

THE IMPACT OF FINTECH ADOPTION ON REMITTANCE TRANSFERS

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Annotation FinTech is revolutionizing various aspects of financial services, reshaping how markets are served. The remittance industry is no exception, as FinTech solutions make transactions faster and more cost-effective. Remittance payments play a crucial role in the economies of emerging markets. This thesis examines the remittance sector in the context of these markets, aiming to understand the market dynamics and identify key factors for successful FinTech implementation.

The study focuses on three key areas: reducing remittance costs, encouraging FinTech adoption, and enhancing financial inclusion. It includes six mini case studies from leading remittance-receiving regions to evaluate the effects of FinTech adoption on transaction costs and financial inclusion. The research highlights influential factors such as infrastructure development, regulatory frameworks, financial intermediaries, compliance requirements, and the simplicity of technology.

It also investigates the role of traditional financial institutions within the FinTech ecosystem and explores how the financial sector can extend its reach to unbanked populations in emerging markets. By analyzing trends in the study countries, the thesis provides actionable insights for FinTech companies designing solutions for these markets and for regulators seeking to foster innovation while ensuring industry governance.

The findings suggest that FinTech challengers must tailor their solutions to leverage existing infrastructure, while regulators should create policies that balance innovation with oversight. Overall, the thesis demonstrates the transformative

impact of FinTech on the remittance sector.

Key words: FinTech, remittance services, developing economies, infrastructure growth, remittance providers, money transfer companies, established players.

Introduction

Millions of individuals from developing nations migrate to North America, Europe, and other developed regions in search of better economic opportunities and an improved quality of life. According to the International Organization for Migration (IOM, 2020), there were 272 million international migrants in 2019. Asia, Europe, and North America were home to approximately 84 million, 82 million, and 59 million migrants, respectively. Migration continues to rise each year due to factors such as violence, conflict, economic hardship, political instability, and natural disasters. Many migrants move to stable regions to live and seek employment opportunities.

In 2019, about two-thirds of international migrants, roughly 176 million people, were labor migrants residing in high-income countries. These migrants frequently send financial support to their families in their home countries. In 2018, over 200 million migrant workers remitted a total of USD 689 billion, with USD 529 billion directed to developing nations (UN, 2019). The top three remittance-receiving countries that year were India (USD 78.6 billion), China (USD 67.4 billion), and Mexico (USD 35.7 billion). Conversely, the leading remittance-sending countries were the United States (USD 68.0 billion), the United Arab Emirates (USD 44.4 billion), and Saudi Arabia (USD 36.1 billion) (IOM, 2020). Notably, the primary recipients of remittances are developing nations, while the major remittance-sending countries are either developed nations or high-income economies driven by the oil and gas sector. This thesis focuses on examining the development and impact of FinTech in emerging markets, particularly in relation to remittances, economic development, and financial inclusion. It begins with an

introductory chapter that provides background information on the topic, a summary of relevant literature, and associated theoretical frameworks.

The subsequent chapter delves into the remittance industry, emphasizing solutions within this sector. Following this, the thesis explores how FinTech functions in emerging markets, aligning its operations with the identified theories. Hypotheses are formulated in this section to guide the analysis and testing process.

A summary of the methods and data utilized in the study is then presented. The analysis and research findings are detailed in the next section, along with insights and lessons learned. The thesis concludes by highlighting its contributions to academia and industry, as well as acknowledging its limitations.

Foundational literature and applicable theoretical framework

This chapter reviews literature and theories related to the FinTech industry and remittance services, laying the groundwork for understanding FinTech adoption in emerging markets. It begins by defining key terms associated with FinTech and remittances, followed by an overview of FinTech's evolution. Next, it examines the factors and characteristics influencing FinTech adoption using a theoretical framework. The chapter concludes with an exploration of theories relevant to addressing the research questions.

The theories discussed include newly vulnerable markets, technological innovation, process disruption and industry transformation, and network effects. These frameworks are crucial for investigating the thesis topic and answering the research questions. Emerging markets, often characterized by higher growth rates and untapped potential despite inherent risks, are attractive for introducing new products or extending existing offerings. The theory of newly vulnerable markets is used to examine these traits within the remittance sector.

Organizations leverage an understanding of technological evolution to forecast trends, seize market opportunities, and sustain or expand market share (Adomavicius, Bockstedt, Gupta, & Kauffman, 2007). Technological innovations in

new markets often disrupt existing processes and methods of service delivery, creating conditions for the emergence of novel business models and leading to industry transformation. Additionally, the adoption of remittance technologies in emerging markets will be analyzed in the context of network effects.

Study approach and methods

This thesis employs a combination of qualitative and quantitative analysis of secondary data, focusing on countries and regions as case studies. The methodology involves analyzing and interpreting information sourced from various articles, reports, and books related to FinTech in the context of emerging markets. The study is guided by the theories of newly vulnerable markets, technological innovation, process disruption and industry transformation, and network externalities to explore and understand FinTech adoption in these settings.

Research context

For innovative businesses to thrive, they must engage with others, form partnerships, and share resources. According to Moore (1993), a business is not confined to a single industry but is part of a broader ecosystem spanning multiple industries. These ecosystems consist of participants who contribute to and facilitate value creation, either directly or indirectly. Value is delivered to users through the collaboration of participants fulfilling various roles, with each entity leveraging its position to create and capture value.

Iansiti and Levien (2004) describe keystone organizations as central entities with the power to influence the ecosystem significantly. Keystone players collaborate with numerous smaller companies within the ecosystem to enable value creation. Meanwhile, niche players serve as specialized contributors, enhancing the ecosystem's diversity and providing unique capabilities that benefit both the keystone organizations and the broader network. While business ecosystems encompass several roles, this thesis focuses on a select few that are most relevant to the research topic.

The FinTech ecosystem fosters a range of niche players to drive innovation in various areas of finance. FinTech startups typically operate as niche players, specializing in specific aspects of finance such as payment services, personal banking, digital wallets, remittances, insurance, retail investing, online banking, or crowdfunding. In contrast, established institutions like banks offer a broader range of services. Niche players often rely on keystone players to create value for users. They distinguish themselves in the market by leveraging the capabilities of keystone players, building unique services on top of their platforms. Keystone players possess large-scale financial and technological resources that connect ecosystem participants, and without them, the ecosystem would not function. In these ecosystems, keystone firms provide the platform, while niche players contribute value to it (Rong, Hu, Lin, Shi, & Guo, 2014). For example, in open banking, independent developers access customer data from banks to offer additional services through APIs. FinTech startups typically focus on specific niches, and their efforts to scale are often driven by accessing data through banks (Singh, Chandrashekar, & Singh, 2020). In most instances, FinTech startups do not directly own their customers; instead, they provide value to the customers of traditional financial institutions. These interactions and collaborations foster innovation in various areas, contributing to the development of a healthy and expanding ecosystem.

The FinTech ecosystem is continuously growing through innovation and cooperation among its participants. Some established companies partner with or acquire FinTech startups to maintain their position as key players in the ecosystem. Startups can leverage the financial strength and market presence of incumbents, while incumbents gain access to the creativity and technology of startups without needing to overhaul their existing systems. This allows them to modernize their operations and retain customers who might otherwise be attracted to FinTech challengers.

This thesis categorizes the roles within the FinTech ecosystem into six groups, as shown in the figure above. End users are the individuals or entities that benefit from the value generated by the ecosystem. Incumbents, or traditional financial institutions, despite their outdated operations, occupy a central position in the ecosystem. They remain the primary providers of financial services, and other ecosystem participants must interact with them at various levels, making their role crucial for the ecosystem's proper functioning. FinTech startups are the challengers introducing financial innovations to the market. The enablers are those players who provide the necessary hardware, software, and network infrastructure that support the ecosystem.

The development of FinTech varies across different countries, with some emerging markets having more advanced and integrated FinTech ecosystems than others. The level of development is influenced by factors such as digitalization, infrastructure, regulatory challenges, and investment in FinTech. In large Asian markets like China and India, the FinTech industry is highly developed and well-integrated, with numerous companies offering digital financial services.

While the FinTech sector is growing rapidly in both Africa and Asia, Africa's progress is slower due to factors like inadequate infrastructure, regulatory obstacles, and currency instability. Although Africa boasts the highest mobile penetration rate globally, it lacks the necessary infrastructure such as reliable electricity and internet access. This infrastructure gap hinders FinTech adoption. For example, M-PESA, one of Africa's largest money transfer operators, struggled to enter the South African market due to strict regulations on digital wallets and low mobile network subscription rates (Alexander, Shi, & Solomon, 2017).

In finance, customers prioritize security and reliability. They are less likely to adopt digital payments if network disruptions or technical issues undermine the trustworthiness of services (Demirgüç-Kunt, Klapper, Singer, Ansar, & Hess, 2017). One reason for the continued preference for traditional financial institutions in these

regions is their reliability—they have physical locations where customers can receive in-person assistance if needed. These institutions have established trust over many years. For FinTech companies, the lack of enabling infrastructure negatively impacts their ability to deliver quality services. As a result, existing customers are less likely to continue using these services or recommend them to others.

FinTech companies offer faster, more affordable, secure, and transparent financial services to their customers. In emerging markets, customers are becoming increasingly aware of the advantages of FinTech, either demanding better services from traditional financial institutions or adopting FinTech solutions themselves. Cash-based economic activities are often opaque and difficult to trace, which can contribute to issues like corruption and money laundering in many countries. For example, remittance payments made through informal channels can facilitate the movement of illicit funds across borders and inject them into the global economy. Governments are recognizing the benefits of FinTech for economic development and financial transparency, prompting them to amend laws and invest in infrastructure to support its growth.

The COVID-19 pandemic negatively affected FinTech investments in emerging markets during 2020 and 2021. However, several studies indicate that the pandemic had a positive impact by accelerating the digitalization of financial services. Due to global restrictions, people were compelled to use digital financial solutions for transactions during lockdowns.

Conclusion.

This thesis examines the factors influencing remittance costs, FinTech adoption, and financial inclusion in emerging markets. It explores the challenges that affect the implementation and adoption of FinTech, which must be addressed in future implementations to successfully tackle issues like remittance costs and financial inclusion through innovation. The thesis contributes to the broader

understanding of FinTech adoption in various emerging market contexts. FinTech companies must consider the interactions and dynamics of these factors when deploying their solutions. They need to leverage existing infrastructure, technology, and networks to enable their services. For example, providing high-tech digital services may not be the best approach in emerging markets where access to smartphones, the internet, and electricity is limited. Therefore, bridging the gap between what emerging markets currently have and what FinTech innovations require may involve using low-tech solutions and collaborating with partner networks to provide services. Digital remittance providers should also consider integrating their services with domestic payments and other financial services, as offering multiple services on one platform accelerates both FinTech adoption and financial inclusion.

Governments must avoid overregulating the FinTech sector, as excessive regulation can stifle innovation and growth. While strong regulation and compliance requirements are essential, there must be room for innovation and progress. Regulators need to strike a balance between protecting consumer interests, safeguarding the national economy, preventing illegal activities, and fostering an environment conducive to innovation in the financial sector. Additionally, governments should invest in national infrastructure that supports FinTech innovations. Users are more likely to adopt digital financial solutions if they are backed by reliable infrastructure.

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