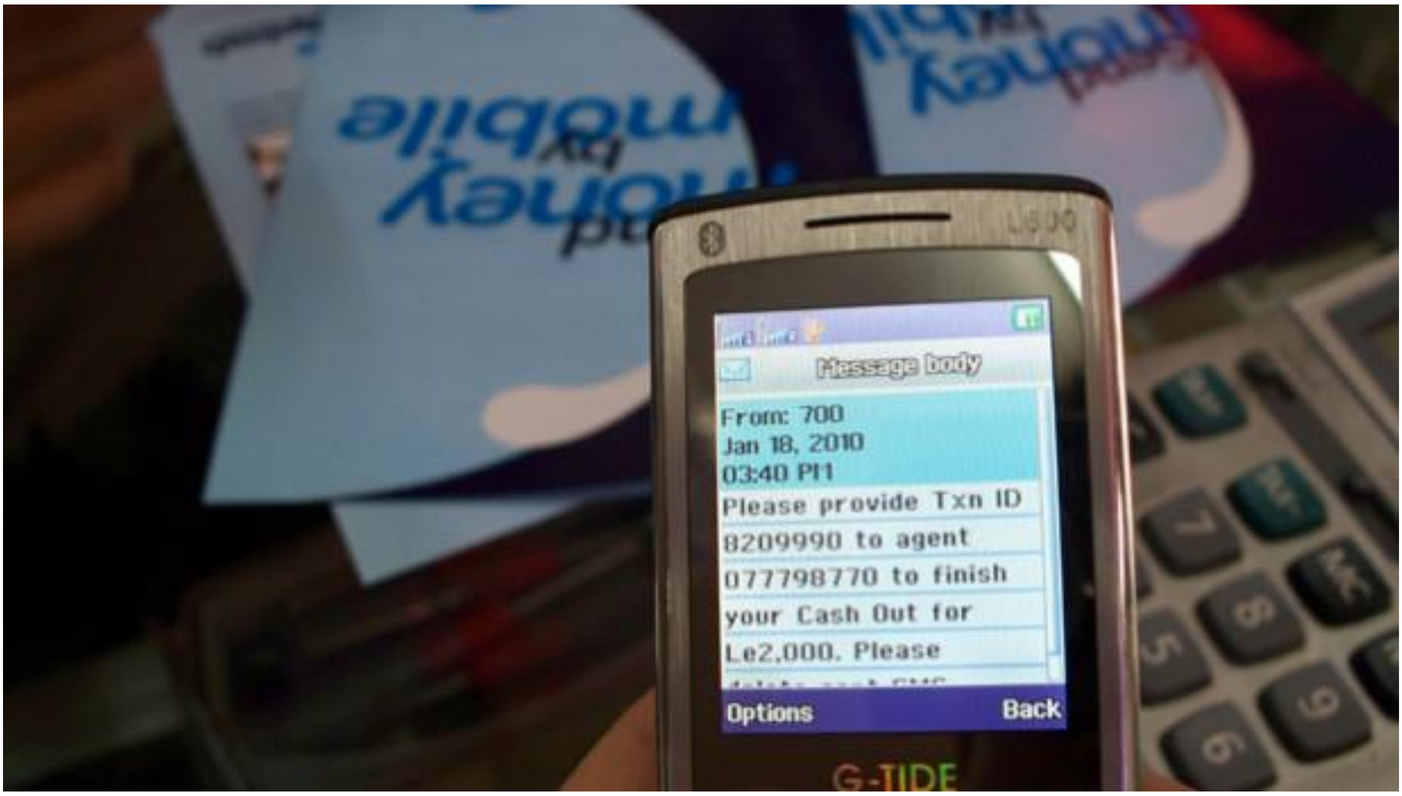
FUNDING TRENDS | REMITTANCES

Diaspora financing: What role for development organizations?

By Flavie Halais | 22 September 2014



Mobile technology has enabled money transfer companies to reduce transaction fees. Photo by: Ben Lyon / Institute for Money, Technology and Financial Inclusion / CC BY-SA

Each year, migrants around the world send money back to their home countries to help relatives cover basic expenses like food or clothing, or launch small businesses to secure stable incomes. Their total remittances are expected to reach $436 billion this year — thrice as much as the $134.8 billion total development aid in 2013.

Remittances certainly play a substantial role in ensuring sustainable livelihoods in recipient countries, but their potential is still largely untapped. Poor financial literacy among senders and recipients, high transfer fees and tightening regulations around money service providers are just some of the factors that render remittances underutilized.

What's more, the World Bank estimates that an additional $500 billion may be lying dormant in savings accounts held by migrants in high-income countries. Surveys also indicate that diaspora communities are hungry for other ways to contribute financially to the development of their home or heritage countries, through targeted investments and other business opportunities.

A wide variety of actors, however, are beginning to find ways to better channel migrant money. Governments are targeting diaspora as a source of foreign direct investments, and new money transfer companies are using mobile technology to lower fees.

Diaspora financing is poised to play an increased role for development organizations as well, whether they be development finance institutions, impact investors, aid agencies looking for co-financing opportunities or nongovernmental organizations involved with financial literacy programming.

"There is a huge potential for using these funds for specific development projects, especially for economic development projects," said Daniel Naujoks, author of "Migration, Citizenship and Development" and a consultant on diaspora investment for the U.N. Development Program and the International Organization for Migration.

Leveraging the potential of money transfers

Scientific evidence has long pointed to the positive impact of remittances on poverty alleviation and economic development in recipient countries. About 8 percent of money transfers, however, are currently lost to transaction fees, thereby reducing this impact.

Efforts by G-20 countries to lower these fees have been met with varying results, with costs dropping significantly in certain parts of the world — such as in India, Philippines, Mexico — and rising in others, notably between African countries. Tightening regulations meant to prevent money laundering and terrorism financing have increased compliance costs for banks dealing with money transfer operators, somewhat limiting efforts to lower fees.

"There is too much of check and balances, and that is causing general problems of inefficiency in the system [and] costs going up, and people are getting harassed by this process," said Dilip Ratha, manager of the Migration and Remittances Unit and CEO of the Global Knowledge Partnership on Migration and Development at the World Bank.

While Ratha has suggested several novel ways in which transfer fees might be lowered, including getting large retail networks such as Facebook or Amazon into the remittance business or private charities like the Gates Foundation to launch nonprofit remittance centers, innovation has come from mobile technology. Certain online services like World Remit and Skrill already enable transfers to local mobile money wallets like M-Pesa at a much lower cost than traditional money transfer operators. BitPesa, a new startup, allows users to remit money to Kenya with bitcoins. And Boom Financial, an online financial services company, enables transfers to Haiti via its Android app.

Lowering transfer costs, however, is only part of the solution to get more money flowing to recipient countries.

"This is the low-hanging fruit," Naujoks said, adding that the next step in maximizing the use of remittances and increasing money flows is to improve financial inclusion and financial literacy among senders and recipients. For instance, the Philippines' Worldwide Initiative for Savings Investment and Entrepreneurship project, or PINOY WISE, runs financial education programs for both Filipino migrants and their families back home to improve budgeting skills and increase savings. It also provides access to savings and investments schemes through partner financial services and banking institutions.

Dormant funds

Certain governments have already understood that direct money transfers are just some of the ways in which their diaspora can contribute to economic development. India, Ethiopia and Zimbabwe are among the countries that have launched diaspora bonds or allowed members of their diaspora to participate in government bonds. Others have launched initiatives aimed at targeting their diaspora for direct foreign investment and business development opportunities. However successful these initiatives may have been, there is still a long way to go before governments and organizations design a whole range of financial instruments that meet the needs of vastly diverse diaspora communities.

“Different groups have different priorities,” said Nana Boakye-Adjei, associate director of Developing Markets Associates, a leading consultancy firm in the remittance and diaspora investment sectors. “The types of tools and innovations that are coming up now to try and encourage diaspora investment really need to take that into consideration.”

Factors like region of origin, expectations for impact and return, and disposable income can significantly affect appetite for investments. Trust is often an issue for those that have left countries with high levels of corruption or security problems. And priorities seem to shift as diasporas settle in their host or heritage countries.

“Generation matters,” said Leigh Moran, who leads the Calvert Foundation’s efforts in creating impact investing opportunities for diaspora communities. “The closer you are to the country of heritage, the more attached you tend to be to a particular place in that country. And second and third generations tend to take a broader view of their giving back to their country of heritage.”

One company, Homestrings, is trying to breach this flexibility gap by providing accredited investors — to qualify as accredited investors, individuals must have a high net worth — with a wide range of vetted investment opportunities in emerging markets through their online platform. Projects vary by sector, socio-economic impact and rate of return. Most opportunities are currently in Africa, but the company hopes to diversify its geographical reach as its member base grows.

Just how impactful diaspora investments really are is unclear. While most available studies and surveys focus on investment appetite, no research has been conducted on the impact of diaspora foreign investments on their country of origin. Naujoks is currently leading the first study on the subject, looking at the case of Tunisia. In addition, there is virtually no way to collect data on the myriad other investments that are made informally.

“There aren’t that many products to channel nonaccredited capital back to these countries of heritage,” Moran said. “There's a lot of unofficial investments in businesses, family or friends, or unofficial lending clubs, and that's very hard to quantify and track.”

What role for development organizations?

With growing evidence of the impact of diaspora funding on poverty reduction, and increased money flows from transfers and investments to developing countries, diaspora financing is set to play an increasing role in development initiatives, both for programming and funding opportunities. Here’s how.

Financial literacy: Projects like PINOY WISE show the importance of literacy skills and access to financial services for both recipients and senders.

“The development industry always focuses on country of origin [of migrants],” Naujoks said. “Sometimes it’s good to focus on what can be done in the country of destination.” Budgeting skills and saving schemes for migrants can help leverage remittances even before the money has left.

Partnerships in host countries: Research shows migrants send more money home if they’re well integrated in their host countries. With no access to financial services, undocumented migrants are in a particularly vulnerable position. By forming partnerships with organizations involved in migrants’ rights and integration, NGOs could plan their financial literacy programming more strategically.

Partnerships in countries of origin: NGOs can play a role in helping local governments streamline money flows from remittances. In the Philippines’ Calabarzon region, the NGO Athika and the National Economic Development Authority co-chair a committee on migration and development, which discusses ways migrants can contribute to economic development, including investment opportunities, in consultation with provincial and municipal stakeholders.

Co-financing and public-private partnerships: “There's certainly a role to be played by donors and development finance institutions in looking at the diaspora as a valuable source of finance for development,” Boakye-Adjei said.

At a joint event focusing on investment opportunities in East Africa set to be held later this year, Developing Markets Associates and Homestrings will explore co-financing opportunities between development finance institutions and diaspora investments. The U.S. Agency for International Development, meanwhile, has engaged with diaspora groups through public-private partnerships. With Western Union, for instance, the agency launched the African Diaspora Marketplace, a business plan competition.

“De-risking” activities: Fear of corruption, scams and mismanagement of funds, as well as general misperception of risks on the part of diaspora members, are seen as significant obstacles to diaspora financing. With a proven track record in project management and transparency, development organizations could bring the right set of skills to investment projects or local stakeholders looking to build credibility.

“Trust remains a big issue,” Boakye-Adjei said. “Having an institution like that as a partner would bring a lot of confidence and comfort to those individual investors that are keen and want to be more active.”

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Flavie Halais is a freelance journalist based in Montreal who covers cities and international social issues. In 2013-2014, Flavie was an Aga Khan Foundation Canada International Fellow, reporting for Nation Media Group in Nairobi, Kenya. She’s also reported from Rwanda, Brazil and Colombia.