

Table 38 Ratio of Bank Account Holders (I)

	Nomad			Farmer			Soum Resident			Enterprise			Total		
	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Yes	Ratio	
1 Arhangai	31	4	12.9%				61	7	11.5%	21	2	9.5%	113	13	11.5%
1 Tssetsrieg	15	2	13.3%				31	5	16.1%	11	1	9.1%	57	8	14.0%
2 Hairhan	16	2	12.5%				30	2	6.7%	10	1	10.0%	56	5	8.9%
2 Dornod	30	2	6.7%				74	5	6.8%	7	0	0.0%	111	7	6.3%
1 Marad	15	1	6.7%				35	3	8.6%	5	0	0.0%	55	4	7.3%
2 Choibalsan	15	1	6.7%				39	2	5.1%	2	0	0.0%	56	3	5.4%
3 Omnogovi	32	12	37.5%				47	6	12.8%	30	12	40.0%	109	30	27.5%
1 Noyon	15	5	33.3%				23	1	4.3%	17	7	41.2%	55	13	23.6%
2 Gurvantes	17	7	41.2%				24	5	20.8%	13	5	38.5%	54	17	31.5%
4 Selenge 1	31	11	35.5%				28	6	21.4%	54	15	27.8%	113	32	28.3%
1 Altainbulag	16	5	31.3%				14	3	21.4%	25	8	32.0%	55	16	29.1%
2 Saihan (Hutul)	15	6	40.0%				14	3	21.4%	29	7	24.1%	58	16	27.6%
5 Selenge 2				100	9	9.0%							100	9	9.0%
1 Orhon				50	5	10.0%							50	5	10.0%
2 Tsagaannuur				50	4	8.0%							50	4	8.0%
6 Hovd	36	11	30.6%				48	16	33.3%	26	9	34.6%	110	36	32.7%
1 Bulgan	21	3	14.3%				23	5	21.7%	13	5	38.5%	57	13	22.8%
2 Darvi	15	8	53.3%				25	11	44.0%	13	4	30.8%	53	23	43.4%
Total	160	40	25.0%	100	9	9.0%	258	40	15.5%	138	38	27.5%	656	127	19.4%

\* The data reflect those who intend to deposit money when banks re-start their business.

(Compiled by JERU)

Table 39 Ratio of Bank Account Holders (II)\*

	Nomad			Farmer			Soum Resident			Enterprise			Total		
	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio
1 <i>Arhangai</i>	31	17	54.8%				61	24	39.3%	21	5	23.8%	113	46	40.7%
1 <i>Tseserleg</i>	15	9	60.0%				31	4	12.9%	11	3	27.3%	57	16	28.1%
2 <i>Hairhan</i>	16	8	50.0%				30	20	66.7%	10	2	20.0%	56	30	53.6%
2 <i>Dornod</i>	30	9	30.0%				74	22	29.7%	7	0	0.0%	111	31	27.9%
1 <i>Matad</i>	15	5	33.3%				35	15	42.9%	5	0	0.0%	55	20	36.4%
2 <i>Choibalsan</i>	15	4	26.7%				39	7	17.9%	2	0	0.0%	56	11	19.6%
3 <i>Omnogovi</i>	32	19	59.4%				47	25	53.2%	30	17	56.7%	109	61	56.0%
1 <i>Noyon</i>	15	9	60.0%				23	12	52.2%	17	10	58.8%	55	31	56.4%
2 <i>Gurvantes</i>	17	10	58.8%				24	13	54.2%	13	7	53.8%	54	30	55.6%
4 <i>Selenge I</i>	31	28	90.3%				28	17	60.7%	54	36	66.7%	113	81	71.7%
1 <i>Altanbulag</i>	16	14	87.5%				14	6	42.9%	25	13	52.0%	55	33	60.0%
2 <i>Saihan (Hutul)</i>	15	14	93.3%				14	11	78.6%	29	23	79.3%	58	48	82.8%
5 <i>Selenge 2</i>				100	79	79.0%							100	79	79.0%
1 <i>Orhon</i>				50	39	78.0%							50	39	78.0%
2 <i>Tsagaannuur</i>				50	40	80.0%							50	40	80.0%
6 <i>Hovd</i>	36	4	11.1%				48	8	16.7%	26	3	11.5%	110	15	13.6%
1 <i>Bulgan</i>	21	2	9.5%				23	5	21.7%	13	1	7.7%	57	8	14.0%
2 <i>Darvi</i>	15	2	13.3%				25	3	12.0%	13	2	15.4%	53	7	13.2%
Total	160	77	48.1%	100	79	79.0%	258	96	37.2%	138	61	44.2%	656	313	47.7%

(Compiled by JERI)

\* The data reflect those who intend to deposit money when banks re-start their business.

Table 40 Reasons for Unwillingness to Deposit (multiple answers)

	Total	Other than Enterprise	Enterprise	High Income People*	Arhangai	Dornod	Omnogovi	Selenge1	Selenge2	Hovd
Difficult system	8.3%	8.8%	6.5%	7.1%	4.5%	14.5%	8.3%	3.2%	19.0%	5.3%
Low interest rate	22.0%	19.6%	29.9%	16.1%	31.3%	21.1%	33.3%	35.5%	9.5%	8.5%
May not be able to withdraw	36.5%	36.5%	36.4%	25.0%	37.3%	52.6%	58.3%	32.3%	19.0%	17.0%
Banks are far from abodes	1.5%	0.8%	3.9%	3.6%	0.0%	0.0%	2.1%	6.5%	4.8%	1.1%
Not enough money	46.3%	50.0%	33.8%	25.0%	44.8%	61.8%	22.9%	38.7%	19.0%	55.3%
Cannot trust banks	44.2%	43.1%	48.1%	35.7%	47.8%	57.9%	52.1%	64.5%	38.1%	21.3%
Unfriendly service	13.1%	11.2%	19.5%	12.5%	22.4%	6.6%	4.2%	38.7%	14.3%	7.4%
Other reason	12.5%	11.9%	14.3%	14.3%	10.4%	11.8%	20.8%	0.0%	23.8%	11.7%
The number of respondents	337	260	77	56	67	76	48	31	21	94
Ratio of people who don't want to deposit money	52.3%	50.3%	55.8%	42.7%	59.3%	72.1%	46.0%	28.3%	21.0%	86.4%

(Compiled by JERU)

\*"High Income People" are those who have annual cash revenue categorized as among the top 25% of the subjects other than enterprises. (1,385 MNT thousand)

Table 41 Ratio of Bank Account Holders (III)\*

	Nomad			Farmer			Soum Resident			Enterprise			Total	
	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Yes	Ratio
1 Arhangai	31	31	100.0%				61	61	100.0%	21	21	100.0%	113	100.0%
1 Tsetserleg	15	15	100.0%				31	31	100.0%	11	11	100.0%	57	100.0%
2 Hairhan	16	16	100.0%				30	30	100.0%	10	10	100.0%	56	100.0%
2 Dornod	30	28	93.3%				74	68	91.9%	7	6	85.7%	111	91.9%
1 Matad	15	14	93.3%				35	33	94.3%	5	4	80.0%	55	92.7%
2 Choibalsan	15	14	93.3%				39	35	89.7%	2	2	100.0%	56	91.1%
3 Omnogovi	32	30	93.8%				47	44	93.6%	30	30	100.0%	109	95.4%
1 Noyon	15	14	93.3%				23	22	95.7%	17	17	100.0%	55	96.4%
2 Gurvantes	17	16	94.1%				24	22	91.7%	13	13	100.0%	54	94.4%
4 Selenge 1	31	31	100.0%				28	26	92.9%	54	53	98.1%	113	97.3%
1 Altanbulag	16	16	100.0%				14	13	92.9%	25	24	96.0%	55	96.4%
2 Saihan (Hural)	15	15	100.0%				14	13	92.9%	29	29	100.0%	58	98.3%
5 Selenge 2				100	98	98.0%							100	98.0%
1 Orhon				50	49	98.0%							50	98.0%
2 Tsagaannuur				50	49	98.0%							50	98.0%
6 Hovd	36	33	91.7%				48	45	93.8%	26	23	88.5%	110	91.8%
1 Bulgan	21	18	85.7%				23	21	91.3%	13	13	100.0%	57	91.2%
2 Darvi	15	15	100.0%				25	24	96.0%	13	10	76.9%	53	92.5%
Total	160	153	95.6%	100	98	98.0%	258	244	94.6%	138	133	96.4%	656	95.7%

\* The data reflect those who intend to deposit money when the quality of banking services is improved.

(Compiled by JERU)

Table 42 Ratio of Borrowers (I)

	Nomad			Farmer			Soun Resident			Enterprise			Total		
	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio
1 <i>Arhangai</i>	31	5	16.1%				61	21	34.4%	21	9	42.9%	113	35	31.0%
1 <i>Tsetserleg</i>	15	3	20.0%				31	8	25.8%	11	4	36.4%	57	15	26.3%
2 <i>Hairhan</i>	16	2	12.5%				30	13	43.3%	10	5	50.0%	56	20	35.7%
2 <i>Dornod</i>	30	2	6.7%				74	18	24.3%	7	2	28.6%	111	22	19.8%
1 <i>Marad</i>	15	1	6.7%				35	10	28.6%	5	2	40.0%	55	13	23.6%
2 <i>Choibalsan</i>	15	1	6.7%				39	8	20.5%	2	0	0.0%	56	9	16.1%
3 <i>Omnogovi</i>	32	6	18.8%				47	20	42.6%	30	9	30.0%	109	35	32.1%
1 <i>Noyon</i>	15	3	20.0%				23	12	52.2%	17	5	29.4%	55	20	36.4%
2 <i>Gurvantes</i>	17	3	17.6%				24	8	33.3%	13	4	30.8%	54	15	27.8%
4 <i>Selenge 1</i>	31	3	9.7%				28	9	32.1%	54	20	37.0%	113	32	28.3%
1 <i>Altanbulag</i>	16	1	6.3%				14	6	42.9%	25	8	32.0%	55	15	27.3%
2 <i>Saiban (Hutul)</i>	15	2	13.3%				14	3	21.4%	29	12	41.4%	58	17	29.3%
5 <i>Selenge 2</i>				100	21	21.0%							100	21	21.0%
1 <i>Orhon</i>				50	11	22.0%							50	11	22.0%
2 <i>Tsagaannuur</i>				50	10	20.0%							50	10	20.0%
6 <i>Hovd</i>	36	8	22.2%				48	11	22.9%	26	9	34.6%	110	28	25.5%
1 <i>Bulgan</i>	21	6	28.6%				23	5	21.7%	13	5	38.5%	57	16	28.1%
2 <i>Darv</i>	15	2	13.3%				25	6	24.0%	13	4	30.8%	53	12	22.6%
Total	160	24	15.0%	100	21	21.0%	258	79	30.6%	138	49	35.5%	656	173	26.4%

(Compiled by JERI)

Table 43 Lenders Chosen by the Interviewees

(multiple answers)	
Agricultural Bank	4.5%
Post Bank	0.0%
Post Company	0.0%
Savings Bank	0.0%
Reconstruction	3.4%
Agriculture cooperatives	0.0%
Cooperatives	0.0%
Relatives	19.3%
Pawnshops	0.0%
Others	77.3%
The number of respondents	176

(Compiled by JERU)

Table 44 Reasons for Choosing a Particular Lender

(multiple answers)				
Borrowing from	AB	RB	Relatives	Other
Low interest	37.5%	66.7%	23.5%	50.0%
Good service	0.0%	16.7%	0.0%	2.2%
No collateral	0.0%	0.0%	32.4%	25.0%
Long period	0.0%	0.0%	2.9%	2.9%
Convenient	0.0%	33.3%	2.9%	7.4%
No alternative	50.0%	33.3%	35.3%	50.0%
Other reason	12.5%	0.0%	35.3%	37.5%
The number of respondents	8	6	34	136

(Compiled by JERU)

Table 45 Purpose of Borrowed Money

(multiple answers)				
	Total	Nomad	Farmer	Residents
Car	2.3%	8.3%	0.0%	1.3%
House	2.8%	8.3%	0.0%	3.8%
Livestock	1.7%	0.0%	0.0%	3.8%
Tuition	6.8%	0.0%	4.5%	11.3%
Motorbike	0.6%	4.2%	0.0%	0.0%
Electric	0.0%	0.0%	0.0%	0.0%
Agri-equipment	6.3%	4.2%	27.3%	0.0%
Tax	1.1%	4.2%	0.0%	1.3%
TV	0.0%	0.0%	0.0%	0.0%
Furniture	1.7%	8.3%	0.0%	1.3%
Start business	19.3%	8.3%	0.0%	18.8%
Living expenses	36.9%	41.7%	18.2%	57.5%
Other reasons	25.6%	4.2%	22.7%	20.0%
The number of respondents	176	24	22	80

(Compiled by JERU)

Table 46 Ratio of Borrowers (II)\*

	Nomad			Farmer			Soun Resident			Enterprise			Total		
	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio
1 Arhangai	31	20	64.5%				61	51	83.6%	21	19	90.5%	113	90	79.6%
1 Tsetserleg	15	9	60.0%				31	26	83.9%	11	11	100.0%	57	46	80.7%
2 Hairhan	16	11	68.8%				30	25	83.3%	10	8	80.0%	56	44	78.6%
2 Dornod	30	21	70.0%				74	55	74.3%	7	7	100.0%	111	83	74.8%
1 Matad	15	13	86.7%				35	30	85.7%	5	5	100.0%	55	48	87.3%
2 Choibalsan	15	8	53.3%				39	25	64.1%	2	2	100.0%	56	35	62.5%
3 Omnogovi	32	8	25.0%				47	36	76.6%	30	13	43.3%	109	57	52.3%
1 Noyon	15	3	20.0%				23	17	73.9%	17	7	41.2%	55	27	49.1%
2 Guvantes	17	5	29.4%				24	19	79.2%	13	6	46.2%	54	30	55.6%
4 Selenge 1	31	19	61.3%				28	22	78.6%	54	45	83.3%	113	86	76.1%
1 Altanbulag	16	8	50.0%				14	10	71.4%	25	21	84.0%	55	39	70.9%
2 Saihan (Hutul)	15	11	73.3%				14	12	85.7%	29	24	82.8%	58	47	81.0%
5 Selenge 2				100	80	80.0%							100	80	80.0%
1 Orhon				50	38	76.0%							50	38	76.0%
2 Tsagaanuur				50	42	84.0%							50	42	84.0%
6 Hovd	36	19	52.8%				48	26	54.2%	26	19	73.1%	110	64	58.2%
1 Bulgan	21	14	66.7%				25	15	60.0%	13	11	84.6%	57	40	70.2%
2 Darvi	15	5	33.3%				25	11	44.0%	13	8	61.5%	53	24	45.3%
Total	160	87	54.4%	100	80	80.0%	258	190	73.6%	138	103	74.6%	656	460	70.1%

(Compiled by JERI)

\* The data reflect those who intend to borrow money when banks re-start their business.

**Table 47 Reasons to Borrow when Banks Restart Their Business (by categories)**  
(multiple answers)

	Total	Nomad	Farmer	Residents	Enterprise
Car	1.3%	0.0%	2.5%	1.5%	1.0%
House	3.2%	3.4%	4.9%	4.1%	0.0%
Business	57.1%	67.8%	24.7%	71.6%	46.2%
Agri-equipment	18.2%	12.6%	43.2%	11.3%	16.3%
Other reason	30.0%	25.3%	32.1%	18.0%	54.8%
The number of respondents	466	87	81	194	104

(Compiled by JERU)

**Table 48 Reasons to borrow when Banks Restart Their Business (by aimags)**  
(multiple answers)

	Total	Arhangai	Dornod	Omnogovi	Selenge1	Selenge2	Hovd
Car	1.3%	1.1%	0.0%	3.4%	0.0%	2.5%	1.6%
House	3.2%	2.2%	2.3%	1.7%	3.5%	5.0%	4.7%
Business	57.1%	64.8%	70.1%	77.6%	44.2%	25.0%	67.2%
Agri-equipment	18.2%	7.7%	17.2%	6.9%	23.3%	42.5%	7.8%
Other reason	30.0%	30.8%	10.3%	15.5%	57.0%	31.3%	31.3%
The number of respondents	466	91	87	58	86	80	64

(Compiled by JERU)



**Table 49 Reasons to Not Borrow Yet (by categories)**

(multiple answers)

	Total	Nomad	Farmer	Residents	Enterprise
Soon	13.7%	17.2%	17.3%	11.9%	11.5%
No bank to provide loans	50.9%	48.3%	33.3%	58.8%	51.9%
High interest	26.2%	27.6%	19.8%	30.4%	22.1%
No collateral	10.1%	3.4%	23.5%	10.3%	4.8%
Other reason	48.1%	95.4%	49.4%	33.0%	35.6%
The number of respondents	466	87	81	194	104

(Compiled by JERU)

**Table 50 Reasons to Not Borrow Yet (by aimags)**

(multiple answers)

	Total	Arhangai	Dornod	Omnogovi	Selenge1	Selenge2	Hovd
Soon	13.7%	12.1%	13.8%	5.2%	9.3%	17.5%	25.0%
No bank to provide loans	50.9%	65.9%	56.3%	44.8%	50.0%	32.5%	51.6%
High interest	26.2%	40.7%	10.3%	48.3%	22.1%	20.0%	20.3%
No collateral	10.1%	6.6%	8.0%	12.1%	2.3%	23.8%	9.4%
Other reason	48.1%	46.2%	32.2%	84.5%	30.2%	50.0%	60.9%
The number of respondents	466	91	87	58	86	80	64

(Compiled by JERU)

Table 51 Ratio of Those Who Transfer (send) Money (1)

	Nomad			Farmer			Soun Resident			Enterprise			Total		
	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio
1 Arkhangai	31	1	3.2%				61	3	4.9%	21	5	23.8%	113	9	8.0%
1 Tsetserleg	15	0	0.0%				31	0	0.0%	11	1	9.1%	57	1	1.8%
2 Hairhan	16	1	6.3%				30	3	10.0%	10	4	40.0%	56	8	14.3%
2 Dornod	30	2	6.7%				74	11	14.9%	7	7	100.0%	111	20	18.0%
1 Matad	15	2	13.3%				35	7	20.0%	5	5	100.0%	55	14	25.5%
2 Choibalsan	15	0	0.0%				39	4	10.3%	2	2	100.0%	56	6	10.7%
3 Omnogovi	32	19	59.4%				47	20	42.6%	30	18	60.0%	109	57	52.3%
1 Noyon	15	4	26.7%				23	10	43.5%	17	13	76.5%	55	27	49.1%
2 Gurvantes	17	15	88.2%				24	10	41.7%	13	5	38.5%	54	30	55.6%
4 Selenge 1	31	3	9.7%				28	5	17.9%	54	15	27.8%	113	23	20.4%
1 Altanbulag	16	2	12.5%				14	3	21.4%	25	7	28.0%	55	12	21.8%
2 Saihan (Hutul)	15	1	6.7%				14	2	14.3%	29	8	27.6%	58	11	19.0%
5 Selenge 2				100	9	9.0%							100	9	9.0%
1 Orhon				50	5	10.0%							50	5	10.0%
2 Tsagaannuur				50	4	8.0%							50	4	8.0%
6 Hovd	36	8	22.2%				48	21	43.8%	26	11	42.3%	110	40	36.4%
1 Bulgan	21	4	19.0%				23	12	52.2%	13	6	46.2%	57	22	38.6%
2 Darvi	15	4	26.7%				25	9	36.0%	13	5	38.5%	53	18	34.0%
Total	160	33	20.6%	100	9	9.0%	258	60	23.3%	138	56	40.6%	656	158	24.1%

(Compiled by JERI)

**Table 52 Reasons for Sending Money**  
(multiple answers)

Remit to family member	24.5%
Business	21.5%
Daily goods	12.9%
Proceeds	10.4%
Other reason	49.7%
The number of respondents	163

(Compiled by JERU)

**Table 53 Reasons for Choosing the Institution for Remittance**  
(multiple answers)

No choice	66.3%
Reliable	12.3%
Good service	11.0%
Low charge	1.8%
Other reason	12.9%
The number of respondents	163

(Compiled by JERU)

Table 54 Ratio of Those Who Transfer (send) Money (II)\*

	Nomad			Farmer			Saum Resident			Enterprise			Total		
	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio
<b>1 Arhangai</b>	<b>31</b>	<b>21</b>	<b>67.7%</b>				<b>61</b>	<b>54</b>	<b>88.5%</b>	<b>21</b>	<b>18</b>	<b>85.7%</b>	<b>113</b>	<b>93</b>	<b>82.3%</b>
1 Tsetserleg	15	11	73.3%				31	25	80.6%	11	9	81.8%	57	45	78.9%
2 Hairhan	16	10	62.5%				30	29	96.7%	10	9	90.0%	56	48	85.7%
<b>2 Dornod</b>	<b>30</b>	<b>13</b>	<b>43.3%</b>				<b>74</b>	<b>47</b>	<b>63.5%</b>	<b>7</b>	<b>7</b>	<b>100.0%</b>	<b>111</b>	<b>67</b>	<b>60.4%</b>
1 Matad	15	10	66.7%				35	28	80.0%	5	5	100.0%	55	43	78.2%
2 Choibalsan	15	3	20.0%				39	19	48.7%	2	2	100.0%	56	24	42.9%
<b>3 Omnogovi</b>	<b>32</b>	<b>30</b>	<b>93.8%</b>				<b>47</b>	<b>35</b>	<b>74.5%</b>	<b>30</b>	<b>30</b>	<b>100.0%</b>	<b>109</b>	<b>95</b>	<b>87.2%</b>
1 Noyon	15	13	86.7%				23	15	65.2%	17	17	100.0%	55	45	81.8%
2 Gurvantes	17	17	100.0%				24	20	83.3%	13	13	100.0%	54	50	92.6%
<b>4 Selenge 1</b>	<b>31</b>	<b>24</b>	<b>77.4%</b>				<b>28</b>	<b>20</b>	<b>71.4%</b>	<b>54</b>	<b>34</b>	<b>63.0%</b>	<b>113</b>	<b>78</b>	<b>69.0%</b>
1 Altanbulag	16	15	93.8%				14	8	57.1%	25	13	52.0%	55	36	65.5%
2 Saihan (Hutul)	15	9	60.0%				14	12	85.7%	29	21	72.4%	58	42	72.4%
<b>5 Selenge 2</b>				<b>100</b>	<b>87</b>	<b>87.0%</b>							<b>100</b>	<b>87</b>	<b>87.0%</b>
1 Orhon				50	48	96.0%							50	48	96.0%
2 Tsagaannuur				50	39	78.0%							50	39	78.0%
<b>6 Hovd</b>	<b>36</b>	<b>24</b>	<b>66.7%</b>				<b>48</b>	<b>31</b>	<b>64.6%</b>	<b>26</b>	<b>18</b>	<b>69.2%</b>	<b>110</b>	<b>73</b>	<b>66.4%</b>
1 Bulgan	21	15	71.4%				23	15	65.2%	13	10	76.9%	57	40	70.2%
2 Darvi	15	9	60.0%				25	16	64.0%	13	8	61.5%	53	33	62.3%
<b>Total</b>	<b>160</b>	<b>112</b>	<b>70.0%</b>	<b>100</b>	<b>87</b>	<b>87.0%</b>	<b>258</b>	<b>187</b>	<b>72.5%</b>	<b>138</b>	<b>107</b>	<b>77.5%</b>	<b>656</b>	<b>493</b>	<b>75.2%</b>

\* The data reflect those who intend to send money when the quality of banking services is improved.

(Compiled by JERI)

**Table 55 Reasons to Send Money if Banks Restart**

**Their Business (multiple answers)**

Remit to family member	58.1%
Business	45.7%
Daily goods	34.0%
Proceeds	18.8%
Other reason	8.7%
The number of respondents	494

(Compiled by JERI)

**Table 57 Reasons for Not Having Sent Money Yet (Dornod, Selenge 1 & Hovd)**

**(multiple answers)**

No bank to send money	10.1%
Not reliable	26.3%
Bad service	13.8%
High charge	5.5%
Other reason	37.3%
The number of respondents	217

(Compiled by JERI)

**Table 56 Reasons for Not Having Sent Money Yet (Total)**

**(multiple answers)**

No bank to send money	4.3%
Not reliable	18.0%
Bad service	8.5%
High charge	4.5%
Other reason	40.9%
The number of respondents	494

(Compiled by JERI)

Table 58 Ratio of Those Who Transfer (receive) Money (1)

	Nomad			Farmer			Sown Resident			Enterprise			Total		
	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio
1 Arhangai	31	1	3.2%				61	5	8.2%	21	4	19.0%	113	10	8.8%
1 Tsetserleg	15	0	0.0%				31	2	6.5%	11	1	9.1%	57	3	5.3%
2 Hairhan	16	1	6.3%				30	3	10.0%	10	3	30.0%	56	7	12.5%
2 Dornod	30	3	10.0%				74	4	5.4%	7	6	85.7%	111	13	11.7%
1 Matad	15	3	20.0%				35	4	11.4%	5	4	80.0%	55	11	20.0%
2 Choibalsan	15	0	0.0%				39	0	0.0%	2	2	100.0%	56	2	3.6%
3 Omnogovi	32	0	0.0%				47	1	2.1%	30	4	13.3%	109	5	4.6%
1 Noyon	15	0	0.0%				23	1	4.3%	17	2	11.8%	55	3	5.5%
2 Gurvantes	17	0	0.0%				24	0	0.0%	13	2	15.4%	54	2	3.7%
4 Selenge 1	31	2	6.5%				28	3	10.7%	54	12	22.2%	113	17	15.0%
1 Altanbulag	16	0	0.0%				14	3	21.4%	25	4	16.0%	55	7	12.7%
2 Saihan (Hunul)	15	2	13.3%				14	0	0.0%	29	8	27.6%	58	10	17.2%
5 Selenge 2				100	9	9.0%							100	9	9.0%
1 Orhon				50	4	8.0%							50	4	8.0%
2 Tsagaannuur				50	5	10.0%							50	5	10.0%
6 Hovd	36	14	38.9%				48	28	58.3%	26	15	57.7%	110	57	51.8%
1 Bulgan	21	3	14.3%				23	10	43.5%	13	8	61.5%	57	21	36.8%
2 Darvi	15	11	73.3%				25	18	72.0%	13	7	53.8%	53	36	67.9%
Total	160	20	12.5%	100	9	9.0%	258	41	15.9%	138	41	29.7%	656	111	16.9%

(Compiled by JERU)

**Table 59 Reasons for Choosing the Institution by which to Receive Money**  
(multiple answers)

No choice	79.1%
Reliable	14.5%
Good service	10.9%
Low charge	0.9%
Other reason	6.4%
The number of respondents	110

(Compiled by JERI)

**Table 60 Reasons for Receiving Payment**  
(multiple answers)

Receive money from family	10.0%
Business	38.2%
Pension	29.1%
Salary	27.3%
Other reason	6.4%
The number of respondents	110

(Compiled by JERI)

Table 61 Ratio of Those Who Transfer (receive) Money (II)\*

	Nomad			Farmer			Soun Resident			Enterprise			Total		
	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio	Samples	Yes	Ratio
<b>1 Arhangai</b>	31	26	83.9%				61	48	78.7%	21	16	76.2%	113	90	79.6%
1 Tsetserleg	15	11	73.3%				31	24	77.4%	11	9	81.8%	57	44	77.2%
2 Hairhan	16	15	93.8%				30	24	80.0%	10	7	70.0%	56	46	82.1%
<b>2 Dornod</b>	30	14	46.7%				74	36	48.6%	7	7	100.0%	111	57	51.4%
1 Matad	15	14	93.3%				55	25	71.4%	5	5	100.0%	55	44	80.0%
2 Choibalsan	15	0	0.0%				39	11	28.2%	2	2	100.0%	56	13	23.2%
<b>3 Omnogovi</b>	32	30	93.8%				47	45	95.7%	30	29	96.7%	109	104	95.4%
1 Noyon	15	14	93.3%				23	23	100.0%	17	17	100.0%	55	54	98.2%
2 Gurvantes	17	16	94.1%				24	22	91.7%	13	12	92.3%	54	50	92.6%
<b>4 Selenge 1</b>	31	20	64.5%				28	20	71.4%	54	44	81.5%	113	84	74.3%
1 Altanbulag	16	10	62.5%				14	8	57.1%	25	19	76.0%	55	37	67.3%
2 Saihan (Hurul)	15	10	66.7%				14	12	85.7%	29	25	86.2%	58	47	81.0%
<b>5 Selenge 2</b>				100	88	88.0%							100	88	88.0%
1 Orhon				50	48	96.0%							50	48	96.0%
2 Tsagaannuur				50	40	80.0%							50	40	80.0%
<b>6 Hovd</b>	36	30	83.3%				48	39	81.3%	26	18	69.2%	110	87	79.1%
1 Bulgan	21	19	90.5%				23	18	78.3%	13	11	84.6%	57	48	84.2%
2 Darvi	15	11	73.3%				25	21	84.0%	13	7	53.8%	53	39	73.6%
<b>Total</b>	160	120	75.0%	100	88	88.0%	258	188	72.9%	138	114	82.6%	656	510	77.7%

\* The data reflects those who intend to receive the money when the quality of banking services is improved.

(Compiled by JERI)



**Table 62 Reasons for Wanting to Receive Payment**

(multiple answers)

Family	48.3%
Business	60.9%
Pension	15.4%
Salary	21.4%
Other reason	5.2%
The number of respondents	501

(Compiled by JERI)

**Table 63 Reasons for Not Having Used Payment Receiving Service Yet**

(multiple answers)

No bank offering the service	6.2%
Not reliable	20.2%
Bad service	7.8%
High charge	4.8%
Other reason	39.9%
The number of respondents	501

(Compiled by JERI)

### **4.3 Major Issues in Rural Banking**

Based on the above observation, we summarize the major issues in rural banking as follows.

#### **4.3.1 Insufficient Banking Services in Rural Areas**

Sufficient banking services are not available in rural areas and stagnant economic activities there are all the more affected. Major players in rural finance at the soum level are AB, RB and PB. (Each soum has a sub-branch of one of the banks.) Among them the AB and RB branches have been under BOM administration. They don't provide any new lending. Their outstanding deposits and loans have been decreasing, particularly after the conservatorship. In addition, PB only carries out the transfer/payment function. In some soums closely located to aimag centers, sub-branches have already been closed.

Pension and salary payments were actually delayed in the last few years and again in 1999. AB's liquidity has improved after the government announcement; however, financial problems of the government and employers (enterprises) still remain.

Liquidity at the aimag and soum levels is very low. An additional detrimental factor is that NIC (a main liquidity supplier in the rural banking sector) sales have been decreasing due to gasoline shortage.

#### **4.3.2 Low Trust in the Banking Sector by the Public**

The common perception by the public is that banks are non-reliable and inefficient. Major reasons are as follow.

- (1) Several banks were closed in the recent past, and three banks are currently under receivership. Two of them (RB and ITIB) have officially been decided to be closed soon.
- (2) The banking sector as a whole has accumulated bad loans and accordingly their liquidity is quite low.
- (3) Customers have experienced difficulty in withdrawing deposits, delays in receiving pension and salary payments and slowness in transferring money.

#### **4.3.3 Low Usage of Banking Services by the Private Sector**

Common features were observed nationwide concerning rural area cash flow. The major money inflows to soums are pensions and general budget subsidy from the central government via aimag government, and the major money outflow is NIC sales transfer

to its headquarters. In practice, cash flows one way in the rural banking system: from the aimag center to the soums. Cash leaks out of the banking system in the soums and returning cash flow doesn't go through the banking system.

Private businesses (mainly traders), large or small, don't use banking services, particularly in rural areas. The private sector doesn't want to use banking services because of their lack of trust in the banking system, the slow services in transferring money, and the government's current practice of imposing taxes based on bank records.

#### **4.3.4 Rural Economy behind the Rural Banking**

In order to have a healthy banking system in rural areas, the rural economy has to be healthy and viable. However, common unfavorable economic structure is observed in rural areas.

- (1) The main economic activities are livestock farming and large or small-scale crop farming, with very little value added to raw materials.
- (2) Other than micro-scale trade, non-agriculture business does not exist.
- (3) Thus, rural residents have very limited cash revenue.
- (4) There are no economic complements among soums. Since all soums have exactly the same economic structure and activities, they can't expand their markets to neighboring soums.
- (5) The economic channel is formed in a star-network system between the aimag center and soums, soums being dependent on the aimag center. As things stand, there is very limited possibility for economic expansion.

## **5. Policy Alternatives for Rural Banking Network**

Based on the observations in chapters 1 through to 4 above, the following measures in 5.1 are generally advised to the Mongolian government, taking into account that the rural banking has structural and difficult problems and that appropriate measures require medium to long-term perspective. In 5.2 we analyze three basic alternatives for the rural banking network, focusing on their cost aspect: Alternative A (active use of the existing bank network), Alternative B (active use of Post network) and Alternative C (no active government measures).

### **5.1 General Suggestions for Improvement in Rural Banking Services**

#### **5.1.1 Maintenance of a Banking Network in Rural Areas**

A banking network is basic infrastructure, necessary not only for economic activities but also for social welfare in rural areas. The stagnant rural economy will further deteriorate without financial tools. It seems that it would be difficult to make a commercially viable rural banking network, but not totally impossible given certain government measures explained in 5.2. It also should be noted that there already is a rural banking network in Mongolia, which is difficult to be newly set up.

Though the government basically has to bear a part of the cost of maintaining a banking network in rural areas, the policy decision regarding rural banking network should give due weight to the cost effectiveness aspect for both the government/institution involved and the consumers. We should note that the government has not regularly paid the transfer fees it owes to banks. Only once, in 1997, the government paid MNT600 million to AB, which, according to MOF officials, compensates the accumulated unpaid fees. After repeated requests from the banking sector, the government is planning to pay MNT100 per transaction for soum residents beginning in the year 2000.

There are several alternative measures (types of network) that can be taken, and comparative analysis of the alternatives is a necessary step. Simultaneously, cost-reducing and/or revenue-increasing measures of the network must be studied to minimize the government burden. The transfer/payment function alone clearly is not sustainable. The scope of business (economy of scope) and, accordingly, possible cross-subsidization must be studied.

#### **5.1.2 Improvement in Reliability in the Rural Banking Sector**

In order to restore reliability in the banking system, the government has to get AB out of

receivership, and show its policy direction to the public at the earliest possible timing. A government stance to keep a banking network (not necessarily AB's) in rural areas, assures the rural residents of the banking system.

It surely hinders consumers from using banking services when their deposits are frozen, or otherwise difficult to withdraw and their transferred money gets lost for long periods of time in the bank pipeline. Under the above circumstance, the credibility of the rural banking system can be enhanced by assuring the safety of deposits and the liquidity of the deposit taking banks. As we noted earlier, deposit withdrawal has subsided after the government's announcement on the safety of AB deposits. However, the government needs to carefully analyze the pros and cons of any deposit insurance scheme.

The banking sector has to stop neglecting to inform the public of its activities and its effort for creating sound banking. Banks must provide speedy and secure service, for which they must improve liquidity management, in line with improvements in their telecommunications network.

#### **5.1.3 Improvement in Money Flow in Rural Areas**

Low liquidity in rural banking is caused by several factors as we have seen. They are (1) low usage of banking services by the private sector (including individuals), (2) inefficient information network of the banking system, (3) bad loan problems of the financial sector, and (4) insufficient payment by the government for local governments and pensioners.

Thus, to improve liquidity levels in rural areas, the banking sector must make an effort to increase the private sector usage of banking services, and at the same time settle its bad loan problems. The business sector needs quicker and more reliable services, and banking services are not desirable if bank accounts are reported to the tax authority. An increase in deposits from residents, another form of private sector use, is also necessary to improve the liquidity.

#### **5.1.4 Medium to Long-term Strategy for Basic Problems**

Rural banking is a socially important but economically small part of the banking sector. In order to attain a sustainable banking network in rural areas, there must be long-term strategies to resolve basic problems that the rural economy and the financial sector face: (1) the government deficit, (2) the bad loan problem, and (3) the extent of rural

(agricultural) economic development.

The economic gap, which will increase as the national economy develops, can not be neglected, either socially or politically. Thus, it is inevitable that the rural economy must be subsidized by the central government. Keeping a banking network is one possible measure. The government has to secure sources of funds for rural economic development.

Bad loan problems prevent the financial sector from fulfilling its intermediation function. Rural clients are the first to be hurt. Banks (formal finance) are generally not willing to finance rural borrowers, because their business, agriculture, is risky and their borrowings are small-sized.

The government needs integrated policies and measures for the economic development of rural areas. There are only a few possible industries in rural areas and even industries such as cashmere products processing do not have comprehensive strategies.

The current issue is whether it is feasible to have a banking network in rural areas. Having just one sub-branch at each soum may not be commercially viable. The government, however, may need to address the issue of competition once the basic banking issues are secured. We should avoid the cost of monopoly. Informal finance may be a practical competitor in some areas. In a few soums, both AB and PB are operating.

## **5.2 Alternatives for Rural Banking Network**

Table 64 shows three alternatives for rural banking network.

### **5.2.1 Alternative A (Active Use of the Existing Bank Network)**

In Alternative A, the government decides to maintain the Agricultural Bank's existing rural network. Regarding the current rural network other than that of AB: Post Bank also continues to provide transfer service in Hovd Aimag, and the Reconstruction Bank network in Selenge Aimag is to be transferred to the AB network (with some conditions).

Alternative A is largely divided into two sub-alternatives. (1) One is to utilize the whole organization of AB through recapitalization, and (2) the other is to utilize only the rural network of AB—separating it from the head office, UB branches, and aimag center branches. In the case of sub-alternative (2), either (2-1) a new bank would be established for the rural network, or (2-2) the separated rural network would be merged with the postal network. In the following analysis, we focus on merits and demerits of basic option (1), recapitalization of AB. Then we explore two other particular sub-options, namely "Separation of rural network accounts from head office and aimag center branch accounts" and "Regional banks." Sub-option (2-2) is seen in 5.2.2 Alternative B.

#### **I. Merits**

##### **(1) For the central government and the financial sector**

- The government can sustain a nationwide banking network that can provide full banking services.
- The government does not have to establish an alternative network.
- The government can mobilize savings from the countryside. Soum-level sub-branches have been collecting more than 50% of the total deposits of AB.
- The government can stimulate the rural economy through lending activities of sub-branches. Since 1996, sub-branches have been providing small-size loans. In 1997, sub-branches disbursed about MNT1 billion in loans, and in 1998 more than MNT3 billion. The average size of the loans was MNT660 thousand in 1998. The overall repayment rate on these loans is higher than 95%. In 1998, 46% of the loans were used for agricultural sectors, 30% for manufacturing, and 23% for trading. Lending activities of sub-branches seem to be sound and beneficial for local economies.
- The government can develop financial services and know-how in the countryside by

Table 64: Alternatives for Rural Banking Network

	A: Active Use of the Existing Banking Network (use of AB's rural network)	B: Active Use of Post Network	C: No Active Government Measures
Merit	<ul style="list-style-type: none"> <li>• Nationwide network is available for potential full banking services</li> <li>• No need to establish a new network</li> <li>• Savings can be mobilized in rural areas</li> <li>• Regional economy is stimulated through lending</li> <li>• Accumulated banking experience of AB is utilized</li> <li>• Support of GTZ is expected</li> <li>• Formal employment opportunities are maintained</li> <li>• Various financial services are supplied to residents</li> <li>• Least cost for keeping rural banking network</li> </ul>	<p>(PC: transfer only)</p> <ul style="list-style-type: none"> <li>• PC is reliable as state-owned company</li> <li>• Nationwide network is available</li> <li>• No bad loan problem</li> <li>• Reputation of efficient transfer in Hovd aimag</li> <li>• PC has other revenue sources</li> <li>• Better telecommunication capacity</li> </ul> <p>(PC: transfer and deposit taking )</p> <ul style="list-style-type: none"> <li>• Contributing to savings mobilization</li> <li>• Contributing to branch profit</li> </ul> <p>(PC/PB joint operation)</p> <ul style="list-style-type: none"> <li>• PB's banking business experience is useful</li> <li>• Full banking service may be supplied</li> </ul>	<ul style="list-style-type: none"> <li>• No cost of keeping rural banking network</li> <li>• Financial sector reform may progress</li> <li>• Financial sector may develop due to market economy principle</li> <li>• Informal finance may be more effective</li> <li>• Sourns near aimag centers may develop with strengthened economic ties with aimag centers</li> </ul>
Dement	<ul style="list-style-type: none"> <li>• Recapitalization is costly</li> <li>• Fear of another burden from another AB failure</li> <li>• Remittance speed is slower than that of PC</li> <li>• Low trust of AB as a financial institution</li> </ul>	<p>(PC case)</p> <ul style="list-style-type: none"> <li>• Shortage of banking business experience</li> <li>• Necessity of BOM authorization to start business</li> <li>• Necessity of proper transfer fee to compensate cost</li> </ul> <p>(PC/PB joint operation)</p> <ul style="list-style-type: none"> <li>• Conflict of management policy difference</li> </ul>	<ul style="list-style-type: none"> <li>• Government has to create new measure for transferring government funds to sourns</li> <li>• No banking services in rural areas</li> <li>• Loss of institutional assets for rural banking</li> <li>• No savings mobilization tools in rural areas</li> <li>• Lack of economic development mechanism</li> <li>• Loss of formal employment opportunity</li> </ul>
Implementation Measures	<ul style="list-style-type: none"> <li>• Making clear vision and concrete business plan</li> <li>• Establishment of management responsibility</li> <li>• Technical assistance on large loan appraisal</li> <li>• Strong supervision by BOM</li> </ul>	<ul style="list-style-type: none"> <li>• Discuss the procedure with the authorities, under non banking regulation</li> <li>• Banking business training for employees</li> <li>• Banking services promotion (e.g., direct debit of utility charge)</li> <li>• No delay of pension, salary is essential</li> </ul> <p>(PC/PB joint operation)</p> <ul style="list-style-type: none"> <li>• Making clear business policy to cooperate</li> </ul>	<p>Alternative measures</p> <ul style="list-style-type: none"> <li>• Local government channel</li> <li>• NIC channel: using NIC cash collection network</li> <li>• Collection by local residents</li> <li>• Promotion of informal finance</li> </ul>



utilizing the accumulated experiences of AB. AB has experiences not only in small lending but also in loan collection. Most AB sub-branch employees are well trained and have a high academic background. More than 70% of the employees have longer than five years of experiences in the banking sector. Of the sub-branch managers, 70% have college degrees or higher. Post Bank employees' education levels in Hovd Aimag are lower. AB has effective loan collection units that have collected about MNT2 billion since 1996.

- The government can expect international support from GTZ. GTZ is ready to provide 3 million German marks (with some conditions).
- The government can sustain the basic banking infrastructure in rural areas at the lowest possible cost, as we see in 5.2.4. The average sub-branch cost of AB is lower than that of PC/PB. AB has already been streamlining sub-branch expenditures. AB reduced sub-branch employees by 35% (361 employees) in 1999. Now AB is trying to reduce operating expenditures by 20 % from the level of 1998. AB will close 22 of its 269 sub-branches in 1999, and may close an additional 5 to 10 in the year 2000. However, AB will still have more than 240 sub-branches scattered all over the country.

#### (2) For local government

- The local government does not have to worry about government fund delivery.
- An economic development mechanism with lending is available in rural areas. The local economy may be stimulated, and increase tax revenues.
- Formal employment opportunities for 600 people are secured (non post office jobs scattered among more than 240 soums).

#### (3) For local residents

- Full banking services are available.
- Residents may deposit surplus money and earn interest.
- Residents may be able to borrow necessary money.
- Residents' welfare level is maintained and may be lifted up through economic development.

### II. Demerits

#### (1) For the central government

- Recapitalization of AB costs the government about MNT7.3 billion—to attain the minimum required capital. The government may convert its existing current account

balance and deposits (MNT5.8 billion) into capital, BOM may also convert its loans (MNT1.1 billion) into capital. In addition, the government can expect support from GTZ, which will provide MNT1.7 billion if AB meets GTZ's conditions. The total MNT8.6 billion may be sufficient to recapitalize AB. In this context, the government may not have to inject new money into AB. We should note that liquidation of AB would cost the government even more. The liquidation cost is around MNT7—9 billion, depending on AB's recovery of delinquent loans and sales of collateral. In case of AB pays out only 80% of the current account and deposits (20% being written off and borne by depositors)<sup>3</sup>, the liquidation cost can be below MNT4.6 billion. The preceding estimations assume that the recapitalization or liquidation occurs at the beginning of the year 2000. If the decision is delayed, AB will add up loss on the MNT7.3 billion.

- If AB fails again, the government will have to shoulder another financial burden. AB's current business plan is vague. AB has not gained enough capacity for large-size loans. If AB fails again, the peoples' trust in the banking sector will be damaged significantly and financial development in Mongolia may be delayed.

### (3) For local government

- Remittance may be slower than that of the postal network. AB's sub-branches have a disadvantage in competing with the post network in telecommunications.

### (4) For local residents

- Remittance may be slower than that of the postal network.
- AB still has a bad image and people may not want to use banking services.

## III. Implementation Measures

### (1) Problems in the existing AB restructuring plan

- There is neither a clear vision nor a concrete business plan on how AB can balance revenues and expenses.
- There is no clear vision of who will take ultimate responsibility of the new AB. If several parties evenly share responsibility, it will become unclear who has ultimate responsibility and in the end no one will take it.
- AB still does not have enough capacity to offer large-sized loans—loans larger than

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<sup>3</sup> When Insurance Bank was liquidated and taken over by Savings Bank, deposits were cut by 20% and current accounts were cut by 50%. In the case of AB, we do not consider such cuts to be appropriate, because most depositors in rural areas have not had any choice other than to use AB.

MNT1 million. It may take time to improve AB's ability in this field.

(2) Necessary measures in addition to recapitalization

(Recapitalization is just a start for a new AB.)

- International consultants are needed to help formulate a concrete business plan, though it is not so difficult to balance revenues and expenditures.
- It is necessary to clearly set who will take ultimate responsibilities and to ensure transparency on decision making.
- AB needs significant technical assistance on loan appraisal techniques.
- Lending beyond MNT1 million should be strictly controlled and surplus deposits should be invested in government bonds and BOM bonds for a while.
- BOM needs to perform closer inspection.
- The head office and aimag center branches need to be streamlined further. The average personnel cost for one person in the head office and branches are respectively 4.2 times and 2.4 times higher than that of sub-branches. The number of sub-branch employees was reduced to 29% of its 1991 figure by September 1999, while the numbers of the head office and aimag center branches were 312.5% and 83.5% of their 1991 figure respectively. If we focus on the most recent trend, the number of sub-branch employees was reduced by 35% during the first nine months of 1999. On the other hand, staffing at the head office and aimag center branches increased by 10% and 14% respectively.

(3) Conditions for taking over the Reconstruction Bank network in Selenge Aimag

- Examine why the Reconstruction Bank incurred huge losses in Selenge Aimag and solve all problems.
- Classify loans outstanding properly into sub-standard, doubtful, and bad loans, and establish measurement to cover losses.
- Cut the number of employees and operating costs.
- Set severe discipline standards for bad loan-making. Scrap the Reconstruction Banks' corporate culture completely.

#### IV. Further Measures

(1) Separation of rural network accounts from the accounts of headquarters and branches

One sub-option of Alternative A is the separation of a rural network account from accounts of the head office and aimag center branches. If the sub-branch accounts are separated, then the government can transparently subsidize the rural network alone. The

separation also avoids the business risk of the head office and aimag center branches. (The major demerit of Alternative A is the inefficient management of AB, mainly at the head office and branch levels.) By not being completely cut off from the organization, the rural network can enjoy such management services as fund management, human resource management, auditing and legal consulting. Although there are merits to this sub-option, as we see above, there still are some issues to be resolved: How could the accounts be separated transparently and safely? Who could take on the responsibilities of management effectively and efficiently? And who could supervise such operations?

A number of schemes exist for separating financial accounts within an organization. For example, "trust banks" in Japan separate trust accounts from banking accounts in order to avoid the misappropriation of entrusted funds. It would be quite difficult to apply the Japanese trust bank scheme to AB's rural network, because there is no reliable trustee for the management of the rural network in Mongolia. Banking operations have to be transparent, and thoroughly monitored by the central bank. However, even the supervision of commercial banking has been less than adequate in Mongolia. The other option is to separate one account from the other, as the IDA account is separated in the World Bank. This option may be viable; however, it needs a complicated legal and accounting scheme. Firstly, the Mongolian authorities have to establish objective and transparent standards on overhead cost-sharing between accounts. Ensuring transparent management of the two accounts will also be difficult in Mongolia, where even simple banking operations have not been appropriately managed. Thirdly the central bank will have to closely monitor the operations of all accounts. The central bank needs more time to strengthen its supervisory capacity. The sub-option may be feasible as a mid-term or long-term option.

## (2) Regional bank

There are two different approaches to the regional bank concept. One is a sub-alternative, restructuring AB into a holding company with several aimag-based regional banks. The main features of this approach are nationwide operation and local capital participation. The other approach is to set up a few or several regional banks. The main logic of this sub-option is the abandonment of nationwide operation and services, and the provision of more flexible programs for regional development. There are some areas which have economic conditions for commercially viable rural banking. However, the sub-option does not seem appropriate under the current economic and political circumstances, because of the following demerits:

- **Vulnerability to political intervention:** The biggest cause of AB's insolvency was directed loans (i.e., political intervention in the lending decision). Regional banks have to be closely tied to local politics and may be more vulnerable to political intervention.
- **Weaker management:** Management size at regional banks has to be smaller than at aimag centers because overhead costs such as management cost have to be smaller for smaller banks, and smaller management tends to be subjective and closed. External auditing may be weaker than that on aimag center branches. In addition, regional stockholders' check on management may be weak, compared with UB's stockholders.
- **The shortage of human resources:** There are not sufficient human resources in rural areas to soundly provide modern financial services.
- **Difficulty in technical assistance:** Regional banks also need technical assistance on financial know-how from international donors; however, it seems it would be difficult to obtain such TA in rural areas. Currently TA is mostly provided in the UB area.

*Box 5.2.1.1: AB's operation after the conservatorship*

AB's insolvency is due to both external causes (such as directed and inherited loans, confusion after the economic transition, inappropriate government and central bank policies) and internal causes (such as weak management and low credit appraisal ability).

AB was placed under conservatorship on February 12, 1999 and then under receivership on October 5, 1999. When it was put under conservatorship, AB's past dues in transfers and payment totalled MNT2.3 billion—1 billion for pension transfer, 0.7 billion for payment to other banks, and 0.6 billion for payment to the Bank of Mongolia—and its liquidity ratio was minus 2.6%. After the conservatorship, a sort of bank run occurred and the deposits outstanding of the private sector decreased by about 0.7 billion by the end of August. The conservators, who were appointed by the central bank, have been cooperating with legal authorities to try to collect cash from the delinquent loans and assets collected as payments. AB has succeeded in recovering more than MNT2 billion from these. In addition, the public sector has increased its outstanding in the current account of AB by more than MNT1.2 billion and BOM increased loans outstanding by MNT0.6 billion. As of the end of September, AB's liquidity had improved beyond the required 18%. When AB was transferred from conservatorship to receivership, the transfer and payment delays relating to the private sector were completely removed. Past dues relating to the public sector are within AB's liquidity. Now the outflow of private deposits has been stopped and the transfer and payment function of AB is operating normally.

### 5.2.2 Alternative B (Active Use of Post Network)

In Alternative B, the government decides that Mongol Post Company either (1) independently or (2) jointly with a commercial bank is responsible for the transfer services of pension and benefits. PC currently cooperates with Post Bank in rural areas, and accordingly we assume in the following analysis that PB is the joint business partner of PC. However, there are other alternatives: PC may cooperate with AB to utilize AB's rural banking network and experience, or PC may cooperate with SB focusing on savings mobilization promotion. We will also see sub-options of PC/AB and PC/SB joint business.

If PC were to start banking business independently, it would provide either transfer services alone or transfer and deposit taking services. PC would not provide lending services because lending requires considerable resources and experience and because PC considers lending to be risky business. If it took deposits, PC would invest the collected deposits surely and safely in government bonds or BOM bonds (presupposing that government bonds are marketable). These additional businesses will contribute to the earnings of PC's soum branches.

#### I. Merits and Demerits of Sub-cases

##### (1) CASE 1. Independent operation of PC (only transfer services)

###### Merits

- ① Being a state-owned company PC is regarded as a reliable institution.
- ② PC already has a nationwide network that has been managed very efficiently. Their network is more comprehensive than AB's. It would be convenient for rural people to use the nearest post office for financial services.
- ③ PC has no bad loan problem.
- ④ In Hovd aimag, money transfer is fast and safe using the already established telecommunication network.
- ⑤ Having postal service revenue, PC has scope of economy in soum level operations.

###### Demerits

- ① PC's transfer/payment experience in Hovd Aimag may not be adequate enough for nationwide operation.
- ② PC needs time to establish a banking network.
- ③ PC has to get BOM authorization for a new financial business, which may take

time.

- ④ PC requires a slightly higher transfer fee than AB, as we see in 5.2.4.
- ⑤ Full banking services (especially lending) would not be supplied to rural people.

## **(2) CASE 2. Independent operation of PC (transfer and deposit taking services)**

### **Merits**

Adding to the merits of Case 1,

- ⑥ Deposit taking at all post offices would contribute to national savings mobilization.
- ⑦ Deposit taking (and investing them in safe securities) contributes to sub-branch revenue. The government could pay less transfer fee than in Case 1.

### **Demerits**

Adding to the demerits of Case 1,

- ⑥ PC has no financial business experience other than transfer/payment services. It may take time before financial services could be managed properly.

## **(3) CASE 3. PC/PB joint operation**

### **Merits**

- ①,②,④,⑤,⑥and⑦ are the same as in Case 2.
- ⑧ The banking business experience of PB is useful for management.
- ⑨ Full banking services may be supplied to rural people.

### **Demerits**

- ①PC's transfer/payment experience in Hovd Aimag may not be adequate enough for nationwide operation.
- ②PC needs time to establish a banking network.
- ③PC has to get BOM authorization for a new financial business, which may take time.
- ⑦ PC has no financial business experience other than transfer/payment. PB also has limited experience and coverage in rural finance. Even with the cooperation of PB, it may take time before those services could be managed properly. Lending service is especially difficult to manage.
- ⑧ There may be conflict between the management policy of PC and that of PB. While PC is a state-owned company, PB is a private commercial bank. Their



basic business behaviors are different, especially regarding social welfare and benefits.

**(4) Sub-option of CASE 3. PC/AB joint operation**

**Merits**

The merits of joint operation are the same as PC/PB case. Additionally,

- ⑩ AB's rural finance resources (network, human resources, experience) are utilized.
- ⑪ It is socially economical to have only one network in rural areas.

**Demerits**

- ⑧ There may be conflict between the management policy of PC and that of AB.
- ⑨ It may take time for the two corporate cultures to merge.
- ⑩ Bad effects may arise from the monopolistic operation.

**(5) Sub-option of CASE 3. PC/SB joint operation**

**Merits**

The merits of joint operation are the same as PC/PB case. Additionally,

- ⑫ Both PC and SB are state-owned companies and are regarded by the public as reliable.
- ⑬ Rural banking is a socially important infrastructure and accordingly has a public goods aspect. It may be suitable to be performed by a public sector organization.

**Demerits**

- ② PC needs time to establish a banking network.
- ③ PC has to get BOM authorization for a new financial business, which may take time.
- ⑦ PC has no financial business experience other than transfer/payment. SB also has limited experience and coverage in rural finance. Even with the cooperation of SB, it may take time before those services could be managed properly. Lending service is especially difficult to manage.
- ⑪ There is potential for SB to have a liquidity problem. Though most of its collected deposits are invested in government bonds, the bonds do not have a maturity date and the government has not regularly paid interest on them.

## II. Implementation measures

Under the current banking law in Mongolia, it is impossible for PC to start banking business independently. It is necessary to amend the law or to think of other ways to provide such services. One possibility is to establish a non-banking organization to take deposits at soum branches. However, non-banks are not permitted to take deposits from the general public.

Cooperation with a commercial bank is a practical way to get into banking business, as is done by PC/PB. Full banking service could be offered to the public. However, differences in management policy have to be taken into account when starting a joint business.

### (1) CASE 1 and CASE 2:

#### PC needs

- ① To provide banking services, based on the current non-bank financial institution regulation. It is necessary to discuss the procedure with the authorities.
- ② To provide banking business training for the employees
- ③ To hire persons who have banking service experience

### (2) CASE 3:

#### PC/PB needs

- ① To make clear each organization's business policy (for cooperation)
- ② To provide banking business training for the employees
- ③ To hire persons who have banking service experience

## III. Measures for the authorities concerned:

#### The government and BOM need

- ① To restore the rural residents' perception of banking services
- ② To mandate the use of banking services (for example, tax and public utility charges should have to be paid at financial institutions)
- ③ To support PC's financial activities, especially at its start
- ④ To provide proper supervision of financial institutions to ensure their credibility
- ⑤ To secure that there be no pension, salary and budget transfer delays
- ⑥ To pay whatever transfer fee is necessary to maintain a viable nationwide network

### **5.2.3 Alternative C (No Active Government Measures)**

In Alternative C, the government decides to close the Agriculture Bank network as well as the Reconstruction Bank network in rural areas, without formulating policy measures to promote the postal network as a financial tool. In this case, alternative measures must be developed to, at least, transfer government funds.

#### **I. Merits**

##### **(1) For the central government**

- The government does not have to bear the cost of maintaining a rural banking network.

##### **(2) For the central government and the financial sector**

- There may be progress in financial sector reform, if AB can be recreated as a commercially viable institution without the burden of the rural network. We should note again, however, that the insolvency of AB was not caused by its rural network.
- The financial sector may develop more by adhering to the market principle than by having a system replete with government intervention.

##### **(3) For local governments**

- Informal finance may be more effective than formal banking.
- Soums existing near aimag centers could strengthen economic ties with those centers.

##### **(4) For local residents**

- Informal finance may be more effective than formal banking.

#### **II. Demerits**

##### **(1) For the central government**

- The government has to formulate a measure for transferring government funds to rural area soums and may incur cost burdens beyond the formal banking network cost.
- People's trust in the government may decline—seeing the loss as government's negative stance regarding social welfare.
- No savings mobilization tools are available in rural areas (sوم residents may/would go to aimag centers to receive pensions, but would not go for deposits.)
- The economic gap among regions (soums) will become greater.

**(2) For the financial sector**

- The financial sector will lose institutional assets for rural banking.
- Trust in the banking system will further deteriorate among rural residents.

**(3) For local governments**

- The overall welfare level of local residents will decline.
- The local economy does not have this important economic development mechanism.
- The local economy does not have an important formal employment opportunity for its residents.
- The local economy does not have an important communication channel with aimag center.
- The soum system may not survive without development tools and perspective.

**(4) For local residents**

- No banking services (transfer, deposit or borrowing) are available in rural areas.
- Local residents have to travel to aimag centers to get banking services (practically impossible in the case of remote soums).
- Local residents do not have an important formal employment opportunity.

**III. Implementation measures**

**(1) Alternative measures for government funds transfer**

We analyze three scenarios involving alternative measures for transferring funds: (a) local governments by themselves transport and deliver funds, (b) the government entrusts NIC to function as a pension deliverer, (c) the government gives up to create any measures. In this last case, local residents have to help themselves.

**(a) Local government channel**

Local governments take the responsibility for transferring pensions to local residents.

- An IMF study elaborates on the measures to be taken.

The cost for a local government to implement the transfer is marginal, a half person may be necessary for accounting, and delivery cost is very marginal considering the possibility of security cost. In each soum there are on average 800 payments per month.

$\text{MNT}20,000 \text{ (accountant)} + \text{MNT}5,000 \text{ (security)} = \text{MNT}25,000$

$25,000/800 \text{ payments} = \text{MNT}31$

- Banking law amendment is not necessary, since local governments would take on their own banking-service responsibilities.

- However, considering the low liquidity in rural areas, local governments may have to handle inflow from NIC and other fees, and receive only the difference, from aimag centers. Local government would be functioning as a bank; thus, making this scenario no better than Alternatives A and B.

#### (b) NIC channel

The government entrusts NIC with paying pensions to local residents.

- NIC either has to (a) take over the AB network (facilities and staff), or (b) set up a new network. A banking office can not be housed in a gas station, which is flammable and is located away from the soum center.
- The cost of taking over the AB network is the same as the cost for Alternative A plus a set-up cost for a financial subsidiary (Minimum capital of MNT2 billion is necessary).
- The cost of setting up an entirely new network is higher than that of Alternative B—office space would have to be acquired and there would not be a chance to take advantage of the postal business (economy of scope).
- Thus this alternative is no better than Alternative B in terms of potential coverage of soums (due to business competition), institutional experience in financial business, telecommunication network, and the governance issue.
- Prohibition of side business is stipulated in Banking Law § 7.1. However, it may be possible to apply for “banking business” under the new NFBI regulation.
- NIC has to set up a banking subsidiary to separate its accounts from those of the government. From a governance point of view, it is not recommendable for a company which needs bank borrowings, to have a banking subsidiary.
- NIC sales fluctuate according to the demand/supply and import of gasoline, and have decreased in recent years. Due to competition, NIC has already closed rural stations in some aimags.

#### (c) Local residents’ receipt of benefits

Local residents have to travel to aimag centers to collect their social benefits.

- The traveling cost of residents (transportation fee, security, physical burden) would not hold for the nation at large. Even the potential economic cost to the public is quite high.

Economic cost calculation:

#### Case 1: Soums close to aimag centers

Assuming a soum is located 50km away from aimag centers and there are 500 pensioners and benefit receivers. Being rather close to aimag centers, residents can access aimag centers by themselves. Residents probably take turns traveling to aimag centers by minibus or jeep (in 5-to-10-person groups).

**Annual potential social cost per soum:**

Travel cost:  $\text{MNT}1000 \text{ (minibus fee)} * 500p * 12m = \text{MNT}6m$

**Annual real economic cost per soum:**

$\text{MNT}6m / (5-10) = \text{MNT}0.6 - 1.2m$

**Case 2: Soums distant from aimag centers**

Assuming a soum is located 200km away from an aimag center and there are 500 pensioners and benefit receivers. Since it is impractical to go to the aimag center (if soums were located more than 100 km), the residents wait for an occasion when a government official comes to the soum (maybe once every three months). For such visits the aimag government has to hire another car and three security guards to transport the funds.

**Annual potential cost:**

Travel cost:  $\text{MNT}1,000 * 4 * 500p * 12 = \text{MNT}24m$

Accommodation cost:  $\text{MNT}5,000 * 500P * 12 = \text{MNT}30m$

**Real cost:**

Delayed interest:  $\text{MNT}13,000 * 500 * 3m \text{ (the 3-months amount)}$

$* 1m \text{ (weighted average delay)} * @2\% \text{ (the monthly interest rate)} = \text{MNT}0.39m$

Car cost:  $\text{MNT}500/km \text{ (car cost)} * 200km * 2 \text{ (round trip)} * 4t/y = \text{MNT}0.8m$

Security cost:  $\text{MNT}(5,000 + 5,000) * 3p * 4t/y = \text{MNT}0.12m$

Insurance cost:  $\text{MNT}13,000 * 500 * 3 * 1\% \text{ (insurance fee)} * 4t/y = \text{MNT}0.78m$

Total:  $0.39 + 0.8 + 0.12 + 0.78 = \text{MNT}2.09m$

**Total economic cost:**

Out of 321 soums, excluding aimag centers, one-third are located rather close to aimag center and two-thirds are located away from aimag center.

$(\text{MNT}1m * 1/3 + \text{MNT}2m * 2/3) * 321(\# \text{ of soums, excl. AC}) = \text{MNT}535m$

**Total potential social cost:**

$(\text{MNT}6m * 1/3 + (\text{MNT}24m + \text{MNT}30m) * 2/3) * 321 = \text{MNT}12.2b$

## (2) Promotion of microfinance in rural areas

In order to fill the formal banking sector void in rural areas, informal tools must be

promoted. It should be noted that rural finance projects in Mongolia are naturally targeted at areas with relatively high prospects: the Ulaanbaatar area, aimag centers, areas along the railway and border areas. Such a pattern of development will inevitably widen the economic gap among soums.

**Table 65: Comparison between Alternative A and Alternative B (I)**

Criteria	Alternative A (Active Use of the Existing Bank Network)	Alternative B (Active Use of Post Network)
<b>Readiness to provide financial services (mainly transfer of public funds) at soums.</b>	<p><b>YES</b> AB is able to provide financial services through the existing network of 247 branches(as of end of 1999).</p> <p><i>Concerns</i> "Restructuring Plan" is not so concrete about the new management members and new business plan. It is unclear if AB can fix all problems that caused the insolvency and if AB can immediately provide a large amount of sound lending services. In addition, it may take a long time for AB to restore its credibility, which is necessary in order to mobilize savings.</p>	<p><b>NO</b> PC/PB has a network reaching 21 aimag centers, but can not provide financial services at soums except in Hovd and several sub-branches. PB seems to have no intention to expand its network to small soums. Money collection of NIC's sales can be handled solely by the post offices, though there may be safety problems. In order to expand the operation, it takes time and cost to hire and train additional staffs. Furthermore the number of instructors is limited (only 7 instructors), so additional time will be necessary. (At least one week is needed to open one branch. PB may be able to open seven branches concurrently under ideal circumstances.) An additional concern is that many mistakes tend to happen at the initial stage of operation.</p>
<b>Reliability and quality of service</b>	<p><b>YES for transfer and small loans</b> <b>Low credibility from past failures</b> <b>Concerns for re-failure</b> AB's quality of services at soum level branches seems to be high, as its staffs are familiar with operation and have more experience compared to the staffs at other banks. It is not clear if AB has completely solved previous problems, including weak management and lending control. AB's ALM (asset liability management) capacity is also not clear.</p>	<p><b>YES for transfer</b> In terms of money transfer, PB is providing quicker and better services than any other commercial banks in Hovd aimag. It's operation fully meets requirements of the Bank of Mongolia. In terms of deposit taking and lending, PB's ability is not clear. Even though PC/PB does not provide lending, they need to earn interest through appropriate ALM, (asset liability management), for which they have no expertise.</p>

(Compiled by JERI)



**Table 66: Comparison between Alternative A and Alternative B (II)**

<b>Criteria</b>	<b>Alternative A (Active Use of the Existing Bank Network)</b>	<b>Alternative B (Active Use of Post Network)</b>
<b>Initial cost (re-capitalization cost)</b>	<b>High</b> Both liquidation and recapitalization are costly. Billions of togs are needed. There are significant gaps between accounting prepared by Arthur Andersen and that by AB.	<b>High</b> The nationwide network setup cost of PC/PB is less than one billion togs.
<b>Operating cost</b>	<b>Relatively Low</b> AB's sub-branch operating cost is the lowest in Mongolia. Advantageous if soum branch can earn decent interests through small-size loans as before and can circulate NIC's money within soums through existing network. According to the estimation of pension transfer fees, that of AB seems to be cheaper than that of PC/PB. The labor cost of AB is cheaper than PC/PB, though AB's employees have higher degree and longer banking experiences. Disadvantageous if they have to frequently deliver cash between aimag center and each soum.	<b>Slightly High</b> Advantageous over using other banks, as indirect cost can be shared by the postal operation. Cost of money transfer between aimag centers and soums can be shared with the postal service. The decrease in indirect cost due to revenue from other operation, such as lending, will not be expected for a while. The costs borne by the Postal service are lower than those borne by Agricultural Bank, through its micro-lending operation. Generally banks can not be self-supporting without interest revenue.
<b>Possibilities of future service development</b>	<b>Relatively Advantageous</b> AB has relatively advantageous human resources at soum level with experience in banking operations and potentials measured by academic record. They may be able to provide various services in the future. Though they have only two years experience in micro lending (about 2 years), AB has a lot of experiences to manage lending activities and recovery bad loans. However, it is doubtful whether AB can appropriately manage large-sized lendings.	<b>Relatively Small</b> PC/PB limits its functions to transfer and deposit taking for a while. It is difficult to expect that they would operate sound lending programs in the near future.

(Compiled by JERI)

**Table 67: Comparison between Alternative A and Alternative B (III)**

Criteria	Alternative A (Active Use of the Existing Bank Network)	Alternative B (Active Use of Post Network)
<b>Impact on the regional economy</b>	<p><b>Relatively Positive</b>  More contribution can be expected to the regional economy if the funds flow back to the region smoothly through sound lending activities.  There seems to be significant demand for lending in soums.  Funds that cannot be used in rural areas (about 2/3 of the total) go to UB.  It is unclear if AB can fix all its problems by its Restructuring Plan.  If AB will cause same problems in the future, people's trust in banking services will be badly damaged.</p>	<p><b>Relatively Small</b>  PC/PB will only pump up rural area funds into UB because PC/PB is not going to provide lending services and may not be able to provide better lending services than AB. It is uncertain whether funds are well distributed to rural areas through purchase of government bonds and other measures.  Japanese postal deposit taking is set with lending activities by sound governmental financial institutions.  In terms of providing reliable transfer, PC/PB is advantageous for restoring people's trust of banking services.</p>

(Compiled by JERI)

#### **5.2.4 Cost Analysis of Rural Banking Network**

In the following, we analyze the economic cost of rural banking network. We analyze comparatively the revenue and cost structure of Alternative A (Agricultural Bank) and Alternative B (Post Company/Post Bank). The analysis provides the Mongolian government with objective and supporting data for their policy decisions. Here again the rural network is defined as a nationwide banking network at the soum level with minimum management units at aimag centers.

Data of 1998 is used as the benchmark for PC/PB, but data of January through September of 1999 is used for AB, because AB's lending activities varied in the last few years, and data of 1998 with large volume of loans is not appropriate for comparative analysis.

##### **I. Revenue and Cost Structure of Soum Branches**

The average annual costs of a sub-branch are MNT1.6 million for Agricultural Bank and MNT1.7 million for Post Company/Post Bank. However, the total revenue is only MNT0.8 million per year for AB and MNT1.0 million for PC/PB. The total operating costs of 264 sub-branches of AB would be MNT483 million per year. The costs of PC/PB would be MNT551 million, provided they have 264 sub-branches. We include a 12% of aimag center branch costs as a necessary management cost of a sub-branch network. The government transfer fees can by themselves compensate the network operating costs, if AB is paid MNT244 per transfer, or if PC/PB is paid MNT279 per transfer. The rural network is, by our definition, assumed to provide transfer/payment service only at the soum level. However, if the transfer services at aimag center branches are included in calculation, the number of transfer would increase. As a result, increase in revenue could reduce the fee to MNT230 for AB and MNT261 for PC/PB (Herein after we include these figures in parenthesis).

In the benchmark year, AB had revenue from transfer/payment service as well as from previous lending operations, and PC/PB had postal services revenue and transfer/payment service revenue. We add internal interest revenue to the AB soum branch deposits transferred to aimag center branches or head office (which is currently not recorded to soum branch revenue). Even including these revenues, unit transfer fee of MNT 145(138) is necessary for AB, and MNT 148(139) is necessary for PC/PB to cover the total operating costs of soum branch.

The main cost of a sub-branch is personnel expenses. According to their financial data, they account for more than 60% of all costs in the case of PC/PB and about 80% for AB. However, some items recorded as administrative expenses at PC/PB should be classified as personnel expenses. If this were to be done, the total personnel expenses would account for more than 80% of the total cost. A typical sub-branch has three employees: a manager, a cashier and a watchman. It is difficult to reduce the number of staff out of the only three employees. The minimum number of employees necessary for managing sub-branch of a financial institution should be three, from the viewpoints of security and of avoiding error and misappropriation.

AB sub-branches are cheaper to manage than PC/PB sub-branches. The above cost figure of AB includes one-time severance cost arising out of restructuring measures. In addition, AB is currently trying to reduce its operation cost. Therefore, the potential cost of AB could be lower than the figure we use. PC/PB's cost includes postal service expenses. But even if postal expenses were to be deducted, the annual cost of a PC/PB sub-branch would still be slightly higher than AB's current costs.

## II. Distribution Cost of Pension and Other Benefits

An additional revenue source for soum branches should be the government transfer fee. The government has not regularly paid the fee so far, but is planning to pay MNT100 per transfer from the year 2000. We see above that the break-even fee for the networks is between MNT244(230) and MNT279(261) without any other revenue and between MNT145(138) and MNT148(139) with revenue from the current operations. We see below the real cost of transfer/payment services.

The work time spent on pension transfers is 31% of the total hours. The proportionate cost for pension transfer can be calculated as a 31% of the total cost of soum branch operation cost and aimag center branch management costs (assuming 12% of the aimag center branch total cost). Using the proportionate cost, unit transfer cost (i.e., for one pensioner per month) is calculated as MNT98 for AB and MNT117 for PC/PB. These MNT98 and MNT117 would bring break-even revenue to AB and PC/PB respectively, if the rest of their business hours were fully used and had break-even revenue.

## III. Measures to Sustain the Rural Banking Network

It is difficult for transfer/payment service to be commercially viable. The transfer fee of MNT 100 (for soum pensioners) or MNT 90 (for aimag center pensioners) the

government included in the budget is not sufficient to compensate the total costs of sub-branches. Other revenue sources such as deposit taking, lending and postal services are necessary to keep the rural network.

AB needs lending business and PC needs to invest collected deposits in marketable government bonds. Here the assumption is that micro lending by AB's soum branches is at 1997 levels. We also assume that PC/PB takes in the same volume of deposits as AB does and earns a 0.5% margin on them. The unit transfer fee from the government could be reduced to MNT82(80) in the case of AB, and to MNT97(91) in the case of PC. Particularly, the transfer fee required by AB would fluctuate with the level of lending activities. The higher the lending level, the less unit cost AB needs from the government.

#### IV. Initial Cost of Nationwide Transfer Operation

We also have to consider initial costs of nationwide rural banking when we analyze the network costs. Agricultural Bank already has a nationwide network. However, in order to utilize AB's rural network, either AB has to be re-capitalized or its network has to be separated from the main body of AB. AB needs MNT7.3 billion to be re-capitalized. After reducing this amount by the MNT1.7 billion to be contributed by GTZ, the government would have to inject MNT5.6 billion. In order to separate AB's rural network, it may be necessary to liquidate AB, which would be more costly than re-capitalization.

PC/PB could utilize the existing post office network. As in Hovd Aimag experience, PC/PB can establish banking offices within post office buildings. As a benchmark, we can estimate the setup cost of a nationwide rural banking network utilizing 330 soum post offices and 21 aimag center offices to be MNT560 million (excluding computer installation cost). It would cost PC/PB MNT 304 million to have additional 243 offices in order to match AB's network of 264 offices.

Any entity without a rural banking network would either have to take over the existing network or establish a new network of its own. The initial setup cost would be more than MNT1 billion and its operation cost would be higher than it would be for either AB or PC.

#### V. Government Expenditure to Sustain a Rural Banking Network

If the transfer fee were to be MNT150, the government payment would bring break-even revenue to soum branch operations, as shown above. In this case, the annual budget needed would be MNT744 million<sup>4</sup>, which amounts to 1.3 % of the MNT59 billion in annual pension and other benefits payments (Table 28). In other words, if social benefits could be curtailed by just 1.3 %, the beneficiaries could keep the payment network. More than one percent of the economic value of benefits has been easily lost in delayed payments so far. We can confirm here that the more important cost is the cost of either recapitalizing or liquidating AB, rather than the rural network operation cost.

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<sup>4</sup> MNT 150 times 413.6 thousand pensioners and social benefit receivers times 12 months

## 6. Concluding Suggestions

This study considers two issues: (1) whether the Mongolian government should keep a rural banking network or not, and (2) if so, how. As candidates of the latter issue, we mainly analyze the rural network of Agricultural Bank and that of Post Company.

In deciding policy, the government at least needs to analyze the issue from two aspects, namely cost-benefit and financing. The former clarifies whether the policy decision is justified from the point of overall society. The latter considers the questions of how and by whom the cost of the policy should be shouldered and how the policy goal should be achieved.

### **Cost-benefit analysis of the rural banking network in Mongolia**

At the beginning, the government must cautiously analyze whether the rural banking network is worthwhile for the society—in other words, whether the economic benefit of the rural banking network surpasses the economic cost of the network. Here we consider cost and benefit to the national economy as a whole.

#### *Estimates of annual economic benefit*

How does Mongolia, whose population density is the world's lowest, economically benefit from a rural banking network? One major benefit is reduction in the expenditure by rural (soum) residents to travel to the nearest aimag center. If there is no bank branch in a soum, residents need to go to the aimag center to receive pensions and banking services, spending significant travel cost. We calculated that the reduced annual travel cost would be MNT12.2 billion.<sup>5</sup> Although there are other benefits, such as pensioners and other benefit receivers' reduced opportunity costs, the economic growth arising out of lending activities, and so forth, we exclude them here. Thus we consider this MNT12.2 billion to be the minimum in annual economic benefit.

#### *Estimates of annual economic cost*

We need to take into account both operating cost and the initial cost. We estimate that, after including 12% of the aimag center branch cost as management cost, the rural network's annual operating cost (assuming there are 264 sub-branches) would be MNT483 million for Agricultural Bank and MNT551 million for Post Company/Post Bank.<sup>6</sup> As for the initial cost, we need to take into account the opportunity cost associated with two options: (1) recapitalization of Agricultural Bank, and (2)

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<sup>5</sup> Section 5.2.3, page 90

<sup>6</sup> Section 5.2.4, page 95

liquidation of Agricultural Bank and the initial investment in Post Company/Post Bank. Although it is not accurate to assume that all recapitalization cost is used for the rural network, we do so here for the sake of simplicity and regard it as the maximum cost for that purpose. If Post Company's network is to be used, the government will inevitably need to liquidate Agricultural Bank, whose network cannot survive without government remittances. In this case, the cost for liquidating Agricultural Bank (MNT7–9 billion) would have to be taken into account. As for the other option, we estimate that recapitalization of Agricultural Bank would cost MNT7.3 billion,<sup>7</sup> and the initial setup of Post Company/Post Bank would cost MNT560 million.

Next, in order to get the annual opportunity cost of initial outlays, we make an assumption that the annual opportunity cost of money is about 20%, and we apply this rate to the initial outlays. Adding 20% of the initial outlays (MNT1.46 billion<sup>8</sup> for the Agricultural Bank option, and MNT1.51–1.91 billion<sup>9</sup> for the Post Company/Post Bank option) to the annual operating costs produces the annual economic cost. This annual economic cost thus represents the maximum annual cost of maintaining the network using the respective options, and can be directly compared with the annual economic benefit estimated in the previous section.

#### *Cost–Benefit*

The minimum annual economic benefit of the rural banking network would be MNT12.2 billion in the initial year. The maximum annual economic cost of the network would be MNT1.94 billion<sup>10</sup> for Agricultural Bank and MNT2.07–2.46 billion<sup>11</sup> for Post Company/Post Bank. Therefore, the minimum economic benefit of the rural banking network would be far greater than its maximum economic cost, and maintaining it is good investment from the point of view of the Mongolian economy as a whole.

#### *Financing*

Upon accepting the above conclusion, the government has to pay attention to the issue of financing. Although the rural banking network is beneficial to the economy as a whole, it cannot be maintained without government intervention. It is not likely that the private sector itself would provide rural banking services, from the point of commercial

<sup>7</sup> Section 5.2.4, page 97

<sup>8</sup> MNT7.3 billion \*20%

<sup>9</sup> (MNT0.56 billion + 7 billion)\*20% to (MNT0.56 billion + 9 billion)\*20%

<sup>10</sup> MNT0.48 billion + MNT1.46 billion

<sup>11</sup> MNT0.55 billion + MNT1.51 billion to MNT0.55 billion + MNT1.91 billion



profit. The government is responsible for the economy as a whole and should shoulder the cost for maintaining the rural banking network through subsidy and other means.

The total annual operating cost of the network would be MNT483 million for Agricultural Bank and MNT551 million for Post Company/Post Bank. This could be compensated solely through government transfer fees, if Agricultural Bank were to be paid MNT244 per transfer, or if Post Company/Post Bank were to be paid MNT279 per transfer. If the government would just shoulder the pro rata cost for the time dedicated to the handling of governmental transfers (about 30% of the total business hour of the network) the per unit transfer fee could be reduced to MNT98 for Agricultural Bank or MNT117 for Post Company/Post Bank. In this case—given that the rest of their business hours are fully used at breakeven revenue (even lower if better than breakeven).

There are two basic ways, at opposite extremes, for government to subsidize the network. One is a per-transfer unit subsidy similar in appearance to a remittance fee payment. The other would be for government to, in essence, purchase the rural network and consign its operation to another entity. There are many variations between the two.

The first extreme can potentially lead to bad practices by government that would disadvantage society significantly. If the cost for transfers is based solely on their frequency, the government might have incentive to reduce the number of payments (i.e., to delay payments) causing pensioners and other social benefits receivers to have to shoulder losses related to the deferrals. Whichever way the government chooses, subsidies have to be provided in a transparent manner. In this sense, the rural network account should be clearly separated from others.

The government should vary its subsidy depending on the performance (i.e., quality and speed of service) of the network, in order to provide it with incentives for improvement.

#### *Scope of rural banking activities*

The government should consider policy priority on the scope of rural banking services (i.e., whether only transfer and payment service is sufficient or full banking service is necessary).

In the case that the government only concerns about fulfilling transfer payment services

in rural area, there is a possibility to utilize the Post Company network. This option, though less than optimum, would at least allow the government to secure a reliable means of transfer and payment without fear of bad loan problems. However, the government should seriously consider that if the government chooses this option, the future development of rural banking services will be skewed from what be expected to shape on a full-fledged bank-based principle and will be hampered significantly.

The full banking services have advantages of savings mobilization, economic stimulus through lending, open-end possibilities brought by rural banking services, and so on. After the cross-subsidization through conservative full banking services, the necessary per unit transfer fee would at least be reduced from MNT244 to MNT182 in Agricultural Bank's case. In total, this reduction amounts to MNT333 million a year, which can be regarded as one of the economic benefits of full banking services. This benefit can be even greater if Agricultural Bank can expand sub-branch lending activities to their 1998 level.

The economic cost of the Agricultural Bank network is about the same as that of Post Company/Post Bank in the initial year (though Agricultural Bank's is a little bit smaller, as shown in the cost-benefit section) and may not be a critical factor between the two alternatives. The government should choose the network with better quality. Here, Agricultural Bank's network has better human resources and future possibility for rural banking development,<sup>12</sup> although there remains a possibility of re-failure of Agricultural Bank. If Agricultural Bank's network is utilized, the possibility of re-failure must be minimized. In the short run, Agricultural Bank's network seems to be better, regardless of the business scope chosen by the government. Post Company/Post Bank cannot immediately begin to provide nationwide services.

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<sup>12</sup> Section 5.2.1 (page 76) and Table 65 (page 92)

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