Remittances Vis- A- Vis Foreign Direct Investment- A Case Study

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INTRODUCTION

The money sent by immigrant workers to their families living in their native countries is termed as a Remittance. A key financial flow directed (mainly) to developing countries helps in financing consumption, savings and investments, and also improves the balance of payments. India, China, Mexico and Philippines are among top receivers of remittance flows in the world. Whereas, the United States of America, Saudi Arabia, Germany and Switzerland are the major sources of remittances.

Remittance is carried out through both formal channels and informal money transfer systems. Formal channels include banks and money transfer companies like Western Union (a subsidiary of First Data Corp.) and Money Gram. The advent of the Internet and vast advances in communication technology has spawned the growth of 'new age remittance services' like money transfer websites and use of remittance cards. Even banks have embraced technology to set up online money transfer services. These transfers are fast, easy and economical. Convenience and online tracking status are the major benefits. However, these systems have a higher cost attached to them. This may put these services out of reach of the low income groups who form a major portion of the immigrant population. E-mail frauds and fake websites are also a cause of concern. Informal money transfer systems have been popular among emigrants and expatriates as they cost less and are perceived to be efficient and reliable. Hawala/Hundi is an alternative or parallel remittance system. It exists and operates parallel to the 'traditional' banking channels. The components of Hawala that distinguish it from other remittance systems are trust and extensive use of connections such as family relationship or regional affiliations. Transfer of money takes place based on communications between members of a network of Hawaldars or Hawala Dealers. It works by transferring money without actually moving it. 'Money transfer without money movement' is a well recognized definition of Hawala. The transaction takes one or two days and is faster than most bank wire transfers, without opening accounts. According to a recent IMF report, the Hawala has several characteristics that guarantee its widespread use. They include speed, convenience, versatility and potential for anonymity.

Due to absence of proper records, informal channels have become the preferred route for money laundering and funding of terrorist activities. It would be desirable for regulatory authorities to encourage remittance flows through formal systems by reducing transfer/transaction costs and facilitating better accessibility.

REMITTANCE: AN ECONOMIC FORCE

Remittance by international migrants to their home countries have grown dramatically in recent years. They are now the largest source of external finance for developing nations, even exceeding the Foreign Direct Investment (FDI) in some cases.

TABLE 1.1: COUNTRIES RECEIVING MOST REMITTANCES (US$ BILLION)

INDIA	17.4
MEXICO	14.6
PHILLIPINES	7.9
CHINA	4.6
PAKISTAN	4.0
MOROCCO	3.6
BANGLADESH	3.2

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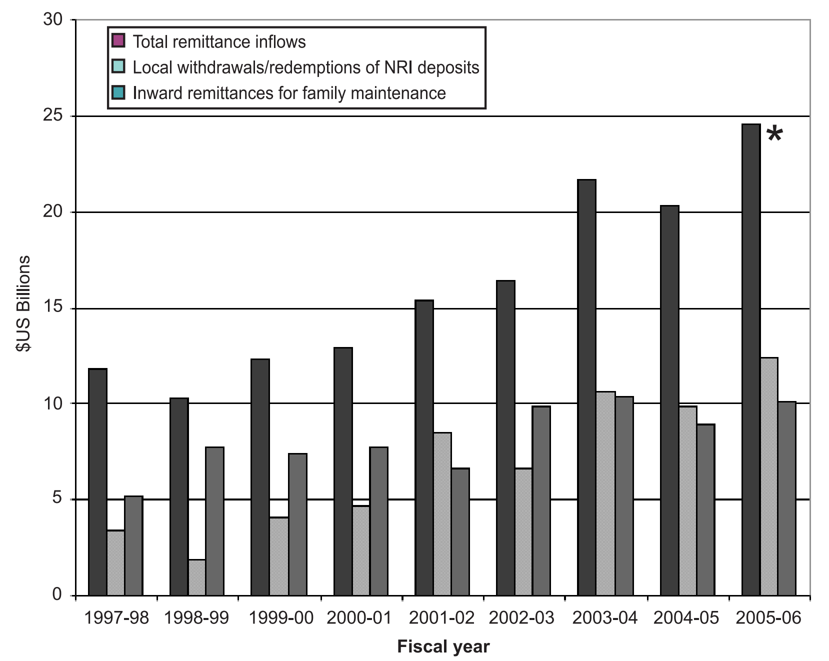
TABLE 1.2: SOURCES OF REMITTANCES, 2003 (US$ billion)

UNITED STATES	34.1
SAUDI ARABIA	14.9
GERMANY	9.9
SWITZERLAND	9.2
FRANCE	4.7
LUXEMBOURG	4.6
ITALY	4.4

Unlike the other capital flows, remittances are stable and directly benefit the poor. During the Asian financial crisis in the late 1990s, remittances to developing countries continue to rise even though FDI and official aid flows declined. Amount of NRI remittances have been exceeding FDI inflows in India for last few years. The Figure 1 shows that the NRI remittances started rolling over against the FDI in India.

Figure 1: REMITTANCES AND LOCAL WITHDRAWALS / REDEMPTIONS OF NRI DEPOSITS, 1997-1998 TO 2005-2006



Note: *Projected amount for 2005-2006.
Source: Reserve Bank of India: "Handbook of Statistics on the Indian Economy," September 2006; and "Invisibles in India's Balance of Payments," RBI Bulletin, November 2006.

BANK'S APPROACH-ICICI BANK

ICICI Bank's key focus in the remittances space was towards building access to low cost and convenient remittances, for both the remitters and the beneficiaries. The value perceived by the overall remittance community was on the following lines:-

- ❖ Increased and easier accessibility for the remitter and beneficiary.
- ❖ Simpler processes on registration, transaction requests and status follow-ups.
- ❖ Faster transfers and payout to the beneficiary.
- ❖ Reduced overall remittances cost per transaction to the remitter.

STUDYING MIGRATION PATTERNS AND KEY CORRIDORS

The business strategy that ICICI Bank evolved was based on a close study of the target customers

(A) Distinct customer segments initiating remittances

- ❖ White collared remitters, technology workers and the likes - originating largely in the US, UK and Japan.
- ❖ Blue collared remitters, labor manpower like contract laborers, maids, drivers, technicians, originating largely in the Gulf countries.

(B) Different remittance and banking patterns

- ❖ The white collared migrants originate large ticket transfers and are highly banked at both ends – origination and distribution.
- ❖ The blue collared migrants typically lead to small ticket transfers and are comparatively under-banked connecting to small towns in the receiving countries.

(C) Differential preferences on the choice of the remittance mechanism

- ❖ The knowledge workers prefer the innovative methods like online transfers, account debits that are relatively low in cost and high on convenience.
- ❖ The blue collared workers prefer the traditional methods of money transfer in the form of cash deposits and withdrawals through physical branches or agent networks, that are relatively high in convenience and speed, but high in cost as well.

THE BUSINESS STRATEGY

The remittances business is largely a low-value, high volume retail payments model. Existing payment transaction mechanisms did not suit well to offer low cost services per transaction. ICICI Bank realized that the money transfer market asked for a creative approach and an independent, dedicated focus on the business. The bank brought in significant innovation and productization based on the use of technology and alliances.

THE PARTNERSHIP STRATEGY

The remittance services model was based on the strategy of building a technologically capable platform strengthened further by creating multiple partnerships in key geographies. The partnerships leveraged the complementary strengths of ICICI Bank – in terms of a strong Indian distribution and a large beneficiary customer base, and strengths of the partner banks – in terms of enhanced reach and origination capability, and specific targeting of the Indian NRI (non-resident Indians) community in the respective geographies. ICICI Bank chose specialized partners with deep reach in key origination markets.

- ❖ **UK:** Alliance with Lloyds Bank. Remitters can integrate their accounts in ICICI Bank, UK with accessible Lloyds Bank branches.
- ❖ **USA:** Partnered with Wells Fargo Bank. Remitters can open Remittance Account at the bank and initiate transactions through ATM, Internet and Wells Fargo branches.
- ❖ **Gulf:** Predominantly a cash transfer market, multiple models to build reach to the remitters. ICICI Bank's own branches in some regions, tie-ups with Emirates bank and Commercial Bank of Qatar; and aggregation of transactions through partnered Exchange Houses (Money Changer Agencies). The partner agency users' are provided access to ICICI Bank's proprietary online system to enter remittance instructions provided by remitters.
- ❖ **Singapore:** Alliance with DBS Bank, which shares good equity within the Indian community in Singapore.
- ❖ The partners are also benefited in this relationship based on the volume of business, and even more from the profitable relationship with the remitters as they avail other account related services from them.

THE ROLE OF TECHNOLOGY

Technology offered the options to use alternate transaction requests and payment delivery channels build scalability and reduce costs through automation. A dedicated technology and processing infrastructure has helped the bank to minimize costs and improve service levels for the remitters. This technology contribution highlights the role of leading vendors like **CashTech Solutions, a Fundtech company**, in providing specialized Remittance Management Solutions. The bank's offering strengthened on account of rich platform features such as:

- ❖ Web-based technology platform leading to instant access and initiation for remitters as well as for bank users.
- ❖ Largely automated funding, forex and centralized payment processing enabling a high degree of Straight Through Processing.
- ❖ Focus on better customer service: continuous online status tracking and dedicated customer care call center.
- ❖ Remittance system well integrated with the other banking and processing systems of the bank leading to significant cost savings.
- ❖ The cost savings are then being passed on to the customer, making the overall remittance service extremely competitive.

- ❖ Automated connectivity of the remittances system to electronic clearings locally at both the origination and distribution side. This improved both the processing speed as well as reach across bank branches.

DIFFERENTIAL STRATEGIES FOR DIFFERENT MARKETS

Given the polarization of remittance volumes along a few key corridors, ICICI Bank deployed customized strategies in the key markets.

- ❖ **Technology Based Solutions For The Knowledge Customers**: Given the limited direct presence of the bank across the world, ICICI Bank invested in a well-designed, completely online solution for sending remittances to India. For the Internet savvy migrants, this offered a seamless online money transfer system along with status tracking facilities, within the comfort of their home. It also nullified the existing banking relationships of the remitter by electronically connecting to their bank accounts.
- ❖ **Riding on Regional Alliances**: For the remitters who were looking forward to visit a branch for submitting a physical request, ICICI Bank builds multi-tiered regional partnerships.
- ❖ **Last mile connectivity through rural bank tie-ups**: This vastly improved ICICI Bank's reach on the beneficiary end, where it could provide money transfers in the interiors of the home country, where it did not have a direct presence.

Technology and alliances with partners have played a key role in ICICI Bank's success and acceptance amongst the Indian remittance community. The strategy is banking on innovations and an active partnership model and riding on latest technology solutions for creating highly effective centralized transaction processing capabilities. The success of ICICI Bank clearly suggests that it is possible for banks to take the lead in becoming remittance players of choice by building on their strengths in forging alliances, product development, technology and transaction processing.

DETERMINANT AND FACTORS RESPONSIBLE FOR REMITTANCE GROWTH

The total amount of remittances is positively linked to:

- ❖ The number of emigrants abroad;
- ❖ The income of emigrants which, in turn, is higher when:
- ❖ The countries in which they are concentrated are rich;
- ❖ Their jobs are remunerated with high wages, which requires a favorable legal setting, a non discriminatory labour market, a rising level of personal and social competences.
- ❖ A high level of employment of emigrants.
- ❖ The savings that emigrants can afford, balancing income with living expenditure.
- ❖ The willingness to send money home, influenced by emotional links (e.g. family) as well as rational perspective (e.g. coming back).

Many host countries, however, maintain quotas for new immigrants; discriminate against foreigners, have large share of illegal immigration, are exploited by employers, who pay extremely low wages. Job segregations are frequent as well, with certain nationalities being accepted in certain jobs but not in others. The high cost of sending and receiving money limits the effectiveness of remittances. But competition among banks and money transfer agencies can reduce fees, to the effect that more hard earned money sent by migrant workers goes to the people who depend on it. Money transfer fees are the lowest in those countries where there is greater competition. Remittance sending patterns vary across gender in many countries: in some cases, males send more than female migrants while in other countries it is reverse.

FACTORS RESPONSIBLE FOR REMITTANCE GROWTH

Remittances to India have witnessed rapid increase since 1991. A combination of factors account for this. India's extensive economic reforms of the early 1990s provide an important context. It gradually ended the state monopoly on a range of industries, allowed foreign capital in most sectors of the economy, lowered taxes and tariffs. These reforms accelerated India's integration into the world economy and represented a larger change in the Indian mindset.

❖ **Diminishing the role of unofficial channels:** A significant factor contributing to the remittance surge is simply the increased use of official channels for remitting money. Prior to 1993, the Government of India strictly regulated the exchange rate of the Indian rupee, creating huge incentives to transfer money through informal, unregulated hawala networks. Hawala networks in India were used because of the advantageous exchange rate as well as to circumvent tight controls on the transfer and possession of gold, a commodity highly valued in India. With the liberalization of gold imports, beginning in 1992, the incentive to employ hawala networks diminished. In 1993, the government established a market based exchange rate, further reducing the appeal of hawala networks.

❖ **Declining Emphasis on Foreign Currency**: The Government of India's change in exchange rate policies was followed by a change in exchange control policies. Before 1991, rigid regulations on the conversion of rupees to foreign currency meant that most NRIs chose to keep their money in repatriable foreign currency. Liberalization of exchange regime started in 1992, and the highly criticized Foreign Exchange Regulation Act (FERA) was repealed in 2000. FERA imposed a strict control system on all transactions per year, and fixed the rupee exchange rate. FERA was replaced by Foreign Exchange Management Act (FEMA) in 2000, which relaxed controls on foreign exchange transactions. With the gradual relaxation of exchange controls, NRIs are now less concerned about being able to convert rupees to foreign currency. Consequently, NRIs reluctance to place money into rupee accounts is declining.

❖ **Shift In Emigration Patterns:** If the migration pattern of Indian workers to the Gulf States was dominant story of the 1970s and the 1980s, the migration of information technology (IT) workers, principally to the United States, has been the trend since the mid-1990s. Indian migration to the United States doubled in 1990s, mostly through the use of H-1B temporary worker visas, which allow those in specialty occupations to work in the country for upto six years with the possibility of receiving permanent residence. Indian software engineers became an important element of the US IT boom. Even in the Gulf countries, the number of Indian professional and managerial workers is increasing. Thus, the relative number of Indian professional workers going abroad has been growing. This new "class" of high skilled Indian workers has greater purchasing power as well as more saving potential than lower skilled workers. The growth of India's homegrown IT services industry has helped foster strong business connections between India and Indian IT professionals abroad. According to RBI, North America has replaced the Gulf States as the most important source for remittances. RBI estimates that 44% of the remittances originate in North America, 24 percent in the Gulf region and 13 percent in Europe. In contrast, studies show that in 1990-91, 40 percent of the remittances came from Gulf countries and 24 percent from North America.

❖ **More Options of Money Transfers:** The stability of remittances reflects the increasing use of formal channels for transmitting money to India. Options for transmitting money to India have become more competitive; the field is no longer dominated by traditional transfer agents like Western Union. A survey of commercial banks conducted by RBI in 2006 indicates that 53% of the remittances were transmitted by electronic wire/swift, making it the dominant choice of overseas Indians. Although electronic wires are the fastest means of remitting, they can be expensive: 2.5 to 8 percent for amounts less than US$ 500; the cost drops to 0.7 to 2 percent for transfers between US$ 500 and US$ 1000. Yet the RBI study indicates that the average size of remittance transfer to India is relatively high. Out of the total remittance inflow to India, remittances of $1,100 and above accounted for 52 percent. Within the high remittance category, 63 percent of remittances exceed $2,200. Only 30 percent of remittances were for amounts less than $500. But the system certainly favors the richer end of the remitting spectrum. For the tech savvy with internet access, Internet based providers have become another option for remitting money. The popular Remit2India, collaboration between The Times of India and UTI, an Indian bank, led the way in 2001. These services are more convenient and less expensive than conventional methods. For example, Remit2India charges US$200; while the Bank of India's online system charges a flat rate of US$8 per transfer. Western Union is reaching out to the lower end of the customer base. It has established an unusual partnership with the Indian Post Office in which the post office's network of 1,50,000 offices- the largest in the world- provides Western Union potential access to customers in the remote parts of the world. Lastly, Indian banks, not known for their agility, are now aggressively tapping into the NRI market. Banks like ICICI, the State Bank of India and the Andhra Bank allow customers who maintain a minimum balance, free transfer from a branch abroad to a branch in India.

❖ **Perception of the Indian Economy:** The most significant factor in the surge in remittances, ultimately, may be the way NRIs perceive the Indian economy. Until recently as 2002-03, "regular" remittances dominated the flow from NRIs. With the Indian economy growing at an average rate of 7.5 percent per year since 2002, NRIs now see India as an "investment destination". Real estate and equity markets are the principal areas of their interest. These sectors, restricted to NRIs in the past, are experiencing a boom. Real estate experts believe that in Delhi, 20 percent of all properties worth over one crore were bought or funded by NRIs. Even second generation Indians are buying property in India. The new found interest in the real estate and equity markets is another explanation for increase in local withdrawals in RBI's remittances figures. NRIs may have finally become "investors" rather than saver.

CONCLUSION

India has clearly achieved a large sustained level of remittances. Policy initiatives by the government and banking institutions have achieved significant results. First, most remittances flow through formal channels. Second, an increasing number of remitters have moved from pure savers to investors. The Indian policy regime has demonstrated its ability to attract NRI capital through NRI deposit accounts and successive bond issues. The challenge is to channel some of these flows for socio-economic development. If the government and the banking community are strategic, they could offer higher rates of return on remittance receipts placed in specified assets in the domestic capital market. Investing in microfinance operations would be a good place to start, given their success in India. The government could issue bonds targeted for infrastructure development or for investments in health and education sectors. The Indian diaspora has proven responsive to incentives. Offering investment options that are tied to development goals could be a winning strategy.

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Use of multitude of market indices and parameter estimation for SVM also provided some glimpse of insight into the Indian security market. Sensex and NIFTY being the two leading (and competing) indices with substantially dominating capitalization, one would expect that the SVM parameters would be comparable. The results obtained do not support this assumption. In fact, the bias parameter α for the two indices showed wide variation. Though it is generally recommended to use about 2 to 5 years market data to obtain the SVM parameters, the same for 2 years and 10 years in case of Sensex were found to be noticeably different. In this respect, NIFTY parameters for 2 years and 10 years have been rather consistent. Variations of parameters across the indices generally discourage application of parameters for one index to be applied for VaR prediction of the others. However, such an exercise did not create any catastrophically wrong prediction as indicated in Table 3. This may be an indicator that the VaR predictor may not be very sensitive to the bias parameter α. Work is continuing to analyse whether the SVM approach brings out significant information regarding country and index specificity.

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