Remittance Market: Ready and Waiting for its ‘Skype’ Moment

The high cost of global remittance is in the spotlight, with the advent of new online models that may end the domination of the current leaders.

Executive Summary
The growth of the high-margin global remittance business is outstripping that of even international migration. The business mainly consists of cash-to-cash transactions, largely by under-banked and unbanked population segments. This partially explains the success of money transfer operators (MTO) Western Union and MoneyGram, both of which leverage their large networks to offer convenience to this demographic, as well as inspire trust.

While MTOs offer their customers easy access and the convenience of cash transfers, the agent-led intermediation at both ends of each transaction bloats the cost of the transaction. The World Bank pegs the average cost of remittance for retail customers at 9.3%; meanwhile, Western Union and MoneyGram boast profit margins in the range of 25% or higher.

At a time when the cost of a long-distance call is zero, thanks to players such as Skype, and the costs of transferring data are marginal, courtesy of the Internet, why should retail customers pay 9.3% to move money? The governments of the G8 nations have resolved to reduce the average cost of remittance by five percentage points by 2014.1 But while government action can provide an incentive, the real drivers for reshaping the remittance business and reducing costs are competition and emerging innovative models – such as TransferWise – which will challenge the conventional agent-led, brick-and-mortar remittance intermediaries. Players aiming to succeed over the long term in this business will, therefore, need to respond by reducing their operational costs.

Fast-Growing Market
While the international migrant population increased 1.4 times between 1990 and 2010, from 156 million to 210 million, the flow of remittances in the corresponding period increased 6.4 times from $68 billion to $440 billion2 (see Figure 1, next page). This growth is due, in part, to the advent of MTOs and their ubiquitous presence, which led to a reduction in remittances through informal channels. The World Bank estimates the global remittance flow to reach $500 billion by the end of 2012, primarily through MTOs at the originating end of the transaction and through banks at the receiving end.3
With their global network of third-party agents, MTOs are able to provide convenience, payment assurance and multi-language capabilities and thus gain customer trust. Today, one in five dollars remitted globally passes through Western Union (which owns 16% of the market) or MoneyGram (with 4% market share).

The Price of Trust
The World Bank’s remittance price data highlights the pricing inefficiency in the market. Because the market is highly fragmented, with multiple players and channels of remittance, a wide range of price points is available across routes or corridors to remit a fixed sum of money. While the global average cost of sending $200 is 9.3%, the average cost for wiring the same amount through MTOs is 10.16% (see Figure 2).

There is wide variation in the average cost of sending $200 even within the G8 countries. Two countries, in particular, stand out: Russia and Japan. The lowest costs are in Russia, which does not allow commercial banks to offer remittance services. The highest are in Japan, where commercial banks dominate the market. Only in 2009 was the Japanese remittance market opened for nonbank remittance service providers (RSPs), following the Payment Services Act of 2009 (see Figure 3, next page).
Within G20 countries, commercial banks turn out to be the most expensive of all remittance service providers, with an average cost of 13.58% to wire $200. Post offices are the cheapest, at 7.16%, while MTOs come in a shade higher, at 7.37%.

The World Bank’s analysis also indicates that commercial banks are the least transparent when it comes to disclosing exchange rates applied to transactions, while MTOs are the most transparent in disclosing information to their customers (see Figure 4).

According to MasterCard, banks in the United Arab Emirates to India corridor exhibit a positive bias toward high-value remittances. This is manifested in the pricing spread among commercial banks, MTOs and exchange houses (see Figure 5, next page).

Of all the global remittance vehicles, cash-to-cash services are the dominant product and are priced competitively (with an average price of 7.6%) when compared with other products. Account-to-account services are the most expensive, with an average cost of 14.10%. Though not widely available, prepaid cards and account-to-cash services were the cheapest products, at 4.2% and 4.91%, respectively (see Figure 6, next page).
Economics of Moving Money

With an operating margin of over 25%, MTOs command hefty pricing power, to the envy of many service utilities. Cash-to-cash products account for 80% of global remittances, mostly due to the under-banked and unbanked segments of the global immigrant population. MTOs, with their ubiquitous presence through exclusive relationships with third-party agents, have built a brick-and-mortar business model that has earned the trust of their franchisees. However, the agent-led intermediation at each end of the transaction results in higher costs for the retail customer (see Figure 7, next page).

MTOs derive their revenues primarily through fees (70% to 75%), exchange rate arbitrage (20% to 25%) and other value-added services (0% to 5%). They have a high fixed cost (35% to 45%), which largely comprises expenses to cover

Low-Value Remittances Have Wider Pricing Disparities

![Graph showing fees and foreign exchange percentages for different money remittance services.](image)

*Source: MasterCard*

*Figure 5*

Average Cost by Product Type

![Bar chart showing average cost by product type.](image)

*Source: Remittance Prices Worldwide, The World Bank, November 2011*

*Figure 6*
salaries, rent, compliance, IT and marketing. The variable cost (55% to 65%) is mostly attributable to agent commissions.\(^5\)

MTOs spend approximately 3% of their revenue on regulatory compliance. Market leader Western Union reportedly employs 600 full-time compliance staff and spends $60 million annually to monitor its money transfer operations.\(^6\)

**Low-Cost Remittance: Triumph of Hope Over Experience**

The current remittance business model looks dated, particularly when compared with the cost of wiring money using ever-lower voice and data communications costs, courtesy of Skype and the Internet. Why should retail customers have to pay transaction fees that are 9.3% of the amount they are wiring? The business model is clearly ripe for change.

We see the green shoots of change in various payment corridors. For example, 80% of remittances to the Philippines today are sent electronically compared with just 20% 10 years ago. Segments of the African market have created a 100% mobile payment infrastructure in a short span of time.\(^7\) Another growing trend is that of disruptive and cheaper online models of money transfer, such as the approach pioneered by TransferWise.

Change, however, will not be dramatic. Online channels of remittance are currently more a supplement than a substitute for agent-led intermediation. Customers need to be nudged toward cheaper online channels. The newer entrants will need to shape consumer behavior over time and proactively rewire their remittance operating models.

**Forces Supporting Low-Cost Remittance**

Banks, public sector initiatives, mobility and new emerging online channels look set to dilute MTOs’ pricing power, rewire the business of moving money and lower the cost of intermediation.

- **Banks:** Commercial banks, which have a 5% share of the remittance market, have traditionally not considered remittance to be a core banking business. However, in today’s “AA” world, where conventional revenue streams are drying up and their revenues and profitability are under pressure, banks must and will take a fresh look at the remittance business.

Banks are not the preferred choice for retail customers to remit money, due to hefty transaction costs resulting from steep fixed costs and compliance needs (know your customer, or KYC, anti-money laundering and fraud detection). Also, MasterCard’s research shows that banks tend to lag MTOs on a host of other parameters, such as speed, customer service and ease of sending and receiving money, which clients value highly. However, banks are in the business of intermediating payments globally, even if they cater to a different franchise and operate on a different scale. There are three

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*Source: “Supply Side Constraints for Remittance Service Providers,” Developing Markets Associates, March 2010 Figure 7*
distinct advantages on which banks can capitalize to become a preferred choice for both banked and unbanked customers:

1. **Reduce remittance time and cost** by leveraging their superior payment capabilities, such as direct access to payment systems, forex rates and access to multi-currency reserves.
2. **Become more accessible to customers** by using online and mobile capabilities.
3. **Extend the bank’s reach** through prepaid cards.

- **Public sector initiatives:** The Federal Reserve banks of the U.S., in partnership with Banco de México, Banco Rendimiento and Microfinance International Corp. (MFIC), began offering an “account to receiver” service in 2010. This service helps customers in the U.S. send money to their unbanked relatives in Mexico and 10 other Latin American countries.

Initiatives such as these, while improving the efficiency and effectiveness of payments systems, also reduce the cost of global remittance and help attract new customers to the mainstream.

- **Mobile money:** The mobile phone as a payment device is a game changer, especially in the emerging economies, where banking inclusivity is still evolving. Case in point is the fabled M-PESA, a mobile phone-based money transfer service for Safaricom, Kenya’s largest mobile network operator. With this facility, unbanked, low-income Kenyans can use their mobile phones for person-to-person money transfers. For remittances from outside the country, Safaricom partners with an MTO, adding a layer to the remittance intermediation process and, therefore, increasing the cost.

MTOs have partnered with mobile wallet providers and GSM, a mobile networks trade association that represents 750 mobile phone operators, and have thus bolstered their competitive advantage. However, if regulators allow mobile phone operators to handle foreign exchange in order to drive down remittance cost, MTOs’ current partners will very likely turn into serious competitors.

- **Online channels:** TransferWise, founded by an ex-Skype employee, uses a crowdsourced model to remit money from customers in the UK and any EU country, at a fraction of the cost charged by the high-street banks. TransferWise uses the daily interbank rate to fix exchange rates and keeps the service charge low — five euros for a GBP 1,000 transfer, in contrast with the roughly 40 to 50 euros charged by banks for a similar transfer.

**The Road Ahead**
Remittance business players are today at the cusp of change that can potentially redraw the business landscape. They must, therefore,
proactively rewire their business model to meet evolving consumer needs and aspirations.

We expect MTOs, the current market leaders, to do the following:

- **Embrace emerging technology platforms**, such as mobile devices and online platforms, to reach customers directly and reduce the cost of remittance intermediation.
- **Move to a variable cost structure** to bring down the cost of remittance. For example, compliance costs can be reduced by partnering with players that can offer compliance as a service at a reduced cost.

Meanwhile, banks — looking to leverage their core proven strengths in financial transactions — will likely take the following actions:

- **Take a long-term view of the remittance business** given its secular growth rate and potential for steady revenue generation.
- **Reduce the cost of remittance intermediation and compliance** through automation of payments, foreign exchange and centralized payment and compliance management.
- **Market themselves as the preferred choice for customers** by offering lower remittance time and costs by leveraging their superior payment capabilities, as well as becoming more accessible to customers through online and mobile capabilities.

Mobile and online operators, hoping to radically change the marketplace, will likely seek to do the following:

- **Disrupt remittance supply chains with innovative models** aimed at convenience, ubiquity and simplicity.
- **Gain market share** through aggressive pricing.
- **Keep the cost of operations and compliance low** in order to stay profitable.

**Footnotes**

1 The 2009 G8 meeting in Aquila, Italy, agreed to reduce the global average remittance cost from 10% to 5% within five years through enhanced information, transparency, competition and cooperation.

2 BBVA Research, with United Nations and World Bank figures.

3 MasterCard Global Insights.


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