

**REMITTANCE SERVICE PROVIDERS IN THE UNITED STATES:
How remittance firms operate and how they perceive their
business environment**

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JUNE 2006

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This paper presents the findings of a survey of 73 remittance firms in 6 U.S. states, where company executives were interviewed in person. The paper finds that the largest obstacles to doing business that remittance firms face are related to obtaining bank accounts, licensing and bond requirements, and competition from the informal sector. Along with obtaining licenses, building agent networks and compliance systems are seen as the major barriers to entry into the remittance business. If we measure success by an increasing number of transactions, our study indicate that a higher number of agents, combining remittance products with other services, the use of technology, and operational efficiency are the key factors of success.

The paper presents transactions, volumes, cost elements, and financial data for the firms. It describes in detail how remittance firms conduct their business and operations, and it looks at functions such as funds capture and disbursement, settlement and communications infrastructure, float yield and currency conversion, and marketing. It addresses pricing, transfer time, and the geographical scope of firms, and the roles of the different agents in the remittance industry.

The author and research team would like to thank all the executives of U.S. remittance firms that agreed to meet with us and to share their experiences and thoughts about the remittance industry. They carry no responsibility for any errors or omissions.

The field research preparation and execution was carried out by a team from the World Bank's Financial Sector Operations and Policy Department: Jose de Luna Martinez, Lisa Taber, Melina Mirmulstein, and Tao Wang. The author would like to acknowledge the team for particular efficient and devoted work in largely uncharted research territory.

The author would also like to thank the peer reviewers, Richard Adams and Maria Soledad Martinez Peria, as well as Thorsten Beck, Massimo Cirasino, Stijn Claessens, Raul Hernandez-Coss, Jennifer Isern, George Kalan, Robert Keppler, Samuel Maimbo, Jose De Luna Martinez, Dilip Ratha, Jan Riedberg, and Marilou Uy for support and constructive comments. Finally, the research was greatly helped by members of the World Bank/Bank for International Settlements Committee on Payment and Settlement Systems Task Force on International Remittance Services. This support leaves the responsibility for any errors and omissions all the more with the author alone.

This paper was written to provide a knowledge base for the World Bank's financial sector work on Payment Systems and Remittances, and in particular as an input to the World Bank/Bank for International Settlements Committee on Payment and Settlement Systems "General Principles for International Remittance Services", available at www.worldbank.org/remittances.

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Abbreviations

<i>9/11</i>	<i>Refers to the terrorist attacks on the United States on September 11, 2001</i>
<i>ACH</i>	<i>Automated Clearing House</i>
<i>AML</i>	<i>Anti-Money Laundering</i>
<i>ATM</i>	<i>Automated Teller Machine</i>
<i>CFT</i>	<i>Combating the Financing of Terrorism</i>
<i>FinCEN</i>	<i>Financial Crimes Enforcement Network, part of the United States Department of the Treasury</i>
<i>ID</i>	<i>Identification Document</i>
<i>IT</i>	<i>Information Technology</i>
<i>KYC</i>	<i>Know Your Customer</i>
<i>MTO</i>	<i>Money Transfer Operator, in this text synonymous with RSP</i>
<i>OFAC</i>	<i>Office of Foreign Assets Control, part of the United States Department of the Treasury</i>
<i>PoS</i>	<i>Point of Sale machine</i>
<i>RSP</i>	<i>Remittance Service Provider, in this text synonymous with MTO</i>
<i>RTGS</i>	<i>Real Time Gross Settlement System</i>
<i>SWIFT</i>	<i>Society for Worldwide Interbank Financial Telecommunication, in this text its secure messaging services for wholesale financial entities</i>

Regional Abbreviations

The regional abbreviations refer to World Bank categorizations. For lists of countries under each region, please refer to www.worldbank.org.

ECA Europe and Central Asia

LAC Latin America and Caribbean

EAP East Asia and the Pacific

AFR Sub-Saharan Africa

SA South Asia

MENA Middle East and North Africa

Introduction

International migration creates a market for cross-border retail payment with special access requirements on the sending and receiving side. A vibrant international remittance industry has emerged to meet this demand. This industry is attracting increased attention from policymakers and commercial interests, but little systematic research has been conducted in order to understand the industry's inner workings. This paper presents the findings of a survey of remittance operators in selected parts of the United States and looks at what characterizes such firms. The paper goes through the different parts of a remittance operation, and it describes how the industry has chosen to organize its operations.

The objective of this paper is to describe the remittance business in the U.S. from the perspective of the remittance service providers. We do not attempt to explain how the business has developed to its current state, we do not attempt to determine market size and shares, and we do not attempt to establish causal links between firm characteristics and performance. This work is exploratory, and we focus on presenting the reader with the patterns we see in the data while including as much information from the survey as possible. Since the work is pioneering in collecting systematic data about remittance firms' operations, it focuses on presenting a detailed picture rather than making a selection of topics.

First we briefly discuss the nature of the remittance service. Then we describe how remittance firms operate based on our survey. Lastly, based strictly on the findings from this survey, we present the business environment as perceived by remittance firms, their policy concerns, and our opinions as for what characterizes firms that are likely to succeed in the future.

The value added by remittance firms

A remittance firm transfers funds from one person in one country to another person in another country. Often, the international remittance is the monetary fruit of migrant labor that is being transferred back to the migrant worker's family. This makes the remittance service a crucial component of the logistics of migration. There is a multitude of companies providing remittance services, of all sizes and using a large variety of technologies. They mainly add value in the following four areas, where their services are unique.

First, there is no global retail payment system. Global payments are largely effectuated by banks with correspondent relationships, or, in a variation of this, through a system of payment card processors that effectuate the retail transactions using correspondent banking relationships to settle balances. Bank wire transfers are often expensive, and the use of payment cards for remittances is in its infancy. Therefore, remittance firms perform a unique function in the cross-border retail payment infrastructure.

Second, the senders of remittances often need an interface to access the banking system. Many do not have bank accounts, and banks' opening hours are often not conducive to migrant work schedules. Cultural and language barriers can be significant, as can reluctance to engage with large financial institutions. Concerns about immigrant status can also prevent some migrants from using banks for international transfers.

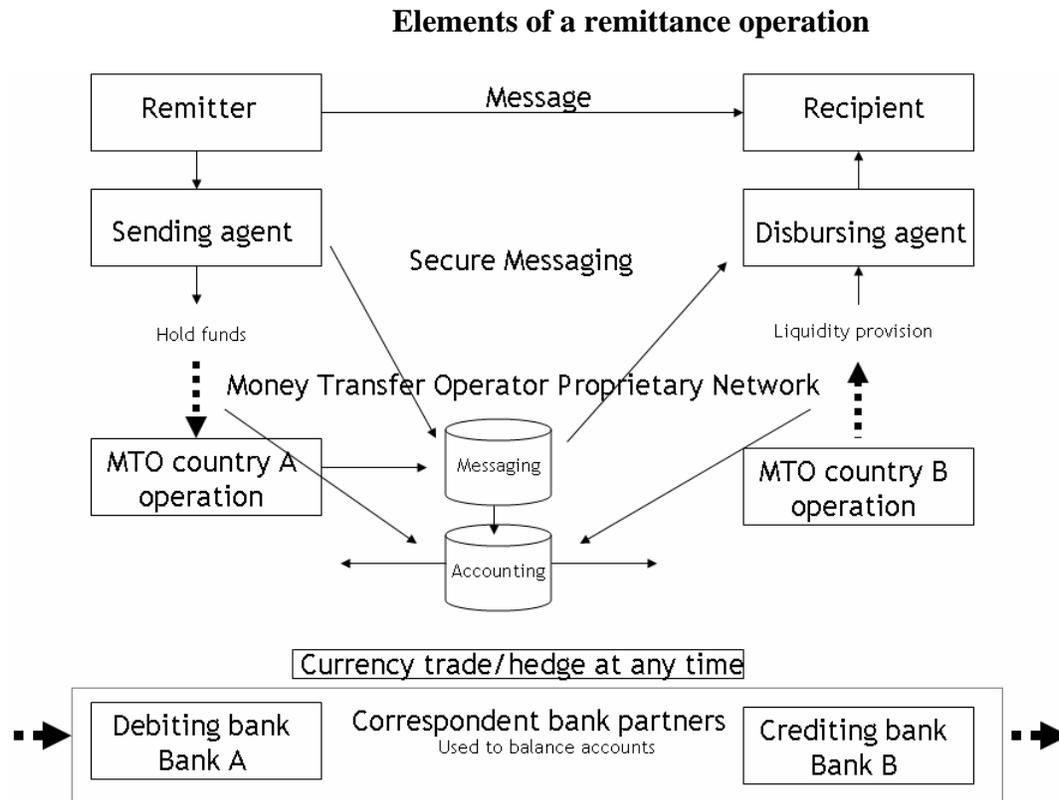
Similarly, migrants often have access to a more limited number of payment instruments, frequently only cash and money orders. Whereas a person with access to bank accounts, internet, payment cards, and checks can initiate payments in a large number of ways, a person with access only to cash and not to a bank account has a limited number of options. Remittance firms provide access to payment services for individuals that would otherwise have been excluded from such services.

Third, remittance firms offer delivery of funds through instruments and channels that the recipient can access, such as cash from a disbursing agent that is located not too far from where the recipient lives or that offers courier delivery. Since domestic payment systems in many receiving countries are underdeveloped, agent networks provide a substitute and prevent recipients from having to travel to places covered by the banking system. As is the case with the senders, remittance firms increase access to payment services for the recipients.

Fourth, remittance firms offer opportunities for cost savings. International wire transfers through banks are costly and slow. Remittance firms 'bundle' a number of transfers, send the bundled funds through the banking system, and 'unbundle' the funds at the other end. In this way, the settlement charges are spread over many remittance transactions. In this way, remittance firms reduce the cost of transferring funds.

The basics of a remittance operation

A remittance transfer is a cross-border retail payment with special access requirements on the sending and receiving side. The figure below outlines the elements of a remittance operation (there exists a large variation in how individual firms organize their operations, as we describe in the subsequent sections).



A remittance operation is initiated by a remittance service provider capturing funds from a remitter using any of a variety of instruments, either directly or through a capturing agent. The most normal instrument is cash; other instruments in use are direct debits, checks, money orders, and credit cards. There is a large number of possible instruments; one example is stored value accounts associated with cell phones. The capture channel can be physical, such as a grocery store operating as agent for a remittance service provider, or virtual, such as the internet or a call center. An ideal capture channel is close to the remitters, trusted, can handle cash, and can easily

be linked to the remittance service provider. The limitations on available capture channels tend to be associated with credit risk, compliance risk, and operating costs. For example, the internet is cost effective but it cannot handle cash, and it poses compliance challenges. An external agent may have good compliance procedures but can be costly and pose a credit risk.

The capturing agent transfers the funds to the remittance service provider (or to a designated third party) using mechanisms such as a domestic payment system, transport of cash or written instruments, or the creation of liabilities to the remittance service provider. The communication between the agent and the remittance service provider can take place through a dedicated computer system, email, fax, or telephone. Credit and compliance risks are addressed at some point in this process, and the data supplied by the remitter is validated.

When the remittance service provider's policies on transaction validation are met, the disbursement process starts. The remittance service provider orders a disbursement agent to make funds available to the recipient. This message goes through channels such as SWIFT, a proprietary database, fax, email, or phone, and it is originated either by an entity in the country where the remittance is initiated or by a partner or subsidiary of the remittance service provider in the country of destination.

In many cases, the time from funds capture to funds availability is close to instant. In other cases, the transfer can take up to several days. Often, the determinants of speed are the instruments used for capture and the means of messaging. Compliance requires the remittance service provider to check recipients against a list of barred recipients, which is a process that must be computerized in order to allow for instant transfers.

The disbursement agent may use a variety of instruments. A bank or non-bank account is credited, cash is picked up, or a check or money order is issued.¹ What legitimizes the remitter to pick up the remittance varies. It may be an official ID showing that the name and other identifying information is the same as in the remittance record, it can be a code communicated

¹ Some remittance service providers also give the option of store credit, the delivery of goods, or the payment of bills to the benefit of the recipient. This study does not address such services.

from the remitter to the recipient, and it can be a code sent to the recipient's cell phone by the service provider.

How the remittance service provider settles across borders varies with the nature of the operation. Smaller service providers typically use a settlement agent, such as an international bank or a bank with correspondent relationships, to wire funds to the service provider's account in the receiving country, or, alternatively, to its disbursement agent in that country. Remittance firms can also rely on disbursing partners that have accounts in the sending country. In these cases no international settlement is required from the perspective of the remittance service provider. Larger providers are able to use corporate treasuries to settle on their own books. International banks and banks with correspondent relationships settle through their usual means.²

Hypothesis and survey methodology

The purpose of this project is to document how remittance firms operate, to describe how they perceive their business environment, and to understand their business models. In addition to the purely descriptive work, our hypothesis is that there are characteristics that will allow us to distinguish successful business models. We conducted interviews with 73 remittance firms in 6 U.S. states between March and July 2005. In addition, we interviewed three remittance firms in the greater District of Columbia area.

² It should be noted that settlement can be completely cashless, although none of our respondents use cashless settlement. A hypothetical example from the "informal" sector is where remittance service provider A captures funds from person B in country 1, promising to disburse the funds to person C in country 2. A then lends the funds captured to immigrant D in country 1, who wants to set up a business in country 1. Simultaneously, A's operation in country 2 has received cash in exchange for goods it has delivered to a third party. A's operation in country 2 pays these funds to person C in country 2. The net result is that B has sent a remittance to C, and A has invested his income from country 2 in country 1, effectively converted at an exchange rate agreed with person B. This operation can be completely legitimate, provided that A is in compliance in all applicable jurisdictions.

State	Firms registered and domiciled in the state	Number of firms interviewed
California	36	13
Florida	69	15
Greater DC	N/A	3
New Jersey	74	11
New York	38	11
Texas	86	11
Illinois	25	9

We focused our study on the states with the highest proportion of migrants (see table below), at the same time as we tried to cover the country geographically. We then identified licensed/registered remittance providers within the states, frequently in coordination with state regulators.³ If necessary, given logistical constraints, we limited our population to the counties with the highest migrant concentration. We then made a random selection of remittance providers.

State	Percent of Persons who were Foreign Born in 2000
1 California	26.2
2 New York	20.4
3 Hawaii	17.5
4 New Jersey	17.5
5 Florida	16.7
6 Nevada	15.8
7 Texas	13.9

³ We used the best sources of remittance firms available. Normally this means the state regulators lists, cross-checked with either regulators with local knowledge or, alternatively, FinCEN's lists of money transmitters.

8	District of Columbia	12.9
9	Arizona	12.8
10	Illinois	12.3

Source: U.S. Census Bureau. We excluded Hawaii because of budget constraints and Arizona because of difficulties in obtaining accurate lists of remittance firms.

We exclude the two largest remittance companies from our sample (Western Union and MoneyGram). These firms operate on a scale that cannot be compared to any other actors and would be more appropriately studied through separate case-studies. Except for these two firms, all licensed/registered firms in our states are included in the population.⁴

We designed a survey instrument and called firms to request their participation. We then traveled to the firms that accepted our invitation. Some firms had to be excluded from the sample because of logistical constraints. In those cases, we replaced the excluded firms with firms within the logistical parameters.

We considered sending a written survey instrument or perform telephone interviews rather than visiting firms in person. Our conclusion after contacts with remittance operators and industry representatives, previous attempts to survey the remittance industry, and discussions with researchers familiar with remittance issues, was that the only way of obtaining accurate information was through personal, face-to-face contact, in order to create a relationship of trust between the interviewer and the interviewee. The remittance industry is in many ways nascent; it is only in recent years that commercial and policy attention has focused on the area. A great number of operators are small, there is much secrecy in the business, competitive pressures are rising, and many operators fear for the future.⁵ This survey is undertaken at a point in time where the opportunity to learn about the business is greater than what has previously been the case. The negative focus on remittance operations in light of terrorism financing has motivated many

⁴ We also exclude the informal sector. Identifying firms in this sector would require a completely difference methodology than ours, and the resources needed for such a study are beyond this current project.

⁵ For example, when we contacted firms, many initially thought we were an organization interested in starting a competing service or a bank interested in providing credit.

industry actors to behave like other, more established financial institutions in their dealings with government, competitors, and researchers. One example of this is that the industry has started to cooperate through industry associations and events.

Every interview was written up into a small case-study of the responding firm. The case-studies were then quantified to the extent possible, and every relationship that is reported in this paper is based on analyzing the quantified data.

For the quantitative data, we report summary statistics to describe how remittance firms perform and structure their services. We also look at two-way relationships between variables. Typically, we will report a two-way relationship when it is statistically significant at the 10% level and when the measure of association is at least 0.25 (Phi for 2xn and Cramer's V for 3x3 and above). Point-biserial correlations are considered significant at the 10% level. Goodness of fit for logistic regressions is measured using McKelvin and Zavoina R-squared.

We do not often use multivariate regression analysis, except in some few cases where we feel safe about the necessary assumptions. In this paper, we only discuss how much variables vary together. We are not trying to describe the impact of a specific variable on company output holding other variables constant. Many of our variables can not be assumed to be independent. We also rely on many measures where we cannot assume normalized distributions for the variables.

Results of the survey

In the following, we present the results from the survey. Firstly, we will report how remittance firms perceive their business environment. As in any industry, the business environment is crucial to delivering an efficient service in an efficient market, and understanding the context in which firms operate is crucial to formulating public policy,

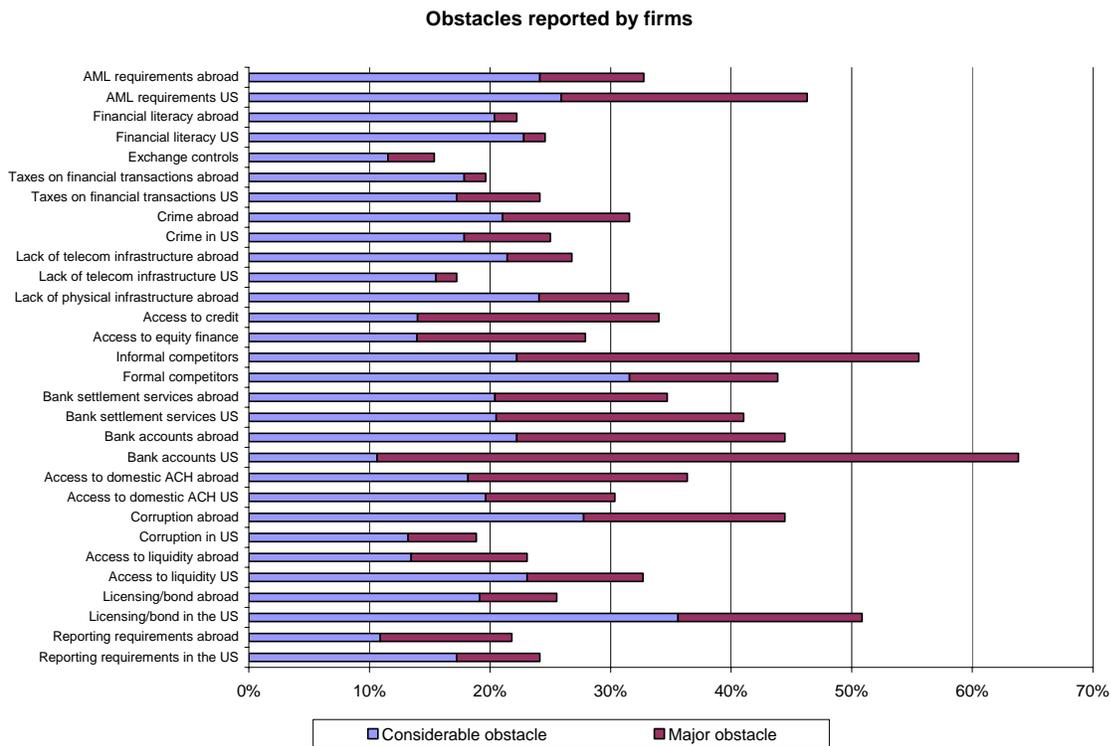
Secondly, we will describe the sample of firms and their main characteristics. Based on our analysis of the sample, we will present the characteristics that are associated with successful firms.

Thirdly, we will describe in detail how firms perform the various elements of a remittance operation as well as which characteristics are associated with each other. We will look at organization, ways of operating, costs, and prices.

Lastly, we will conclude with policy recommendations as reported by the firms during our interviews. We will not endorse or refute these recommendations; as stated initially, the main purpose of this project is to describe the remittance industry in the United States, and we believe part of this description is the firms' own perceptions of what can be done better.

The business environment for remittance services

We asked the remittance firms how they perceive different aspects of their business environment. Specifically, we asked them to rank a list of obstacles to doing business from 1 (no obstacle) to 4 (major obstacle).



The four largest obstacles to doing business are related to the regulatory regime in the U.S., either directly or indirectly. The largest problem is getting access to maintaining or opening accounts with U.S. banks. Banks are the only way for remittance firms to access payment and settlement systems and to maintain transaction accounts and as such a crucial component in a remittance system.

The banks' reluctance to open accounts, and their frequent closing of remittance service providers' accounts, is related to an unclear regulatory situation at the time of writing. From the interviews, we suspect the reason for problems getting bank settlement services is due to the same cause.

Our interviews indicated a strong dissatisfaction with what is perceived as close oversight of formal remittance firms but no oversight or attempts to regulate informal firms, which is perceived to prevent a level playing field and create a competitive disadvantage to the firms that are appropriately licensed. This might be reflected in competition from informal firms being perceived as the second largest obstacle. Note that we are not investigating the actual regulatory activities in the U.S., but the formal remittance firms' assessment of informal competition as an obstacle to doing business. Connected to this is another of the major obstacles: bonding and licensing requirements in the U.S.. The ranking of this obstacle shows how important it is that all firms be treated equally and subject to the same regulations: if being formal entails major obstacles to doing business, then informal competitors gain even more of an advantage. Several firms expressed that it would be more appropriate to have bond requirements based on the overall transaction volume rather than a set amount per state in which the firm operates.

AML requirements in the U.S. rank fourth. This is consistent with 40% of firms noting AML as one of their main expenses, as well as with 50% of firms reporting that they hire outside expertise in order to meet their AML standards.

Region firm is sending to	Top three obstacles firms perceive by region the firm sends to
ECA	Bank accounts in the U.S., bank accounts abroad, informal competition
LAC	Bank accounts in the U.S., informal competition, access to credit
EAP	Bank accounts in the U.S., licensing/bond requirements in the U.S., AML requirements in the U.S.
AFR	Bank accounts in the U.S., informal competitors, access to domestic ACH in the U.S.
SA	Bank accounts in the U.S., informal competitors, licensing/bond requirements in the U.S.
MENA	Bank accounts in the U.S., bank settlement services in the U.S., access to liquidity in the U.S.

Average rating of obstacles overall and broken down by destination region									
		Overall	Europe Central Asia ECA	Latin America Caribbean LAC	East Asia Pacific EAP	Sub Sahara Africa AFR	South Asia SA	Middle East North Africa MENA	Standard deviation of responses
Regulatory induced constraints	Bank accounts U.S.	3.21	3.71	3.24	3.40	4.00	3.25	3.00	0.36
	Informal competitors	2.75	2.67	2.71	2.85	3.13	2.73	1.75	0.47
	Licensing/bond in the U.S.	2.50	2.00	2.44	3.00	2.63	2.70	2.40	0.34
	AML requirements U.S.	2.43	2.11	2.12	3.00	2.63	2.55	2.17	0.36
	Bank settlement services U.S.	2.43	2.00	2.52	2.67	2.83	2.57	3.20	0.39
	Formal competitors	2.33	1.89	2.38	2.62	2.50	2.20	2.75	0.31
	Crime abroad	2.32	2.43	2.50	2.15	2.50	2.20	1.50	0.38
	Access to domestic ACH U.S.	2.12	2.22	2.36	2.31	3.00	2.27	2.00	0.34
	Bank accounts abroad	2.11	2.50	2.25	2.20	2.50	2.00	2.25	0.19
	Access to liquidity abroad	2.10	1.86	2.36	1.92	2.38	1.80	2.80	0.39
	Access to credit	2.10	1.63	2.59	1.80	2.38	1.91	1.83	0.37
	Corruption abroad	2.09	1.57	2.10	1.82	2.00	1.90	1.33	0.29
	Access to liquidity U.S.	2.08	2.00	2.26	2.08	2.75	2.22	4.00	0.76
	Lack of telecom infrastructure abroad	2.02	2.00	2.03	1.85	2.63	2.10	2.50	0.31
	Bank settlement services abroad	1.97	2.17	2.29	1.89	2.50	1.71	1.60	0.35
	Reporting requirements in the U.S.	1.95	1.88	1.85	2.38	2.43	2.00	2.00	0.25
	AML requirements abroad	1.93	1.50	1.94	2.08	2.13	2.00	2.00	0.23
	Financial literacy U.S.	1.91	1.71	1.84	1.85	2.13	1.90	2.00	0.14
	Licensing/bond abroad	1.90	1.57	1.82	1.92	2.38	2.20	1.33	0.39
	Lack of physical infrastructure abroad	1.89	1.75	1.87	2.08	2.38	1.91	2.20	0.23
	Access to equity finance	1.87	1.57	2.28	1.50	1.88	1.80	1.50	0.30
	Crime in U.S.	1.86	1.50	1.94	2.15	1.75	1.64	1.40	0.28
	Access to domestic ACH abroad	1.86	1.50	2.00	1.58	2.13	1.90	1.80	0.24
	Taxes on financial transactions abroad	1.76	2.33	1.90	1.77	2.38	1.45	1.60	0.38
	Financial literacy abroad	1.75	1.86	1.81	1.31	2.14	1.67	3.33	0.70
	Taxes on financial transactions U.S.	1.73	1.63	1.62	2.15	2.13	1.70	2.80	0.46
	Reporting requirements abroad	1.70	1.50	1.81	1.69	2.00	1.78	1.80	0.16
	Exchange controls	1.65	1.50	1.72	1.50	2.13	2.00	3.00	0.56
	Lack of telecom infrastructure U.S.	1.48	1.29	1.53	1.46	1.63	1.55	1.80	0.17
	Corruption in U.S.	1.42	1.38	1.58	1.11	1.50	1.20	1.50	0.19
	Average	2.04	1.91	2.12	2.07	2.38	2.03	2.17	

AML means Anti Money Laundering. ACH means Automatic Clearing House.

If we break down the obstacles by the regions where firms disburse, we see some interesting patterns. Note that the regional abbreviations are explained in the table above. The bank account problem, although it affects all firms, is particularly pronounced for firms sending remittances to Africa, where all the respondents rate it a major obstacle.

Bond requirements in the U.S. are most frequently rated as an obstacle by firms sending to EAP; these are also the firms most affected by AML requirements in the U.S.. Problems related to obtaining bank settlement services affect firms sending to MENA more than others. All these obstacles are rated fairly evenly among regions.

Some obstacles vary more among the regions. Access to liquidity affects firms sending to MENA much more than other firms, as do problems with financial literacy in the receiving country, exchange controls, and access to liquidity in the receiving country, whereas there are few problems in MENA related to crime in the disbursing countries. Licensing and bond requirements abroad affect SA and Africa in particular.

Access to credit and liquidity abroad are problems particular to LAC and Africa. The same goes for bank settlement services abroad. SA and EAP have little problems in these areas. Firms sending to Africa are particularly constrained by informal competition, whereas formal competition affects all firms.

The way firms perceive competition can be linked to firm characteristics other than destination region. In addition to asking how firms perceive competition as an obstacle, we also asked about their perception of the competitiveness of the market in general. Firms that are engaged in remittances only are much more likely to consider the market fragmented than firms that are also engaged in other lines of business, which is what we would expect since firms that have several business lines can use these business lines to retain customers (this relationship holds if we control for age). This relationship is further strengthened for the firms that consider their relationship with their customers as their comparative advantage. Firms perceiving a fragmented market are also the ones that have increased their prices, been spending relatively more of their resources on agent commissions, and see reporting systems as a barrier to entering the business.

Older firms perceive more competition. The explanation can be that older firms compare the current, increasingly competitive situation, with the past. New firms will be more likely to

consider the current situation normal. If we hold firm age constant, no other variables in our sample impact significantly which firms perceive increased competition.

Perceptions of competition in the market

Competition is increasing	50.75%
The market is fragmented	41.54%
The market is oligopolistic	13.85%
The market is consolidating	18.46%

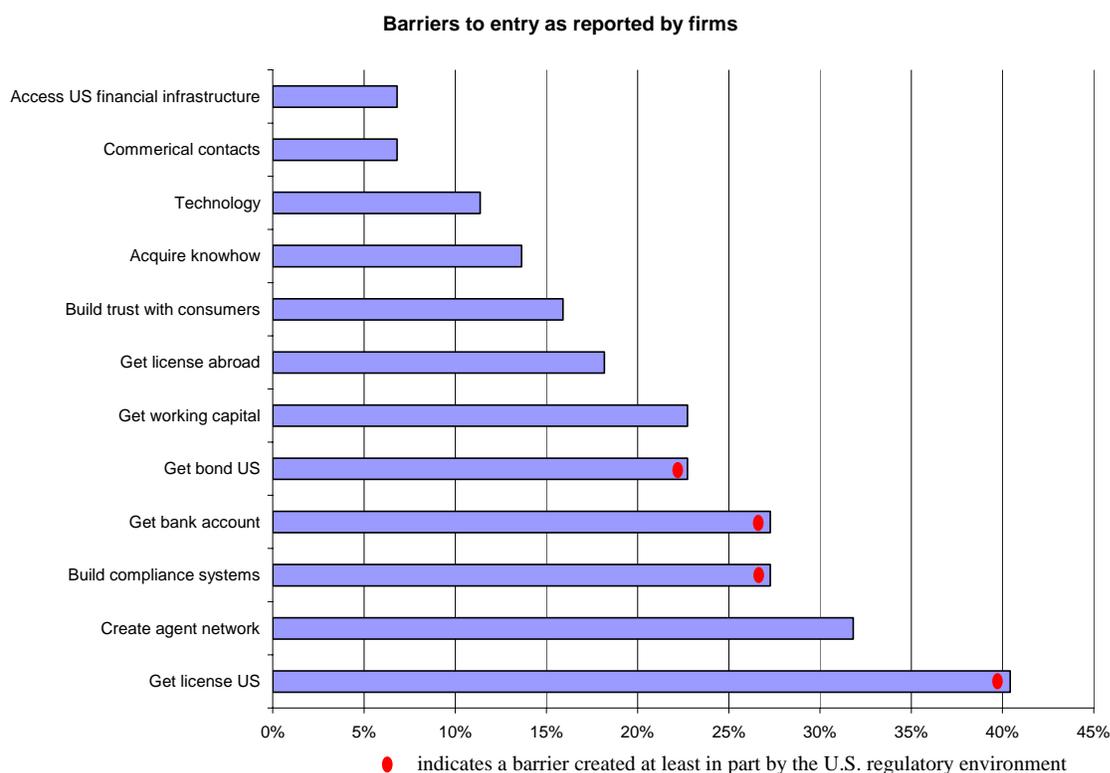
The perception of competition also depends on the state. Competition is in particular perceived to have increased in New York, Florida, and California, whereas it is in particular perceived as fragmented in California.

<i>State</i>	Firms mentioning that competition is increasing	Firms mentioning that competition is fragmented
New Jersey	8.89%	13.04%
New York	20.00%	17.39%
Florida	20.00%	8.70%
California	26.67%	43.48%
Texas	15.56%	17.34%
Illinois	8.89%	0%

Different from the obstacles faced by existing firms are the hurdles that new entrants must overcome, and we will address these hurdles in the next section.

Barriers to entry

We asked the respondents to mention the most significant barriers they would encounter if they were to set up a remittance firm from scratch today. This question is different from the obstacles we reported above: a going concern does not necessarily have the same challenges as a startup. As opposed to the obstacles question, the question about barriers was an open question, and the answers were categorized during the subsequent analysis.



Four of the six major barriers to entry are caused by the regulatory environment, reflecting the major obstacles to doing business.⁶ The key factors from a commercial perspective are building an agent network and raising working capital.

This is not a healthy situation if the goal is to encourage new entrants into the market. Nobody will dispute the necessity of an appropriate regulatory regime in order to ensure the

⁶ The firms filled in the sheets with the obstacles after the interview where they identified the main barriers to entry, so that the structured questions about obstacles would not influence the open question about barriers.

safety and integrity of remittance services. However, if new entrants spend more energy on regulatory requirements rather than on setting up efficient systems and building trust in their brand, there is likely a large efficiency loss due to the regulatory regime.

Note that this does not tell us anything about how the regulatory regime works; it only informs us about the perceptions of the industry with regards to the impact of the regulatory regime on new entrants. This perception might be wrong, and the regulatory regime might be appropriate. However, it is the perception that decides whether or not an entrepreneur will venture into the remittance business.

In the following, we will describe the firms that have already entered the business, and we will start with the main characteristics of our respondents.

Firm characteristics: Transactions, volumes, revenues, and income

The average company in our sample is a profitable venture (the median firm is more modest). It generates \$1,244,003 (median firm: \$60,000) after tax profit per year out of total revenues of \$10,411,189 (\$2,000,000); and its after-tax profit margin is 12% (3%). Its revenue per transaction is \$18.64 (\$9.25), and its after-tax profit per transaction is \$1.76 (1.36).

On average (median), the firms in our sample process 91,874 (10,000) transactions per month, and the volume in dollars is \$36,306,582 (5,000,000). The average transaction size is \$550 (\$387). If we assign weight to the transaction size by how many transactions a firm executes per month, the average transaction size is \$375.

To get a glimpse of the current dynamics in the industry, we extract firms that grow and shrink from our sample. Of the firms in the sample, 49% report an increase in the number of transactions over the last three years, and 23% report a decrease in transactions over the same period. The reasons the firms gave for the changes in transaction volumes are as follows:

<i>Reason for change</i>	<i>Given by percentage of firms with increase in transactions (36 firms)</i>	<i>Given by percentage of firms with decrease in transactions (17 firms)</i>
Changes in competitive landscape	27%	64%
Company gets better/worse	30%	6%

Related to 9/11	7%	35%
Contraction/expansion of firm's footprint	51%	12%
Changes in dollar exchange rate	0%	18%
Changes in migration patterns	30%	12%

If we separate firms that report an increase in transactions from those that report a decrease, we get the following picture:

	<i>Average, all firms</i>	<i>Average, firms with increasing transactions</i>	<i>Average, firms with decreasing transactions</i>
Average transaction size, \$	550.22	492.99	725.17
Transactions per month	91,873.80	146,661.50	18,970.59
Volume per month, \$1000	36,300	57,800	6,121
Commission paid to capturing agent for a \$300 transfer, \$	5.27	5.24	6.19
Commission paid to disbursing agent for a \$300 transfer, \$	3.91	4.16	2.95
Marketing expense per month, \$	21,225.89	34,607.39	11,039.50
Marketing expense per transaction, \$	1.19	0.81	1.67
Foreign exchange spread, %	1.61	1.98	1.51
After tax income per transaction, \$	1.76	2.50	(1.03)
Revenue per transaction, \$	26.52	18.67	21.81
Average fee for sending USD 100, %	0.091	0.097	0.074
Average fee for sending USD 200, %	0.055	0.059	0.048
Average fee for sending USD 500, %	0.033	0.036	0.031
Average fee for sending USD 1000, %	0.021	0.024	0.019
Average number of countries firms send to	9.377	11.600	3.412
Average difference in fees for USD 100*	0.032	0.043	0.024
Average difference in fees for USD 200*	0.024	0.034	0.014
Average difference in fees for USD 500*	0.019	0.025	0.008
Average difference in fees for USD 1000*	0.018	0.024	0.006

* Percentage point difference between least expensive product to least expensive country, priced in % of sending amount, and most expensive product to most expensive country, priced in % of sending amount.

The most noticeable differences between firms that grow and those that shrink are the difference in average transaction size, the difference in volume, the difference in expenses to the disbursing agent, and a much larger price diversification as for destinations and products (which is in part made possible by being engaged in more countries). Note that the price diversification might well be caused by the difference in the number of countries that the firm sends to.

Firms that expand are characterized by being larger, sending smaller amounts to a larger number of countries, with a more nuanced pricing scale, and they spend more on the distribution of funds and on marketing. They are also able to price their services higher, both in terms of fees and foreign exchange spread, and they extract more profits. This indicates that there is an advantage to size not only in reducing operating costs but also in capturing clients (there is no significant twoway relationship between size and fees or foreign exchange spread charged to the user, even after we desegregate by destination region).

Now, having presented the average characteristics of the firms in our sample, we will look at which firms in the sample emerge as successful. Thereafter, we will go into detail on how the firms in our sample perform their business.

Key success factors

Our survey allows us to suggest success factors for remittance firms. These suggestions come with the substantial caveat that the rapid change of the remittance industry may lead to the decay of currently successful business models and the rise of new types of firms. We can, however, use the direction of transaction volume as an imperfect measure of success at least at the present. Although conventional wisdom in the business seems to suggest that high volume is key to profitability per transaction, we cannot find support for this quantitatively (transactions per month and absolute profitability are strongly correlated, however).

If we make the assumption that remittance firms seek to expand the number of transactions they process and thus that whether transaction volumes go up or down can tell us something about a firm's ability to reach its goals, knowledge about firm characteristics associated with increasing or decreasing transaction volume can help us understand where the industry is moving.

These are the characteristics of firms that have experienced increases in transaction volume:

- *A higher number of agents.* Firms that rely on agents to capture funds have experienced increased transaction volumes, and, as expected, the more agents a firm has the more likely is it that the firm has experienced growth.
- *Cross-selling:* Firms with increasing transactions, or their agents, cross-sell products, both on the sending and on the receiving side. On the sending side, it does not matter which kind of cross-selling the firm or its agents engage in; to the recipients, they cross-sell financial products in particular.
- *Advanced technology:* Firms with increasing transactions capture funds through technologically advanced channels such as ACH and payment cards, and they consider technology a comparative advantage. They offer disbursement through banks (often along with other channels). They do not require capture or disbursement locations to be exclusive, which might be an indicator of extensive networks in addition to more capturing agents. They are more advanced in how they communicate with their partners abroad. They are more likely than other firms to mention technology as a major expense.
- *Operational efficiency:* Firms with increasing transactions are efficient: they settle more frequently than other firms and they outsource AML work. They also have fewer problems with corruption abroad than do other firms. Their ranking of the lack of bank accounts as an obstacle to doing business does not significantly differ from other firms, but they do not consider obtaining a bank account as a barrier to entry. They do not use the postal system for distribution, but they use couriers more often than other firms.
- *Control of destiny:* Firms with increasing transactions attribute their success to changes in service level and internal organization, whereas firms that experience loss of transactions blame the increased competition, effects of 9/11, and changes in the dollar exchange rate.
- *Price is not key to success:* Price levels are not associated with changes in transaction volumes (firms with lower fees do not report increase in transactions).
- *Professional, not personal:* Firms that rely on personal contacts in the receiving country have experienced a reduction in transaction volumes. Despite their reliance on such

contacts, these firms do not pay less for distribution, they pay more for settlement, they have more problems with corruption abroad, and they have not been able to significantly lower any obstacles abroad compared to firms that do not rely on connections abroad. Firms that send principally to the founder's home also have also experienced reductions in transaction volumes. These firms tend to consider their reputation a comparative advantage, but there is no evidence this pays off: their income per transaction is significantly lower than other firms.

In the following, we will go through the elements of a remittance operation and describe how these elements are performed by the firms in our sample. We will look at how the firms are organized, their cost of doing business, and the prices they charge.

The elements of a remittance operation

We start out looking at the parts of the remittance operation that are closest to the end user: how firms capture and disburse funds. This section is followed by a description of the internal infrastructure in the remittance operation: how firms communicate, settle, and are organized. We then report the costs that firms incur in providing their services, and, conversely, the prices they charge for these services.

Funds capture and disbursement

Funds capture

The first stage of a remittance operation is to shift funds from the remitter to the remittance system that will provide the transfer. How this funds capture takes place depends on the *channels* and the *instruments* available to the remitter and accepted by the remittance service provider.

Instruments

The *instrument* represents the remitter's funds. The most frequent payment instrument is cash. Other instruments in use in our sample are money orders, personal checks, payment cards, and ACH (Automated Clearing House) debits.

Cash has the advantage that all remitters have access to it, and it is perfectly negotiable. This means that the remittance service provider runs no credit risk in accepting cash (beyond

outright money forgery, which no firm reports), and he can therefore immediately make funds available for disbursement at the other side. Most firms accept cash, except for the business models that are based on the internet or on mailing in of money orders. Money orders, which have many of the same properties as cash as for availability to senders and credit risk, are accepted by approximately half of the firms.

Some instruments are limited to migrants with bank accounts. Personal checks, accepted by 37.50% of the firms, pose a credit risk to the remittance service provider, and it is normal to hold the check until it clears before making the funds available on the receiving side. The exception is if the firm's staff knows the remitter (for example, a repeat customer), in which case the transfer is effectuated without clearing. As with money orders, the advantage of using checks is that the remitter does not have to carry cash around, and it is an instrument that can be sent through the mail. Some firms accept checks and money orders to be mailed after a transaction is initiated through a call center or over the internet.

Whereas mailing checks is a slow procedure, electronic debits are quicker. By having the remitter provide account details, 9.72% of the remittance firms can initiate an ACH debit to the remitter's bank account. If the remitter has a credit or debit card, the remittance service provider may accept this. Checks and ACH debits are inexpensive to use for the remittance service provider, as payment card networks charge commissions that can add to the total cost of effectuating the transfer. Since the payment card commissions often are based on percentages of the payment, such commissions can take up a considerable part of the remittance provider's revenue.⁷ Setting up payment card processing and ACH debit systems requires a higher degree of technological sophistication on the part of the remittance provider than do checks, money orders, and cash. In our sample, 12.50% of firms accept payment cards. This is more common than accepting ACH debits (9.72%). Finally, 4.17% of the firms accept both cards and ACH debits.

⁷ We observed conflicting explanations and practices: some providers said payment card companies did not want to work with remittance firms, whereas some firms accept remittances paid through payment cards. It is clear that several of the respondents had tried to set up arrangements for using payment cards, but for some reason had failed.

Percentage of firms accepting different payment instruments

Money order	55.56%
Personal checks	37.50%
Cash	97.22%
ACH debits	9.72%
Payment cards	12.50%
Account at remittance firm	0.00%
Remittance firm-issued cards	2.78%
Wire transfer	4.17%

Two firms out of the sample of 73 use their own cards, in combination with some other form of payment instruments. More than a payment instrument, these cards are a storage of information about the recipient, information about how the remitter wishes to pay, a validation mechanism in the form of a pre-approval, and an ID document.

Lastly, three of the firms accept domestic wires. This may seem odd since someone who can initiate a domestic wire also can initiate an international wire. However, an international wire is limited to recipients with bank accounts, whereas these firms also disburse in cash.

Channels

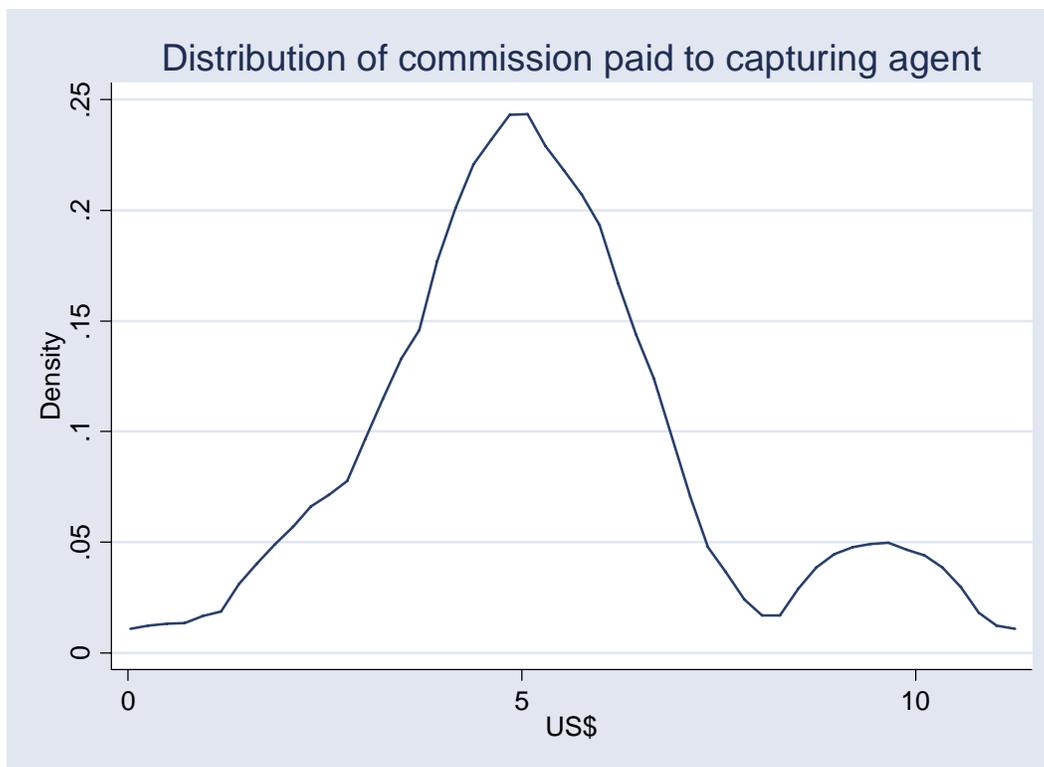
The *channel* describes how the remitter interacts with the remittance service providers in transferring the payment instrument and in providing information about the transfer. One type of channel is a physical location, for example where the remittance service provider has an outlet in a place with a large migrant community. Frequently, remittance service providers use *agents* that are paid a commission for providing the capture service. Agents will accept a payment instrument, such as cash or money orders and feed the transaction details to the remittance service provider, often using an on-line database. Other channels are call centers, sending instructions and the payment instrument by postal mail, and the internet.

Percentage of firms using different capture channels

Internet	8.33%
External agents	66.67%
Own branches	66.67%
Call centers	12.50%
Cell phones	0.00%
Postal mail	20.83%
ATMs	0.00%

Agents

Most firms use agents (66.67%) and or have at least one location that they own and operate (66.67%). Some firms have both agents and own locations (36%). Using agents is attractive because it does not involve the capital outlay and fixed costs associated with operating a proprietary location. Rather, agents are paid by commissions. These commissions range from 62 cents to \$10.67 per transaction for sending \$300; the average is \$5.22.



The uniform distribution across remittance firms of commissions to capturing agents suggests that the market for agent services is relatively efficient, i.e. a market price for these services can be established. Agents are also able to spread their operating costs over several product lines: they can be travel agents, mail services, grocery stores, hairdressers, telecom providers, restaurants, and more. It also means that there is an opportunity cost for the agents in devoting resources to selling remittance products. This constrains the supply of agent services, where the lower bound for the commission is the agent's opportunity cost. Beyond this constraint, the agent commission is set by the supply and demand for agent services. Some of our respondents noted that agents acting for multiple service providers will direct remitters to the provider that pays the agent the highest commission.⁸ Of the firms interviewed, a surprisingly high number, 61.11%, demand that their agents are exclusive and cannot act as agents for other remittance firms.⁹

The competition for agents can be hard; one of our respondents in Texas went out of business because the firm failed to continue its agreements with agents. The main reason for this problem was that, in some places, there is a limited supply of agents, which typically act for several remittance providers. This gives the agents bargaining power over the providers, and many of our respondents indicated that agents often do not pay the remittance service provider the funds due on time, they are not reliable in following the remittance provider's routines, they require to be "treated nicely", and their lack of proper accounting creates problems when funds

⁸ Several firms pointed out this difference in interests between the remitter and the agents, and they noted that remitters often can end up using a more expensive service that pays the agent a larger commission.

⁹ One would think a firm would have to pay more to keep an agent exclusive rather than allowing the agent to sell competing services. One respondent, however, reported paying exclusive agents less than non-exclusive agents, since the non-exclusive agents had to be given incentives to recommend this respondent's service over other services.

are to be transferred from the agent to the service provider.¹⁰ The bargaining power of agents varies with the competitiveness of the market.

The service providers look for ways to reduce the risk associated with agents. Some use agents that come recommended by community members and that are already respected businesses or whose owners enjoy respected positions in the community. Other firms assess the credit risk associated with potential agents; some impose a limit on daily volume in the computer system the agents use to record transfer information. A new mechanism that is being employed is linking this limit to the amount of receivables outstanding from an agent, so that the risk associated with each agent is effectively controlled.

In order to facilitate the matching of demand and supply of agents, a profession of “agent intermediaries” has reportedly evolved. These intermediaries are individuals with good connections within the communities, with agents on the sending and receiving side, and with remittance service providers. They are sometimes ex-employees of remittance firms. Several remittance firms rely on these intermediaries to build their agent networks, and they compensate the intermediaries by a percentage of the agent’s commission of every transfer. Some firms report diverging interests between the intermediaries and themselves, in that outside intermediaries “come and steal” their agents, or “run away” with agents. This is to be expected since an intermediary’s main asset is his fleet of agents, and intermediaries have a natural incentive to draft agents that “belong” to other intermediaries or that do not have any intermediary as their “representative”.

These intermediaries seem to have become a permanent fixture in the industry. One firm we interviewed has gone to the extent of centering its business on the intermediaries. This firm operates exclusively through such independent intermediaries, whom it calls its “marketers”, relying on them for the agent networks. It uses this model in several remittance sending countries, not only in the U.S. On the disbursing side, however, the firm relies on banks, and is not applying the intermediary model. A substitute for intermediaries on the disbursing side is the “meta-remittance firm” that we will discuss below.

¹⁰ These problems with agents having been noted, only 8.33% of the respondents mentioned that creating an agent network was a barrier to entry for a new entrant to the remittance business.

There seems to be varying levels of trust among the service providers regarding how well capturing agents are able to perform their function, and this concern focuses in particular on customer service. Several remittance firms prefer their own locations because they can control the process better, and some firms rely on developing a proprietary network as their comparative advantage.¹¹ Because of the fixed costs involved, this strategy is more realistic if the company also has other business lines. One company following this path also provides telecom services; another offers retail financial services to migrants. However, one of the largest remittance firms we interviewed relies on proprietary agents that only sell remittance products.

Own locations

Of the firms we interviewed, 66.67% had their own locations for funds capture. Of the firms that use agents for capture, 54% also have at least one own location. The reasons for having own capture locations are as follows:

- Firms have administrative offices in areas with high immigrant concentration, and it makes sense to open the office to processing transactions. This is often the case, as firms often are founded in ethnic communities.
- Managers want to maintain contact with the market and operate a limited number of locations for this purpose.
- Managers do not trust external agents to perform sufficiently well and decide to carry the extra cost of own locations in order to ensure the quality of operations
- The firm already has other product over which the fixed costs can be distributed.

The firms that rely solely on own locations give as the most important reason that it is easier to control the quality of service when owning the whole process rather than rely on agents. Given

¹¹ 27% of respondents mentioned their branch/agent network as a comparative advantage, but most of these refer to agent networks, not branches. It is very costly to develop own locations that do not do anything but remittances. Still, among the 14 firms that rely on own locations that only sell remittance products also large players are represented.

what the respondents have told us, another advantage is that the capture network is more stable (as own branches do not “defect” to competitors or recommend competing products to customers) and reliable (they are more likely to use the remittance firm’s systems correctly).

Other capture channels

- Remittance cards

In order to save costs and mitigate problems arising from using external agents, two of the companies that we interviewed issue “remittance cards”. These cards have three advantages. First, they lower the transaction costs of repeat transfers. Since remittances often are repeated regularly between the same remitter and recipient, being able to submit all required information about the transfer through swiping a card saves staff time, reduces the potential for human error in entering the transaction, and increases the convenience for the consumer. Since the remitter provides all information up front, any AML/CFT-related transaction validation can be done up front as well, and is not required for every subsequent transaction (except for validating transaction limits). The remittance cards also create a stronger tie between the firm and the remitter, and it can be used for various loyalty strategies. For expansion of business lines, these cards can allow tagging on other services, such as phone cards.

- Call centers

Call centers are used by 12.50% of the firms. Call centers allow customers to call in with the transaction information. This gives the firm more control of the transaction compared to when this information is captured by an external agent and they relayed to the firm. This remedies a frequently mentioned problem related to agents: that their processing and accounting are unreliable.

The companies that use call centers are, with one exception, in the upper half of the sample in terms of transactions per month, which most likely indicates the costs of setting up a call center service, or integrating a call center service into operations. Indications from the firms show that when economies of scale are taken into account, a call center operation costs around \$1 per transaction.

Some companies combine the advantages of call centers to capture information and agents to capture cash, which is the most frequently used instrument but impossible to use over

the phone. The company has installed phones at the agent locations, so that the remitter can use the phone to provide information about himself, the recipient, and the transfer. The call center then transfers information to the agent by fax, and the agent accepts the money and issues a receipt.

- Internet

The internet is increasingly used for capturing remittance transfers. As with call centers, the instruments are limited, typically to payment cards, ACH debits, or mailing in money orders or checks after having initiated the transaction on-line. This limitation on instruments means that for internet transactions to be competitive on transfer time, the user has to be well integrated into the formal financial system. If the sender mails in money orders, the transfer will often not be competitive on time. This combination is most likely to be used by senders that live far from physical agent locations.

Of the firms we interviewed, 8.33% allow internet transfers. Interestingly, of the nine firms that use call centers, only three also accept internet origination (we would assume that the similarity of technological infrastructure would lead firms to offer both options). It is important to note that there is a sample bias related to this observation. It appears that remittance firms that originate transactions only over the internet sometimes believe that they do not need to be licensed, and our sample consists of licensed firms only.

Although an inexpensive way of capturing remittances, the internet is limited by penetration in the target markets, as well as by access to the required instruments. According to the U.S. Census Bureau, 41.5% of U.S. households had at least one person accessing the internet from home in 2000. For Hispanic households, the rate was 23.6%, and for households where the head of the household had less than a high school diploma (for all ethnic origins), the rate was 11.7%. Internet access by family income category shows a steady correlation with income, where 14.3% of families with income lower than \$ 15,000 are likely to have internet access, and 20.4% of families with income between \$15,000 and \$19,999 are likely to have internet access.

- Postal mail

Although the slowest channel available, postal mail is accepted by 20.83% of the companies. No company accepts mail remittances only (and all but one accepting mail have physical capture

locations as well). The typical mail transaction involves several channels: the customer calls the firm or initiates a transaction over the internet and then mails the instrument to the firm. In our sample, mail as a channel is positively associated with accepting money orders and checks, and it is negatively associated with using cash.

Postal mail is inexpensive and allows a remote initiation of transactions for remitters that do not have access to instruments such as credit card, accounts for ACH debits, or channels such as the internet. It is not as reliable as, for example, a credit card transaction – although it might be more reliable than a badly performing agent.¹²

- ATMs

Only one firm uses Automatic Teller Machines (ATMs) in the remittance origination process, and then not as the main channel. This firm sells “remittance cards” as described above, and allows users to fill up the card using in-store ATMs. The natural extension of this would be to allow remitters to initiate transfers using a wider ATM network, which is a development that is to be expected as more and more banks enter into the remittance business.

Information to the remitter

In general, transparency is good as for the fee and the exchange rate customers pay. Of the firms we interviewed, all report that the remitters are told about the fee before the transaction is initiated. The exchange rate is known by the customers of 96.67% of the firms prior to entering into the transaction.

Common for the two firms that do not disclose the exchange rate is that their only capture channel is external agents, and they accept instruments such as cash, money orders, and checks.

Interestingly, one of the firms where the sender does not know the exchange rate is a highly sophisticated and innovative firm, diversifying into remittances from its core business as a phone card provider. The reason the sender does not know the exchange rate in this case is that the company uses a global payment card company to effectuate the international transfer,

¹² Note that we did not investigate remittances where the remitter mails the instrument directly to the recipient.

including the foreign exchange operation. The way global payment card systems work as of today, it is not likely that remittances based on such infrastructure will give exchange rates up front. This is not likely to be a major disadvantage at present, as the rates global payment card companies offer are generally competitive.¹³ The other firm is a traditional remittance firm in the larger half of our sample. Although the firm does not disclose the exchange rate to the customer, it also does not charge a spread over the exchange rate it is offered by the bank performing the currency conversion.

Most firms market their service through newspaper advertisements (47.83%), radio (37.88%), and community events (40.91%). Only one of the firms we interviewed, a new company branching out into remittances from its existing phone card business (the same firm described above), relies on the existing client base from other business lines. This may indicate that remittance services are still an isolated business, with few synergies extracted from bundling services. It may also indicate that the end users of remittances do not associate remittance services with a greater offering of financial services.¹⁴ We will return to how firms cross-sell services below.

Use of marketing by remittance firms

Marketing method	Percentage of firms
Newspaper	47.83%
TV	40.91%
Radio	37.88%
Community events	40.91%
Internet	9.09%
Existing client base	4.55%

¹³ This may change, depending on how the global payment companies choose to structure their fees for remittance transfers.

¹⁴ Rather than selling remittance products to existing banking customers, banks seem to use remittances to bring in new customers.

Relies on agents	4.55%
Word of mouth	19.40%

The lack of trust that remittance service providers display with regards to their agents is reflected in the means of marketing. Only 4.55% of the firms rely on agents for their marketing, which contrasts with the 19.40% that rely on their clients to spread information through word of mouth about the company. Among the firms that rely on word of mouth, only one also relies on the agents to market their services.¹⁵

Security at the capture stage

Firms ask for customer ID when the transaction size on average is over \$1,488. In our sample, 30% of the firms require ID for all transactions, no matter the amount. All the firms we interviewed require ID when the transaction is \$3000 or higher. The median number of months records of transactions and remitters are kept is 60, only three companies keep records for less time, and it is the policy of 22% of the firms to keep records for 10 years or more.

Companies are generally familiar with the requirements of the U.S. Treasury’s Office of Foreign Assets Control (OFAC), which requires remittance firms to check their transactions against a list of barred recipients. All firms we discussed this issue with expressed that, although they do not see money laundering or terror financing as a risk, they take compliance with the KYC-requirements seriously. As we will see below in the section on costs, this is also reflected in how they spend their funds. This indicates that the fear on the part of the banks that remittance service businesses are high-risk due to lack of compliance might be mistaken.

¹⁵ Note that most agents have some sort of poster or table with fees posted, as well as, frequently, the logo of the various remittance service providers that the agent posts on the outside of his store. When we talk about agents marketing firms, we define this as a more active marketing effort than displaying the posters in the windows/on the wall.

Funds disbursement

Disbursing the funds to the recipient is equally important. This is the essence of a remittance operation: a cross-border retail payment with special access requirements on the sending and receiving side. One would expect most areas in the sending country, the U.S., to be relatively close to capture points given the level of financial development, although the level of competition varies. Some firms have as a strategy to focus on rural areas, where there is less competition from the major players.

On the disbursing side, however, we expect more challenges in reaching out to the recipients. Recipients may live far from banking institutions, or they may have limited access to banking services. Similarly, in countries where the penetration of formal financial services is limited, or where there is a demand for U.S. dollars without the option of holding dollar-denominated accounts, we would expect disbursement to take place in cash, which the survey shows is the case.

Instruments

The vast majority of firms disburse in cash (93.06%). The ones that do not disburse cash will credit the recipient's bank account, and in the cases where there is no bank account to credit, they issue a money order.

Percentage of firms offering different disbursement instruments

Money orders	18.06%
Cash	93.06%
Existing credit/debit cards	2.78%
Account at remittance provider in disbursing country	4.17%
Bank accounts	63.89%
Issue debit cards	6.94%
Issue own non-debit cards	0.00%

Although credits to bank accounts often are discounted as an instrument for disbursing remittances given that banks typically do not penetrate far outside of urban areas, 63.89% of

firms do disburse to bank accounts. Banks can be slow as disbursement channels even if getting the remittance to one bank in a country is instantaneous. This is the case where the domestic payment system is unsophisticated, for example where banks in the same city settle through demand drafts.

Money orders are issued by 18.06% of the firms, and 6.94% issue payment cards or credit existing payment card accounts. One third of these firms issue new cards for the recipient. No firms create their own cards, unlike the situation on the capturing side.

Channels

External agents and external banks are the most common channels for disbursing remittances; 56.94% and 66.67% of firms disburse in these ways, respectively. Of the firms that use external banks, 60.42% also use external agents. 29.27% of firms that use external agents do not use external banks. 70% of the firms disburse through at least two different channels.

Percentage of firms using different disbursement channels

Internet	0.00%
External agents	56.94%
External banks	66.67%
Post offices	1.39%
Own branches	34.72%
Telecom networks	1.39%
Cell phone	0.00%
Postal mail	8.33%
ATMs	4.17%
Couriers	31.94%

A remittance firm must make a strategic decision regarding the reach of the disbursement network. Since the remitter can use a firm only if it has a disbursement mechanism to the recipient's location, it is in the firm's interest to have disbursement locations in as many places as possible, unless it focuses on micro-corridors, such as from one city in the U.S. to one town in

Mexico (many smaller operators do just this, and it is a business model that – bar the licensing costs – is easy to enter into). There is an opportunity for firms to monopolize a location: if only one firm can disburse to a specific village, the firm enjoys a monopoly on transfers to that village. Of the firms interviewed, 31.82% require its disbursement locations to be exclusive, which is less than the number of firms that require the capture channel to be exclusive (61.11%). This can indicate that firms value more – or are more able to leverage – a broad distribution network rather than trying to tie up locations in small monopolies. Whereas one would want to limit competition taking money in, once the transfer has been captured, it is seems more important to be able to disburse through a wide network rather than through an exclusive network. This conforms to viewing the ability to disburse close to the recipient’s location as one of the main value propositions of a remittance firm.

Agents

Although agents are somewhat more common on the capturing side than on the disbursing side, firms seem to have less control of the agents on the disbursing side relative to the capturing side. Except for the firms not having explicit policies barring it, few firms were able to say whether or not the disbursing agents charge commissions to the recipient in addition to the price paid by the remitter. Disbursing through an agent costs the remittance service provider on average \$3.23 for a \$300 transfer, which is 55% of what a capturing agent charges on average. Whether this indicates that the costs of disbursing are lower than the costs of capturing (maybe given lower labor and capital costs in the disbursing country, or less work or technology involved), that there is more competition in general among disbursing agents to enter into agreements with remittance firms, or something else, is difficult to establish. Disbursing agents can come in all shapes of forms, from grocery stores to furniture chains, from telecom firms to banks and exchange houses. They key is reaching out to the recipient.

The issue of control of the quality level of agents arises also on the disbursement side. As we will see below, firms choose different representations to deal with this issue. Some firms go to the length of placing staff in disbursing banks to ensure that its clients are treated well.

Phone and mail

No firm we interviewed uses fixed phones or cell phones as a disbursement channel other than for notifying recipients about the transfer and providing a code (see below). One firm uses a telecom operator's network to disburse funds to remote locations in Mexico.

More common is using postal mail or mail couriers such as FedEx. Some firms we interviewed, with the majority of their transfers to Latin America, the Philippines, India, Pakistan, and the Dominican Republic, send various instruments by mail. Examples are checks through postal mail, cash through FedEx, and debit cards through postal mail. One firm uses satellite phone to transfer information to agents in rural areas, which print money orders to deliver to the recipients.

Except in the case of cash, the recipient becomes dependent on accessing a bank, check casher, store that accepts written instruments or ATM/Point of Sale (PoS) machines in order to turn the instrument into goods or services. We do not have data to assess the level of access for recipients, but it is likely that some of these ways of turning the transfer into cash entail further costs.

ATMs and couriers

The firms that offer courier delivery are mainly sending money to South Asia and Latin America and the Caribbean. This service tends to be combined with funds disbursement to bank accounts. Whether or not the firm offers courier delivery often depends on what is "normal" in the market, and in some cases, in particular in Latin America outside of the Dominican Republic, as a way of adding a differentiated service rather than as a main delivery channel.

Courier delivery is not significantly slower than other delivery mechanisms. Where we have information, the recipients do not pay for courier delivery. Compensation to couriers varies; they normally seem to be paid on a per-delivery basis and not salaried. One company uses couriers also for making manual deposits to bank accounts (the banks do not want to cooperate with the remittance firm through accepting direct credits).

Three of the firms in our sample offer disbursement through ATMs. These firms disburse to accounts with existing debit cards, issue new debit cards, or disburse to a bank account with an understanding that the bank will issue a debit card. They are not distinguished from the rest of

the sample in terms of size, profitability, corporate structure, or expenditure on technology, but they do consider technology as a barrier to entry for new firms.

As for the use of instruments in general, disbursing to bank accounts tends to be associated with the use of payment cards, and the use of customer accounts with the firm tends to be negatively associated with disbursing to bank accounts. If we look at how instruments and channels are connected, we discover that firms that use mail tend to also issue debit cards or money orders, whereas firms that offer courier delivery tend also to disburse to bank accounts.

Communications and settlement

We will now describe how firm communicate and settle. We will go into details about how firms are represented overseas, how they communicate with the overseas entity as well as with their agents and customers, and how float and currency conversion are handled. We also report the time it takes for the firm to deliver a transfer for its end users.

Representation overseas

Remittance operations need representation in the receiving country, both for ensuring that funds are correctly received in the disbursing system and to ensure that disbursement to the recipient takes place correctly. Firms solve this in different ways.

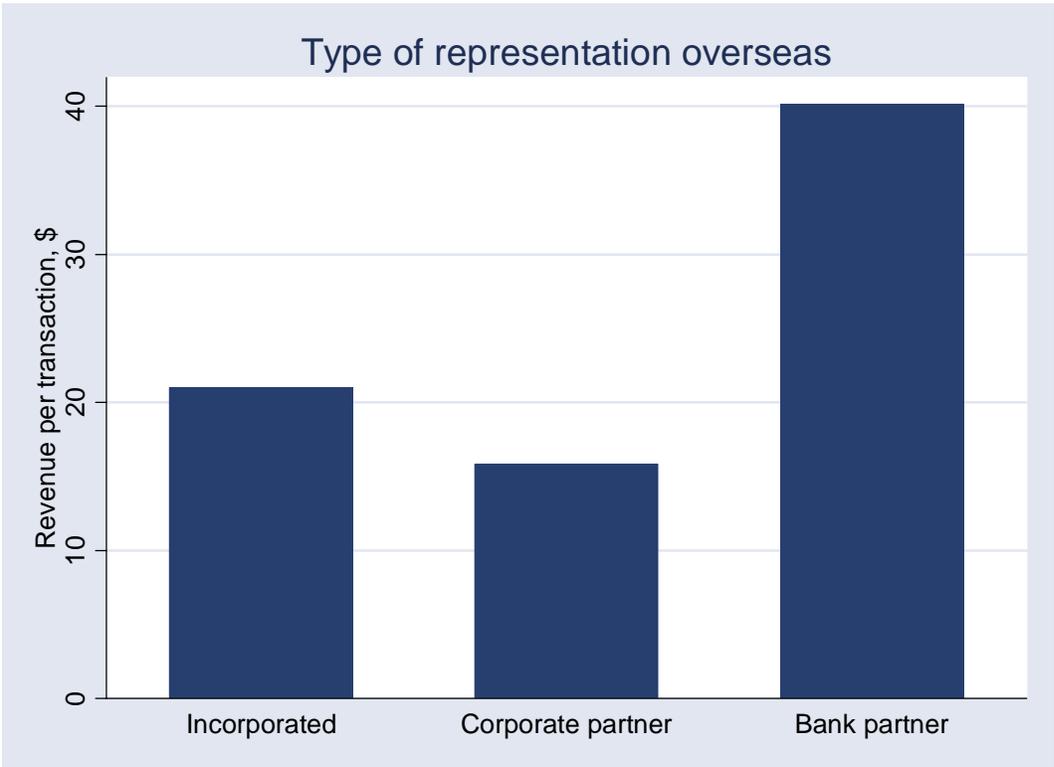
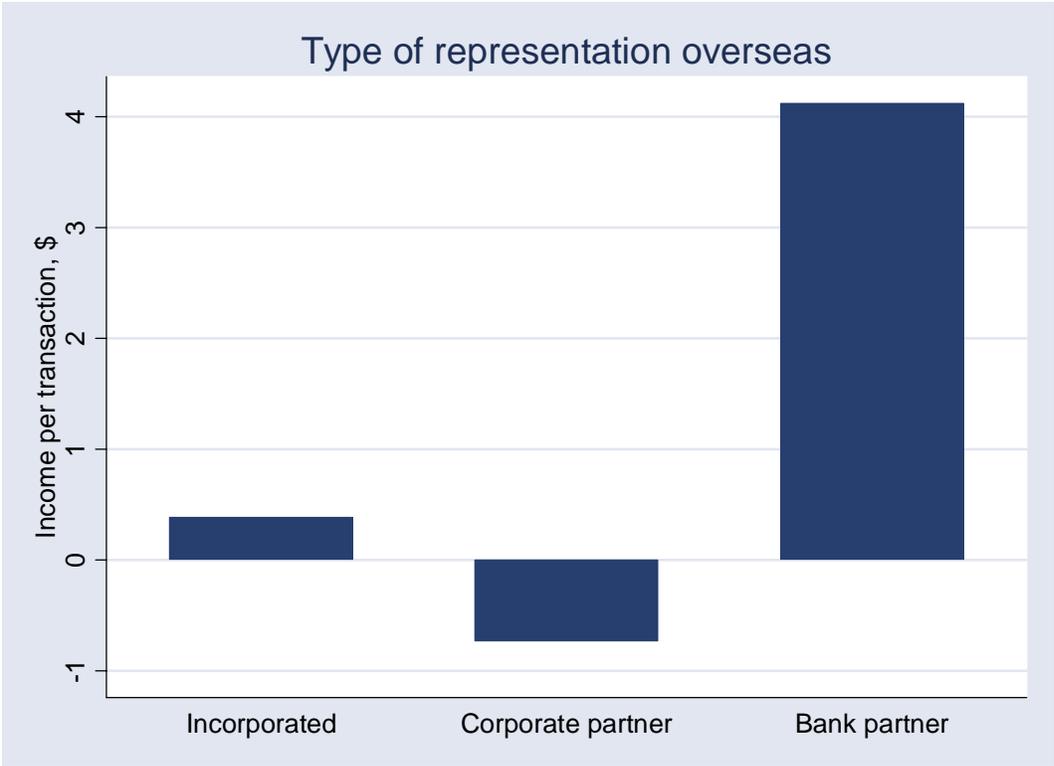
Type of representation	Percentage
Incorporated overseas	37.14%
Firm partner overseas	22.86%
Bank partner overseas	37.14%
Manages account overseas from the U.S. (without other representation)	5.71%

In our sample, 37.14% of the firms rely on bank partners to manage the disbursement of remittances overseas. These firms are not more or less likely to engage in, or cross-sell, other services, but they are significantly more profitable than other companies. In particular, they spend less money on AML as a portion of their overall expenses. Since they are more likely to use banks for distributing remittances, they are also less likely to have exclusive distribution

locations. There are some indications that these firms offer less service to recipients. They are, for example, less likely to notify recipients about the transfer; they rely on the remitter to do so.

In the cases where the remittance service provider's main representative in the disbursing country is a bank, the float accruing to the bank can be seen as part of the compensation. In our sample, however, firms with bank partners do not pay less commission than other firms. Also, as opposed to what we would expect, in such arrangements, the bank is not more likely to be in charge of the currency exchange. Having a bank as a main partner has certain advantages. It allows direct access to international and domestic payment infrastructure and to the bank's network. Firms with banks as main partners tend to rely more on disbursement to bank accounts than other firms. It also has disadvantages. Bank networks are often limited, and recipients may feel intimidated by banks. There might also be quality concerns. One of the firms we interviewed has staff present in the branches of its bank partner in order to ensure that recipients get adequate treatment.

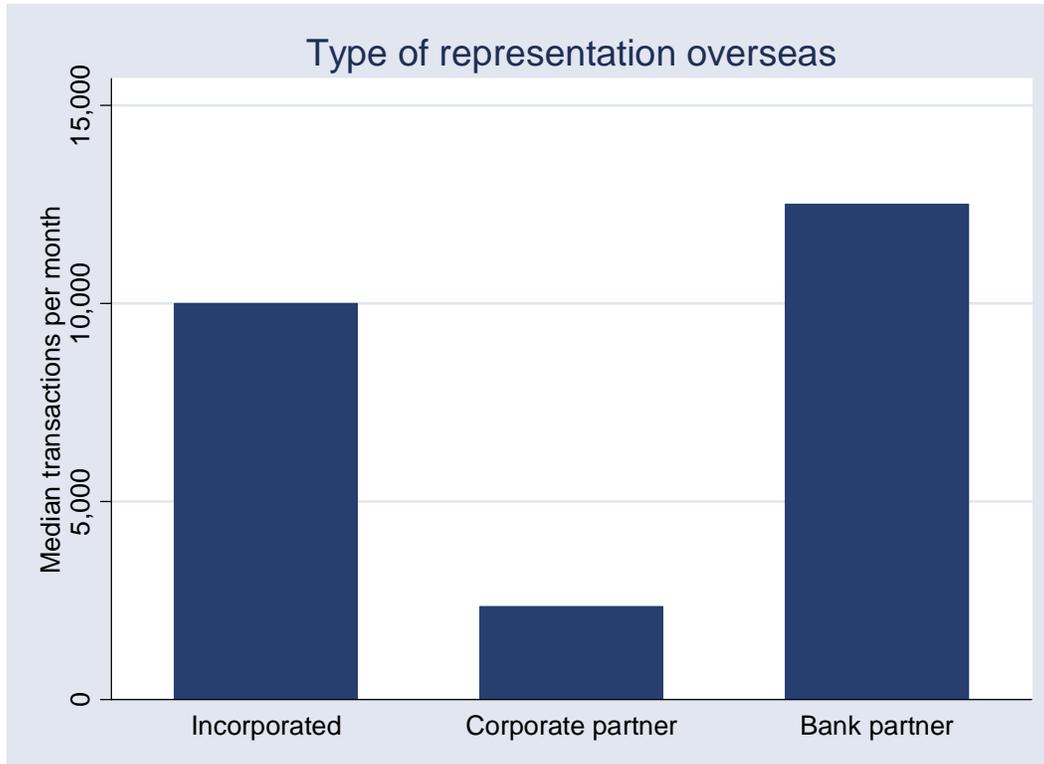
Firms with banks as main representatives are less likely to base their capture locations by where there are large migrant communities in the U.S.. They also generally do not regard corruption in either country as an obstacle to doing business, and they are less likely to feel threatened by competition in the U.S. When asked for policy advice, these firms recommended making it easier to obtain bank accounts in the U.S., but they were less likely than the average to mention a rigid policy regime in the U.S. when talking about policy recommendations. Firms with bank partners overseas report a much larger income per transaction than do other firms.



In our sample, 22.86% of firms have a non-bank main partner overseas, and this arrangement is more frequent for the firms that send remittances to Africa than for the sample average. These partners are often either networks of exchange houses or firms specialized in distributing remittances. They do not seem to be penalized for their lack of direct representation or access to the domestic payment systems by, for example, having to pay higher commissions to agents or higher fees for settlement services.

Of the firms we interviewed, the firms that rely on *non-bank* firms as partners abroad always disburse using agents, 56.25% of them also use banks, and 43.75% of them also use couriers. In our sample, they never use cell phones to notify the recipients, they use proprietary databases less frequently for cross-border communication than the sample average, and they never use ACH debits to capture funds in the U.S. The firms relying on non-bank partners always use international wires for cross-border settlements, whereas other firms often use other means such as domestic transfers (faster and less expensive) for settlement. These firms typically see as obstacles access to liquidity in the U.S., and there is some evidence they regard corruption abroad as more of an obstacle to doing business than do other firms. They are less likely to be involved in providing banking services in the U.S. but more likely to be engaged in tax services.

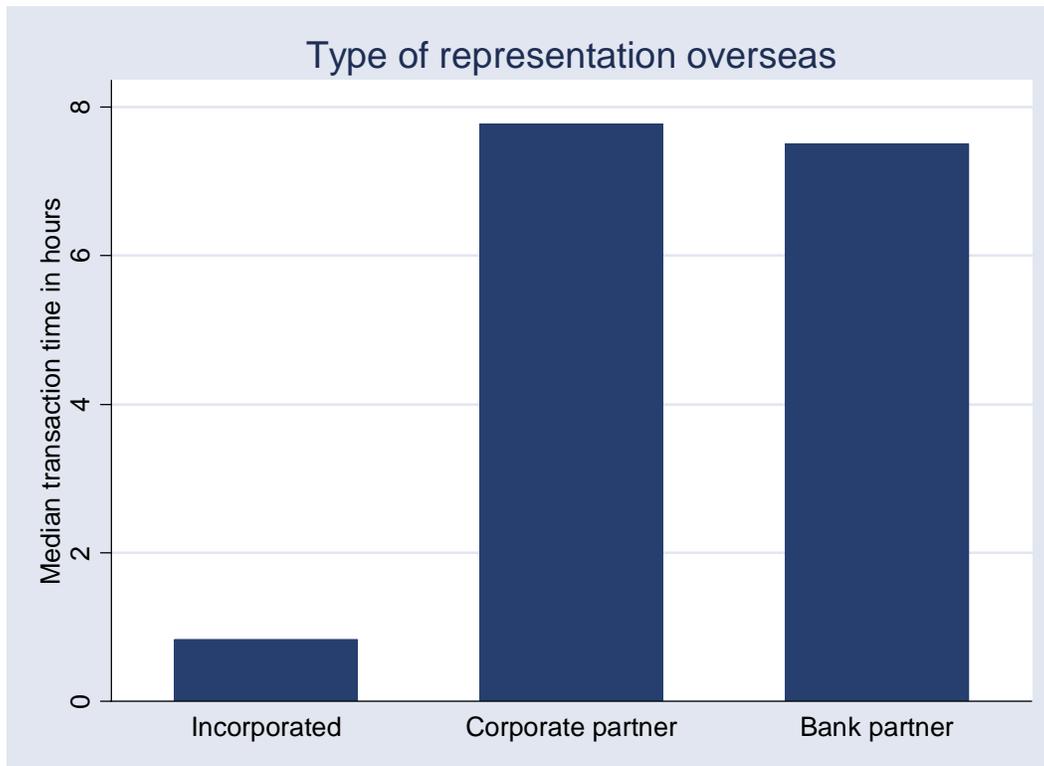
The description above would, intuitively, seem to depict smaller, technologically less advanced firms, which is also the case. Firms with non-bank partners to represent them abroad are skewed towards the smaller operators. They also have characteristics that we do not associate with the typical smaller firm: these firms are less likely to mention salaries as one of their major expense categories, and they are less likely to regard their reputation or their relationship with their customers as their comparative advantage. They are also less likely to require that the remitter fill in forms to effectuate a transfer or register as a customer.



The low income per transaction in this segment could signify that this is where competition is stronger, but there is no significant relationship between the representation abroad and the perception of competition, as measured by a variety of variables in our dataset.

Of the remittance firms, 37.14% are incorporated overseas and have own staff to represent the interests of the company, and, frequently, to administer relationship with the disbursing agents. These are typically older firms and firms that are engaged in other lines of business than remittances; often these are firms engaged in banking services and are incorporated abroad as banks. The normal business model in this case is a foreign bank that establishes a remittance service in the U.S. rather than going through the expenses of obtaining a banking license. Being incorporated abroad allows for the best control of the disbursement and settlement process (for example, these are the firms that use cell phones for notification), but it is also likely to be the most expensive option (we do not have cost data that would allow us to assess this beyond that such firms report salaries as a major expense significantly more often than do other firms). As would be expected, such firms are much less likely to use disbursing agents and much more likely to disburse through own locations, and they deliver remittances faster than do other

firms. Firms that principally send to the owner's country are generally not incorporated overseas, which can signify that there is value in outsourcing to the owner's contacts there.



Communications infrastructure

Remittance firms act as a layer over the existing domestic and international payments infrastructure, adding increased access on the sending and disbursing side. In order to provide added access points on the capturing and the disbursing side, firms need to transmit information beyond what the existing payment systems can provide.

There are three main flows of communication in a remittance operation:

Capturing agent to remittance service provider

The main purpose of the agent in addition to receiving the payment instrument is to record information about, at the minimum, the size of the transfer and the identity of the beneficiary. In addition, regulations often require information to be recorded regarding the identity of the remitter. For remittance service providers that offer several products, information is needed regarding the user's product choice.

This information needs to be submitted to the remittance service provider in a way that is cost-efficient, secure, and fast. Cost-efficiency is often obtained through batching the information in fax transmissions or email, or, more frequently, through entering it directly into an on-line database. Security can be achieved through many means, the most basic being a phone call where the agent and the remittance service provider's staff know each other personally and can confirm the accuracy of the information. Other alternatives are password-protection of access to databases or signed faxes.

**Use of communication channels between capturing agent
and remittance service provider**

Own-developed database	75.00%
Partner-provided database	9.38%
Web-based solution	21.88%
Fax	18.75%
Phone	12.50%
Email	4.69%
Remittance firm pays for agent's soft or hardware	40.68%

The increased competition on speed (one of the most frequently mentioned comparative advantages by remittance firms) creates a need for computerized systems that the agents can access. A high number of firms, 75%, have developed some sort of proprietary computerized communication system that they use to communicate with their agents or, in the case where a firm operates its own capturing locations, with its branches. Among the firms that have not developed their own system, 37.5% have their partner overseas provide a platform, and the rest operates by fax, phone, or email. A company that uses fax tends also to use phone communication with the agents. Firms that have developed own systems are more likely to carry the cost of hard- or software for the agents; if the system comes from their partner, they typically do not carry this cost. Of the firms that have developed systems, half carry the cost of agent soft- or hardware.

Web-based platforms can create savings and improved user-friendliness compared to dial-up solutions, and 21.88% of the firms use some sort of web-based solutions. All companies but one developed these systems themselves.

Remittance service provider to overseas partner

The remittance service provider needs to communicate the information about the transfer to the overseas structure that receives funds and ensures disbursement to the recipients. In addition, aggregate information needs to be transferred periodically in order to reconcile the accounts.

Use of communication channels between the remittance firm in the U.S. and its branch or partner overseas

Own developed database	54.41%
Partner-provided database	22.06%
Web-based solution	16.18%
SWIFT	0.00%
Fax	11.76%
Phone	4.41%
Email	35.29%

Most firms, 54.41%, communicate through own-developed computerized systems. Of these, the majority (71.74%) also has such systems developed for communicating with their capturing agents. Firms that have not developed cross-border communication systems rely on email, fax, and phone. Two firms have developed cross-border platforms but rely on email in order to communicate with their capturing agents.

In 22.06% of the cases, the overseas partner provides the cross-border platform. These firms tend to extract a higher foreign exchange margin than other firms, and they also tend to settle to a domestic bank account of the overseas partner rather than through wire transfers or other means.

Notification to recipient

For the recipient to know when to pick up the remittance, or to know when the remittance is available, he needs notification of the transfer.

Means of notifying the recipient of the transfer

Firm calls recipient	38.57%
Firm emails recipient	5.71%
Firm sends message by cell phone	8.57%
Sender is expected to notify recipient	84.29%
Firm gives phone card to sender	11.43%
Firm notifies recipient by postal mail	1.43%

Most firms rely on the sender to notify the recipient (84.29%). Some firms, 11.43%, give the senders a prepaid phone card with which he can call the recipient.¹⁶ 38.57% of the firms call the recipient in order to notify about the transfer. These are typically not the ones whose main representative abroad is a bank.

A number of firms use cell phone text messaging to notify the recipient (8.57%); these firms send to Central America and Asia. Using cell phones is associated with other technologically sophisticated aspects of operations as well: they typically accept ACH debits and payment cards for funds capture, and payment cards for funds disbursement. They are also likely to disburse through own locations and using couriers. These firms are more likely than others to have community events as their marketing channel.

In the sample, 5.71% of the firms use email for notification; these firms are of different characters, and there is no pattern in our data to describe them. Sometimes the decision to email

¹⁶ The firms giving out phone cards are more likely also to capture remittances through call centers and to be involved in IT side-business.

the recipient is at the initiative of the disbursing agent. Only one firm, which is incorporated as a bank in the Philippines, uses postal mail for notification.¹⁷

Domestic Settlement

Agents that capture cash need to transfer the funds to the remittance service provider. The most prevalent method is that the agents deposit cash into the remittance service provider's account; this method is used by 89.09% of the firms. In our sample, 40% of firms use direct ACH debits of agents' accounts.

Generally, receiving deposits is considered expensive by the firms and initiating ACH debits is considered cost effective. Fees for deposits can be dependent on the deposit size, whereas the ACH fee is calculated at a flat rate per transaction.

Physical collection of money using armored trucks is used by 21.82% of the firms. Cash collection by armored truck can be seen as a lack of sophistication, but it does get the cash quickly to the remittance service provider. There can be other explanations as well: in one case, the firm said agents prefer physical cash pick-up because they are afraid that the banks will close their accounts if they use the accounts for money transfer related services.

Domestic settlement mechanisms between agents and remittance service providers

Deposit to firm's account	89.09%
ACH debit	40.00%
Physical collection of cash and written instruments	21.82%

International Settlement

The international settlement is how the remittance funds get from the country of origin to the country of disbursement, and it is as such a core part of the remittance operation. The core of this element is to transfer value from the remittance service provider to the entity that disburses funds

¹⁷ Note that in most cases when remittances are credited to an account, the recipient will eventually get to know about the transfer provided he receives account statements.

in the recipient country. An account affiliated with the disbursing entity needs to be credited, whether this account is located in the country of origin, the country of disbursement, or in a third country.

International settlement

Wire transfer	62.86%
Deposit to domestic (U.S.) account	45.71%
Internal treasury	1.43%
Direct settlement	2.86%
Own correspondent bank relationship	4.29%
Settlement through third non-bank party	2.86%

Our study found the following ways of settling between the capturing and the disbursing side of the remittance system:

International bank wire: 62.86%. Typically, firms settle across borders using international bank wire. Theoretically, any individual could do the same, but a remittance service provider allows many transactions to share the cost of the same wire (to be bundled). Generally, firms settle through wire transfer once per business day at an average cost of \$27.58 per settlement. With high daily volumes, the settlement costs become negligible. However, given the time it takes from initiating a wire until it is credited to the beneficiary, there is a float expense directly proportional to the volume (see below).

Settlement to domestic accounts: 45.71%. Some firms' overseas partners or affiliates have accounts with U.S. banks, and settlement is done through a domestic credit transfer. This is less expensive and faster than international wire, and the float loss is reduced. This settlement costs \$17.57 on average, and is, like international wire, effectuated normally once per business day.¹⁸ How and if these funds are eventually transferred to the country of disbursement depends

¹⁸ Note that roughly one quarter of the firms settle domestically only. Remittances through these firms may never show up in balance of payments statistics as international remittances. The

on the affiliate's business model. In cases where the affiliate is a bank with a banking license in the U.S. or a multinational company, its corporate treasury operations will balance its international accounts.

The capture locations firms that settle to domestic accounts are more likely to be engaged in cross-selling and more likely to accept payment cards. They are also much more likely than other companies to disburse through banks. This is to be expected, as many overseas banks keep accounts in the U.S. for correspondent purposes, and a firm engaged in other business and using electronic payments will make it predisposed to crediting and debiting U.S. bank accounts more easily.¹⁹

Other settlement mechanisms: 11.44% of firms settle in various other ways. One Caribbean firm settles directly with the central bank of its home country, to the central bank's U.S. based account. Another newly established firm settles through the VISA network. Some of the remittance operations that are owned by banks settle through accessing their owners' correspondent banks. Remittance divisions of foreign banks with a presence in the U.S. settle through the banks' treasury operations. Some firms outsource the international settlement and currency exchange to a third party, which credits the owner company (which distributes the funds) in the receiving country.

Using existing structures to settle remittance transfers, such as payment card networks or existing correspondent relationships, gives increased control over the settlement process and can reduce costs and negative float. In comparison, remittance firms that are dependent on buying wire transfer services from outside banks have a comparative disadvantage. For companies with

firms that settle domestically only are on average smaller than the ones that settle by international wire.

¹⁹ Another indication that firms settling domestically have a different business model, is that they report settlement expenses more frequently as a major cost item but actually pay significantly less in settlement fees per transaction than do other firms.

complex operations, settlement costs can become large. One company with one million transactions per month estimates that it spends \$3 per transaction in settlement-related services.

Emerging settlement and distribution services: “Meta-remittance firms”

A current development in the remittance field is “meta-remittance service providers” that allow any remittance firm in the U.S. to link up to their system, which then provides international settlement and disbursement through their established network of banks and agents. These “meta-RSPs” also typically have their own capture locations, and they provide settlement and distribution services to remittance service operators of all scales, from “mom and pop” firms to large, nationwide organizations.

Two examples of such services appeared in our sample transfer funds to Latin America, which is not unexpected given the sophistication and competitiveness of the Latin American market. One meta-RSP is Central American, one is Mexican; both are banks, and both are major payment card issuers in Latin America. One of the firms has around 40,000 operating agents in the U.S. and reports to control 40% of the market between the U.S. and Mexico. They represent different, but large, sizes: one is our largest firm, the other is in the upper 15% in terms of transactions processed. None of them market their services actively.

One of the services rely only on banks as disbursement agents, because they consider banks essential to service and compliance. The other service uses both banks and other firms in their disbursing network.

These “meta-RSPs” do not require the recipients to have bank accounts, but disburse in cash (and through other means such as ATM cards). Recipients can pick up a remittance in any affiliated bank (or agent). They report not adding an exchange spread to the transaction. They both try to cross-sell financial services in the receiving country, and one of the two cross-sell also in the U.S. (this firm recently obtained a banking license in the U.S.).

Some remittance firms in the U.S. that use these banks’ services are billed monthly for the transfer fees, in some cases remittance service providers have to prefund a balance with the bank, and other firms again get one day credit.

Effectively, what these banks do is to open up their international and domestic payment backbones to the outside, which creates potential for network benefits. This development could lead to lower remittance fees, as it promises to foster competition on service among the various remittance service providers that link up to these systems. At the same time, the cooperation on infrastructure can lower operating costs. This is a powerful combination. The remittance service providers can focus on their core business in developing and marketing a broad network of capture locations and methodologies in the U.S.. At the same time, the “meta-RSPs” can focus on the disbursing countries and through their core business’ banking platforms they can easily move funds between countries. Also, through developing a shared platform for information exchange, fixed costs can be spread on a large number of transactions. The business model is reflected in their cost structure. Both meta-RSPs report AML (because they are dealing with a large number of agents) and technology (to develop the networks) as major cost items.

Float

The level of float in a remittance system depends on the structure of how funds flow through the system. The average transfer time in our sample is 14.72 hours; the median is 3, and the funds move between several institutions in the course of a transfer. This means that there is little opportunity for a net float income. This is consistent with firms settling cross-border on average once per weekday. The more funds move from institutions to institutions, the less opportunity there is for creating float. In a best-case scenario, where a firm has the control of funds for the entire process and funds are available to the recipient in 12 hours, a firm with the average volume per month from our sample, \$36.3mn, which could earn 10% on float, will have a float income of only around \$3,500 per month.

Of the firms interviewed, 16.33% report some float income, 83.67% report that they have no float income, and 73.47% report float loss. Of the firms that report float income, one is very small and settles with its overseas partner every month, one has an agreement with its partners allowing it a day of float, and the majority are subsidized by their owners in that the owner is in charge of disbursement and collects money less frequently than technically feasible, thereby carrying the cost of working capital on the disbursement side. The net effect for the latter type of

operation depends on the cost of capital in the receiving country versus the return on capital in the sending country.

In most cases, pre-funding takes place by transferring money to a bank account in the receiving country, ready for disbursement. This means that any float is most likely to accrue to the financial institution providing the account, bar a possible interest rate on the bank account. The only real option for investing float in such a case, is where the bank owns, or is the same entity as, the remittance operation.

Currency conversion

In our sample, 8.82% of the firms disburse in USD only, 48.53% disburse in local currency only, and 42.65% disburse in both currencies, normally at the discretion of the recipient. This means a core component of most remittance services includes a currency conversion. Remittance firms solve this in different ways. Only 19.70% of firms do this themselves; in 62.12% of the cases, the overseas partner (or parent/subsidiary/sister company) does the currency conversion. In 7.58% of the cases, the currency conversion is outsourced to a third party.²⁰

The average spread that a remittance firm charges over the rate it obtains is 1.63%, the median is 1%. The firms that exchange currency themselves gain a 3.31% spread on average, the firms that have the partner exchange currency gain a 1.24% spread, and the ones that outsource gain 1.01%. Note that this rate is the spread that accrues to the remittance firm; it is not the spread over the wholesale rate. Since the firms typically do not do the currency conversion themselves, it is likely that the entity that does the conversion charges a spread over the wholesale rate, which means that the exchange rate spread over a wholesale rate faced by the remitter is higher than the numbers reported above.

²⁰ Some firms go to great lengths to convert currency. One firm sending money to Mexico and using the Mexican domestic payment system has had to reconcile the fact that the Mexican ACH is peso only, and their customers' desire for dollars. The firm converts funds to pesos, then sends them through the Mexican ACH, and reconverts back to dollars at the disbursement location in order to be able to disburse in dollars.

Where the remitter is quoted a rate, the remittance service provider runs the risk of covering that rate. Many firms take on such risk, and assume that the spread they quote will cushion them from currency fluctuations, but there are many variations. One firm, for example, notifies agents of the rate its disbursing partner is able to obtain several times per day, but if it turns out the agent promises a rate that the disbursing partner is not able to cover, the agent carries the risk.

Firms that consider their comparative advantage in commercial relationships and strong finances tend to also have a higher spread, perhaps related to their bargaining power in the relationship. They tend to settle internationally more frequently, which also allows them to match their buy and sell rates better, and they use banks and credits to payment cards more frequently than the average company for disbursement.

Higher spreads are significantly correlated with the perception that exchange controls are an obstacle to doing business, which might indicate that exchange controls give opportunities for charging higher spreads.

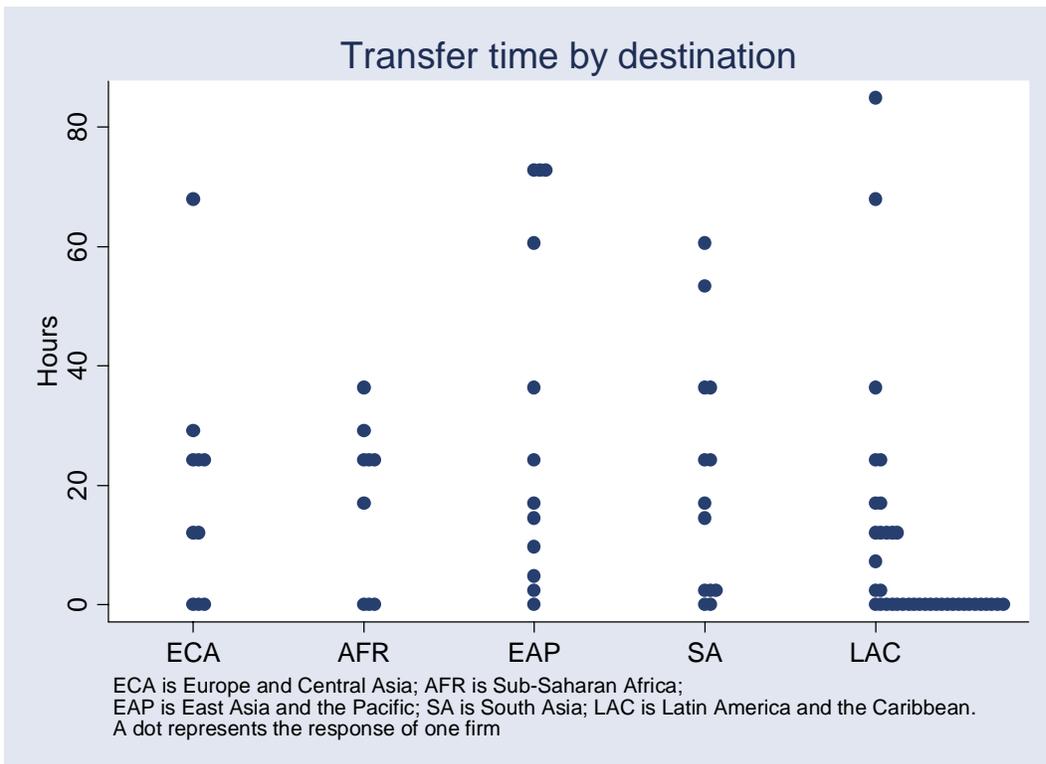
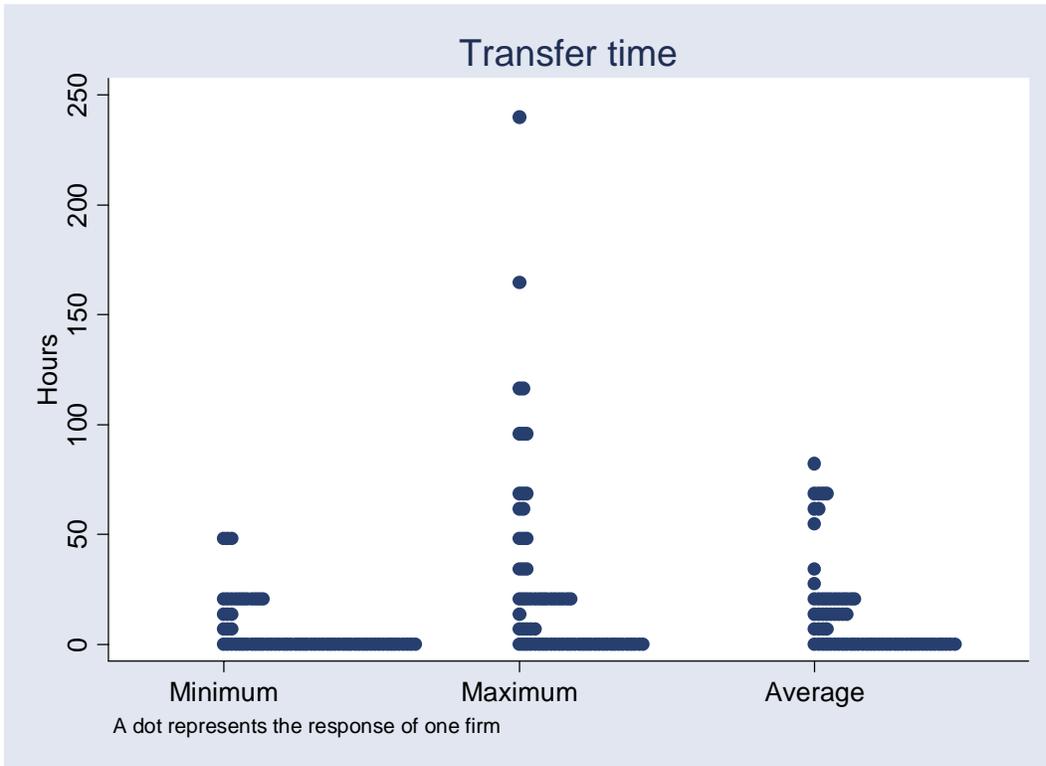
The exchange revenue is shared in 29.09% of the cases. There is no significant correlation between the size of the spread and whether it is shared or not. Firms that perceive an increasingly competitive environment are more likely to share their foreign exchange revenues than the sample average. Sharing the exchange gain with a partner can be a way of buying oneself out of trouble. Firms that share foreign exchange gain have less problems with corruption and reporting requirements abroad. The firms that share the foreign exchange need on average 20.13 hours to make the funds available to the recipient, the firms that do not share exchange gain need 9.59 hours on average. A possible explanation of this is that the gain is realized immediately during the transaction (which takes time) rather than being settled after the transaction has taken place.

Transfer time

Companies spend on average 14.72 (median: 3) hours getting a remittance to the recipient.

Transfer times vary within the different products that a company offers. The minimum transfer time reported by companies is 7.34 hours on average (0.58 hours median), while the

longest is 32.06 hours on average (5 hours median). The average difference between the longest and shortest transfer time reported is 25.17 hours (1 hour median).



<i>Region</i>	Average transfer time (hours)	Median transfer time (hours)
EAP	29.6	18
LAC	8.23	0.5
MENA	22.21	18.5
ECA	17.7	12

When we look for factors in the firms’ business environment that might be correlated with longer transfer time, we find that firms with longer transfer times perceive competition both in the U.S. and abroad as a higher obstacle than other firms. We also find that longer transfer time tends to be associated with higher average transaction sizes.²¹ There can be several explanations for this. Remitters may send transactions less frequently if it takes longer, or firms that principally send higher amounts may not face the pressure to transfer fast. There is no apparent relationship between transfer time and fee or exchange rate spread, even if we control for destination region.

Cost, prices, and cross-subsidies

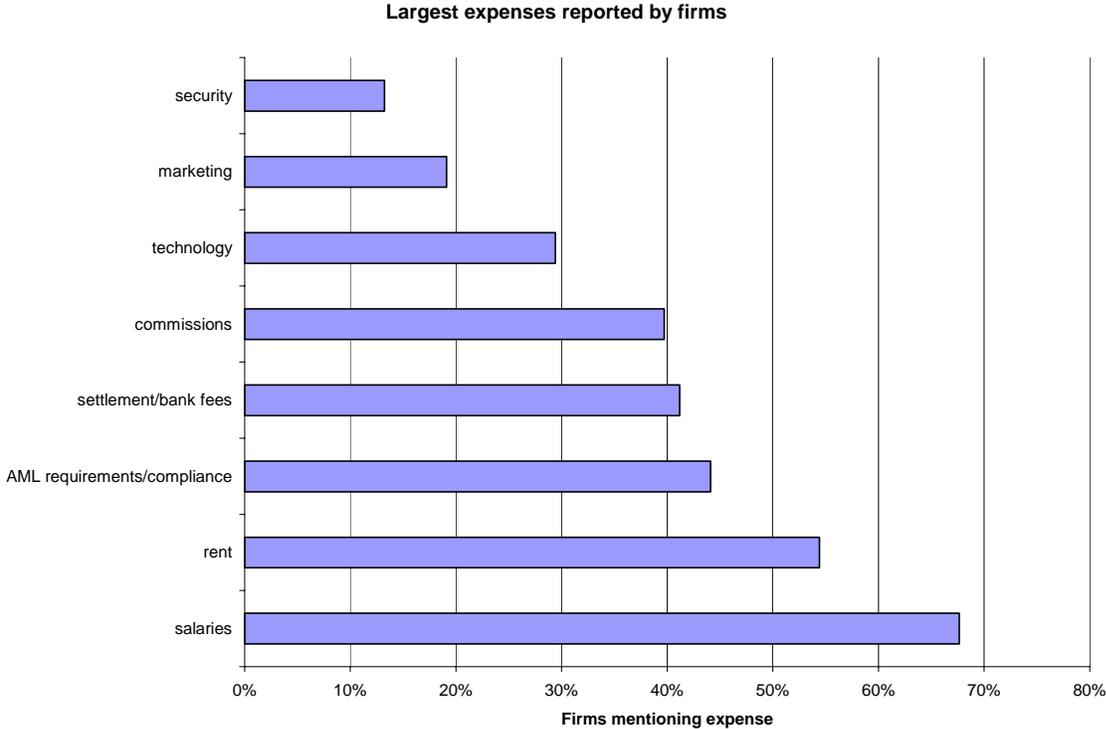
Costs

Remittance operations can differ a lot. During our research, we encountered a number of different business models. Each business model has its own cost structure. Despite this, we can quantify some core cost components of a remittance operation. It is important to note that there is no one benchmark that gives us the “lowest possible cost” or the “true cost” for a remittance service. For example, disbursing to a large city may be inexpensive, while disbursing to a remote

²¹ Transfer time does not fit any distribution, and the test applied here is Kendall’s rank correlation.

village can be costly. Similarly, setting up a dedicated remittance infrastructure incurs large up-front investments that will have to be recovered through the transaction price, whereas leveraging other, existing infrastructure can reduce the capital costs substantially.

In identifying expenses, we asked the firms to list the most important expense items in their operations. This was an open question, in order not to create bias in the responses based on any preconceived notions of how a remittance business is run.



Salaries

Salaries rank, as expected, as the highest expense. There is no significant relationship between whether salary is an important expense and the volume or number of countries that the firm sends money to, which suggests that the economies of scale in remittance service do not lie in personnel. Firms that rely on own capture locations are more likely to mention salaries as a major expense.

Commissions

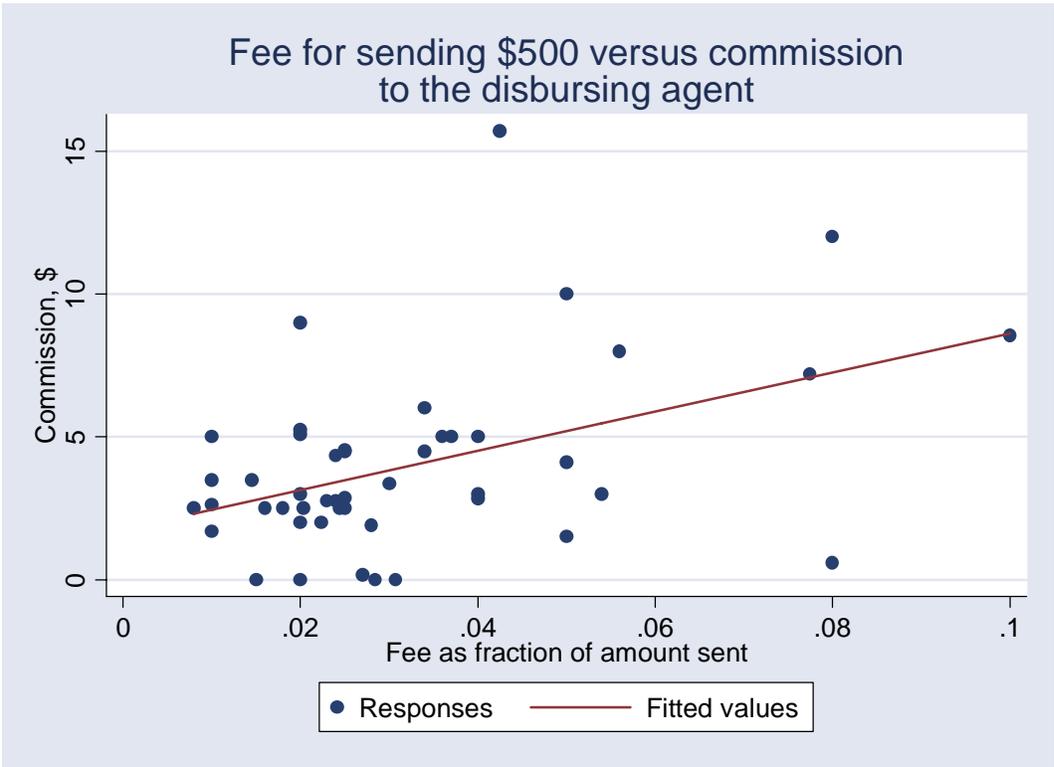
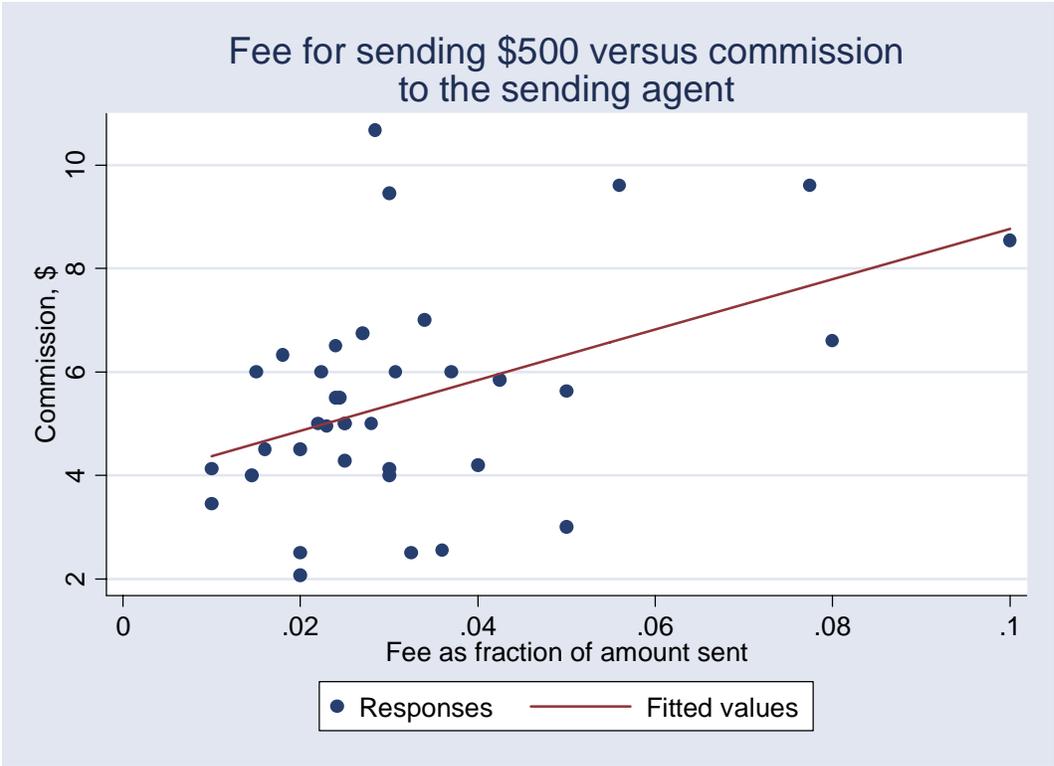
The most frequently mentioned expenses after salaries are commissions. 66.67% of the firms use external agents to capture funds, and 56.94% use external agents to disburse funds. Our

respondents expressed that in competitive sending areas, the agents have a high negotiating leverage vis-à-vis the remittance service providers. Firms that have exclusive capture *and* distribution agreements with agents typically do not report commissions as a major expense.

Spending money on agents seems to be a deliberate choice. Firms that report commissions as a major expense typically consider their comparative advantage to be the speed of their transfers. Reducing commissions may be a key to financial viability, or financial viability may be the key to handling increasingly demanding agents: of the seven firms that considered financial strength a comparative advantage, only one mentioned commissions as a major expense. Technology has an ambiguous effect on commissions. There is no relationship between commission expenses and whether the firm uses ACH debits or payment cards for funds capture, but firms that disburse through ATM networks do face higher commission expenses relative to other expenses.

Commissions paid by the remittance service provider for a \$300 transfer average \$5.91 to the capturing agent and \$3.23 to the disbursing agent (the medians are \$5 and \$3).²² There is a significant relationship between the commissions and the fee charged to the customer.

²² There is no significant change in commission paid to the receiving agent if the partner overseas does the currency exchange, from which a profit could be extracted.



<i>OLS regression</i>	<i>Fee for sending \$300 (t-statistics)</i>
Commission to sending agent	.46 (2.98)
Commission to receiving agent	.28 (1.82)
Observations	31
R-squared	0.33

One standard deviation increase in commission to the sending agents is associated with 0.46 standard deviations increase in the percentage fee for sending \$300. One standard deviation increase in commission to the receiving agent is associated with a 0.28 standard deviations increase in the percentage fee for sending \$300. There is no significant relationship between the commissions and the exchange rate spread.

Firms that also perform IT (Information technology and telecommunications) services pay lower sending commissions than do other firms. Some firms (34%) state that good connections in the receiving country are important to doing business. These firms, however, do not pay lower commissions in the receiving country than do other firms.

There is a payoff in investing in a solid agent network. Firms that consider their agent network a comparative advantage are less likely to pay high commissions. Our data indicate that there is a price to pay for quality: firms that consider quality a comparative advantage are more likely to pay higher commissions. Similarly, there is a price to pay for exclusivity. Firms that have exclusive capture locations pay more commissions to these agents than do other firms. Interestingly, if they are able to control the whole channel, i.e. have exclusive agents on both sides, they do not consider commissions a larger expense. This can be because the rent they extract from controlling the channel allows them to focus on other issues. Firms losing money on float pay agents less, and firms making money off the float pay agents more. We cannot determine from our data if this generally cancels out float loss and gain.

We find that in one of the most competitive states, Florida, the competitive dynamics are reflected in commissions to the sending agents firms' bargaining power versus agents: firms that experience increasing transaction volumes pay significantly lower commissions, and firms that

experience decreasing volumes pay more. This can indicate that agents go with the ‘winners’ to secure future flows. (There is no significant relationship between prices and increase in transaction flows.)

There are regional differences in commissions paid. Firms sending to MENA and SA pay lower commissions to the sending agents than do other firms. There are no significant correlations between region and commissions to the receiving agents. Also, there are no significant differences in commissions depending on in which state the remittance service provider is located (which would not be expected since its agents may be anywhere in the country).

Rent and AML

Rent and AML/compliance rank next after commissions. Rent is a normal expense for any firm, and the importance of rent to the firm is mainly driven by whether the firm owns its locations and whether the firm does only remittances or can spread its fixed costs over several business lines.²³

AML/compliance costs, however, are driven by policy as opposed to by the market. Some firms are less affected by this, and it is of interest to know which firms are able to operate without considering AML as a major expense. Older firms are less likely to list AML as a major expense, as are firms that are technologically advanced (if we define this as firms able to accept payment cards or as firms that consider technology a comparative advantage). Generally, the more profitable firms allocate proportionally less of their expenses to AML-related issues. Firms spending less on AML are much less likely to perceive competition in the U.S. as a major obstacle to doing business.

Firms that rely on agents to capture funds are more likely to consider AML a major expense. This can be caused by the fact that these firms do not spend as much on rent and staff (so AML becomes a relatively larger part of expenses) or by the fact that it is more difficult for

²³ Together these two variables account for the equivalent of 39% of the variation in whether rent is mentioned as a major expense (McKelvey and Zavoina R-squared, probit regression). The home state of the firm has no impact, neither has the number of states where the firm operates.

these firms to control what happens at the capture location. When agents are exclusive, firms are less likely to mention AML as a major expense, presumably because it is easier to control an exclusive agent. Also, firms that consider their brand or reputation a comparative advantage spend less money on AML. Some side activities are associated with higher spending on AML, such as goods transportation or travel services.

Other expenses

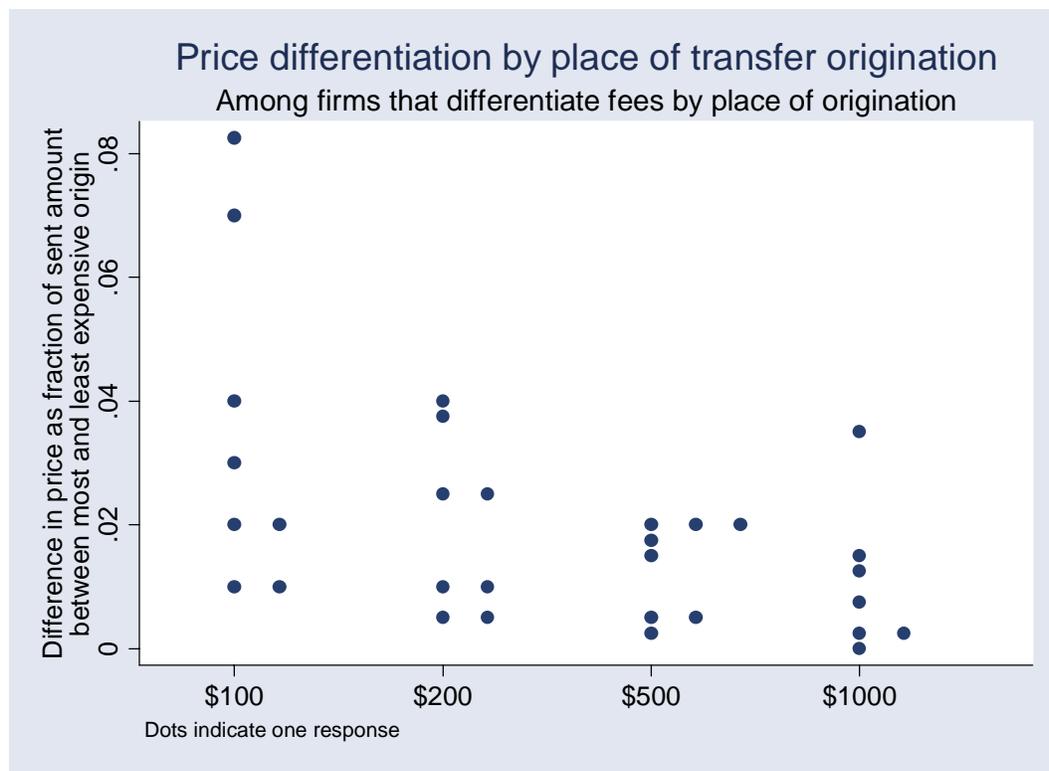
The expenses ranked after AML are related to settlement and bank fees. Firms that only do remittances and as such cannot spread settlement cost on other activities are more likely to mention this expense. Interestingly, firms that settle through domestic transfers are much more likely to mention this expense as major, and firm that settle through wire transfers are less likely to do so. This is despite the average fees for settlements. The average cost of settlement, which the average company performs 18 times a month, is \$17.58 for domestic settlement and \$28.01 for international wire transfers.

Marketing is mentioned as a major expense by 19.11% of the firms, and these firms have higher marketing costs per transaction when compared to other firms. The average monthly marketing expense among the firms we interviewed is \$27,225, or \$1.19 per transaction; this value falls as transactions per month increase. Firms focusing on marketing are those that consider price their comparative advantage, whereas the firms considering technology their comparative advantage are likely not to mention marketing as a major expense. Firms that focus on expanding in areas where there are large migrant communities are less likely to spend money on marketing relative to other costs – most likely because word of mouth and personal relationships become more important marketing through media. Firms that focus on community events for marketing typically mention marketing more often as a major expense. The more likely the firm is to spend money on marketing relative to other expenses, the higher are the reported revenues per transaction. What channels the firms focus on (TV, radio, community events, etc.) are not associated with the actual marketing expense per transaction.

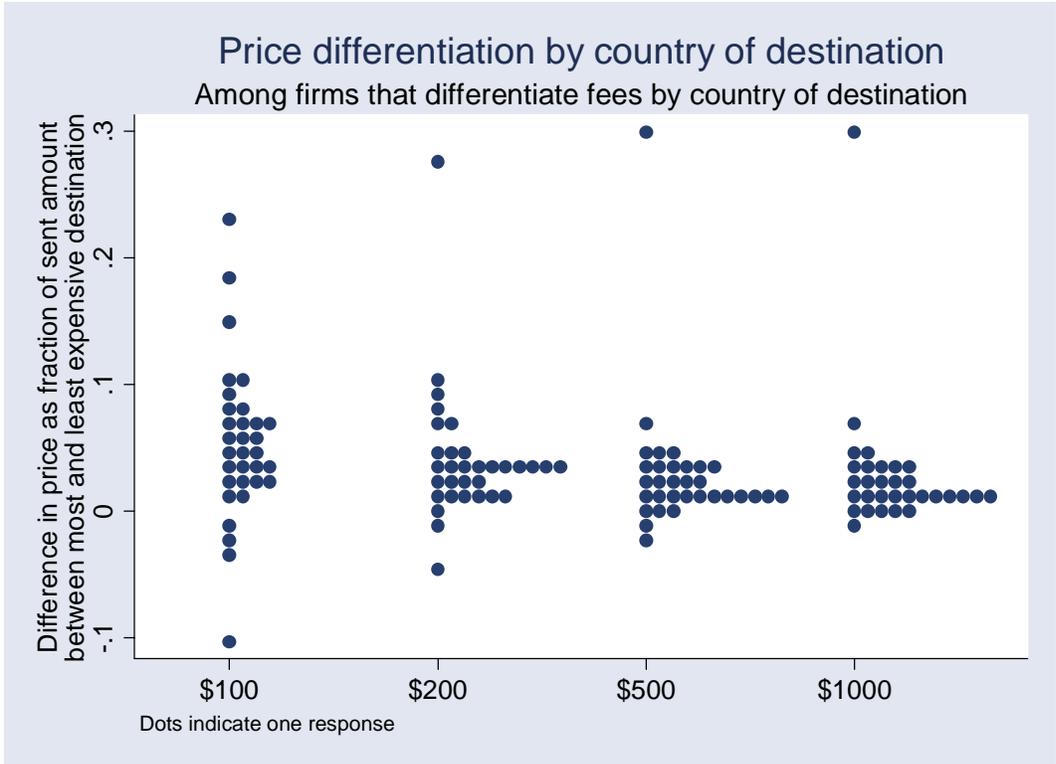
Prices

We asked the firms to report fees for their services, broken down by highest volume, most expensive, and least expensive destination, most and least expensive product, and by most expensive and least expensive originating city.

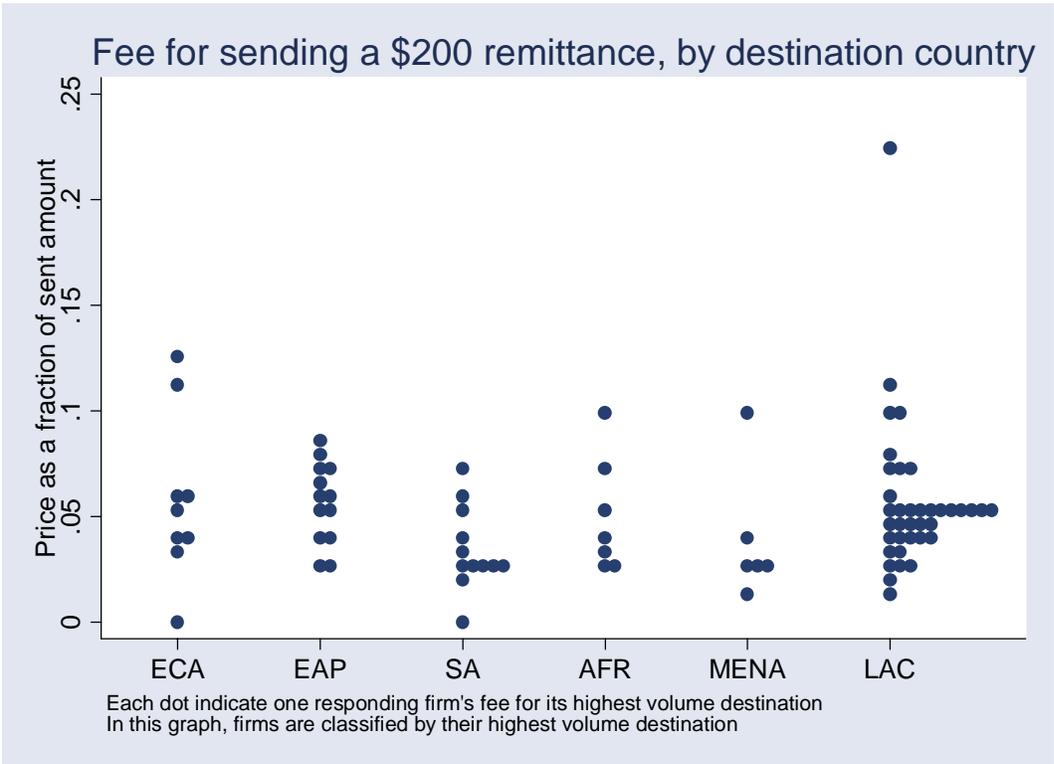
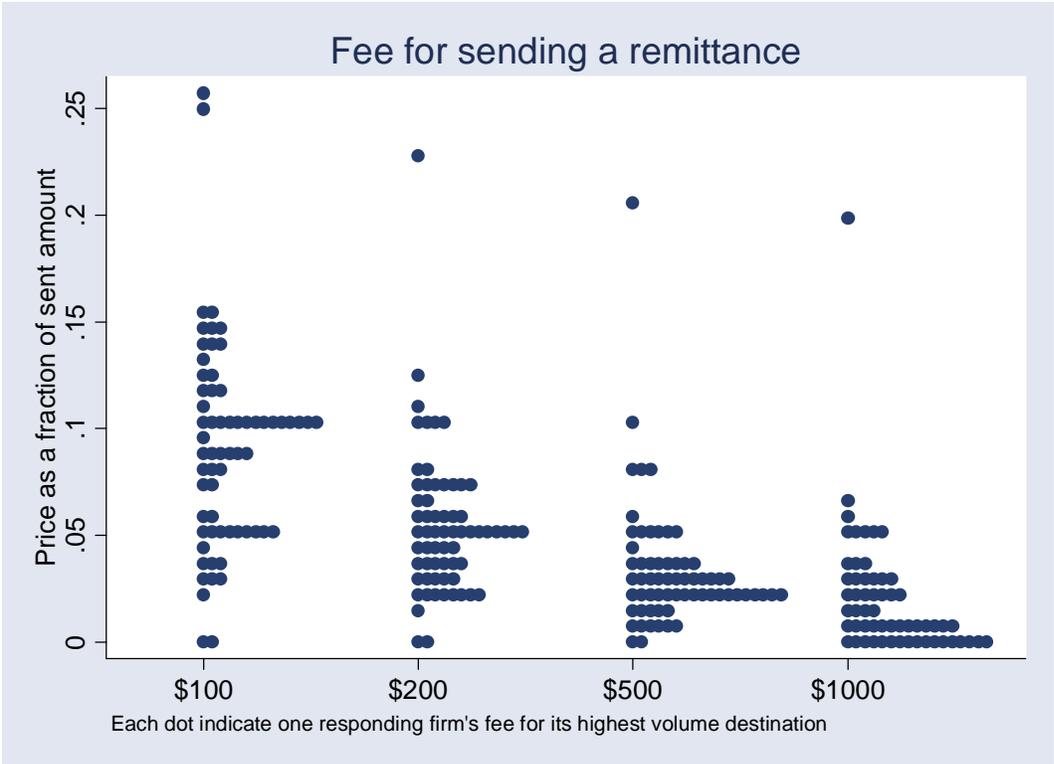
In general, the fee schedules do not distinguish between originating cities (only 12.5% of firms do so). These numbers can be misleading, however. Several respondents noted that the agents adjust prices themselves, also subject to negotiations with individual senders, even if there might be an official price list supplied by the service provider.



Most firms have different fees for different countries. As the sending amount increases, so does the spread between the most and least expensive destination. In percentage terms of the transfer amount, however, this spread decreases as the transfer amount increases.

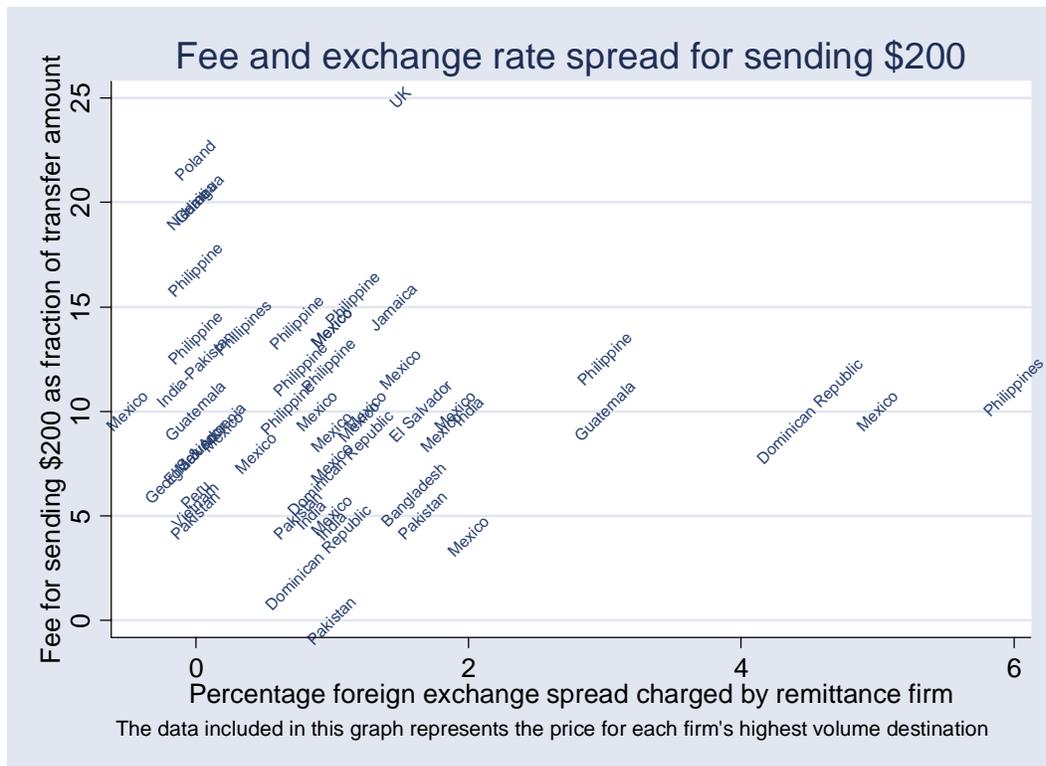


We observe the usual patterns of fees decreasing in percentage terms as the send amount increases. Besides this, there are few patterns to be extracted. If we look at average prices for sending \$200 with companies that service different regions, there is no significant difference.



Similarly, if we plot fees for the most important countries per company against foreign exchange spread, we see that there is no apparent relationship between region and fee, region and exchange spread, or between fee and exchange spread.

There appears, however, to be some patterns when we look at individual countries. Fees to Mexico, which is the most important recipient country for several of the firms in the sample, seem to be capped around \$10, whereas the exchange rate spread varies. The Philippines, another important destination, is generally more expensive than Mexico. Central American countries are scattered with many pricing combinations, whereas South Asian countries generally have thinner exchange rate spreads charged by the firms as well as lower average fees.



Cross-selling

Several of the fixed costs of a remittance operation, such as staff costs, rent, cash handling, customer relations, and brand development, could in theory successfully be spread over supplemental product lines. We have seen during our interviews that some firms are interested in capturing remittance business through building on customers that buy other services from the

firm. Also, we have seen some firms interested in expanding from remittances into other services, building on their remittance customer base.

A frequent comment we encountered when asking specifically about cross-selling products and services was that there is potential for such a type of marketing, but that this potential is not being exploited by the market participants; this seems to be conventional wisdom in the industry. Our interviews give the following picture.

Firms' responses when asked about cross-selling

The firm is only engaged in remittances	51.39%
The firm is also engaged in travel services	13.89%
The firm is also engaged in goods transportation	18.06%
The firm is also engaged in selling goods	4.17%
The firm is also engaged in publishing	1.39%
The firm is also engaged in information technology and telecommunications	15.28%
The firm is also engaged in tax preparation	6.94%
The firm is also engaged in banking services (not only loans)	12.50%
The firm is also engaged in foreign exchange services	8.33%
The firm also provides loans (but not other banking services)	1.39%
The firm also provides notary services	4.17%
The firm is also engaged in check cashing	13.89%

Half of the firms are engaged in remittances only. Goods transportation and IT are the second most frequent supplemental business lines, followed by travel services, check cashing, and other banking-type services (some firms are owned by foreign banks or have micro-credit type operations).

There is a difference in a situation where the remittance service provider is engaged in other business lines and a situation where its agents are cross-selling other services. A remittance

service provider can conceivably leverage its infrastructure to perform other business operations. But even if the remittance firm is engaged in other business lines, this does not mean it is actively cross-selling services to its remittance customers. Looking at whether the remittance firm itself is engaged in other business lines tells us about how it leverages its infrastructure. Looking at whether agents cross-sell products and services to the customer tells us something about how the firm relates to its customers.

There is not a perfect correlation between firms that engage in other business lines and firms that actively cross-sell products, consistent with the observation that cross-selling is an untapped potential, but firms that actually are engaged in other business lines are 37.37% more likely to have services cross-sold at the capturing locations in the U.S..

On the technological side, firms that only do remittances use internet and proprietary platforms less frequently to communicate with agents and overseas partners, and more often platforms provided by their overseas partners. They do not give senders phone cards to communicate with recipients as often as do firms that engage in other business lines, notably IT business. Firms that only engage in remittances are less likely to be incorporated overseas.

On the market side, firms that only do remittance service perceive the market as more fragmented than do other firms. This can be because they cannot lock in customers through selling other services or because their perception of competition is made up of the competition they face in all business lines. Such firms are more likely to consider the challenge of getting business contacts abroad as a barrier to entry. They are more likely to send to the founder or parent company's home.

Our data do not allow us to draw any meaningful relationships between the remittance providers whose agents cross-sell and their final customers, because our data on cross-selling does not distinguish between cross-selling on the part of the remittance firm and cross-selling on the part of the agent. The agent may be independent from the remittance firm and as such will not reflect the remittance firm's strategy.

It can seem intuitive that firms that diversify their product lines and cross-sell different products to the same customer base – or expand the customer base through alternative products – have a comparative advantage. There is a clear pattern showing that firms where at least some of

the capture channels cross-sell report that transactions over the last years have increased, whereas firms without cross-selling report that transaction volumes are going down.

Policy advice from the remittance firms

We leave the final word in this study to the remittance service providers. Above, we have described the business environment for remittance providers based on our research, we have laid out what we believe are characteristics of successful firms, and we have described how remittance firms operate. Those are the main purposes of this study – we hope that this initial description of the remittance industry will lead to further research, in particular regarding what decides how to reduce the costs of remittance services and how to make the remittance experience as easy as possible for the end users. We also hope that this study can provide a basis for policymakers in obtaining those goals.

Remittance firms have become increasingly involved in influencing the policy environment. In our interviews, we asked the firms for advice that they would offer to policymakers, which 66 firms choose to do. We did not offer choices of policy advice; we asked an open question and recorded the responses. When analyzing the responses, we grouped the advice into main categories.

We did not in any way influence the responses below, and this section reflects the opinions of the firms we interviewed, not the opinion or the endorsement of the authors or of the World Bank.

A large number of firms, 65.15%, said that the regulatory regime is incoherent and/or too rigid, and authorities should remedy this. Here we also include firms that mentioned that inspections are inconsistent, so that firms operating without a license are not inspected. The “rigid” advice is strongly associated with which state the firm is headquartered; it is particularly associated with firms in California, Florida, and Texas.

Regulatory regime is rigid/incoherent	NJ	NY	FL	CA	TX	IL	DC
No mention	5	5	0	2	2	3	0
Mention	5	6	15	11	6	4	2
Total firms giving advice	10	11	15	13	8	7	2

Almost half of the firms, 47.06%, said that authorities should remedy problems the firms face regarding the opening of bank accounts. This advice, however, is not determined by state. It should be noted that at the time of the data collection, remittance firms in the U.S. were experiencing a wave of account closures by commercial banks. Several explanations have been offered for such closures. The two most frequent reasons in the debate have been 1) banks are unsure what level of Know Your Customer policies they are supposed to implement with regards to remittance firms and the remittance firms' customers; 2) banks do not want to run the reputational risk of contributing to a "bad" transaction, i.e. a money laundering or terror-related transaction; and 3) banks want to suppress competition in the remittance field in order to enter themselves.

It is clear that a number of our respondents have had their accounts closed, and some of these are, at the time of writing, facing a real risk of having to discontinue operations because of account closures.

These bank closures may also be the reason for responses in the "rigid"-category, as several remittance firms we interviewed cited lack of communication between the various U.S. regulatory bodies as the reason banks were uncertain about their obligations and therefore exited the remittance-related business account market.

Other policy advice given by firms focused on creating open access to financial infrastructure (suggested by 18.18%), making it easier to obtain a license (16.67% of the firms), have authorities build financial infrastructure (6.06%), have authorities provide identification documents to migrants (6.06%), have authorities educate the consumers (6.06%), making bond requirements dependent on transaction volume rather than how many states the firm operates in (4.55%), lowering taxes in the U.S. (3.03%), and prohibiting exclusivity contracts (3.03%).

Conclusions

This study has reviewed the business environment for remittance service providers. It finds that the largest obstacles to doing business are within areas that can be influenced by public policy, such as licensing, bond requirements, and removing disincentives that may prevent banks from

providing remittance firms with bank accounts. It also gives a picture of a maturing and industry that is increasingly dependent on economies of scale, the use of technology, and improvements in infrastructure and logistics.

These developments are good news for policymakers. First, policymakers can contribute to better and less expensive remittance services through improving the business environment. Second, a maturing and increasingly dynamic industry is a better partner for policy development than a nascent industry.

Annex: Survey instrument

In the following are the main questions asked by the interviewers. In most cases, when a question asks *how* or *what*, the interviewer was also instructed to follow up with a *why* as well as inquire about associated costs. Many of the questions were followed by further explanations. The full instruction sheet can be obtained from the author.

Note that the questions below are not part of a written questionnaire. Developing a written questionnaire requires a different methodology than does structuring oral interviews.

Questions about the company and its remittance operations:

1. What is the ownership structure of the company?
2. There are several steps in the chain of sending a remittance. Examples are: receiving money from remitters, disbursing to recipients in another country, exchanging currencies, providing settlement services across borders, carrying messages among the various participants in this process. Where does your company best fit in?
3. Some companies providing remittance services are independent, some are franchises, and some are part of larger corporations. Some operate only here in the US and have partners abroad; some also operate in the receiving countries. Which describes best your firm?
4. In what year did you start to provide remittance services?
5. Do you only provide remittance services, or do you also provide other services?
6. Are you engaged in remittance services in order to profit from these services directly – or indirectly through customers' use of other services?
7. If you do not make a profit from remittances directly, what is the business that remittances facilitate?

Questions about how money is sent and received:

8. From which states can people send remittances through your remittance operation? To where can people send remittances from these locations?
9. What are the main “corridors” of transfers?
10. What is your primary strategy in having chosen these locations and countries?
11. From what kind of stores, outlets, branches, etc., can people send remittances through the remittance operation you are a part of?
12. In the remittance operation that you are a part of, how do the remitters send funds?
13. How and when does the agent/branch transfer money to the part of your operation that sends the funds on to the recipient country? How does the agent/branch notify your company that there is a transfer initiated?
14. What, if any, documentation or verification is required to verify the identification of the individual sending the funds?
15. Are records kept of the remitters’ identity and/or the remittance transaction?
16. How many and which forms must the remitter fill in when sending money?
17. From the time the remittance transaction is initiated, how much time does it take to have the funds available to the recipient.
18. How does the recipient receive the funds?
19. What is the geographical extent of the network where funds can be received?
20. Do you require your partners not to work with other remittance businesses (exclusivity agreements)?
21. How does the recipient know that he/she is receiving a remittance and where to pick it up or how to go about receiving it?
22. Does the place where the recipient picks up the remittance cross-sell any other financial products?

Questions about infrastructure:

23. How does the receiving remittance firm/bank that is going to disburse the remittance know that a remittance has been initiated at the sending remittance firm/bank from where the remittance was sent?
24. Please describe how settlement takes place between your company here in the US and the receiving company abroad (or your branch in the receiving country)?
25. How often does settlement take place?
26. When the money is paid to the recipient, how does the agent/bank that pays out the money have the funds (liquidity) to do so? Does the agent/bank that pays out the money wait for settlement, or does it pre-fund the disbursement?
27. Is there any float income in the remittance operation you are a part of, and who benefits from the float?
28. How much do you estimate that the float returned last year given how it is normally invested?
29. How much of the total remittance volume that passes through your remittance operation do you estimate is used for float at any time (%)?
30. How often do you experience that funds are lost (total lost funds as a percentage of transactions)? What part of this is fraud, and what part is due to technical and human error?
31. What are the main reasons funds are lost?
32. When funds are lost, who carries the risk? Please explain the procedure for sharing losses:

Questions about currency conversion:

33. In what currencies are funds made available to the recipient?
34. Within the remittance operation that you are a part of, who performs the currency exchange operation?
35. How do you protect yourself against currency fluctuations?
36. How do you determine the exchange rate to offer for a transaction?

37. What is the exchange rate spread charged to the customer?
38. Does the remitter know the exchange rate before engaging in the transaction?
39. Does the recipient know the exchange rate?

Questions about price and volume:

40. How much does it cost to send remittances through your company, both for the remitter and the recipient? (For this question, a standardized data sheet was filled in by the respondent.)
41. Have the fees to the remitter or to the recipient have over the last three years?
42. What are the remitter and recipient told explicitly about the fees before engaging in the transaction?
43. How much of the total fee and exchange rate spread accrues to you (as opposed to other partners with which you share the revenue)?
44. How many transactions do you process on average per month in numbers, and what is the total volume of remittances you process on average per month in dollars?
45. What is the country with the highest number of transactions, and how many transactions do you send there?
46. How have transaction volumes changed over the last three years?
47. How do you market your services to remittance senders?

Questions about firm structure and competitive environment:

48. Which companies do you consider your competitors?
49. In the U.S., is the market that you address, in other words your customers, dominated by some few remittance firms, or is it a field of many firms with similar services?
50. Has there been any change in the number or types of competitors to your business over the last three years? If so, what have the changes been and how has this changing competitive landscape affected your firm and the market.

51. Have these changes in the competitive environment made you start using any new technologies, or made you plan to start using any new technologies?
52. What are the advantages of your firm over your competitors? In other words, why do your customers come to you for remittance services rather than go to your competitors?
53. What are the disadvantages of your firm compared to your competitors? In other words, why do the customers that use your competitors prefer using your competitors to using your firm?
54. What are the barriers to entry in your segment of the remittance market? In other words, what prevents an entrepreneur from setting up a firm competing with you? Which problems would that person run in to that would make it difficult for him to start a competing business to yours?
55. What is your market share?
56. What are the most important laws and regulations governing your remittance business?
57. Have any legal, regulatory changes over the last five years affected your business?
58. If there is a dispute between the remitter/recipient and your company, how do you resolve such disputes?
59. Do you believe money laundering is a concern for your business? What, if any, mechanisms do you have in place to avoid money laundering through your company?
60. The World Bank often advises governments on improving the environment for doing business. What would you like to see the government, regulators, state authorities – both in the U.S. and in the receiving countries – do for you to be able to provide better and less expensive services to your customers?
61. Lastly, let me see if I have understood where your revenue and your expenses come from.(Interviewers summarizes income statement)
62. What is the most important source of income among these?
63. What are the largest expense items (and what % of the transaction do they account for)?
64. What were your firm's total after tax revenues and operating net income from providing remittance services for your most recent fiscal year? What percentage of total revenues and net income come from providing remittance services?

65. Finally, we would like you to indicate, on this sheet, how the listed obstacles to doing business affect your company. (Interviewer presents a written questionnaire with the obstacles)



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