the total population in the country (1.02 billion), 30 per cent are migrants (307 billion). Out of the total number of migrants, a significant 14.7 per cent people migrated for work/employment reasons. Out of the total migrants again, 37 per cent males migrated for work/employment reasons (3.2 per cent in case of females; marriage being the most important reason for migration for them), rural to rural and rural to urban being the two main streams of migration. This data is sufficient enough to identify the presence of huge flows of internal remittances. Size of individual remittances within the country may not be big enough compared to international flows from immigrants but these small amounts may have greater significance for the poor households receiving them.

b. Large network of Bank branches, Indian Post Offices and MFIs in India

In India there exists a large network of branches of banks, POs as well as that of MFIs. But compared to banks, MFIs have greater outreach in most interior areas of the country. However, they cannot take part in providing remittance services directly due to legal obstacles. But, due to their informal nature, they can play a pivotal role in providing remittance services as intermediaries of banks and Indian Post Offices. Banks and POs are unable to reach the rural households with their remittance services at their door step due to lack of staff and formal environment of these organisations. However, with the help of local MFIs, banks and POs have the opportunity to tap this relatively under explored market of remittance delivery.

For International remittance services, several banks already have overseas branches and IPO-Western Union money transfer scheme is relatively popular. However, these services are restricted to cities. It may be possible by banks and IPOs to make an effort to extend these services to the rural India with the help of local MFIs. It is learnt that through this international money transfer, IPOs have earned lot of foreign exchange. With the help of MFIs, IPOs might be able to earn more foreign exchange.

c. Venture into remittance market can expand the outreach of the MFIs

There has been an enormous growth in microfinance sector in India post 1992. But, at the same time, regional imbalances of the outreach have been found in this sector. It is found that around 54 per cent of total outreach of NABARD (National Bank for Agriculture and Rural Development) promoted SHG (Self Help Group) Bank linkage programme is concentrated in Andhra Pradesh whereas it is only two to three per cent in North Eastern States. In certain pockets of India, some MFIs are poaching clients of other MFIs in order to increase their outreach. Many of the MFIs are not only concerned about the increase in horizontal[3] outreach but also the increase in vertical[4] outreach.

d. Urgent demand for financial Services by remittance senders and receivers

There exists substantial demand for financial services by remittance receivers in interior regions of the country. Though this issue has not been explored extensively, yet certain cases provide evidence for existence of demand for such services in the country. For instance, two districts in the state of Uttar Pradesh, Azamgarh and Jaunpur which experience maximum emigration to Gulf countries do not have sufficient banking facilities resulting in migrant families relying on informal means

(Sasikumar and Hussain, 2007). Similarly, such demand exists in case of migrants moving domestically also. Initiative of '*Adhikar*' to venture into remittance services to serve the poor rural migrants from the state of Orissa to Gujarat, has also proved the huge existence of such demand for remittance services. *'Adhikar'* claims that their client base in this category in Surat grew fast to 913 in 2006 within a year of extending their remittance services from Gandhidham (Ghate, 2008).

e. Remittance as an alternative source of fund for new MFIs to venture and existing MFIs to expand their portfolio

In 1970s, when Micro-credit movement started in India, most of the programmes were funded by national and international developmental agencies. The outreach of the programmes was insignificant. In 1990's the success of micro finance movement had proved that the poor were bankable. At present donor agencies have changed their strategies to finance micro finance programmes. No grants or aids are presently available for microfinance programmes (Tedeschi, 2006). Most of the donor agencies offer loan-funds to MFIs. Hence, it is difficult for MFIs to meet the financial needs of the poor with these funds. The financial sustainability of the MFIs is a big question in present scenario.

Existing, as well as new MFIs can possibly create a new source of income by entering remittance services as a new financial product. Established MFIs would be able to increase their loan portfolios by using the earned income from remittance services and new MFIs can design innovative products like combined products by linking credit and remittances or savings and remittances. In this way, existing MFIs may also provide options to remittance receivers from the already existing savings and investment schemes that they have.

On the one hand, inclusion of remittance services by MFIs as a new product with the help of IPOs and banks would lead to generation of a new source of income for them. The question of financial viability of such MFIs does arise but may be resolved. On the other hand, rural poor can avail of the service at their doorstep. this also would lead to the possibility of reduction in charges paid by them as they would not need to pay exorbitant charges for those services to the informal service providers as well as they would not need to lose their daily wage to get these services. In this fashion, MFIs can design innovative need based products for those not covered by the formal sector. In other words, there is tremendous scope for banking the 'unbanked'.

f. Scope for return migrants

Managing return migration of people with skills as well as money (usually temporary workers) has been one of the important agenda in 'management of migration' (see Martin, 2004 and IOM, 2008). It has been widely identified and accepted by empirical studies that return migrants bring with them not only pooled resources in terms of money, but also necessary skills and innovativeness that they have acquired during their employment in the host country. Fernando (2007) identifies a scope for return migrants where they pool their remittances in deposits with MFIs and then the MFIs can generate a wide range of activities which can be helpful in cases where business development programmes aimed at return migrants fail due to lack of business acumen by the most of the returnees[5].

3.2 The Challenges

a. Unfriendly legal framework of MFIs to provide financial services to the poor

First and foremost, the crucial challenge faced by MFIs in providing remittance services is the legal structure (see RBI, 2005). It occurs that, very few MFIs can be a part of this financial service in the present circumstances. The legal limitations of the MFIs are as follows:

***i) MFIs registered under Society Act and Trust Act*:** In a charitable institutional form, conducting micro financial activities in a for-profit mode becomes inappropriate. According to Section 45 of RBI Act, 1934, unincorporated bodies are prohibited from accepting deposits from public. Unincorporated bodies refer to those which are not registered under Companies Act 1956. These institutions are not allowed to collect savings according to law. Tax exemption for surpluses might be challenged on the question of whether microfinance service is considered as charitable activity. Also, these MFIs are restricted from raising equity. This makes these institutions less attractive to commercial investors.

***ii) MFIs registered as Not-For-Profit Companies under Section 25 of Companies Act, 1956*: ** The above said restriction of deposit mobilisation applies to Section 25 Companies. The status of not-for-profit companies restricts distribution of dividends amongst the investors. Hence, it becomes difficult to attract investors. Even the exit route for the investors is not smooth. They are required to wait till other investors who forego the dividends on the investment are found. RBI instructions exempt Section 25 Companies from registration and reserve requirements for NBFCs, however, there is lack of clarity on the ceiling.

***iii) MFIs registered as Non Banking Financial Companies*: ** NBFCs are registered under the section 45-I of the RBI Act. This is the only type of MFI which fall under the prudential regulations of the central bank that is the RBI. Presently, some of the MFIs, registered under Trust Act and Societies Act transformed into NBFCs in order to perform the microfinance activities in a convenient way. However, to get registered, the minimum capital requirement is Rs. 2 crore (Sa-Dhan, 2006). The challenge for small MFIs is to mobilise this huge amount of funds. Apart from this, NBFCs are not allowed to mobilise deposits before two years of their operation, after which they get an investment grade rating. But it is very difficult for an MFI to get this rating certificate as conventional rating agencies consider providing financial services to the rural poor as a risky affair. However, for the clients, deposits service is an attractive financial product. Some of the socially responsible international investors want to invest in MFIs in India. However, financial sector is denied to access to external commercial borrowing and venture capital investment. Foreign Direct Investment in equity is permitted but it should not comprise more than 50 per cent of the total equity of the NBFCs. The challenge for NBFCs is that they have to manage Rs. 2 crore from domestic sources before they are allowed to get the foreign equity.

***iv) MFIs registered as Cooperative Banks*: ** There are three types of Cooperative Banks under the Banking Regulation Act: State Cooperative Banks, District Cooperative Banks and Primary Cooperative Banks (Urban Cooperative Banks (UCBs)). The suitable framework for MFIs is UCBs. These banks are controlled by Registrar of Cooperative Societies and RBI. Advocates of Development have found that duality of control have created lots of managerial and operational problems. Due to the poor public image of cooperatives banks and managerial problems, UCBs have failed in different parts of India. Presently it is difficult for MFIs to obtain the new licences from the RBI due to the above reasons.

From the above discussion it is clear how lack of suitable regulatory framework hampers the operation of MFIs in India. Initially Trusts and Societies have proved that the poor are bankable through their micro-credit initiatives. However, the present legal structure does not permit them to increase their operations to raise the equities or to mobilise the savings. Section 25 Companies face similar problem in raising funds. However, it must be mentioned that Cooperative Banks and NBFCs are most suitable legal structures for MFIs to perform all the financial activities. Though, RBI has been reluctant to issue new licences to MFIs. Recently, RBI has expressed interest to provide registration to NBFC-MFIs.

b. Financial constraints-problem of funds for MFIs

The legal issues and obstacles of MFIs in raising funds has already been discussed. Due to rigid legal structures, MFIs registered as Non Profit Organisations and Not-for profit Organisations are not allowed to raise the funds in the form of equities. Additionally, it needs to be mentioned that as the donor agencies have changed their strategy for microfinance operations, these MFIs are not able to get grants or aids for microfinance programmes. Though the representation of these MFIs is large in rural areas in India, they are not in a position to scale up their operation due to lack of funds. For instance, *Prayas*, an NGO-MFI has provided financial services to the earth quake victims in Kutchh, Gujarat. According to the fieldwork coordinator, the rural poor have three types of need- micro savings, micro credit and micro insurance. However, due to the lack of funds they were not in a position to extend services to the larger community in Kutchh[6]. If NGO-MFIs are interested to provide remittance services, they would require new legal structure. Existing structure restricts these institutions from mobilising remittances.

c. Information asymmetry and financial illiteracy

In the rural sector, information asymmetry prevails. Formal financial institutions are not aware about the extent of demand for remittance services and the rural households receiving remittances do not know about the available options in the formal sector. This asymmetric information amongst the service providers and customers provide an opportunity for the informal agencies to charge exorbitant prices for remittance services.

To provide the remittance services to the poor, there arises a need for organisations to conduct financial literacy workshops/training programmes. It was found that initially, during 1970s to early 1990s, MFIs could avail funds for the training and capacity building. But, in recent times, the scenario for developmental donor agencies has changed. Hence, funds for training and financial literacy programmes are not easily accessible. This affects the operations of the MFIs. For instance, during a survey in Sabarkantha district in Gujarat, it was found that some of the Self Help Groups under SHG-Bank Linkage programme promoted by NABARD had maintained their record books for four to five years. However, due to discontinuation of the practice of keeping records, they were denied loans from banks. Most of the groups informed that they did not attend any training programmes on record keeping or financial literacy.

d. Database on international migration not available to public

Unlike internal migration data, international movements are very poorly recorded. Though information on emigrants or departures are collected by Bureau of Immigration through ‘embarkation cards’ which is supposed to record important information on ‘date of birth’, ‘place and country of birth’ of the emigrants, yet such detailed information is neither published nor available to public for use. Also, it does not include skills or qualifications of the emigrants. Though it includes ‘purpose of visit’, essential information on nature and type of work is not included. This information collected is published annually as ‘Immigration Control and Measures in India’ but only for restricted use by government departments (UNESCAP, 2006). There appears no apparent reason as to why such information may not be available for use by public.

e. Convincing migrant families about formal channels of transfer and savings mobilization:

Prevalence of large and well established network of informal operators in interior rural areas creates a big challenge for formal institutions to persuade rural (usually illiterate) migrants and their families about the benefits of using formal channels of remittance delivery and savings mobilization. Though the informal institutions charge exorbitant rates, they are still most preferred by the migrants because of their informal network and usually quick services. Since remittances are strictly personal transfers, it poses a great challenge to make migrants and their families realize the importance of mobilizing their hard earned savings. It becomes, more or less, an ethical issue to interfere in their decisions to use the remittances.

f. Lack of technological infrastructure

To provide remittance services at the doorstep of the rural receiving households, technological infrastructure is a requirement. For instance, during a formal discussion with FINO (Financial Information Network and Operations) personnel in Mumbai, Mr. Rastogi, it emerged that the poor and illiterate people are not comfortable with the formal financial services due to the paper work involved in it. Hence, FINO attempts to offer cost effective services to the poor which involves less paper work. They are providing innovative technological solutions like Biometric Technologies to banks, MFIs, and other financial service providers, in order to serve the bottom end of the pyramid[7] in rural and urban areas. However the outreach, again, is not significant. FINO is involved as a Business Correspondent of banks. Mr. Rastogi, also state that training programmes at the initial stage of operation had played an important role. But the major challenge for them is to convince people about the technology like that of Biometric Technology and to assure them about the safety in the process of transferring money. Initially most of the rural people were sceptical about these technological solutions. However, he opined that continuous training programmes about the technology and finance might make the operations easier.

From a formal discussion with a manager of Axis Bank, Mr. Mukherjee, it was known that adopting Biometric Technology involves a ‘humongous’ cost. On the one hand, no individual bank can develop this network for domestic remittance services for the poor. On the other hand, due to KYC (“Know Your Customer”) norms of RBI, poor migrant workers are not allowed to open bank accounts for availing the remittance services. Banks open accounts in the name of the BCs. RBI allows BCs to certify the beneficiaries. However, there is no trigger mechanism in this BC model. According to Mr. Mukherjee, any remittance model is bound for failure if there is no trigger mechanism. As a result, the viability of this model is questionable. Another important factor highlighted by him was that acceptability of use of technology also differs across cultures. Citing an example, he said that households in Gujarat and coastal Kerala that are primarily entrepreneurial in nature have more acceptability of this technology compared to non entrepreneurial households or members. He, however, pointed out that customer base in this regard is huge and may be categorized as absolute rural poor (beneficiaries of National Rural Employment Guarantee Scheme, NREGS), rural and urban self employed people, rural blue collared workers and urban blue collared workers.

Lack of proper infrastructure for availing technological solutions is one of the reasons for insignificant outreach. This is applicable in case of usage of mobile technology also. Mr. Mukherjee said that Grameen Bank in Bangladesh has adopted the mobile phone technology for money transfer. However, in interior rural regions usually there are network failures or errors. Citing an instance he said, a person trying to send money using this technology ended up sending thrice the amount unknowingly due to network error. This was because his requests were accepted thrice and debited three times of the amount which he wanted to send from his account. Hence, this type of technical failures creates confusion and ambiguity.

4. Recommendations

1. Extend database on migration and remittances

So far, census data on international migration in India comprises only of immigrants and not of emigrants. Data on emigration is essential for research on remittances. Data on emigration from India is available from Ministry of Labour, Bureau of Immigration with plenty of shortcomings. It gives state wise data on workers granted emigration clearance. A major drawback of such data is that it does not give a holistic picture of the total number of emigrants as it gives information on those migrants who have been granted emigration clearance. A huge part of labour who are professionally qualified, holding graduate or higher degrees and diploma holders and also those who have vocational training certificates, do not require emigration clearance (UNESCAP, 2006). Also data on place of birth for emigrants is not available, so migration streams cannot be identified. Also duration of stay and nature of work is not available (contract work or otherwise). On the other hand, data on inward remittances that is available from RBI is also an aggregate data. Disaggregated data on flows of remittances from states and major cities to smaller towns and rural areas need to be collected on yearly basis. Hence one of the first and foremost recommendations would be to collect information on emigrants and remittances that give a holistic picture. This information should also be made public and user friendly for ease of researchers and policymakers. For instance, an RBI study on remittances to India, costs and time taken for transfer and their utilization by households show that remittances received by India are less frequent but more in average size compared to Latin American countries. The study which collected data from bank branches across major centres, mentions that these cities were also important corridors from where the remittances are delivered to the interior areas of the specific states (see Table-2 in RBI, 2006). Data from such studies, if produced on a yearly basis (panel data), can prove to be useful for policy makers.

2. Need for research in specific areas

In order to understand the extent to which MFIs can venture in remittance business, there is a pressing need to research on various micro aspects of impact of remittances at both the household as well as the community level in the country. Macro aspects such as macroeconomic atmosphere and policies need specific investigations. Flow of remittances through both formal and informal channels needs to be tapped. The specific areas at micro level that need focus are: i) socio economic background of the remittance receiving families, ii) the size of remittances, iii) the channels and costs of transfer including investigations on informal channels and reasons for preference for this channel[8], iv) the utilization patterns of remittances by households, v) the demand for financial services by the households and the communities[9], vi) the scope for return migrants who intend to be future entrepreneurs, especially low skilled. This is applicable in cases of both internal as well as international remittance receiving households.

Continuity of migration is essential for continuity of remittances. Hence, in case of international migration, considering the current global meltdown and increase in the number of return migrants (including skilled migrants) and increased immigration controls for the moment, there is a need to investigate future flows after the crisis and the countries that would be more receptive of immigrants[10] and those which would have tighter immigration controls post crisis and therefore, likelihood of remittances flows.

Also, remittance behaviour of both temporary and permanent migration patterns requires investigations. For instance, if 'remittance decay hypotheses'[11] is sought to be tested for permanent migrants in the country, panel data on patterns of remittance flows for the same households over a period of time becomes a requirement. This kind of data is extremely crucial for a lot of investigations related to remittances.

Another area which calls for research is 'return migration' and the 'returnees'. Return migration is said to be advantageous or developmental to the countries of origin, though different theories of migration differ in their approaches to the study of return migration. For instance, the neoclassical theories conceptualize it as a failure of the migration process, whereas for the structuralists and the New Economics of Labour Migration theorists, it as a 'calculated strategy' (Cassarino, 2004 and Riosmena and Massey, 2004), but to understand the dynamics, there is a need to take into account the diversity of return migrants. A typology of return migration and that of migrants need to be framed (see for instance Cerase, 1974 as cited in Cassarino, 2004) and the ones which have the potential for development at the origin need to be identified.

3. Identify major inter-state corridors from existing census data and use them for building partnerships with existing banks in India and destination countries of migrants

Existing census data on internal migration gives lot of scope to identify major corridors of migration state wise. Major migration streams can also be identified. For instance, available census data show high incidence of rural to urban and rural to rural migration in the country in search of work/employment (give data and percentage of total migrants) between states and also within states. If this type of data is achieved state wise, we get the flows of migrants. For instance, Maharashtra is one state in India which receives maximum number of migrants from other states. And from data we know that most migrants come from the rural areas of the state of Uttar Pradesh. Similarly, this can be found out for every state, district and major urban agglomerations. MFIs venturing into the area of, especially, internal remittances can make use of the data to form partnerships with banks and other MFIs or NBFCs working in those sectors receiving maximum migrants.

Partnerships should also be aimed at feasibility and cost reduction for remitters. They can also negotiate about the technology usage and transactions cost for transfer of remittances with the foreign banks. Give example of Focus Guatemala for international partnership.

4. Designing of Innovative products for Migrants based on Research Findings

The above investigations can be utilized by the new age financial institutions to design innovative products and services like foreign currency accounts, local currency accounts and joint accounts of migrant and households (see FDC, 2007). Return migrants with entrepreneurial ability can access investment funds. Also, even though these return migrants lack entrepreneurial skills, or if there exists unsuitable schemes for utilization of their resources, they can pool their resources in the form of deposits with the MFIs who can channelize them for entrepreneurial activities. It becomes imperative to quote Sasikumar and Hussain (2007) in this regard,

> "Another important policy option for maximizing the developmental benefits of remittances is to channel remittances to small and micro enterprises through financial intermediaries as deposits rather than expecting migrants to directly participate in entrepreneur activities. This will imply that the focus of policy then would be to induce micro finance institutions to capture remittances to be in turn used to fuel productive activities, and not on migrant-centered investment programmes. The basic policy initiative would be to enable migrant's funds to be transferred to entrepreneurs through these financial institutions. Savings and credit schemes and investment instruments specifically designed to suit migrant workers' risk profiles could be important vehicles in this regard."

5. **Financial reforms**:

Till this date there is no unique legal framework for MFIs. Taking a cue from Micro-Credit Regulatory Authority Act, 2006, of Bangladesh, Government of India with the help of Reserve Bank of India can also come up with a similar Regulatory Act for MFIs. This Act should promote small and local MFIs to reach the financial needs of the rural and urban poor. If possible, the regulatory authority will allow these local organisations to provide remittance services along with savings, credit and insurance services. Government of India can allocate emergency funds for these MFIs at the time of uncertainty like recession, drought and other natural calamities.

6. **Pre migration orientation programmes**:

Sasikumar and Hussain (2007) highlight the ignorance of especially the low skilled migrants about formal channels of transfer, which give the agents and advantage to charge exorbitant from this category of migrants, sometimes at exchange rates that is lower than those prevailing in the market. They also state that this is one of the main reasons for their preference for informal channels. Hence, MFIs, through their remittance services products can also take the initiative to educate and provide this category of migrants (usually less educated) about the benefits transferring through formal institutions. Presently, in India, there is no policy for orientation of migrants' pre departure about these issues. Irudaya Rajan and Mishra (2007) also highlight the importance of such programmes by learning from the example of Philippines which has major orientation programmes for their potential migrants pre departure about various issues related to emigration process. Such programmes are necessary in both the cases of internal as well as international migration. Sasikumar and Hussain (2008) emphasise on the need for collaboration between financial institutions and correspondent banks in India and 'Indian community organisations' to organize such events. Similar measures can be applied in case of internal migration as well. Though internal migration is huge and difficult to track, yet as a starting move, MFIs in most migrant sending regions may take an initiative to collect information on potential migrants and educate them about remittance services and the importance of transferring through formal channels. Also, they may conduct orientations on benefits of spending higher percentage of remittances on savings and productive investments so that families can develop their own resources of income on a sustainable basis.

7. **Existing MFIs can find out the percentage of remittance receiving clients**:

Due to the lack of database on internal remittances, financial sector are not able to address the needs for the transfer and mobilisation of these remittances. Most of the MFIs usually conduct socio-economic survey on beneficiaries before implementing microfinance projects. From this database they could regenerate data about the remittance receivers. It could be shared with the local financial institutions. On the basis of this database, financial institutions could design need-based remittances related products.

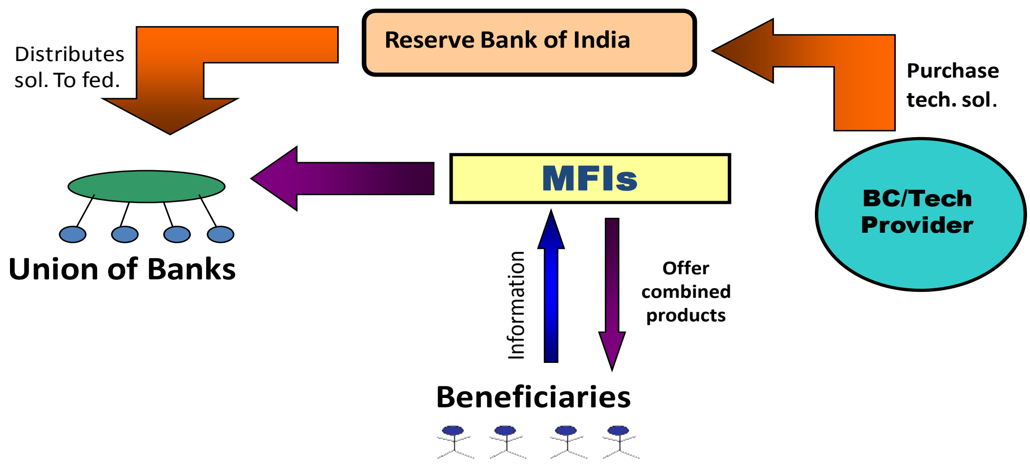
8. Engaging Diaspora and Permanent Migrants:

There are numerous instances of Diaspora organisations of countries who are involved in the development of their hometowns through collective remittances. Latin American countries are good examples in this regard (Orozco and Rouse, 2007). Members of these associations are usually wealthy enough and maintain ties with their homeland. There have been proposals to divert their activities towards support and development of their communities at the origin in various ways, that is, through philanthropy, business interests, investments and also return plans. Even if permanent migrants do not wish to return, may contribute through their savings by investment in MFIs. This will have both, a philanthropic side as well as a return on investment (Sriskandarajah, 2005). Members of the Indian Diaspora also have a great development potential (Maimbo and Ratha, 2005). The Indian Investment Centre is said to facilitate the development of enterprises in India through mechanisms that enable collaboration of Indian companies with Non Resident Indians (NRIs). The centre provides various investment options for NRIs. This centre could precede a step further by attracting the Indian Diaspora and/or the permanent Indian settlers abroad, who have a philanthropic side, and providing them with investment options in Indian MFIs.

9. Proposed models for remittance services for the rural poor:

Considering the present circumstances, an attempt is made to design two models where the formal agencies can provide the rural poor migrant households with remittances services by tying up with MFIs / BCs in an effective and convenient manner. It is clear from the earlier discussions that only banks and NBFCs can provide the remittances services. Hence the two proposed models[12] are as follows:

Figure 3: Proposed Model I



Source: Authors

Working of Model I

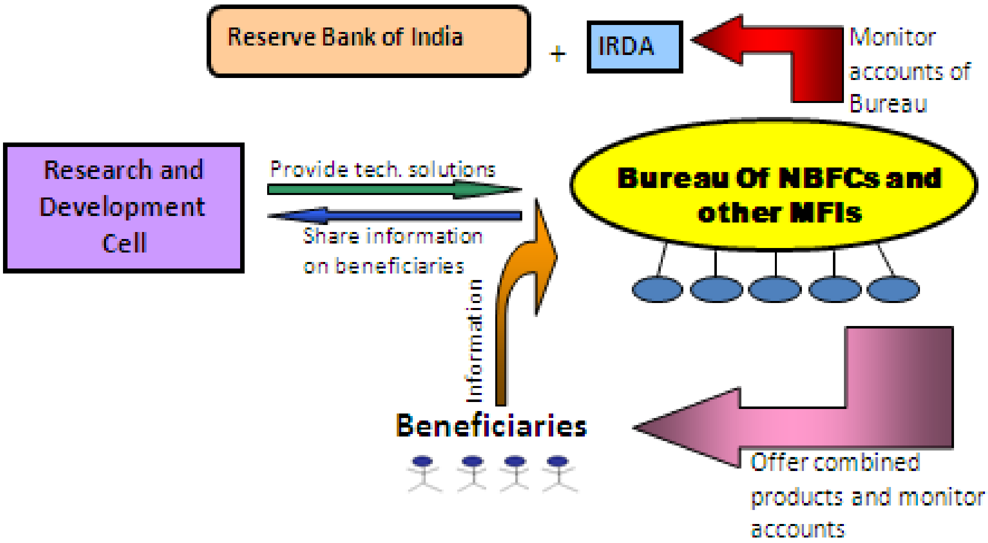
Figure 3 is explained as follows: All the banks in the same locality form a union/federation[13] → RBI chooses the BC/Technology service providers and purchases technology →RBI distributes the technology solutions to every union of banks or federation → Federation provides the technology to all banks that are part of the federation → Banks/NBFCs offer remittances services → MFIs collect information about the beneficiaries who need remittance services → MFIs help the beneficiaries to open their accounts with banks for availing remittance services → MFIs offer combination of products of remittances and savings or remittances and investment at the doorstep of their clients →The accounts of beneficiaries who are going to avail these combined products would be monitored by MFIs and banks.

Viability criteria of Model I

- Bankers should be oriented on how domestic remittances play important role in improving livelihoods of the poor.
- RBI should develop a criterion for choosing the Business Correspondents for buying the technology-solutions. They should conduct workshops on how to use these solutions for the bankers and MFIs.
- Banks would register the selected MFIs to work as intermediaries in providing remittance services after checking their records.
- Banks would monitor MFIs so that they do not compell the beneficiaries to transfer the remittances amount either in savings account with the MFIs or repay their debts by the remittances amount. If banks receive any complaints from the beneficiaries, they may cancel the registration of the MFIs.
- Banks and MFIs should design the mixed products together.
- MFIs should conduct workshops for financial literacy and usage of the technology for availing remittances services by beneficiaries.
- Paperwork should be avoided as much as possible to make the operation simplistic by the use of technology.
- Before providing the services MFIs should be ready with all information about their clients.
- Clients should be free to use the remittances amount.
- Clients pay the service charge to the banks for availing the service. However, banks should provide incentives through commissions to MFIs for providing this service.

This model has been designed in a manner which could provide remittance services specifically to the rural poor who do not have access to formal financial sector for the same services and whose livelihoods highly depend on the domestic remittances from migrant members who mainly work as labourers.

Figure 4: Proposed Model II



Source: Authors

<u>Working of Model II</u>

Figure 4 is explained as follows: Group of NBFC-MFIs from different geographical areas set up a bureau →This bureau will set up research and development cell which will innovate technological solutions for providing the services → MFIs collect information about their beneficiaries who are in need of remittance services and share it with the bureau → MFIs offer combined products of remittances with savings, investment and insurance → The accounts of the beneficiaries, who would avail these combined products, would be monitored by the MFIs and the bureau → The bureau will be monitored by RBI and IRDA (Insurance Regulatory and Development Authority).

Viability criteria of the Model II

- The bureau should be registered either as a private company limited or a NBFC under section 45-I of RBI registration.
- Each of the MFIs will take charge for the remittance services. Beneficiaries will be requested to keep certain amount of remittances as compulsory savings with the MFIs.
- Each of the MFIs should be monitored by the bureau. Beneficiaries can submit their complaints about the respective MFIs to the bureau directly case of any inconvenience. In this case the bureau will be responsible for taking the appropriate steps.

This model has been designed specifically to serve those clients who belong to middle income group or higher middle income group and who need the services frequently (for instance, households receiving foreign remittances in interior rural regions). This would be a quicker process to serve those clients.

5. Conclusion

Migration for survival and betterment of lives has been an inevitable phenomenon in the present globalized world, of which remittances are an integral source of survival for many a poor families. However, in the present economic situation, developing countries like India, with a huge population, do not have a developed market for remittance services. This paper has made an attempt to provide two sustainable stylised models for remittance services for the rural and urban poor through a collaboration of formal financial sector, rising micro finance institutions and the providers of technological solutions for financial inclusion. In India, the micro finance movement has entered the fourth decade of its operations. Development practitioners have found that this movement has successfully reached the poor with effective financial services. Through the exploration process in this study, it has emerged that the market for remittance related services in India has tremendous scope for growth. Unlike international remittances, where the formal financial sector has shown its interests in terms of various financial gains, especially in the urban market, the market for internal remittances has been relatively neglected due to various operational, legal and political obstacles. In this context, the new age MFIs comes across as an alternative option for migrants in the most interior rural pockets to avail the formal remittance services.

This paper illuminates some important issues related to MFIs and formal financial sectors in the context of possible remittances related services. For instance, on the one hand, India has a large network of banks and IPOs through which they can serve the migrants in the interior pockets without any legal obstacles. On the other hand, MFIs could bridge the information asymmetry gap between the clients and the financial service providers. Though MFIs have legal obstacles in providing remittances related services to the beneficiaries, they could work as financial intermediaries and provide these services indirectly along with the formal financial institutions. However, sufficient homework remains to be done by various agents involving government, civil society as well as academicians for this relationship to gain momentum from the present state of affairs.

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Endnotes

[1] '*Hawala*' and '*hundi*' refer to informal and illegal channels of transfer. These systems of transfer is said to have existed since long and took pace during the increased migration of 70's and 80's to Gulf countries (El Qorchi, 2002). This system works without actual transfer taking place between countries (for details see Buencamino and Gorbunov, 2002). These systems, however, are infamous for their involvement in transfers of money originating from both formal as well as illegal sources of income. They are also linked to money laundering and use by criminal agents including terrorism.

[2] This was another reason for continued high rise in remittances figures in Indian Balance of Payments since late 1990's apart from liberalized macroeconomic policies and emigration of high skilled professionals.

[3] increase in horizontal outreach means increase in number of beneficiaries

[4] Increase in vertical outreach means increase in number of products and improve its quality.

[5] For instance in the Indian state of Kerala, the state government has initiated certain schemes aimed at return migrants, but they were mostly found to have been formulated on an ad-hoc basis rather than long term. They had to be discontinued because it was found that the returnees had neither skills, nor any investment plans (Sasikumar and Hussain, 2008). Hence, even though they had the resources, yet due to a lack of vision, they could not be channelized to productive uses.

[6] This had emerged during an informal discussion with the programme coordinators of *Prayas* in Kutchh, we came to know this fact. It is a part of the study taken by MFMI Chair, IRMA in 2005.

[7] According to C.K.Prahlad (1998), a pyramid can be constructed about the poverty of an economy. Bottom of the pyramid indicates the poorest of the poor section of the society.

[8] Sasikumar and Hussain (2008) through their investigations in areas where there are relatively few banking institutions like Azampur and Jaunpur in Uttar Pradesh that migrants from these areas to Gulf prefer informal channels because of their prompt service that never fail, minimal charges and their useful networks. They indicated that these informal agents also provide the potential migrants with money for their initial costs of migration on promise that they would in future use their services for remitting money. The migrant households were also satisfied with their services. They also state that majority of the financial institutions are located at towns and do not have outreach in rural areas, hence, in these areas informal channels were the only means of receiving remittances.

[9] This has to be matched with the existing products offered by the existing MFIs. For instance, Siddiqui and Abrar (2003) in their survey find that a section of migrant workers want to put their savings in and remittances in productive investments but their financial needs do not meet the requirements of the traditional micro credit or the commercial lending institutions.

[10] See 'Recession Proof Race of Highly Skilled Migrants' in Top 10 Issues of Migration http://www.migrationinformation.org/feature/display.cfm?ID=712

[11] Remittance decay hypothesis states that the amount of remittances sent my migrants to their homes decrease as the number of years lived by them abroad increases.
[12] Though these models are proposed in the context of India, they could be replicated in other developing nations as well.
[13] For example, in India State Level Banker's Association or Block Level Banker's Association already exists which can work as federation or association according to our model.