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Passing the Buck in East Africa
The Money Transfer Practice and Potential for Services in Kenya, Tanzania, and Uganda

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Executive Summary

East African economies are heavily cash-based and have weak financial infrastructures. Given this context, the starting question for a series of ***MicroSave*** market research studies was how low-income individuals and small or microentrepreneurs transfer money and make payments in Kenya, Tanzania, and Uganda, the three countries comprising the East African Community (EAC).

This paper synthesises the studies' findings on the reasons for sending money and the regulated services and other ways available to transfer money. These are the result of interviews with microfinance clients as users and banks and other service providers in all three countries. Combining their perspectives with complementary research, the paper identifies gaps and weaknesses in the existing money transfer services. These offer a market opportunity for new or different services, including the potential for services by microfinance institutions (MFIs).

The findings show that money transfer is a service almost everyone needs – not only government agencies and big business, but also the small trader, who needs to purchase new stock, or the parents or migrants, who need to send home a supporting remittance or pay fees to the school. Typical amounts sent for personal purposes range from $5 to 500 and for small traders up to $-50,000 per transaction.

While commercial and regulated transfer services exist, financial service coverage in the region is low and access barriers, such as high fees or minimum account balances, are common. Fees for the typically small amounts individuals need to send often amount to 20 to 30% of the transfer value (e.g. $10 fee for a transfer of $50). Thus many transfers in East Africa by-pass these and use niche services that fill the gaps. Domestic and intra-regional transfers especially are often transacted by informal means or non-financial services such as busses or couriers – both because they are better known and often also significantly cheaper as well as faster. Even international transfers of migrant remittances are still frequently transacted through informal channels and thus the volumes are underreported in official statistics. Exporters of commodities such as coffee or tea often need to transport cash directly into the buying areas to pay producers at the farm gate or local trading centre.

These are some of the indications the paper analyses which point to an under-serviced market where MFIs might have a comparative advantage. Their typically 'under-banked' clients lack accessible, affordable, and speedy money transfer services and often compensate by using informal means. The opportunity to provide the service and generate fee-based income is there in both international and domestic transfer services. In many cases MFIs will find, however, that regulatory and other aspects suggest that a money transfer product limited to the domestic market is the more feasible option. For international transfer services MFIs are less likely to meet regulatory requirements, which include authorisation to deal in foreign exchange, and capacity implications, such as operational systems, cash volumes, or being part of a large international service network. A domestic product is less onerous. Still, interested MFIs need to carefully assess its feasibility including assessing the market, clearing any regulatory issues, checking their operational capacity (e.g. liquidity management) and service network, and then offer a well designed and tested product to become a competitive and sustainable service.

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Introduction

East African economies are heavily cash-based and characterised by weak financial infrastructures. Given this context, the starting question for *MicroSave* was how low-income individuals and small or microentrepreneurs transfer money and make payments in Kenya, Tanzania, and Uganda, the three countries comprising the East African Community (EAC). To explore the reasons for sending money and the regulated services and other ways available to transfer money, 224 microfinance clients (on the demand side) and 25 service providers such as banks (on the supply side) were interviewed. The aim was to identify gaps or weaknesses in the existing services and so reveal the market potential for new or different services, especially involving microfinance institutions (MFIs).

This paper synthesises the two market research studies, which used *MicroSave*'s tools: the first conducted in Tanzania and Uganda in 2001 (Sander et al., 2001), and a subsequent study in Kenya in 2003 (Kabbucho et al., 2003).[1] It also draws on recent work by the author on migrant worker remittances (especially Sander, 2003, and Sander et al., 2003a and b) and on a limited set of additional studies which are referenced accordingly.

The research indicates that weak financial infrastructures in East Africa have left a gap in the market for money transfer services. Developments in this market since the latter part of the 1990s underscore the existence of an unmet demand: for instance, the rapid expansion of money transfer services such as Western Union across the region, and the emergence of new services by bus companies in Tanzania and courier companies in Uganda. Despite the emergence of these new providers, money transfer services in East Africa are still inefficient, inaccessible, and often costly. This leaves market opportunity for other providers and offers the potential for microfinance institutions (MFIs) to develop services, especially in their respective domestic markets. MFIs tend to reach segments of the population who do not have ready access to other financial services but who typically need to send and receive money.

Serving the domestic rather than the international transfer market is the more realistic option for most MFIs in the region. This is because most MFIs are still unregulated and have so far not been allowed to become part of international transfer service networks (primarily because they cannot be authorised to deal in foreign exchange). In the East African context at least, this is unlikely to change in the near future. Yet, while there are fewer regulatory hurdles in the provision of domestic services, capacity issues as well as regulatory requirements should still be the first consideration for any MFI interested in exploring this new market.

The paper looks briefly at the financial infrastructure followed by an overview of purposes, frequency, and amounts of money sent. Migrant remittances are highlighted specifically as an important and growing flow, which has in part likely fuelled the expansion of money transfer operators (MTOs) in this region, as elsewhere. An analysis of the different services and ways of transferring money, their service fees and respective risks and inconveniences, and a discussion of the bottlenecks in service coverage due to the regulatory environment leads into an assessment of the potential opportunities for MFIs to become a money transfer service provider. The paper thus provides both market information and also a discussion of what MFIs who want to consider entering it might look at as part of a feasibility assessment. While a synthesis of the market research conducted, this is not a summary that replaces or even reiterates in large part the complete studies. The interested reader should consult them directly for a wealth of more detail.

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[1] Unless otherwise indicated, the findings are drawn from these two studies. They provide much more detailed information which should be of interest to people and organisations or institutions engaged in providing or improving money transfer services or in creating an enabling environment for such services as well as to users of these services.

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The Financial Infrastructure

The East African financial infrastructure is weak, especially in the more remote parts of the region and for the low-income and rural populations. The capital cities and regional administrative or trading centres have the highest availability of commercial financial services. Access to commercial banks is, however, limited not only by the physical distance to the nearest branch, but also because of thresholds in account fees or minimum required balances. These reflect bank preferences for serving high-income client segments.[2] For the majority of the population, post banks offer the most accessible services which are delivered through extensive networks of branches, sub-branches and post offices (via agency agreements) While accessible, these services are often highly inefficient: clients report long queues, limited liquidity, and overall a low quality of services.

> **Client Frustration with Post Offices**
>
> *"Some of us have limited time to queue at post offices to be able to send money home. The easiest way is to just use a friend or relative whom you trust"*, said a Housekeeper in Kampala.
>
> *"Today, you send to your child and after three weeks, the child is sent home because the money never arrived. And you will never get it back. It is stolen"*, said a POSTA client in Nairobi.

As a result, low-income and rural individuals and microentrepreneurs are particularly under-serviced by the financial industry. This situation is more pronounced in Tanzania and Uganda: Kenya's regulated financial sector is relatively stronger and has better outreach. Ugandan coverage has, however, been improving rapidly, as a number of banks have introduced ATMs since the beginning of 2003. This includes Stanbic, which now has the largest branch network in the country, and has an interest in mobilising savings by lowering access barriers such as account fees and minimum balances (Wright et al., 2003).[3]

A very rough proxy indicator for financial service coverage is the ratio of bank branches to population (see Table 1). Kenya's relative strength in the region is reflected in the higher number of licensed banks and bank branches relative to its population and land mass in comparison to Tanzania and Uganda. Compared to a better developed financial infrastructure, such as that in the UK or the United States, however, the region is clearly far behind. Given this very limited regulated financial infrastructure in East Africa, the market research aimed to learn about how people and businesses transfer money. The findings show that due to the limitations in the services provided by traditional banks, money transfers by MTOs, corporate arrangements, non-financial firms such as buses, and by informal channels are very popular throughout East Africa.

Table 1: Financial Services Coverage

	number of licensed banks	bank branches	population (million)	population : branch ratio	area size (land only, in square miles)	ratio adjusted for area size
Kenya	45	494	32	64,777	569,250	1,152.33
Tanzania	14	170	36	211,765	886,037	5,211.98
Uganda	17	120	26	216,667	199,710	1,664.25
UK	385	10,877	60	5,516	241,950	22.24
USA	9,209	86,500	290	3,353	9,158,960	105.88

Sources: World Factbook, central bank annual reports, British Bankers Association, U.S. Census Bureau and calculation of ratios

Money Transfers: Purposes, Frequencies and Amounts Sent

Purposes

People, companies, governments, and institutions transfer money to pay salaries or pensions, cover operational expenses, pay school fees or invoices, pay for commodities at the farm gate, and also to support family members. Thus both large and small amounts need to be transferred – some regularly, some intermittently, and some in an emergency, such as illness or death. Most of these are domestic

[2] See also Rutherford, 1999

[3] Stanbic acquired Uganda Commercial Bank (UCB) in 2002 when it was privatised and has since begun to build up the capacity to attract low-income as well as other clients and mobilise deposits, including through the introduction of ATMs. Several of the smaller local banks had started the ATM trend in Uganda introducing proprietary ATM networks by early 2003.

transfers though some are intra-regional or international, since business and family ties – e.g. children at boarding schools or migrant family members – frequently cross borders, and especially within the immediate region. Trade ties, for instance, are most pronounced between the capitals and to the nearest ports such as Mombasa (Kenya) but also Dubai (UAE), South Africa and Europe.

Frequency

The interviews showed that many microfinance clients and individuals as well as many businesses, government, and NGOs transfer funds regularly. Transactions are mostly initiated from urban centres and often have to reach rural destinations. For family and traders, there are seasonal peaks, such as before religious holidays when people spend money on food, new clothing, and other preparations for their celebration. Another very noticeable set of peaks for transfers clusters around the trimestrial payment dates for school fees.

Amounts Sent

Interviewees indicated that transaction values range from as low as $5 to as much as $150 for family support, which some pay monthly. School term fees range between $25 and $500. For business purposes, values per transaction vary and can frequently be as high as $50,000 for the larger traders or small importers.[4] The total value of transfers is impossible to establish from available data and also very difficult to estimate.

Table 2: Transaction Purposes and Values

Sender	Purpose	Value	Frequency & Other Notes
Individual	family support / migrant remittances	$5 to 150	as often as monthly but variable with seasonal peaks (e.g. religious holidays)
Individual	school fees	$25 to 500	term fees due in January/February, May/June, and September for secondary education, private or boarding schools
Small / Microentrepreneurs (traders, importers, etc.)	business transactions / purchases	up to $50,000	frequency depends on business; amounts at the upper range value typical for large traders or small importers; small traders transfer smaller amounts
Export Commodity Traders	purchase of commodities (tea, coffee etc.)	$160,000 (example of monthly value of farmgate purchases of coffee post harvest) $6.5 million (example of monthly payment to tea farmers, each receiving on average $14)	seasonal / post harvest peaks for farmgate transactions; monthly transactions can be the case with government commodity marketing boards
Government / NGOs	salary payments / operational funds	(not available)	regular weekly, bi-weekly or monthly transfers

Migrant Remittances

Many migrants remit money frequently and some very regularly. They tend to send money home primarily to support their families, but also to purchase land or livestock, or to build a homestead in their village of origin.

[4] Translated at typical exchange rates in November 2003 as each of the currencies has devalued since the time the Focus Group Discussions were held. The rates used here are 1 $to Kenya Shilling 77; Uganda Shilling 1,975; Tanzania Shilling 1,025.

These migrant remittances have recently received considerable attention as a key financial flow to developing countries.[5] Globally, migrant remittances to developing countries are estimated at $88 billion (2002), equivalent to almost triple the value of Official Development Assistance (ODA), and have become the second largest flow behind Foreign Direct Investment (Sander, 2003; Ratha, 2003).

They are also one of the key attractions for MTOs. Western Union followed by MoneyGram and others have expanded fairly aggressively into markets such as East Africa and increased their market share servicing especially migrant remittance transfers.

How much is received in migrant remittances in East Africa is not known. Available data and anecdotal evidence indicate, however, that this is an important financial flow for many families in the region (Sander et al., 2003a). In East Africa, internal or domestic migration is very common. Similarly, intra-regional emigration to neighbouring or other countries on the continent is quite common. Overseas emigration, however, is relatively less prevalent compared to other developing regions.

Domestic Remittances

Internal or domestic migrants tend to move from rural areas to either rural or urban centres of employment within their home country. While domestic remittances are estimated to be significantly lower in cumulative value than international remittances, research in some countries suggests that this domestic flow benefits more households and is therefore at least as important, if not more so than international flows.[6]

Data for domestic remittances is not readily available as only occasionally household or other surveys attempt to capture data. A microfinance client survey in Uganda in 1997, for instance, found that respondents had remitted on average some $40 to other family members in the three months preceding the interview (Barnes et al., 1999). Central banks do not track domestic remittances as there is no foreign exchange transaction involved and tracking each domestic transaction is unnecessary.

International Remittances

East Africans tend to emigrate to neighbouring countries and to a lesser extent overseas. Many of the overseas migrants can be found in the United Kingdom, Germany, or the United States. Overseas remittances are typically higher than domestic or intra-regional remittances as income levels of overseas migrants tend to be higher than of those who stayed close by (Sander et al., 2003a).

Overseas remittance flows are tracked and reported to the International Monetary Fund as part of the balance of payment statistics. Only one third of Sub-Saharan African countries, however, have reported data. Kenya has not reported[7] and Tanzania reports low levels of receipts since the mid-1990s. Uganda has been reporting all residual forex receipts in recent years and is in the process of improving its data collection. Once these data are refined, the Bank of Uganda will capture the migrant remittances through regulated services, primarily banks.[8] Figure 1 shows the available data on international remittance flows to the region.

Remittance flows through regulated services are thus largely underreported and unrecorded. In addition, remittance flows via informal channels or non-financial services, such as overland busses, are still very common. The extent of this has not been estimated. For overseas remittance flows, estimates of total flows to developing countries suggest that these may exceed the officially reported data by a factor as high as 2.5. Given the lack of data for two thirds of the Sub-Saharan countries, the factor applicable to the region would likely be even higher.[9] The high levels of unrecorded remittance flows in the region are in

[5] The current growing interest in this flow is reflected in, for instance, the World Bank Global Development Finance Report (World Bank, 2003) and the International Conference on Migrant Remittances, London, October 2003 www.livelihoods.org/hot_topics/migration/remittances.html).
[6] See Sander, 2003
[7] Occasionally newspaper articles report figures, such as the Daily Nation of 4th April 2003 quoting Prof. Peter Anyang Nyongo, Minister for Finance and Planning, stating apparently based on statistics of transfers through Western Union that Kenyans in the United Kingdom send more than Ksh.50 billion (ca. $650 million) to Kenya every year, while those in Germany remit up to Ksh.30 million (ca. $390,000) a month.
[8] See Sander et al., 2003a
[9] See Sander, 2003, and Sander et al., 2003a

part due to the frequent use of informal or non-financial service channels that fill the gaps of a weak financial infrastructure.

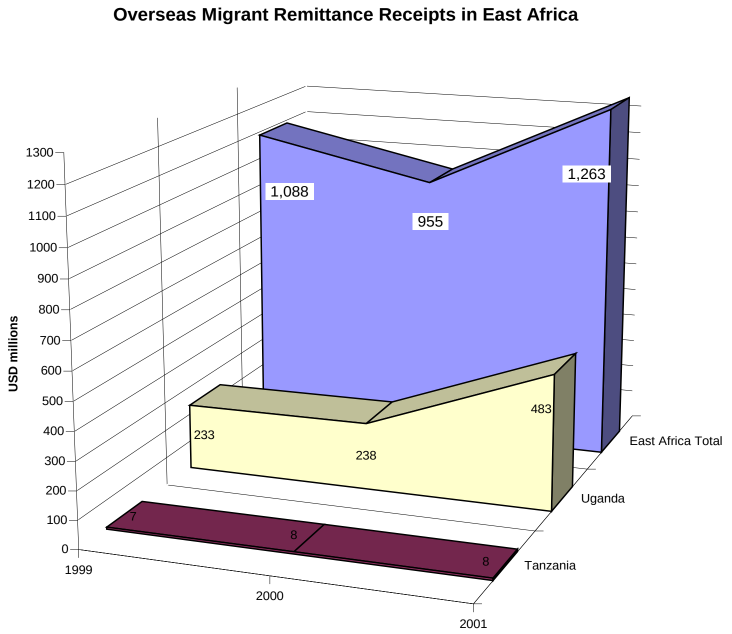

Figure 1
Source: data set used by Ratha (2003)

Ways of Transferring Money

Formal and Informal Means

Bank transfers, cheques, or credit card payments are common means to transfer money in countries where the financial service infrastructure is well developed. Informal means are typically used where financial services are weak or lacking; where financial service regulations limit the range of service providers, and their products and outreach; or where monetary policies, such as overvalued currencies or foreign exchange controls, make it unattractive to use regulated channels. They are also more common where physical proximity allows for regular travel and transport of funds or where cultural groups have strong bonds of trust and have developed their own transfer systems.[10] Lack of awareness or of familiarity with the regulated services is another common reason why many use informal systems to which they are accustomed or which come recommended by trusted relatives or friends.

Domestic

MicroSave's market research in East Africa also reflects these aggregate and more universal findings. In Kenya, with a relatively stronger financial infrastructure, bank instruments such as account transfers and cheques, are more commonly used for money transfers than in Tanzania and Uganda. Postal money orders are quite commonly used in all three countries, especially for paying school fees, for instance. Another postal service, mailing funds by registered or expedited mail, is also a popular way to send especially smaller amounts.

Yet, in all three countries informal means are still very common. Whether for personal or business purposes such as trading, people often still carry money with them physically, despite a growing fear of theft and

Cash On Delivery

Mwajuma frequently buys maize from Dodoma and Handeni for resale in Kibaha. Traders in similar circumstances, which require travelling long distances to farm gates or markets to purchase stocks, find it difficult to carry cash. *"The biggest challenge for our business is walking around with big amounts of cash for buying our stocks"*, said Mwajuma, a maize trader at Kibaha, Tanzania (trader's name changed by authors).

[10] See Sander et al., 2003a

robberies. Alternatively, they send the funds with a friend, a relative, or a taxi or bus driver who is willing 'to do them a favour'.

The range of services and informal means is indicative of the limited availability of licensed money transfer services at both the sending and the receiving points. Access to services for the sender or the receiver of funds, and sometimes for both, is a major obstacle. Only a minority of low-income individuals and microentrepreneurs, have a bank account, and cheques or bank transfers are thus often impossible.

Not only individuals or small traders revert to informal means, however. Companies, governments, and organisations such as NGOs still need to have their own arrangements to bridge frequent gaps: where the financial infrastructure does not service the destination of the funds; or where the recipient does not have ready access to financial services, either because the next bank branch is too far away or because they do not meet the requirements for opening a bank account. As the case of a coffee exporter in Uganda illustrates, they sometimes send staff to travel with money, or they hire a security service to transport the funds. Especially for operations away from the main centres, such as purchasing coffee or tea harvests from smallholders, such arrangements are currently the only option, and they are relatively risky and also expensive. As the Ugandan scenarios in Figure 2 illustrate, a direct bank or similar transfer would be much preferable if the necessary infrastructure were available.

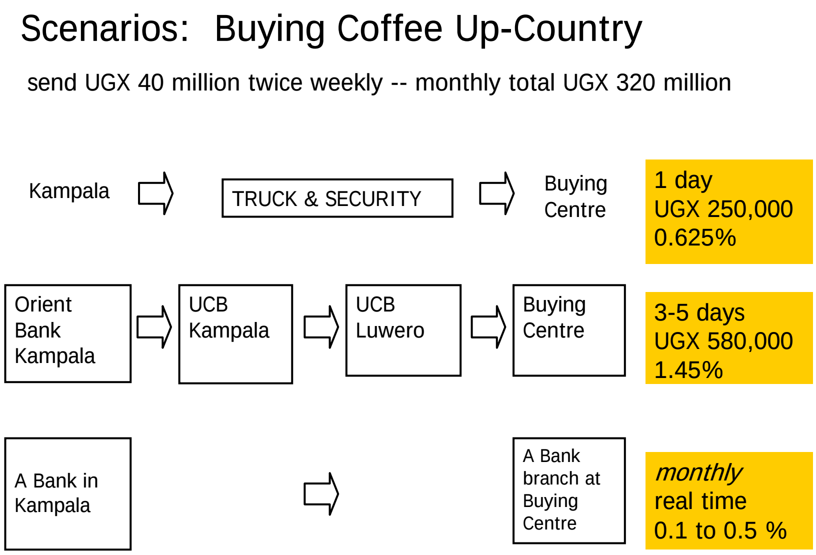

Figure 2
Source: Sander et al., 2001; (Uganda Shilling (UGX) 1,975 : 1 $)

International
For business purchases across borders, such as cars or automotive parts in Dubai, informal arrangements through business people at both ends are still common. Thus, for instance, a buyer will deposit funds with the owner of a shop in Kampala prior to travelling to Dubai. Upon arrival, the buyer will visit the designated shop owner in Dubai and either use the 'credit' to purchase directly from the shop or draw cash as needed from what is their temporary 'prepaid credit line' to make purchases elsewhere in the city. This is one variation of what is commonly also referred to as Hawala, from the Arabic word meaning 'transfer'.[11]

For migrant remittances from overseas, similar informal and quite established systems are available. In the case of Kenyans and Ugandans overseas, for instance, and based on anecdotal evidence, remittance transfer services are offered by word of mouth and operate through a back office of a regular business or through a living room of a residence with email or fax. The sender deposits the funds and calls the recipient with the contact details of where to pick up the money and how much they should receive.

Concurrently, however, many overseas migrants send remittances via money transfer operators (MTOs). Best known among these are Western Union and MoneyGram. Western Union has spearheaded an aggressive expansion of service outreach by MTOs into East Africa since the mid-1990s. Since then, MoneyGram and several smaller operators have also entered the market. Most of them record close to one

[11] See also El-Qorchi et al., 2002; Omer, 2002; and Buencamino et al., 2002

hundred percent in receiving transactions in the three countries, with only a negligible amount being sent, such as for tuition fees to overseas universities.

MTOs are not frequently used for either domestic or intraregional transfers. This is partly due to the relatively high service fees which make it too costly to send small amounts that are common for domestic transfers.

Intra-regional

Recognising a service gap in the domestic and intra-regional transfer services, new and non-financial service providers have entered the market in recent years. Share taxis and bus or courier companies, for instance, offer services. Courier companies in both Kenya and Uganda have identified a niche in providing money transport services. In Kenya, however, the courier company Securicor no longer offers the service as it was not profitable enough in their operational context. In Uganda, Elma Express and Yellow Pages transport small amounts. Yellow Pages also transports pay cheques for army officers stationed in Northern Uganda.

In Tanzania and Kenya, overland coaches both transport and also transfer funds, a service not offered in Uganda. The transfer involves receiving and recording the funds in one booking office; the staff then informs the receiving booking office with the name of the recipient, the amount to be paid out, and how they will identify themselves.

In Kenya, the minibuses operating as share taxis are called matatus. Some of the matatu savings and credit cooperatives (SACCOs) offer a service through the SACCO office and by transporting funds between offices and destinations on their share taxi routes.

Money in the Bus Mail

"*We one time received a parcel from Kisumu which had been declared as spare parts. The recipient on receiving it at our counter tore it open in our presence and in there was a small box filled with sand and in the middle of the sand was an envelop with a bundle of US Dollars – probably not less than $20,000*", a staff member of one of the Kenyan bus companies offering parcel services told us.

Money Transfer Service Fees

While respondents indicated that the costs were acceptable and actually of secondary importance to them compared to efficiency and security of the services, people do refrain from using available services due to the costs. To the extent that licensed commercial services are available and accessible to the sender and receiver, the lower risk is appreciated but service fees can be a deterrent in using them, especially for transferring small amounts.

Service options and fees vary somewhat in each of the three countries. Overall, transferring small amounts, as is typical for personal purposes or petty trade, carries the highest service fee relative to the amount sent. Most services, and especially bank transfer services, charge either bracketed or percentage fees depending on the transfer value but also carry a minimum fee (e.g. $10 to 15).

Service fees reach up to 35% of the transfer value in Tanzania and Uganda. In Kenya the maximum is around 30%. For very small transactions the minimum fees can exceed the value of the amount to be sent.

Many of the informal service providers also apply a fee, though it is typically between 3 and 10% and often lower than that of comparable licensed services. They also tend to offer a better foreign exchange rate than banks or MTOs. Some MTOs in fact create a double foreign exchange loss to their clients and cause a foreign exchange loss also when the transaction is domestic as some immediately translate all transactions into US Dollars independent of the pay-in and pay-out point.

Fee Comparisons

Comparing services across the region and using $50 and 200 as two average transfer values, Figure 3 illustrates the variations in fee cost by service. It shows that transfers by money orders and bus companies are most competitive for small amounts though limited in that their services do not reach beyond the national or regional boundaries. MTO charges are the highest and commercial bank fees become competitive when transferring larger amounts.

Using the example of Tanzania, Figure 4 illustrates in more detail the comparative fee price advantages of the different services subject to the transfer value and highlights the domestic and regional services as the cheapest for small transfer amounts. This is very similar for Ugandan and Kenyan services.

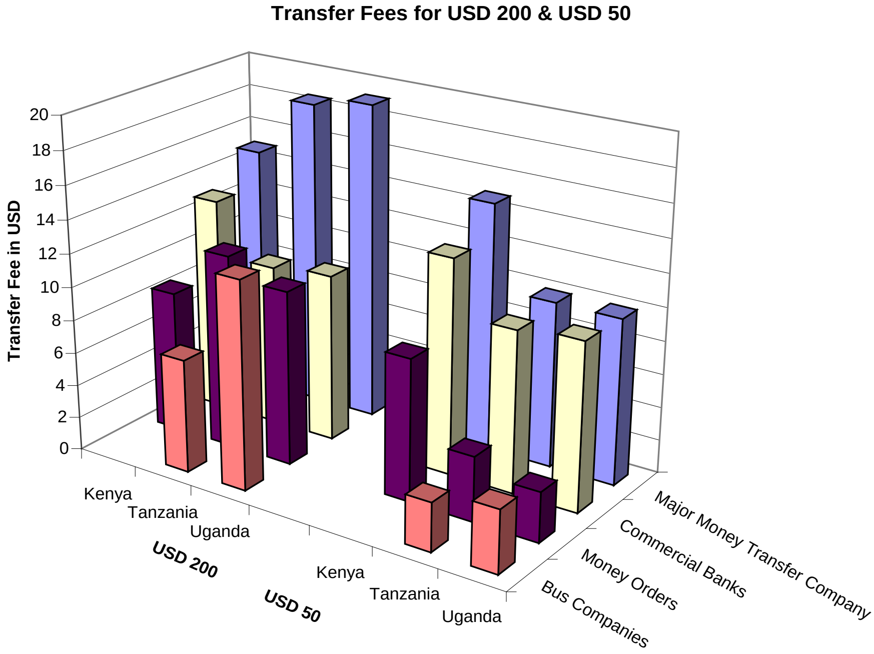

Figure 3; Source: data from Kabbucho et al., 2003, and Sander et al., 2001

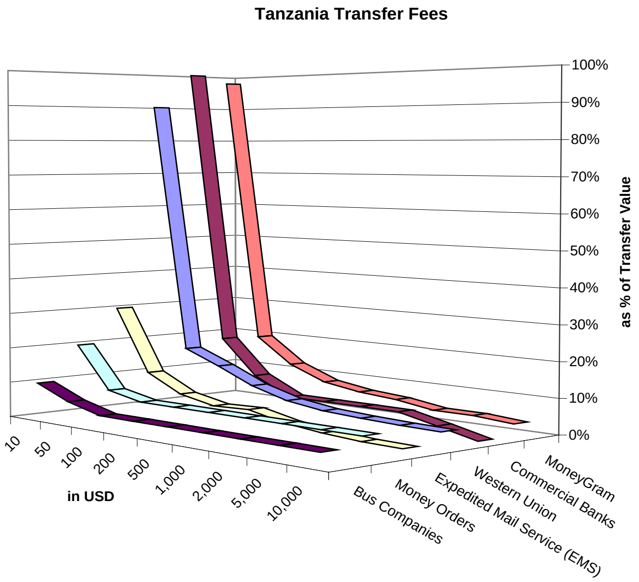

Figure 4; Source: data from Sander et al., 2001

Domestic and Intraregional

For transferring small amounts, services such as postal money orders and transfers offered by bus companies in Tanzania, are the most competitively priced. Often, however, their services are limited to domestic or regional markets. In the case of money orders there is also a cap on the amount that can be sent with each order, though multiple orders can be sent.

Service fees for domestic or regional services by postal and non-financial providers tend to start around $1. For large amounts, bank transfers offer the best service fees, which can be below 1%.

International

For large amounts, again bank transfers offer the best service fees. Some entrepreneurs, however, still prefer informal arrangements as their way of doing business or to cut costs in transfer fees and foreign exchange. For smaller and especially time sensitive international transactions, MTOs offer the most competitive of the commercial services.

Typical minimum fees for MTO or bank services start from around $10 to 15 for international transfers and pay-out can be effected within 30 minutes or less in most cases. Once the transfer value is beyond the minimum fee bracket, however, bank transfers are significantly cheaper though not as fast, with transaction times of 3 to 5 work days at a minimum.

Risks and Inconvenience

The risks and inconveniences in transferring money through any of the service channels was a predominant topic respondents raised in focus group discussions and interviews. A deterrent for using many of the formal services is the need for some form of identification (ID), both as sender and as recipient. In Uganda and Tanzania, where there are no national ID cards, a reference from the local council office or a similar recognised authority serves as identification. Word can then spread that money is arriving and demands might be made on it for council tax payments or for supporting family or friends. This risk is higher for women than for men as women tend to have fewer alternatives in obtaining identification documents, such as company employee passes or tax invoices.

Postal services are often seen as slow, inefficient, and not service oriented. Customers have to queue and sometimes do not receive the full payment on their first visit due to bottlenecks in liquidity at the outlet.

On average, informal transfer methods work well but the loss of funds and also delays are common risks. Carrying the money is seen as highly risky but often the only way to quickly have access to the money where it is needed without spending much of it on fees.

To mitigate the risk of loss, people carry money belts or have hidden pockets sewn into their clothes. Especially women petty traders will also travel in groups for protection, while others break the transfer into several trips so as to reduce the amount at risk on each single trip.

Many interviewees mentioned that they had at some point experienced either loss due to theft or delays in remitting the full amount when the 'friendly carrier' used a part of the funds en route for car repairs or other incidentals. In addition, people refer to a loss of trust in informal arrangements in recent years.[12]

Losing Trust in Informal Arrangements

"*I sent my cousin to deliver Ksh.4,000 ($51) to my daughter in a Polytechnic in Nairobi. On the way this guy used the money and my daughter almost failed to register for her examinations had I not called somebody I knew in Nairobi who bailed her out. In all these I suffered three things: Lost Ksh.4,000, broken relations and stress*", reported one respondent in Gikomba Market in Nairobi.

Regulatory Environment for Money Transfers

The conservative approach by the East African regulators limits the services available and especially their outreach. The regulatory environment in all three East African countries restricts money transfers services in large part to regulated banks. In Kenya, and to a lesser extent in Uganda, some foreign exchange bureaus have been authorised to transfer funds, though typically as sub-agents to banks that have agency agreements with MTOs such as Western Union.

Though the service is provided through a bank, it does not typically have the effect of integrating this client segment to make them 'banked' as it is not integrated with other banking services, such as savings. On the contrary, it is typically offered at a separate teller window for reasons of product branding and speed. To the bank it is a service they offer as a 'commissioned product' where characteristics of the

[12] A finding reflected also in other *MicroSave* market research in the region; see, for instance, Wright et al., 2001, on trust issues in ROSCAs (savings groups).

product, such as the foreign exchange rates applied to the transactions, are set centrally by the MTO, rather than by the individual bank.

Domestic

Due to foreign exchange exposure and international settlement, for instance, international transfers have different implications than domestic transfers and thus need to be treated differently. Interviews with central bank staff in East Africa show that there is no explicit distinction yet in the thinking about regulation between domestic transfer services and international transactions, though this might open up market-specific opportunities to local providers.

The focus of central banks and the regulators for all money transfer services, however, has been undifferentiated and therefore remained on service provision almost exclusively through banks. For domestic transfers, their focus is similarly the infrastructure related to bank services, such as cheque clearing houses and national payment systems more generally.

International

Banks and MTOs are the main regulated international money transfer service providers. Due to in-country regulations in the region, MTOs have to operate through agreements with fully licensed commercial banks and a limited range of sub-agents. This severely restricts their service outreach. In countries with more progressive regulation they can acquire specific operating licenses and set up their own network of agents. An even more user-oriented approach to regulation can be found in parts of Latin America, North America or also Europe, for instance, where pharmacies, groceries and other retail establishments can be used as points of sale for money transfer services.[13]

East African microfinance providers have become sub-agents to banks for international transfer services. This applies mostly to cases where they are fully licensed banks or alternatively either have or are very close to receiving another regulated status.

As MFIs are beginning to be regulated, the concern should not only be to protect deposits but also how to facilitate a broader range of services and operational models. With microfinance regulations in the region quickly taking shape, the range of products or services that a small number of well-performing and eligible MFIs can offer will expand. International transfers are unlikely to be part of this, however, unless the foreign exchange aspect can be handled through a bank. Thus in Uganda, for instance, an MFI has received agreement in principle from the central bank to become a sub-agent to an MTO subject to the MFI gaining their licence of a Micro-Deposit-taking Institution (MDI) – a new level of regulated institution introduced specifically for the purpose of graduating MFIs to financial institutions.

Opportunities & Challenges for Money Transfer Services Through MFIs

The market gap for money transfer services exists and demand for such services is bound to increase. This applies to both domestic and international transfers as governments decentralise, migration continues to increase, and the middle classes and salary earners grow in number, and along with them their support to family members and investments in assets (e.g. land, housing, livestock).

The examples of National Microfinance Bank of Tanzania, Uganda Microfinance Union of Uganda (UMU) and Centenary Rural Development Bank in Uganda (CERUDEB), for instance, illustrate that money transfer services can be a profitable product, even if primarily provided for the domestic or a very small niche market, as is the case for NMB and UMU, respectively. The research indicates, however, that few MFIs have been involved in this market, partly due to regulatory limitations but also due to capacity issues. Those who have been involved, tend to be mostly regulated institutions.[14]

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[13] See Sander, 2003

[14] In Sub-Saharan Africa, relatively few MFIs offer money transfer services. Typically they are credit unions, primarily in Western Africa, or either licensed as banks or, if not regulated, at least very strong and commercially run MFIs. For more details, including case descriptions, see Sander et al., 2001, and Sander, 2003a.

International

For international transfers, MFIs have to overcome regulatory and operational hurdles related to foreign exchange trading. They would also need to find correspondent banks and become part of a network with 'hubs and spokes' in key transfer markets. Alternatively, they can identify a sub-agency opportunity for one of the MTO services.

Domestic

Domestic transfers would seem much simpler and address a broader client segment. The demand within the operating area of an MFI is therefore also much more likely to be sufficient without necessarily needing access to a broader, and especially an international network.

Yet, even for domestic transfer services, MFIs in East Africa are very limited by the regulatory framework. For member-based organisations and regulated institutions, however, opportunities can be explored. This should include looking at different options, such as:

- agency agreements for proprietary products which tend to come as a package, with software and sometimes also hardware and training;
- the development of a proprietary product, probably either very specific to the market or a client segment, and adapting available systems and processes rather than setting up new ones – such as using a commercial bank account and cheques as transfer instruments; or by
- exploring the potential for a collaboration with other services who can help to expand the outreach, such as bus operators.

Key Questions and Issues for MFIs in Considering Money Transfer as a Potential Product

- *Regulations*

Do regulatory requirements allow us to engage in international and/or domestic money transfer services?

- *Capacity*

Do we have the capacity to handle such a product?

- *Network*

Are we or can we become part of a transfer network?

- *Market*

Do we have a market and demand for the service and clients trust us

Risks & Challenges

- Sufficiently strong MIS and back-office systems
- Strong monitoring and control systems
- Staff capacity (different from lending or savings)
- Pricing at a sustainable cost level yet attractive to client
- Sufficient liquidity and handling cash floats between high volume pay-in and pay-out service locations
- Moving cash between high volume locations, especially if no access to central bank cash centres
- Cost of insurance
- Sufficient and consistent market
- Forex issues (for international transfers)

MFIs should also make sure that they can provide transfer services which satisfy clients' minimum requirements. The market research identified the following aspects which should be carefully integrated into product design and testing:

- accessibility
- efficiency and timeliness
- reliability
- sufficient service network
- affordability

To offer a product with these attributes, the MFI must have adequate staff capacity, liquidity management and reserves, and preferably a highly efficient MIS (see also text box in this section).

The market opportunities exist. For MFIs with sound systems and the capacity to move into a completely new product, money transfer can be an attractive business as well as a valuable additional financial service for their clients. Finding their market niche and competing as a highly accessible, reliable and well priced service will, however, become increasingly important as ATM networks expand and other technological advances will bring stronger competition and better market coverage into this market.

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