The Role of Postal Networks in Expanding Access to Financial Services

Volume II

COUNTRY STUDIES
   Egypt
   Kazakhstan
   Namibia
   Romania
   Sri Lanka
   Uganda
   Vietnam

The Role of Postal Networks in Expanding Access to Financial Services

Country Case: Egypt’s Postal Finance Services

The World Bank Group
Global Information and Communication Technology

Postbank Advisory, ING Bank
Postal Policy
**Author’s Note**

This paper discusses the role of the postal network in expanding access to financial services in Egypt. It reviews the public postal operator within the postal sector and within the broader context of the communications sector. The roles of the postal network and state and privately-owned banks are also reviewed from the perspective of the financial sector development, with particular focus on payments systems development and microfinance.

This paper was prepared with desk research in 2004. Field visits were not scheduled.

While this country case on Egypt can stand alone, it is an integral part of this large study of the potential of postal networks to coordinate with financial service providers in 7 countries (*Egypt, Kazakhstan, Namibia, Romania, Sri Lanka, Uganda, and Vietnam*) and 5 regions (*Africa, Asia, Eastern Europe and Central Asia, Latin America and the Caribbean, and the Middle East and Northern Africa*).

**Glossary of Abbreviations and Acronyms**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>ATM</td>
<td>automated teller machine</td>
</tr>
<tr>
<td>BdC</td>
<td>Banque du Caire</td>
</tr>
<tr>
<td>CIDA</td>
<td>Canadian International Development Agency</td>
</tr>
<tr>
<td>EFT POS</td>
<td>electronic fund transfer at point of sale</td>
</tr>
<tr>
<td>EGP</td>
<td>Egyptian pound</td>
</tr>
<tr>
<td>ENPO</td>
<td>Egypt national post office</td>
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<tr>
<td>FFI</td>
<td>formal financial institution</td>
</tr>
<tr>
<td>GDP</td>
<td>gross domestic product</td>
</tr>
<tr>
<td>HR</td>
<td>human resources</td>
</tr>
<tr>
<td>ICT</td>
<td>information and communications technology</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>KfW</td>
<td>Kreditanstalt für Wiederaufbau</td>
</tr>
<tr>
<td>LAN</td>
<td>local area network</td>
</tr>
<tr>
<td>MCIT</td>
<td>Ministry of Communications and Information Technology</td>
</tr>
<tr>
<td>NBD</td>
<td>National Bank for Development</td>
</tr>
<tr>
<td>NGOs</td>
<td>non-governmental organizations</td>
</tr>
<tr>
<td>NPL</td>
<td>non-performing loan</td>
</tr>
<tr>
<td>PBDAC</td>
<td>Principal Bank for Development and Agricultural Credit</td>
</tr>
<tr>
<td>piaster</td>
<td>EGP 0.01</td>
</tr>
<tr>
<td>POS</td>
<td>point of sale</td>
</tr>
<tr>
<td>ROSCAs</td>
<td>rotating savings and credit associations</td>
</tr>
<tr>
<td>SME</td>
<td>small and medium enterprise</td>
</tr>
<tr>
<td>SWOT</td>
<td>strengths-weaknesses-opportunities-threats matrix</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Programme</td>
</tr>
<tr>
<td>UNICEF</td>
<td>United Nations International Children’s E Fund</td>
</tr>
<tr>
<td>UPU</td>
<td>Universal Postal Union</td>
</tr>
<tr>
<td>USAID</td>
<td>United States Agency for International Development</td>
</tr>
<tr>
<td>USD</td>
<td>United States dollar</td>
</tr>
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</table>
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## Summary

### SWOT Analysis of Egypt Postal Financial Services

<table>
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<tr>
<th>Strengths</th>
<th>Opportunities</th>
</tr>
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<tbody>
<tr>
<td>• Has historical operator of postal savings and payment services.</td>
<td>• Postal banking offers potential to broaden and deepen access to financial services by increasing propensity to save, increasing savings, improving payments efficiency, and offering small credit, pension, and life insurance products.</td>
</tr>
<tr>
<td>• Provides broad-based, low-threshold access through more than 9,000 post offices compared to approximately 2,000 bank branches; particularly well-represented in rural and poor sub urban areas; about 60 percent of the post offices run as agencies by private or public sector entities.</td>
<td>• The postal network’s existing infrastructure and customer streams can be the nation's channel for small-value, standardized financial services.</td>
</tr>
<tr>
<td>• Mobilizes small deposits with low minimum deposit requirements and has more than 12 million savers (30 percent of adult population)—more than the number of individuals served by the entire banking sector.</td>
<td>• In the short term, the postal network could capture much more of the international remittances market if modern marketing, ICT, and alliances are applied; this could also be the basis for new savings and payments products.</td>
</tr>
<tr>
<td>• Processes considerable volume of payment transfers per year (money orders, pensions, and electricity bills)—40 million semi-cashless transactions as compared to 12 million check payments transactions by the banks. Operates an efficient nation-wide postal giro circuit for some 10,000 public entities.</td>
<td>• Synergies are possible when the postal network modernizes with implementation of ICT, Internet access, and a platform for e-government and e-commerce (fulfillment).</td>
</tr>
<tr>
<td>• Is piloting new services (debit cards, pensions, and payroll accounts) with new technologies (ATM and EFT POS) in Greater Cairo.</td>
<td>• The post office could become Egypt’s first chain of convenience stores, providing basic financial services, communications, and retail trade.</td>
</tr>
<tr>
<td>• Initiates co-operation with the banking sector to develop cost-efficient, sector-wide, small-value payment instruments and services.</td>
<td>• Egypt has several modern private sector banks that might be poised to expand their position in the growing retail market, through an alliance with Egypt National Post Office (ENPO).</td>
</tr>
<tr>
<td>• Is perceived as a non-bank by the population, which also has a high level of personal trust in postmasters/post offices in rural areas.</td>
<td>• Postal reform strategy has not been determined and role of the government in day-to-day management of ENPO is significant.</td>
</tr>
<tr>
<td>• Is showing record profits; has no NPL portfolio and has never defaulted in payments to depositors.</td>
<td>• In financial sector development, broad-based access to financial sector does not feature as a priority; state banks continue to dominate the sector.</td>
</tr>
<tr>
<td>• Recently has invited involvement of private sector management and taken first steps towards private sector partnerships.</td>
<td>• Postal mail service in a further liberalized sector may limit pace of development in postal financial services.</td>
</tr>
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<table>
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<tr>
<th>Weaknesses</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Non-transparent performance measurement; management information system measuring postal financial services and mail revenues non existent</td>
<td>• Postal reform strategy has not been determined and role of the government in day-to-day management of ENPO is significant.</td>
</tr>
<tr>
<td>• Non-transparent regulatory and managerial structure</td>
<td>• In financial sector development, broad-based access to financial sector does not feature as a priority; state banks continue to dominate the sector.</td>
</tr>
<tr>
<td>• No qualified banking management, basic marketing skills only</td>
<td>• Postal mail service in a further liberalized sector may limit pace of development in postal financial services.</td>
</tr>
<tr>
<td>• No role in international remittances, leaving informal channels a significant role to play</td>
<td>• No connected to any clearing house</td>
</tr>
<tr>
<td>• Incomplete product package; demand for small credit, life insurance, pensions and other payments and savings products not met; cannot expand due to legal framework</td>
<td>• Slow progress toward modern ICT in post offices due to investment in information technology and human</td>
</tr>
<tr>
<td>• Not connected to any clearing house</td>
<td></td>
</tr>
<tr>
<td>• Slow progress toward modern ICT in post offices due to investment in information technology and human</td>
<td></td>
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</tbody>
</table>
resource training; limited access to funding
- Limited by legal framework for commercial flexibility and asset management
- Problems with overstaffing and low productivity

1--Postal Sector Development

The history of state postal services in Egypt can be traced back to Pharaonic times, more than 2,500 years ago. In 1866, when part of the Ottoman Empire, the foundations were laid for the current national postal system, when the Egyptian Viceroy acquired the private postal administration “Posta Europea” and renamed it “Postes Egyptiennes,” which the public used with confidence. French experts helped set up postal service standards as practiced by the French postal state service at that time. The network of services expanded and a few years later included postal money orders.

The postal law underwent major revision and modernization (in some respects) in 1980, and postal services were entrusted to the Egyptian National Postal Organization (ENPO). To date, there are no annual reports published by the ENPO. Most of the data here relies on what ENPO reported to the Universal Postal Union (UPU), plus privileged access to internal annual accounts and budgets of two different years, 1996–97 and 2000–01.1

Performance Indicators of the Egyptian National Postal Organization

Egypt’s postal services comprise the same traditional core services provided by postal systems in most countries: delivery services (addressed letters and parcels), a number of financial services (such as postal service and current accounts, issuance and delivery of money orders), and agency services where the postal system performs some activities on behalf of the government (for instance, selling duty stamps, disbursing pension payments, and issuing vehicle licenses).

Egypt’s combined per capita flow of domestic and outgoing international letters is low (3.3 pieces per capita in 1997, 2.87 in 2002), even when compared to other African (7 pieces per capita) and Arab countries (7.6 pieces per capita). Per capita flow of parcels in Egypt is also low compared to other regions.2 For both parcel and letter traffic, domestic post is quite limited. The number of packages internationally mailed in Egypt, however, is closer to the amount posted in other regions. Egypt’s postal system issues fewer money orders per capita per year than most countries, but has an impressive number of postal savings accounts. Each post office serves an average of 8,948 individuals, compared to the larger numbers served by a single post office in Qatar (23,600), Saudi Arabia (13,400), and Syria (22,000).

In terms of operational efficiency, the Egyptian National Postal Organization employs close to 41,000 workers, with an average number of 5.25 workers per permanent postal establishment. This is not significantly different for postal establishments in other parts of the world.

Output per worker, however, is much lower, in Egypt. The average number of domestic letters delivered in Egypt in 1997 was 3,385 per letter carrier, and 3,002 per worker in 2002, compared to around 40,000 pieces per worker in Africa and Latin America. Mail productivity has declined 3–5 percent per year since 1997, but this indicator may be misleading because a large part of the postal workers are engaged in postal savings and payments services.

1 The fiscal year in Egypt runs 1 July–30 June.
2 Per capital flow of parcels in Egypt is 0.03 and 0.003 per every 1000 inhabitants, compared to flows close to 150 pieces per 1000 inhabitants in Latin America and Eastern Europe and the Commonwealth of Independent States (CIS).
Despite low demand and poor operational performance indicators, ENPO incurred a small deficit of around 1 percent in 1997, which turned into a slight surplus in 1999 when current expenditures accounted for 98 percent of total revenues. This “break-even” situation is not atypical of postal systems in different parts of the world. Since 2000, the net results of ENPO have moved upward considerably from USD 2.5 million in 2000 to approximately USD 5 million in 2002, representing 2.1 percent of total revenues. About two-thirds of revenues stem from postal financial services and less than 30 percent from postal (mail) services.

As a result of demand, productivity, financial results, and investment patterns, ENPO appears to exhibit patterns of the vicious cycle faced by many developing countries’ postal authorities: low demand volumes result in poor financial performance, which translates into low investment levels causing reductions in quality of service that leads to further cycles of depressed demand. In addition, competition from other sectors and services exert more pressure on postal services. ENPO is trying to improve itself to generate funding for the modernization needed to improve services and attract more customers and business.

**Competition from Telecommunications and Information Technology**

Egypt has witnessed significant developments in both basic telecommunication services and access to the Internet (or e-mail service) in the past decade. These trends are expected to reduce demand for traditional postal services, especially with limited developments in e-commerce in the country. Therefore, it appears that the ‘substitution impact’ of developments in IT and telecommunications outweigh the ‘complementary impact’ that requires expansion in e-commerce activities. The latter is delayed because of the need to establish the right financial instruments not yet adopted by Egyptian consumers and businesses.

Examining Egypt’s indicators for telecommunications and IT, current indicators still show limited service in Egypt compared to other regions. For example, there were only 8.64 fixed lines per 100 inhabitants in 2000, a figure that is only higher than Africa and is just over half the world average of 16.17 lines per 100 inhabitants. Similarly, cellular phone subscriptions per 100 individuals are still low compared to other regions in the world: Egypt has 2.14 subscribers per 100 inhabitants, compared to a world average of 12 subscribers per 100 inhabitants. In these areas, developments take place rapidly, and Egypt’s ratios are expected to improve substantially before 2010.

As indicators of competition replacing traditional mail services, IT and Internet use exhibit a similar picture, as rates in 1998 compare poorly to other regions of the world. Internet users in Egypt numbered 16.3 per 100,000 inhabitants in 1999, which was lower than the average for African countries (22.0), while the world average was 270 per 100,000 inhabitants. Estimated use of personal computers and Internet hosts per 10,000 inhabitants gives more or less the same position for Egypt.

Telecommunications and IT development in Egypt in the past 3–4 years, however, has accelerated rapidly. For instance, between October 1999 and February 2002, fixed-line subscribers increased by some 40 percent and the Ministry of Communications and Information Technology (MCIT) projected it to reach 50 percent 2004. The number of mobile phone subscribers in February 2002 was 5.4 times the subscriptions in October 1999. The Internet user population has also multiplied and in December 2003 was 2.7 million, nearly 3 times the rate in October 1999.

The growth of mobile phone subscriptions by 183 percent annually over the period 1995–2000 (being the highest in the world) has added to the growth momentum in these markets, either in terms of substituting phone calls or freeing up fixed phone lines for Internet access.

Estimates for Egypt do not exist on how actual or projected developments in IT and telecommunication services will impact demand for traditional postal services. Electronic services, such as e-mail, teleconferencing, and faxing are already cutting into first-class mail business, which generates a relatively large part of the mail volume and mail revenues in Egypt. It is also somewhat unlikely that banks, utilities, credit card companies, and other businesses will develop bulk mail services, since they have not already and since alternative electronic communications are increasingly available.
On the other hand, Egypt’s e-commerce lags and there are still barriers to any short-term potential for its growth. This also applies to direct mail (e.g., catalogue shopping), which is not popular in Egypt. The combination of high urban concentrations with access to nearby bazaars and shops, and rural communities with poor and often illiterate inhabitants, limits short-term market opportunities for direct mail and marketing. Egypt may not ever develop a direct mail industry but move directly into e-commerce, if and when the legal and technical infrastructure sufficiently matures, the logistic providers can handle physical fulfillment, and banks manage the payment fulfillment.

While Egypt’s current IT and telecommunication conditions are not as threatening to postal services as they are in more developed countries, progress in these areas is sufficient to increase competitive pressures on postal services and to limit development of the postal business. At the same time, slow development of e-commerce and mail-order delivery imparts a net negative impact on telecommunications development in Egypt, which is basically the substitution of letter and document traffic from regular mail to telecommunications and electronic means.

Other countries’ experiences suggest that this environment, where the threat of competition is perceived as severing important value-added postal markets, triggers postal sector reform. In addition, postal reform in many countries has been part of a comprehensive strategy for improving government services. These two conditions exist in Egypt, for example, in the Ministry of Finance’s program to link expenditures in various government bodies to performance indicators and tangible outcomes. Thus, with the environment indicating that postal reform is needed and feasible, the need to analyze postal reform options becomes urgent.

**Postal Sector Reform**

The two main areas covered in this section are the degree of corporation and commercialization of ENPO and how that guarantees the autonomy and accountability necessary for independent management, and the market framework in which ENPO operates and how that enhances competition from private operators in areas that are not reserved for the public operator.

**Corporation: Laws and Decrees**

Two laws govern the operation of ENPO: Law 16/1970, the Postal Services Law; and Law 19/1982, giving ENPO economic authority. These two laws grant ENPO many features given to postal authorities under the corporate model. ENPO also has independence, which is not granted to many public entities in Egypt or even to postal authorities in other countries. For example, the Postal Services Law (16/1970) grants ENPO an exclusive area for delivery and mailing of all postal materials, including parcels. Law 19/1982 gives ENPO the exclusive right to provide postal financial services, such as money orders, postal savings, and checking accounts. ENPO is free to “enter into agreements with other ministries or public agencies, subject only to approval by ENPO’s Board of Directors.”

Furthermore, Law 19/1982 allows ENPO to subcontract the provision of such services as the sale of post stamps and the delivery of mail items to private entities (i.e., postal agents). Ministerial Decree 31/1985 added international and domestic express mail to the list of services that ENPO provides. Additionally, the regulations allow the Board of the Authority to delegate any other services that it deems feasible to the private sector. The Board of Authority, in this respect, relies on a standard contract with either the urban or rural “postal agency” that stipulates standard physical requirements for private providers of these services. Law 16/1970 states that the postal authority is the sole entity entitled to transport and deliver letters and parcels, as well as provide postal financial services and management of postal savings accounts. The Executive Regulations, issued in 1972 to expand and clarify Law 16/1970, define these services plus weight and dimension limits for packages and materials being posted through ENPO.

In 1985, the Postal Law was amended to allow private courier services to offer express mail services. The only condition the Law mandated is that the private courier services acquire a license to practice for an annual fee payable to ENPO. The amendment opens the exclusive area granted to ENPO for express mail service, making this the only service where ENPO faces competition.
Two weaknesses in Egypt’s Postal Law are handicaps for ENPO. The first is the law itself, which defines no clear pricing formula, and neither the law nor its executive regulations links prices in any way to inflation indicators, competition, or market development. Instead, the executive regulations accompanying Law 16/1970 stipulate that a committee periodically determine the prices (which are changed by ministerial decrees). If the prices do not cover the cost of providing the services, the government reimburses ENPO for the difference. The last update occurred in 1998. The law and its amendment do not address the pricing of private sector services contracted by ENPO.

Similarly, prices that ENPO charges for agency services, such as payment of pensions and salaries, are negotiated between ENPO and the corresponding government agency. Requirements include features of the space to be utilized as well as “integrity” requirements for the person operating the postal agency (e.g., a minimum education level and a clean criminal record among other preconditions). The unrealistic pricing is underpinned by the fact that ENPO has very weak management information systems and is unable to determine actual cost per item or product profitability. (ENPO is further handicapped in these interagency negotiations. For example, regarding pension payments, ENPO is actually required to provide these payments without charges to the corresponding pension agency.)

The second weakness concerns public utilities, which in other countries rely on the postal system for distribution and collection of bills. Similarly, other large entities in Egypt are not (and have not been) obliged to use the postal system, depriving ENPO of “captive” major clients. While it is not suggested that regulations impose constraints on how utilities and banks conduct their businesses, this requirement underlies the economies of scale in standard letter delivery. As a result, one should not anticipate that postal reform will lead to strong growth in mail volume.

Commercialization and Pricing

According to the institutional environment set by the Postal Law and its amendments, ENPO commercialization is not constrained by any legal or institutional barriers. In practice, however, many of the conditions necessary for successful commercialization are not present.

An essential pre-condition for commercialization is commercial management and availability of management information systems (MIS) to help determine the priorities and course of commercialization. For a long time, ENPO's management was selected through internal promotion only. This produced technically very skilled and experienced postal management with relatively limited experience with competition and commercialization. Efforts to introduce MIS have been limited, and commercial MIS analysis (for product profitability, client profitability, post office or regional profitability, for example) remains underdeveloped.

Since 2002, ENPO has been lead by a Director General who has more than 15 years of private sector management experience and who has the ability to introduce private sector practices within ENPO. The Director General is supported by several private sector representatives appointed to ENPO's Board. Commercialization efforts have gained some momentum since these changes.

The absence of a pricing formula means that postal service pricing lags considerably behind inflation and market developments in general. The main beneficiary of this policy is domestic mail/parcel traffic. For example, while domestic prices increased 25-fold from 1970 to 1998, the price of sending a standard domestic letter in 1998 was only 10 times the price in 1970. Other domestic postal services exhibit more or less the same pattern, even for services that typically serve the business community, such as the delivery of parcels and periodicals. Because this policy serves an agreed-upon social goal, ENPO must be reimbursed for the difference if these prices are lower than the actual cost of providing the service. Based on conversations with officials at ENPO and public discussions, it appears that ENPO does not get reimbursed regularly for the difference between prices and actual cost of providing the service.

International services have outpaced domestic inflation, in some cases with prices that are 400 times those charged in 1970 for the same service. It is not clear—due to weak MIS—whether the universal service obligation is partially financed by increases in international service charges (while domestic prices continue to be subsidized) or whether these increased rates for international services result from the need to cover part of
the cost of international service with foreign currencies that have significantly appreciated against the Egyptian pound.

Two issues have to be considered regarding commercialization. First, the bulk of the mail service, particularly parcel delivery, in developed and developing countries is generated by the business sector. Second, given that Egypt’s postal service indicators are lowest in the domestic service segment, commercialization policies must focus on improving the quality of domestic services provided. These policies can help to break the vicious cycle in the postal mail sector. Therefore, price liberalization of services not representing core universal service obligations (as defined by the majority of countries) could serve two objectives: to improve the price/quality combination of value-added services, such as express mail and parcel delivery (which could be of more value to businesses than the subsidized-price/lower quality combination), and to make a positive impact on ENPO’s revenue flows.

In addition, not requiring large utilities to use ENPO for their bill delivery and payment collection seriously reduces domestic demand for standard postal services in Egypt. This is a critical drawback given the fact that even in developed economies the largest 10 percent of all mail customers typically produce well over 80 percent of all the mail. These large mail users include banks, insurance companies, utilities, publishers, mail-order companies, and direct-mail houses, among others. As it would be difficult to justify regulatory intervention to force these potential bulk mailers to use the postal system, ENPO should consider developing a marketing approach to attract these large clients through account managers that can offer tailor-made services, including special rates. Within the current structure of ENPO, there is no identifiable marketing and sales function.

Even if major clients voluntarily switched to ENPO, there are limits to potential gains in delivery services from economies of scale, especially with the expected expansion of e-commerce and other IT-telecommunication means of payment. This same development, however, presents postal services with a **valuable opportunity in terms of economies of scope in financial postal services.**

### ENPO Outlet Network: Strength in Rural and Low-Income Areas

<table>
<thead>
<tr>
<th></th>
<th>Post offices</th>
<th>Banks</th>
<th>Insurers</th>
<th>Stockbrokers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greater Cairo</td>
<td>393</td>
<td>525</td>
<td>&lt; 50</td>
<td>&lt; 150</td>
</tr>
<tr>
<td>Alexandria</td>
<td>117</td>
<td>138</td>
<td>&lt; 30</td>
<td>&lt; 50</td>
</tr>
<tr>
<td>Port Said</td>
<td>29</td>
<td>31</td>
<td>&lt; 20</td>
<td>&lt; 10</td>
</tr>
<tr>
<td>Sinai</td>
<td>37</td>
<td>38</td>
<td>&lt; 20</td>
<td>&lt; 10</td>
</tr>
<tr>
<td>Rural and remote areas</td>
<td>2,440</td>
<td>541</td>
<td>&lt; 20</td>
<td>&lt; 20</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>3,016</strong></td>
<td><strong>1,273</strong></td>
<td><strong>&lt; 140</strong></td>
<td><strong>&lt; 240</strong></td>
</tr>
</tbody>
</table>

*Source: Egyptian Banking Company for Technological Development (2000).*

This potential is pursued in many countries, but different sizes of the postal and the bank branch networks in Egypt suggest that ENPO has a golden opportunity to use its existing network to more advantage. Its extensive postal network had postal establishments in 5,152 public offices, in addition to 4,015<sup>3</sup> private offices in 1999–2000 (according to the Central Agency for Public Mobilization and Statistics, 1999–2000), a total of 9,167 post offices. Over 40 percent of the post offices are in rural areas—far more extensive coverage than the number of bank branches in rural and lower-income urban districts. While banks outnumber post offices in Greater Cairo, the number of banks in rural and remote areas is only slightly over 20 percent of the number of postal offices. Postal savings accounts represent only 3 percent of total national savings. Therefore, while it may not be economically rewarding for banks and other financial institutions to set up branches and networks for financial services outside the main cities, ENPO’s commercialization efforts could focus on becoming a

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<sup>3</sup> Data on the size of the postal network widely differ. In particular, the number of postal agents varies between approximately 2,000 and 6,000.
strong financial network backbone with or without collaborating with the banking system. These developments can balance competition facing postal services in business delivery.

ENPO has begun to explore this potential by proposing to electronically connect all postal offices supplying financial services. It is not clear, however, if ENPO is considering major increases of this electronic financial network in its short-term development plan. Additionally, ENPO has plans to use other sources to create a network of postal business centers that would supply such commercially-oriented services as photocopying, faxing, and Internet access. Again, the idea is to better utilize ENPO’s presence in rural and low-income areas while keeping additional operating costs low.

**ICT-Based Modernization**

With more than 9,000 outlets throughout Egypt, a labor force of 41,000 individuals, 12 million Egyptians holding EGP 22.5 billion in postal savings accounts, and multiple delivery services for the Egyptian public, the postal sector holds special importance and enormous potential in the nascent information society. The owner of the ENPO, the Ministry of Communications and Information Technology (MCIT) has identified the postal system as a key component of the government’s information infrastructure and a major tool in fostering e-business and propagating its benefits at the grassroots level.

MCIT is exploring ways by which ICT can be used to improve quality of services, efficiency, capabilities, and the organizational structure of Egypt’s postal sector. Reforms propose to use modern technologies to improve the quality of services provided to customers, while creating a new stream of revenues for Egypt. To date, MCIT supported an ambitious sectoral modernization program under which more than 400 major post offices around the country have been equipped with computers, local area networks (LANs), and local servers, with more to follow in the coming years. MCIT is also setting up a postal information network, which will improve communication within the postal system by connecting individual post offices and improving the exchange of financial information and operational data. The network will connect computerized local post offices with the regional postal centers and the four main postal hubs in order to computerize all existing financial applications. This will allow easy access to all the necessary operational information and will ensure that postal customers will receive efficient service.

Extending e-business and e-commerce activities to the grass roots level, MCIT launched a major pilot project in 2002 to establish an electronic fund transfer (EFT) network using automatic teller machines (ATMs) and points of sale (POS) in 56 post offices in Greater Cairo. Using smart card technology, this project will help establish the necessary infrastructure for electronic payments for government services at postal outlets. It will also facilitate access to postal savings accounts as well as pensions and salaries for more than 10 million individuals, in addition to Internet banking capabilities.

Another key element of the postal reform process is the development of new services to increase postal revenues. Additional modernization efforts include the development of a hybrid mail project, a service aimed at corporate customers looking to implement an e-delivery system for business documents. Plans are also in place to introduce e-billing for postal customers, allowing individuals and companies to pay their bills over the Internet.

The Egyptian National Post Organization, responsible for distributing pensions in Egypt, has also launched a new system in co-operation with the Ministry of Social Affairs to end the long waiting times and huge crowds at the monthly distribution times. Features of the new system include increasing the number of days and hours it offers the services as well as introducing new means of distribution, such as transferring the pensions to clients’ savings accounts and offering the use of ATMs.

In addition, in 2003, MCIT and ENPO agreed to the establishment of a joint venture company named Giro-Nil with two banks, Banque Misr (state-owned) and CIB Bank (privately-owned), to develop advanced cashless payment services. The joint venture is currently designing its strategy and business model.

The ultimate goal of postal reform is to create a system where modern technology and a free flow of information benefit the customer. A modern, efficient postal service that utilizes the latest information
technology will not only increase Egypt’s social and economic development, but will also contribute significantly to the creation of an Egyptian information society.

The initiatives taken by the MCIT and ENPO appear to be promising steps toward providing public access to modern information and communication technology. These projects could reposition the postal network as the vanguard of financial and information services by installing ATMs, EFT, POS, and Internet banking terminals in post offices. An encouraging sign is the growing co-operation between banks and the private sector to develop these services. While these steps are promising, they are small-scale in relation to the scale of needs in the country. Evaluation of the pilot projects and a subsequent cohesive planning and implementation of the nationwide rollout will determine the eventual success of these initiatives.

Regulatory and Market-Based Reforms

At the current stage of development of postal services in Egypt, most of the reform efforts have been directed at the corporation and commercialization of ENPO, not at reforming postal services as a comprehensive market. This section discusses the main principles that must underlie the next phase of postal service reform in Egypt, taking into account the whole postal services market, not just the incumbent national provider.

Separation of Sector Policymaker, Regulator, Owner, and ENPO Operator Roles

As the incumbent public operator responsible for meeting the country’s universal obligation, ENPO should transfer its regulatory role to an independent agency. This regulator should take over the role of granting licenses to private courier operators. It must establish a fair pricing mechanism, particularly if services develop economies of scale. The regulator should delineate and enforce the exclusive (and diminishing) area for ENPO where private companies are not allowed to compete, while ensuring that private operators face a transparent and predictable environment governing their operations in the postal market. The regulator can also determine the performance goals of ENPO, specifying the financial and quality targets to be achieved. In addition, the role of the regulator may be expanded to introduce financial and performance targets that govern the relationship between ENPO and its network of private offices, again with the objective of enhancing service quality and competition for services in public (not ENPO exclusive) areas. In addition, as reform of the postal sector progresses, the roles of MCIT as policy maker, and ENPO as owner and operator of the sector must become transparent.

Enhancing Competition in Services Not Bound by a Universal Service Obligation

Private courier services were introduced in Egypt in a 1985 amendment to Law 16/1970 which had stipulated that postal services (vaguely defined) be supplied only by the public operator. Beginning in 1987, private courier companies were allowed to compete in express mail services, subject to an annual license fee of 10 percent of profits, with a minimum of EGP 250,000. Because no additional requirements were agreed upon, courier companies are free to determine all other aspects of their operation, including setting their prices, as long as they meet the license fee imposed by ENPO. They can also deliver (or ship) parcels heavier or larger than allowed in the state postal system because neither parcel size nor much else is restricted or regulated by the license from the Egyptian postal authority.

Currently, seven private companies are licensed to operate in the courier market: six are branches of foreign companies and the one Egyptian company is Middle East Courier. In addition, an estimated 40–50 companies operate without a license. Their market share is officially estimated at not more than 10 percent of the courier services market. Unlicensed private couriers risk having their operations shut down, deliverables confiscated, and fines levied on them. It is not clear, however, whether the rules and the discretionary power of ENPO are part of a comprehensive market-reform strategy to enhance competition and efficiency in the postal services market.

To regulate postal services, the strategy must focus only on areas where there is reason to believe a market failure exists (increasing returns to scale in delivery) and where a non-commercial obligation needs to be met (universal service). Other competitive services, such as parcel delivery, should be clearly liberalized both for the incumbent operator and its competitors.
Steps to Clarify and Reduce Reserved Area Services

ENPO’s reserved areas are compensation for its non-commercial service obligation. This means that the size of the reserved area has to be based on the actual or expected cost of the universal service obligation. In the case of Egypt’s regulated domestic pricing, the standard reserved area is not attractive to private companies because of its below-cost prices. The government’s universal service commitment for non-standard services discriminates against ENPO by maintaining a uniform price that does not account for the actual cost of providing the service to different geographical areas. By contrast, private courier prices—determined by the market—vary drastically, with prices lower than ENPO’s in the Greater Cairo area, and prices exponentially higher for delivery to remote areas.

ENPO’s constraint on domestic express mail service and other non-standard letter and parcel delivery must be reconsidered. Either ENPO’s prices should be free to compete with private providers or a price floor no lower than ENPO’s service within cities must be imposed on private couriers. The first option is superior because it would enhance competition. But, if the government’s intention is to subsidize express mail delivery to remote areas, then ENPO will have to be compensated for the cost differential.

Conclusions and Policy Recommendations

Egypt’s postal service indicators suggest that a vicious cycle of low demand, low investment, and low quality of service characterize the performance of the industry. Furthermore, competition from expanding IT and telecommunication services will impose more pressure on the industry’s performance. Recent steps by new management at ENPO, with private sector orientations, show some improvement, such as better and more (financial) services, increased profitability, and potential to self-finance further modernization of Egypt’s postal system.

Further reform of the institutional and regulatory environment governing the Egyptian postal services market needs to be addressed. One might conclude that the corporation of ENPO meets (in theory) most of the independence requirements necessary for its solid financial robustness. In practice, however, many social and public finance constraints limit this independence, the most important of which are heavily controlled domestic prices.

These constraints have seriously handicapped ENPO’s commercialization efforts. Yet, there are potential gains from addressing economies of scope in the operator’s expansion of its financial and IT services, which can benefit from the existing extensive network of offices, especially in remote and rural areas. Comprehensive postal market reform in Egypt has not yet been truly initiated. From this perspective, a government-sector strategy that targets enhanced competition, separation of regulatory and management roles, and the need to reduce the burden of universal service obligation is crucial in the industry’s next phase of reforms.

Given the limited economic importance of the mail, it will be equally relevant to assess the postal financial service and the potential of new ICT services and applications, and to use the assessment in determining the eventual course of reform.

2—Postal Financial Services in a Market Perspective

Postal Savings

ENPO provides a range of postal financial services, and both money orders and postal savings have presumably been offered in Egypt for more than a century. The Postal Savings Fund is not a separate legal entity, but is held by the government and operated like a division of ENPO. It does not have an authorized share capital and it is not supervised by the Central Bank of Egypt.

Postal savings accounts are available to any individual who can provide identification or, in the case of minors, has the explicit permission of their parents. The initial deposit requirement is as low as EGP 1 (USD 0.25), and
postal savings passbooks are maintained in the administration as long as a deposit of 1 piaster (EGP 0.01) is kept. By contrast, banks require a minimum of EGP 1,000; and several banks require EGP 10,000 or more and proof of regular income. On the other hand, the Postal Savings Fund limits balances to EGP 300,000 in order to assure the tax exemption and government guarantee privileges for well-to-do individuals.

To the eyes of policymakers, bankers, and Western-trained Egyptians, the services of the Postal Savings Fund look old-fashioned. Nevertheless, demand for postal saving accounts continues to grow. Between 1997 and 2004, the number of passbooks doubled from 6 million to 12 million, representing 20 percent of the total population, or 30–35 percent of the adult population.

<table>
<thead>
<tr>
<th>Year</th>
<th>Postal savings accounts (in millions)</th>
<th>Average balance per account (in EGP)</th>
<th>End-of-year postal savings (in EGP billions)</th>
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</thead>
<tbody>
<tr>
<td>1997</td>
<td>6.1</td>
<td>705</td>
<td>4.3</td>
</tr>
<tr>
<td>1998</td>
<td>6.7</td>
<td>835</td>
<td>5.6</td>
</tr>
<tr>
<td>1999</td>
<td>7.5</td>
<td>1066</td>
<td>8.0</td>
</tr>
<tr>
<td>2000</td>
<td>8.4</td>
<td>1154</td>
<td>9.7</td>
</tr>
<tr>
<td>2001</td>
<td>9.0</td>
<td>1315</td>
<td>12.5</td>
</tr>
<tr>
<td>2002</td>
<td>9.9</td>
<td>1787</td>
<td>17.7</td>
</tr>
<tr>
<td>2004</td>
<td>12</td>
<td>1833</td>
<td>22</td>
</tr>
</tbody>
</table>

Transaction volumes have remained low, in the range of 1.5 to 2 transactions per account per year. This is common in many postal savings banks around the world: it induces one to believe that only 20–25 percent of the savers are actually regular, active savers, while most of the other accounts are dormant. Dormant does not necessarily mean that savers cease to use the account. They may have inherited money and deposited it as an emergency reserve or provision for old age. An analysis of the Postal Savings Fund’s clients and depositors, their motives, and behavior has never been done, although it is perceived as an institution for lower-income groups.

The postal savings product has some good features. Accounts can be opened on the spot at all government post offices and have unique numbers. Deposits and withdrawals can be made at any post office into any savings account, although disbursement of withdrawals can take some time while the post office clerk obtains required approval. The postal savings passbook is a very basic product, useful to people who are not familiar with more sophisticated products. The book gives the client the feeling of "proof" and security, elements, which are quite essential in Egypt.

The Fund does accumulate reserves, and the reserve funds are reported as 1.3 percent of total assets. As the equity of the Postal Savings Fund, this might be considered adequate given the nature of the operation—collection of deposits only and investment of the funds with the government-owned National Investment Bank—but the Postal Savings Fund would need a substantial capital injection if it were to develop and operate as a bank.

**Key Features of the Postal Savings Fund**

- It serves 12 million savings account clients (up from 6 million in 1997), about 30% of the adult population.
- It is the only formal institution in Egypt offering a savings product to small savers, with a low minimum deposit.
- It provides its service through a 6,000-branch network widely present in rural and poor urban areas.
- It shows continued, stable growth despite being regarded as an antiquated service.
- It has no product differentiation; it does not reward active savers over dormant savers.
- It is also in charge of the Postal Giro Service which has less than 10,000 accounts, all held by public agencies for payment services.
- It reports profitability, generating 70% of the revenues of the Egypt Post; its cost allocation not defined.
- There is no asset management; funds are channeled into the National Investment Bank (a fund under the Ministry of the Economy that finances public infrastructure and social security).
- It has limited MIS, and no clearly defined marketing and management targets; hence there is no relevant system of managerial accountability.
- Pilot projects are underway to provide computerized services linked with cashless payment instruments (smart cards, ATMs, EFT, POS).
- It plays no role in international remittances.
Organization

The Postal Savings Fund is a part of ENPO. There are six divisions within ENPO, and two people with the rank of Director General manage the divisions of savings and financial affairs. The Director General for Financial Affairs is responsible for four departments: postal checks, budget and costs, procurement, and accounts. The Director General of the Savings Fund is responsible for another four departments: balance, deposits and investments, and documentary audits.

The accounts department keeps files of postal savings accounts with back-ups, and reconciles all postal savings transactions executed at post offices. The accounts department has a computerized platform, and an increasing number of post offices are linked with ICT to this platform.

ENPO’s organization features a mix of functions for the financial management of ENPO and management of client deposits. Responsibilities for MIS are not clearly defined.

MIS and Product Profitability

Without a management information system, it is impossible to assess the profit contribution for the different business lines. Internal breakdown of revenues and cost show that post services (mail, parcels) operate at a loss and the postal savings profitable. It is unclear how and if the cost of the infrastructure has been allocated to the different product groups. It is possible that postal services are cross-subsidized by postal savings interest margin income or, just the opposite, that postal savings receive subsidized access to postal staff and offices. Moreover, it is unclear if and how the capital expenditure and amortization is allocated. An in-depth analysis could show which product and service really contribute to profit, where cost-reduction or volume increase would help, and where reform is needed.

The analysis should be relevant for assessing the commercial and economic feasibility of the current project using modern payment instruments (ATMs, EFT, POS). An important driver in these projects has been the perceived cost related to the pension payments (nearly 3 million per month), and the aim is—inter alia—to reduce this cost through modern technology and free up space in the post offices for more profitable transactions. Refined product profitability should even become critical when planning links between payments and savings products.

Postal Payments

Postal payments are also a traditional service provided by ENPO. The range of payments services extends from postal money orders to postal check and giro services to modern payment instruments (credit and debit bank cards, and credit and debit accounts on a pilot basis).

The volume of ordinary postal money orders is small—less than 1 million transactions per year—and decreasing. In addition, ENPO processes about 40 million disbursements for pensions and social security. The bulk of these disbursements is paid out in cash at post offices, a small part into postal savings accounts, and another part into newly introduced payment accounts (with ATM card). ENPO also processes more than 10 million payments for utility bills, subscriptions, etc. This volume is close to the volume of payments (12 million checks) processed by the banking sector in 2002.

The check clearing house in Cairo was computerized in 2002, but the other four or five clearing houses clear checks manually (paper-based). In this context, the small but efficient postal giro service appears to be valuable. It maintains nearly 10,000 accounts for public sector entities (e.g., municipalities, hospitals, utilities) and settled about 60,000 (high-value) giro transfers in 2002. Settlement of these payments takes 1–2 days. This differs from check payments that may take several days or weeks depending on the banks and clearinghouses, and the distances involved.

Theoretically, it is possible to transfer money from postal giro to bank accounts and vice versa. In practice, it operates as a closed circuit (which limits the risks for ENPO versus banks). In view of the plans to introduce more advanced payments services, links between ENPO and the banking sector will have to be established.
The joint venture Giro-Nil which uses Banque Misr and CIB to process utility bills is a step in this direction. This could also solve one of the regulatory hurdles, since the joint venture’s operations could be connected to the clearing houses, based on the membership of the two banks involved.

**International Remittances**

Through its postal savings passbooks and bilateral agreements with the postal administrations in the Middle East, ENPO used to provide a handy remittance product for the large group of Egyptian workers in the Middle East. The remittance product—exposed to a variety of operational, currency exchange risk, and regulatory risks—disappeared and no substitutes have been engineered. ENPO also offers a traditional postal money order, but the volume and value of this service faces decline in a fast-growing market. In fact, with fewer than 7,000 transactions and a value of less than USD 1.5 million in 2002, in a market estimated at more than USD 5 billion, it represents an insignificant share.

Reportedly in summer 2003, ENPO selected Western Union—through a public auction—to launch its money transfers service in the post offices. The service is not operational yet, suggesting that ENPO or Western Union met substantial obstacles to implementation. In the Giro-Nil joint venture, CIB, one of the partner banks, recently became a member of the Eurogiro Network to develop cross-border payments between Egypt and the associated postal banks and administrations. This service, too, is not operational yet. Electronic money-order exchange services have been established between the postal operators in other countries, e.g., United Arab Emirates and Sudan, and Tunisia and Yemen, but not with Egypt.

With nearly 5 million Egyptians living abroad and the huge size of the remittance flow (USD 4.5 billion), international money transfers are a key, short-term opportunity for ENPO to improve and expand its financial services. ENPO’s challenge will not be a “stand-alone” product, like Western Union, but a product wherein remittances can be captured in postal savings accounts, and/or the new postal payment accounts linked to a debit card.

**Financial Sector Background**

ENPO is part of the postal sector, and as such, its financial service operations are not regulated or supervised by the Central Bank of Egypt. Occasional discussions on repositioning or even privatizing the Postal Savings Fund have been held over the past eight years. Such a decision could seriously affect ENPO's mail operations, keeping them small and operating at a loss. Nothing will change unless the mail and parcel services are ensured of commercial viability. Another issue that has impacted the discussion to reposition the Postal Savings Fund is its investments in the National Investment Bank. Although this is a relatively small amount (less than 5 percent), there appears some resistance in the absence of an adequately developed capital and money market. With its current services, ENPO appears to fill in a void left by the banking sector.

Some banks do offer comprehensive retail financial services, but their outreach is very small. Fewer than 2.5 million Egyptians (of 65 million) have accounts with banks. About 9 million are said to have savings accounts in banks. The four largest banks in Egypt are state-owned and account for than half of the banking sector. The development of efficient retail financial services is not a key priority. The products these banks offer are neither accessible nor attractive to many low and middle-income Egyptian households, which helps explain why Postal Savings attracts so many clients. Despite a steady reduction of the importance of the public sector in the financial system, its role remains dominant, especially through its ownership of large banking and insurance institutions.

The dominance of the publicly-owned institutions in the Egyptian economy and their inability to match the performance of their international and private counterparts has limited the scope and depth of the financial market and its development. The range of financial products available is insufficient to meet the needs of private sector, and access of small and medium-size enterprises to these financial products is constrained. It is also reflected in the very limited outreach of modern retail banking and payments services. Reportedly, fewer than 2.5 million Egyptians have plastic bank cards and checking accounts like those in OECD countries.
International experience indicates that banking systems dominated by state banks can be reformed effectively through well-designed and well-managed privatization that focuses on improving governance and introducing market discipline. The four state-owned banks in Egypt (National Bank of Egypt, Bank of Alexandria, Banque du Caire, and Banque Misr) account for more than 60 percent of all loans and advances outstanding. Any program to develop the financial markets needs to address the effect of their public ownership on the development. Some preparatory steps have been taken with participation of private-sector management in the state-owned banks, but no clear schedules for privatization of any of the state banks have been published yet.

Access to financial sector data has been limited, making judgments on the health of the financial system difficult. However, based on data provided by the authorities, Egypt's prudential standards conform to international standards. While capital adequacy requirements meet the minimums established by the Basel Committee, and regulations regarding loan classification and provisioning are in line with international standards, disclosure practices need further improvement. Non-performing loans have risen slightly as share of total portfolios (according to Central Bank of Egypt data, from 9.6 percent at the end of 1999 to 10.5 percent at the end of 2000). International experience indicates that rapid credit growth of the type seen in Egypt during the past decade is likely to be associated with a decline in lending standards. Banks, therefore, may be vulnerable to a deceleration of economic activity.

Under these circumstances, further strengthening of regulation and supervision standards needs to be given priority. This should be done in parallel with the extensive training effort being undertaken by the Central Bank of Egypt to upgrade banking skills across the board. The focus on these issues will, however, distract attention and potential sources from developing easily accessible financial services for the public at large and small entrepreneurs.

There are also issues related to the non-bank financial sector, such as implementing a well-designed mortgage law to facilitate better housing finance, developing the corporate bond markets, reforming the insurance sector, introducing new financial services, introducing new instruments (risk management instruments are particularly lacking), and assuring more market-based rural credit. However, in terms of strategic priority, the issue of the health of the banking system and modernization of the regulatory framework for the capital markets receive most emphasis from the government and international financial institutions.

Therefore, major initiatives to provide broad-based access to simple, efficient deposit and payments instruments are unlikely to be implemented. A repositioning of the Postal Savings Fund within the banking sector, e.g., by linking or merging it with one of the existing commercial banks, would not necessarily be an improvement or provide more services to individuals or small entrepreneurs.

ICT and Financial Services

MCIT, the ministry that leads ENPO and regulates the postal sector, has also undertaken significant initiatives to modernize and liberalize the financial sector. MCIT has formed committees with the Central Bank of Egypt and the banking community. These initiatives may not immediately improve access to financial services, but may create conditions that could facilitate the development of efficient and solid retail financial services in the medium and long term. These committees have developed a framework for establishing the first retail credit information center, or credit bureau. Credit bureaus play an instrumental role in expanding microcredit services and are essential for the growth of the bank card industry and the transformation to a cashless society.

To encourage e-business in Egypt, the government is working to draft an Electronic Signature Law that will create an enabling regulatory and legal environment for conducting online transactions. The law is one of the new cyber-laws that should have a major impact on developing a thriving e-business in Egypt. Signing transactions online will soon become a reality, making both banking and e-government services in Egypt faster and easier to use. A law authenticating e-signatures has been drafted in cooperation with all concerned public and private sector partners and has been submitted for approval to the cabinet and parliament.

A number of projects to help establish a business environment conducive to ICT-driven commerce have been launched. MCIT has developed a framework to network chambers of commerce to facilitate the flow of information and improve trading and economic performance. Each chamber of commerce will have an internal
network (local area network, or LAN) and access to a shared electronic database. A wide area network will be established to connect them with MCIT, which will provide the necessary infrastructure for this purpose.

Almost all banks currently operating in Egypt are fully automated and have core banking applications with SWIFT and fast-cash services, as well as their own switching software for online transactions. Over the past decade, the banks were automated, and routers, mail servers, and LAN switches installed. More than 70 percent of all Egyptian banks have developed or are in the process of developing, e-banking solutions that give both individual and business clients access to accounts and other banking services. Some have set up systems for e-banking, e-commerce, archiving systems, interconnected databases, and smart cards for customers’ deposits. During fiscal years 2002 and 2003, there were nearly 217,000 SWIFT electronic transfers, related to settlements between banks through the Central Bank.

An information network linking the Central Bank of Egypt with 50 banks using frame-relay technology has been established. In addition, banks possess communication links between their branches. The information network is vital to efficient utilization of the financial information systems at the Central Bank. These systems include an electronic check-clearing system that handled over 10 million checks during the fiscal years 2002 and 2003, totaling about EGP 245 billion. The information systems adopted at the Central Bank also include the credit risks’ management system, and the foreign currency exchange system.

This trend toward adopting ICT solutions in banking began in the early 1990s with the implementation of consumer credit programs and automatic teller machines (ATMs). Egypt currently has over 1200 ATMs—particularly used by tourists—and the number is increasing annually by an average of 40 percent. Major merchants and retail stores in the Greater Cairo area have almost 15,000 point of sale (POS) devices that accept local and international credit cards. The estimated value of transactions through ATMs and POS is over EGP 15 billion. The annual growth rate in the number of credit and debit bank cards issued exceeds 30 percent, with over 2 million cards in use. Banks issue debit cards to give customers access to their accounts, and banks have, on average, issued cards to more than 70 percent of their customers. There are projects currently being implemented at the National Post Authority and in commercial banks to provide pension payments through ATM machines.

Several banks in Egypt have started mobile and Internet-banking pilot projects to make it easier for people to do their banking from their home or office. Internet access and a browser that supports 128-bit encryption, such as Netscape Navigator or Microsoft Internet Explorer, are almost all that is needed for Internet banking. Comprehensive account services are available with Internet banking, including account information, trust checking accounts, savings accounts, certificates of deposit, loans, transaction inquiries. Currently, seven Egyptian banks are licensed by the Central Bank of Egypt to offer e-banking. The Egyptian Banking Company for Technological Development operates a system for linking and switching transactions for electronic fund transfer from 865 ATMs owned by 30 Egyptian banks with links to regional and international networks, such as Diners Club, American Express, and MasterCard.

These important steps are creating a legal and IT framework, and although application is running at a relatively small scale, it should gradually gain momentum. As seen in several other countries, these services could remain privileged to a small group or gain widespread use. The Postal Savings Fund's database and its postal network could have a critical role in expanding the new services to provide broad-based access to cashless (electronic) payments instruments and hence to more efficient retail financial services.

**Microfinance**

Although Egypt may have more than 60 banks and a network of over 2,000 branches, the financial sector does not meet the needs of the microentrepreneurs, as banks have not typically offered loans smaller than EGP 25,000 (the equivalent of about USD 4,025). However, the Economic Reform and Structural Adjustment

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4 Included in the 2,000 branches are about 1,800 branches of the Principal Bank for Development and Agricultural Credit (PBDAC). The PBDAC does provide microloans and small loans primarily for agriculture and rural needs, through village banks in the countryside.
Program that Egypt has undertaken includes the liberalization of the financial sector. The Central Bank of Egypt thus no longer sets an interest rate ceiling which opens the possibility for banks to develop a strategy for serving the market. On the other hand, government ownership of commercial banks continues, with the state-owned banks dominating the sector. (The four public-sector commercial banks have 883 branches versus 298 branches of private and joint venture commercial banks.) The four public banks, National Bank of Egypt, the Bank of Alexandria, the Banque du Caire and the Banque Misr, account for 62 percent of the banking system’s assets. There are 32 business and investment banks, as well as four specialized banks, including the Principal Bank for Development and Agricultural Credit with its network.

The National Bank for Development

The National Bank for Development (NBD) began its program in 1991 (with start-up aid from USAID, the Ford Foundation, UNICEF, and CIDA), as the first commercial bank in the region to branch into microfinance. Microfinance services are now actively provided in 44 of its 66 branches in 17 governates. The program reportedly is now self-sustaining, and NBD has matched all credit funds provided by international donors. Some 20 of the 44 branches are donor-financed and 24 are self-funded. It also provides a program for small and medium entrepreneurs in all 66 branches, funded by its own resources. NBD had 22,600 active borrowers with USD 8 million in outstanding loans. To extend its program, NBD reduced the maximum loan size from EGP 10,000 to 3,000 in 2003. The average loan size is USD 480. NBD has also introduced a successful insurance product.

A unique feature of NBD’s microfinance program is its mobile banking units, which although costly, has extended outreach by delivering services to the doorstep. A mini-van with a driver, tellers, and loan officers visits areas in Cairo where the bank has no branches. Loan payments are collected, new loans are disbursed, and applications are reviewed. Even in areas where the bank has branches, NBD has adopted standard microfinance practices and loan officers visit borrowers every week to collect payments.

There are two exceptions to the barriers to small loans in the banking sector: two commercial banks, the National Bank for Development and the Banque du Caire, have implemented their own microfinance strategies to provide direct loans to microentrepreneurs. The success of these two programs could and should demonstrate to the rest of the sector that microfinance can be a viable business line. In both banks, the microfinance programs have been set up as separate units with different practices and procedures than the rest of the bank. Other exceptions to small loans among commercial banks are the partners who participate in the Social Fund for Development programs.

<table>
<thead>
<tr>
<th>Microfinance Institutions in Egypt</th>
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<tbody>
<tr>
<td><strong>Outreach</strong></td>
</tr>
<tr>
<td>• Borrowers</td>
</tr>
<tr>
<td>• Savers</td>
</tr>
<tr>
<td><strong>Loan portfolio</strong></td>
</tr>
<tr>
<td><strong>Savings</strong></td>
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<tr>
<td><strong>Average loan size</strong></td>
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<tr>
<td><strong>Points of service</strong></td>
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<tr>
<td><strong>Estimated market penetration</strong></td>
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</table>
The banks operating microfinance programs are subject to the regulation of the Central Bank of Egypt. Although, as previously noted, the Central Bank no longer imposes interest rate ceilings, there are two large microfinance programs, which are subject to some special regulations. The PBDAC is subjected to reduced interest rates by sovereign decrees. The Social Fund for Development loans are subject to the same decrees, which means they must offer lower interest rates than non-Social Fund for Development bank loans. Both programs are also sometimes subjected to government imposed constraints to their collection policies, through forced debt forgiveness and/or debt rescheduling.

Microfinance in Egypt dates from the early 1990s, when it developed with substantial support from several international donors. Whether potential is measured by the size of the microentrepreneurial sector or defined population sectors, Egypt has the largest potential market for microfinance in the Arab world, but is far from realizing the full potential of its microfinance market with 220,000 clients. In a recent survey of microfinance in the Middle East, Egypt had 32 percent of the active borrowers and 39 percent of the total microfinance portfolio. (Large government-run programs were excluded from the survey.) Morocco, with a smaller population, had 250,000 microfinance clients, which represented 52 percent of the active borrowers and 35 percent of the loan portfolio outstanding. The number of existing microentrepreneurs (non-agricultural) in Egypt is estimated at between 1.5 and 2 million, of an estimated population of 68 million (which is growing at more than 2 percent per annum). The potential number of microenterprises is estimated at between 2 and 3 million, if access to financial services were available.

In both absolute and relative terms, however, penetration of microfinance into the market is still quite shallow, with only 220,000-plus microentrepreneurs having access to services, according to a 2003 survey. It is widely assumed that this figure underestimates the client base because it excludes those clients funded by Social Fund for Development clients and other providers who did not participate in the 2003 survey. (The Social Fund for Development small enterprise loan portfolio at year-end 2000 totaled USD 115 million.) Morocco, with a population of 30 million with 500,000 existing microenterprises (estimated), has a dynamic microfinance sector serving over 250,000 clients. Most observers feel that only 5 percent of the demand for microcredit is currently being met.

To date, donors and the Egyptian government have financed the bulk of support to the microfinance sector, through direct institutional investments. There has been little effort to look at the sector as a whole. A suitable legal framework does not exist. Most MFIs operate as non-governmental organizations (NGOs), governed by the Ministry of Social Affairs. As such, they face several problems, including inability to mobilize savings, difficulty in accessing commercial banks and other commercial sources to fund their expansion, onerous collateral requirements for commercial bank funding, and structures and governance which are unsuitable for microfinance.

MFI Market

The informal sector in Egypt is large and is generally given credit for providing as much as 50 percent of the economic activity, although no reliable data exists. With 99 percent of the population concentrated in the Nile valley and delta, the high population density should facilitate the expansion of financial services to the informal sector. The informal sector absorbs a major part of the labor in Egypt, providing a wide variety of goods and services. In addition to the NGOs involved in delivering financial services to the informal sector, family members, ROSCAs, pawn brokers, supplier creditors, and moneylenders provide finance to the microenterprises.

In an Egyptian context, microfinance loans are defined by either their size, less than EGP 10,000 (USD $1,610, or 130 percent of per capita GDP) or fewer than five employees. There is considerable variance in the size of loans made by the different microfinance operators in Egypt. In ESED Bank, for example, loans to microentrepreneurs range from USD 150–5,000, for everything from small working capital to purchases of small machinery. The 2003 UNDP survey expected that the 200,000 clients at the end of 2003 would double by 2005. As noted, the survey did not include the Social Fund for Development program, which is substantial. USAID-supported microfinance programs constitute 92.9 percent of the existing 200,000 client base.
The legal forms in Egypt available to MFIs include NGO structures and formal financial institutions (FFIs). The NGO structure for microfinance in Egypt requires all NGOs to be registered under the Ministry of Social Affairs. Specifically, it requires their boards of directors to play an active management role in some types of institutions, including signing all checks, for example. The ministry has the authority to inspect NGOs and to require a change in their boards if the inspection is unsatisfactory. FFIs are subject to regulation by the Central Audit Agency, the Central Bank of Egypt, and the Egypt Bank’s Union. FFIs are subject to other requirements, which include paid-in capital, a license from Central Bank of Egypt, legal reserves at Central Bank of Egypt, and conformity with Central Bank of Egypt reporting requirements.

**Scope of USAID-Supported Microloan Programs in Egypt***

<table>
<thead>
<tr>
<th>MFI</th>
<th>Number of Active Borrowers</th>
<th>Loan Portfolio (USD)</th>
<th>Number of Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>I. USAID-Supported MFIs</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ABA</td>
<td>43,532</td>
<td>8,714,762</td>
<td></td>
</tr>
<tr>
<td>ESED</td>
<td>31,267</td>
<td>7,333,575</td>
<td></td>
</tr>
<tr>
<td>SEDAP</td>
<td>3,980</td>
<td>904,892</td>
<td></td>
</tr>
<tr>
<td>ASBA</td>
<td>35,452</td>
<td>8,191,254</td>
<td></td>
</tr>
<tr>
<td>SBACD</td>
<td>12,470</td>
<td>2,514,476</td>
<td>4</td>
</tr>
<tr>
<td>DBACD</td>
<td>19,606</td>
<td>3,841,833</td>
<td></td>
</tr>
<tr>
<td>Banque du Caire&lt;sup&gt;5&lt;/sup&gt;</td>
<td>38,757</td>
<td>11,754,791</td>
<td>233**</td>
</tr>
<tr>
<td>Other institutions</td>
<td>3,928</td>
<td>1,035,344</td>
<td></td>
</tr>
<tr>
<td><strong>Subtotal USAID</strong></td>
<td><strong>185,708</strong></td>
<td><strong>43,860,573</strong></td>
<td></td>
</tr>
<tr>
<td><strong>II. OTHER MFIS</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>National Bank for Development</td>
<td>22,600</td>
<td>8,200,000</td>
<td>44</td>
</tr>
<tr>
<td><strong>Subtotal Other MFIs</strong></td>
<td><strong>22,600</strong></td>
<td><strong>8,200,000</strong></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>208,308</strong></td>
<td><strong>52,060,573</strong></td>
<td></td>
</tr>
</tbody>
</table>


** Microfinance services are available in all BdC branches, according to Elizabeth Littlefield and Richard Rosenberg in “Microfinance and the Poor,” Finance and Development 41, no.2 (June 2004).

There are 14 NGO programs per 1998 data, compared to the two commercial banks. Despite more NGO programs, the two commercial bank programs provide USD 20 million of a total USD 52 million in loans to the sector.

Egypt has five MFIs that are fully financially sustainable, and six MFIs that are almost financially sustainable (>80 percent), according to a recent SANABEL survey.<sup>6</sup> In Egypt, individual lending is the dominant form of

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<sup>5</sup> The Banque du Caire is a rapidly growing program, and may have surpassed ABA, by the time of this writing, to become the largest program in Egypt.

microfinance, although there are a few village banking systems. Individual loans represent 70 percent of the portfolio. The average loan size was estimated to be around USD 736 in 1998, well below per-capita income levels, suggesting that the existing programs are targeting the poor. Women clients are under-represented, only 20 percent of the client base, indicating depth of the social barriers which confront the outreach efforts of the MFIs.

**Donor Support**

To date, there have been no pilots or experiments with microfinance and the post offices. Inside ENPO, there has been some discussion about microcredit and consumer loans. Microfinance does not fall within the scope of the Postal Savings Fund. In the context of developing stronger and more efficient ICT-based financial services, and the early stage of partnership with two commercial banks, providing small credit is a medium term priority.

### 3—Options for Development

ENPO plays a valuable role in providing broad-based access to basic financial services. With a network that is more than four times larger than the entire banking sector, it provides low-threshold access to deposit mobilization and payments services. With its low minimum-deposit requirement, dense network of post offices, and image as a non-bank, ENPO can attract a growing number of depositors even though its products are somewhat antiquated. As post offices become computerized, the postal savings service can offer fairly efficient, reliable, and straightforward products, compared to what the four Egyptian state banks offer, to lower- and middle-income groups. The number of postal savers has doubled from 6 million in 1997 to 12 million in 2004; the postal savings amount to EGP 22 billion (approximately USD 5.1 billion).

Postal savings are reinvested with the National Investment Bank, a government fund that is also in charge of investing social security funds and reserve management. It invests money in long-term public sector projects. The postal savings and its operations are operated and regulated under the postal sector law, and thus fall outside of the supervision by the Central Bank of Egypt. The Ministry of Communications and Information Technology is responsible for postal sector development and is the owner of ENPO.

The postal savings interest margin income is ENPO's largest revenue component, more than 60 percent of total revenues. The spread between client interest rate and the rate paid by the National Investment Bank is 0.5 percent, and seems to exert a pressure on ENPO to operate efficiently.

The continued growth in postal savings balances and, hence, interest margin income have made ENPO a profitable organization, in spite of its declining mail volumes and heavily regulated pricing (low postal prices that do not cover the cost of mail service). With fewer than three mail items per capita posted per year, Egypt's mail demand is low and, given the market condition, is unlikely to increase much in the medium to long-term. There is no historical bulk-mail market (bank account statements, public utility bills, etc.) and, should demand ever evolve, postal services would be pitted against increasingly available alternative communications. Also, the prospects for mail volume growth from direct marketing and e-commerce are very limited in the short to medium term. Demand for courier, express, parcel, and international mail is concentrated in the business sections of Cairo and Alexandria. These types of mail service have been formally opened to the private sector (e.g., UPS, DHL, FedEx, and TNT), and de facto liberalization has occurred through a large number of other private operators. Substantial growth perspectives for ENPO in mail and parcel services seem non-existent in the short-term, but could evolve in the longer term with support of hybrid mail and e-commerce.

Although there is no publicly available postal sector policy or postal reform strategy, it appears that priority is given to strengthening ENPO's role with ICT as a nationwide network and delivery channel that provides

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The Role of Postal Networks

access to electronic financial services and modern information and communications facilities. Initiatives to build links with the banking sector through a joint venture may also be useful first steps toward developing stronger partnerships between one or more financial institutions and the postal network. Such partnerships could help to expand the range of financial services available at post offices, while operating and managing these services on a competitive basis and in compliance with the financial sector regulations. Nationwide rollout from current small-scale pilots is still a long way off.

One positive aspect is that ENPO generates pre-tax profit currently in excess of USD 5 million, which is critical as a funding source for investing in the modernization of postal services and products nationwide. Although there is a fairly stable outlook for a continued positive cash flow generated through growing postal savings and increasingly cost-efficient postal payments, this is not ensured. The risks to which this revenue stream is exposed vary from (1) volatility in the financial markets (interest rates, emerging competition, technology scams) that could have a negative impact on the behavior of postal savers; to (2) political problems if the National Investment Bank is restructured in view of reforming the social security and pension systems, and/or government finance; and (3) if the decline of postal mail volume accelerates and/or if capital expenditure in postal mail processing is prioritized. The risks are difficult to assess and to manage particularly because there are no market and management information systems within ENPO.

ENPO's current approach of initiating pilot programs to test new products and services or applications may appear sensible. But if they are to be rolled out and sustained, it is critically important that these pilot programs include detailed market and consumer research prior, during, and after the pilot, such as:

- detailed financial planning, budgeting, and control so that the economic and financial impact of the pilot programs can be assessed (Ideally, each pilot should be based on a project finance plan, including a separate cost-benefit analysis with cash-flow forecasts.);
- an evaluation of project and product profitability, subsequent extension of MIS, and the establishment of a broader, company-wide set of planning, budgeting, accounting, control, and internal audit functions;
- organizational (re)design as follow-up to the pilots and the availability of more sophisticated MIS (It would also become necessary to separate the financial management function from the financial services function. One is a staff department supporting the management in financial planning, budgeting, and control; the other is a business unit responsible for marketing and the operations of clients’ postal savings and payment services. A separate treasury function would be responsible for the overall cash and liquidity management of the postal financial services, correspondent bank relations, and the asset management.); and
- steps likely to lead to broader company-wide restructuring, including creation of business units (profit centers) for the mail and parcel services and the retail network, and eventually to provide a basis for overall commercial and corporate development of ENPO.

While the above steps would be key components in a two-year program to strengthen ENPO as an institution, it would be useful for ENPO to consider at least two other pilot programs and apply the experiences to the program testing new products and services (above):

- a pilot testing more advanced international remittance products, utilizing fast electronic communications, in combination with the option of directly crediting the remittance into a postal savings account or into a newly-launched postal accounts with debit cards; and
- a pilot to test microfinance on a small scale in a rural area in collaboration with a reputable microfinance institutions; where the program aims at testing the viability of using the postal network as an agent or channel for microfinance products, such processing credit applications and collecting periodic payments.

The pilot tests should provide practical and locally-applicable experience in setting up new financial services through the postal network, based on modern ICT. The results of the pilots should provide a design for a revised development strategy of ENPO within the changing financial and communication sector. A next step would likely include an organizational redesign of ENPO to strengthen it and help it develop commercially and financially in a sustainable manner. These steps would eventually allow options for private sector participation in ENPO to be assessed in a structured and balanced manner.
The Role of Postal Networks in Expanding Access to Financial Services

Country Case: Kazakhstan’s Postal Finance Services

The World Bank Group
Global Information and Communication Technology

Postbank Advisory, ING Bank
Postal Policy
Author’s Note

This paper discusses the role of the postal network in expanding access to financial services in Kazakhstan. It reviews the public postal operator within the postal sector and within the broader context of the communications sector. The roles of the postal network and state and privately-owned banks are also reviewed from the perspective of the financial sector development, with particular focus on payments systems development and microfinance.

This paper was prepared with desk research in 2004. Field visits were not scheduled.

While this country case on Kazakhstan can stand alone, it is an integral part of this large study of the potential of postal networks to coordinate with financial service providers in 7 countries (Egypt, Kazakhstan, Namibia, Romania, Sri Lanka, Uganda, and Vietnam) and 5 regions (Africa, Asia, Eastern Europe and Central Asia, Latin America and the Caribbean, and the Middle East and Northern Africa).

Glossary of Abbreviations and Acronyms

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ATMs</td>
<td>automated teller machines</td>
</tr>
<tr>
<td>CIS</td>
<td>Commonwealth of Independent States</td>
</tr>
<tr>
<td>EBPP</td>
<td>electronic billing presentation and payment</td>
</tr>
<tr>
<td>EFT POS</td>
<td>electronic fund transfer at point of sale</td>
</tr>
<tr>
<td>EMS</td>
<td>express mail service</td>
</tr>
<tr>
<td>GDP</td>
<td>gross domestic product</td>
</tr>
<tr>
<td>KZT</td>
<td>Kazakh tenge</td>
</tr>
<tr>
<td>MI</td>
<td>transferable deposits and cash in circulation</td>
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<tr>
<td>MFI</td>
<td>microfinance institution</td>
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<tr>
<td>NGO</td>
<td>non-governmental organization</td>
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<tr>
<td>RSEMS</td>
<td>Republic State Enterprises of Mail Services</td>
</tr>
<tr>
<td>SME</td>
<td>small and micro enterprise</td>
</tr>
<tr>
<td>SWOT</td>
<td>strengths, weaknesses, opportunities, threats matrix</td>
</tr>
<tr>
<td>USAID</td>
<td>United States Agency for International Development</td>
</tr>
<tr>
<td>USD</td>
<td>United States dollar</td>
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## SWOT Analysis of Kazakhstan Postal Service

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<th>Strengths</th>
<th>Opportunities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Unique dense network for providing financial services, communication, and retail trade; 3700 post offices versus 368 bank branches</td>
<td>• Market for retail payments, deposits, microcredit relatively underdeveloped and showing fast growth rates; substantial opportunity for KazPost to capture a larger market share, also in value (KazPost could play a strong role in the transformation from cash to cashless/electronic payments); substantial opportunities to become a window for consumer and micro credit</td>
</tr>
<tr>
<td>• Nearly 3,000 post offices in rural areas (approximately 7 million inhabitants), compared to 70 bank branches</td>
<td>• Further consolidation in banking sector expected to take place (A merger or alliance with one or two smaller banks could accelerate KazPost’s position and capabilities, but KazPost could also develop multiple agency relationships.)</td>
</tr>
<tr>
<td>• More than 800,000 deposits accounts; average deposit is USD 26. (Deposits are not tax privileged but implicitly backed by the state.)</td>
<td>• Retail trade in nation-wide chains developing gradually; post office network could be repositioned as a nationwide network of stores, providing a franchise for convenience goods, information, and financial services (This could start with more active direct marketing or mail order business. Catalogue shopping could be gradually expanded with actual shopping in post offices.)</td>
</tr>
<tr>
<td>• Perceived as a non-bank, and has never defaulted, contrary to banks, which lost depositors’ money twice in the early 1990s. Consumer confidence improving, but is still fragile.</td>
<td>• Access to Internet and e-commerce relatively absent due to antiquated telecommunications infrastructure; is expected to improve after 2007 (KazPost could obtain a leading position in providing public access to Internet, and e-commerce, and could benefit from synergies with its postal logistics operations and financial services to provide access plus fulfillment.)</td>
</tr>
<tr>
<td>• Post offices increasingly equipped with modern information communication and technology</td>
<td></td>
</tr>
<tr>
<td>• Has central management, supported by management information system (MIS) which also manages cash and liquidity</td>
<td></td>
</tr>
<tr>
<td>• Management skilled and trained in banking and finance.</td>
<td></td>
</tr>
<tr>
<td>• Several agreements with private-sector entities and profitable under government accounting standards</td>
<td></td>
</tr>
<tr>
<td>• Access to finance for development projects (Islamic Development Bank)</td>
<td></td>
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<table>
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<tr>
<th>Weaknesses</th>
<th>Threats</th>
</tr>
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<tbody>
<tr>
<td>• Virtually all post offices operate on a fixed-cost basis, leading to a low flexibility to adjust cost to actual economic turnover.</td>
<td>• Institutional framework is not transparent. (Agency for Communications and Information is owner, policy maker, and regulator of postal services; National Bank of Kazakhstan for financial services.) Privatization is not determined.</td>
</tr>
<tr>
<td>• Growth perspective in traditional postal mail market is very limited and in some segments negative.</td>
<td>• Market for courier, express, and parcel services is de facto liberalized and in the hands of private and foreign operators; current investment to improve offer of KazPost may not pay back.</td>
</tr>
<tr>
<td>• KazPost has a limited license for banking operations and is confined to re-investing client deposits in low-yield state securities only, resulting in non-competitive client interest rates.</td>
<td>• Letter mail market is (strongly) in decline and distribution of newspapers is likely to be affected by new technologies (hybrid mail) and competitive distributors.</td>
</tr>
<tr>
<td>• In spite of MIS, KazPost lacks transparent accounting and product profitability, with possible capital expenditure on projects that are not economically sustainable.</td>
<td>• It continues to offer incomplete package financial services, and non-competitive rates, KazPost may be perceived as inferior provider of financial services.</td>
</tr>
<tr>
<td>• Lack of separated accounts implies the risk that client deposits can still be used to cover operational deficits within KazPost.</td>
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1—Postal Sector Development

Postal services provided by the state are relatively recent in Kazakhstan. In 1860 the Russian Czar's Postal and Telegraph Services opened its first post office in Verne (now Almaty). In 1883 there were 14 post and telegraph offices, and this number gradually increased to 250 in 1917. The post and telegraph offices mainly served the public administration, police, and military.

After the formation of the Kazakhstan Socialist Soviet Republic, the postal and telegraph services were organized in 1925 under a National Committee, and provided postal mail services to the public. The postal services were also charged with distributing newspapers.

Until 1991 Kazakhstan was part of the USSR and its postal and telecommunications system were organized along the same principles as in other Soviet republics. Its communications industry was organized as a monopoly under the then Ministry of Communications and Informatization, and was also regarded as part of the state military communications network. Under the central planning guidelines, a dense and widespread postal network evolved (called a network of communication centers and communication departments) providing uniform mail, parcels, telephone, telegraph, and other communications services. In 1950 there were more than 2,500 post offices and at the end of the 1960s, more than 4,000.

When Kazakhstan gained independence in 1991 it was endowed with a dense postal network of more than 3,800 post offices and agencies. However, the break-away from the Soviet Union led to an economic recession and a sharp decline in parcels, mail, newspapers, and postal money orders.

The Republic of Kazakhstan became a member of the Universal Postal Union in 1992, which gave it free and direct access to the international postal market and to all the world’s postal administrations, i.e., international settlements with national postal operators of other states.

Telecommunications was separated from the postal service in 1993, a major step in reorganizing the communications sector.

Information Communication and Technology Developments

Although the telecom sector underwent further improvements, in general it was antiquated and inadequate. The telecom sector was and still is dominated by KazTelecom, which has monopoly rights on long-distance and international calls. The primary improvements to the telecommunications infrastructure are the construction of a Trans-Asia Europe fiber optic cable and installation of digital switch centers and fiber optic lines. These programs should be completed after 2007, but the poor quality of the telecom network is a serious constraint to e-commerce and e-government development.

In 2001 there were 1.9 million fixed-line subscribers and 400,000 mobile phone users, implying that less than one-third of the households had access to a phone line. At the end of 2003, there were 910,000 mobile phone users while the number of fixed line subscriptions had increased to 2.2 million.

Kazakhstan's readiness for electronic telecommunication and technology is still relatively poor, but the sector is developing rapidly:

- The number of regular Internet users is increasing approximately 50 percent every year (over 200,000 at present).
- The number of wireless users is increasing rapidly (in 1999, there were 30,000 users; in 2002, 800,000; in 2003, 1,500,000).
- Use of the Internet by businesses for e-mail exchange, information, and market research is growing rapidly.
- Web services (web site development, hosting, etc.) are well developed. The quality of the services is good.
- Online content is increasing, although slowly.
• The financial sector is the leading on-line user. Banks have introduced e-banking, bank cards, online payments processing.1

Policy frameworks for e-government, e-commerce and e-learning have been prepared by the Agency for Communications and Informatization. Kazakhstan2 defined the priorities of information sphere development in the National Information Infrastructure (an integral part of the Global Information Infrastructure which is implemented by the world community as an open system). The main document is the “State Program of Formation and Development of the Information Infrastructure of the Republic of Kazakhstan” (approved by the resolution of the President, No. 573, March 2001).

The main actions of the program are:

• creating the legislative framework for the National Information Infrastructure of Kazakhstan;
• improving state regulation mechanisms in the sphere of informatization;
• introducing new information technologies and technical means;
• providing Internet access to the whole country; and
• creating a state information management system.

At the end of 1995, the Republic State Enterprises of Mail Services (RSEMS) was established under auspices and ownership of the Ministry of Transport and Communications and Tourism as the national postal operator. In 1999, RSEMS became “KazPost” under a government reorganization plan. KazPost was incorporated as an open joint stock company, OAO, with 100 percent ownership initially in the hands of the Ministry of Transport.

KazPost provides national and international letter and parcel services, subscription to and delivery of periodicals, philatelic services, copy services, and retail of consumer goods and lottery tickets. New competitive services, such as international and domestic express mail service and e-mail, have been introduced. KazPost transports the mail via air, rail, and postal vehicles, and holds the exclusive right to issue and distribute state postage marks in a de facto liberalized postal market.

Key Characteristics of KazPost

KazPost is a joint stock company owned by the State Agency for Communications. The State Agency combines the roles of owner of KazPost, policy maker for the sector, and regulator of the sector. In practice, it is involved in several issues of decision making that should the purview of KazPost's management. KazPost provides both postal mail and postal financial services. The post offices provide both lines of service.

KazPost operates under the license of National Bank of the Republic of Kazakhstan for some banking operations in tenge (KZT) and in foreign currency. It has a state license to receive, convey, and deliver mail items, and offer express mail services. It has a category 1 license issued by the National Commission of the Republic of Kazakhstan on Securities for the right to broker and deal on capital market of Kazakhstan and to provide bookkeeping services to clients. This legal framework can be regarded as modern, and relevant to KazPost’s current state of corporation. KazPost can also enter into partnerships and agreements, and establish subsidiaries and joint ventures.

In 2000, KazPost was registered as a joint stock company with total capital of approximately KZT 904 million, comprising 903,660 shares with a nominal value of KZT 1,000. Although KazPost is 100 percent owned by the government, the company is supposed to be self-sufficient, does not receive government subsidies, and has been recording profits since its establishment. When KazPost was established, the shares and ownership were temporarily entrusted to Halyk Bank (then the state-owned National Savings Bank). In 2002 the shares were

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1 “Estimate of Kazakhstan’s Readiness for e-Commerce,” report prepared by PRAGMA (USAID) for a project to develop trade and investments.

transferred to the Agency of Communications and Informatization. There have been plans to privatize KazPost, but this reportedly has not happened.

The postal sector is deregulated in Kazakhstan. KazPost is the universal service provider. There are nearly 50 other operators in the postal sector, both local and foreign-owned. KazPost is believed to hold a dominant position in the mail market, including direct mail, 15 percent of the courier and express market, and less than 10 percent in the parcel market.

**Organizational Structure of KazPost**

KazPost is organized into four basic units. There are 3387 branch post offices (614 in urban districts and 2773 in the countryside) that handle mail collection and delivery of mail items and are retail outlets at the same time. It has 166 city and district post offices, 22 of which receive, process, transport, and deliver all kinds of mail. The 14 regional divisions of the postal service are legal entities that co-ordinate the work of postal enterprises in the various regions. There are 2 specialized divisions: a mail transportation center and Pochtasnab, an enterprise supplying materials and technical means. They are also legal entities, subordinate to KazPost.

KazPost has three levels of administration. The head office or central administration of KazPost, Level 1, manages the regional branches, organizes and co-ordinates postal services at a national level, and represents KazPost internationally. The central administration is made up of the following departments:

- Postal technology, responsible for organizing postal services and agency services
- Transport and collection, which organizes and manages money and material valuables, collection services, and mail transportation
- Cash operations, responsible for providing cash services to legal entities, and administers sub-correspondent accounts of structured departments
- Treasury, responsible for marketing government bonds, monitoring the liquidity, assets and liabilities of KazPost
- Information technology, responsible for checking the information system and developing and introducing program products
- Economic analysis and planning, responsible for managing and maintaining budget allocation, handling labor matters, calculating the primary cost of the services, and strategic planning and marketing
- Accounting, responsible for drawing up accounting policy, and overseeing the financial accounting
- Legal and human resources providing documentation, and handling personnel and clerical affairs

The second level is made up of 14 regional centers plus several specialized units, such as the main post office in Astana, the division of mail transportation in Astana, and the division of mail transportation in Almaty. The third level is the actual postal network with 20 urban postal centers plus the smaller postal outlets and branches.

One can clearly recognize the traditional structure of a postal administration that focuses purely on operations with its territorial subdivisions. Some management functions have developed at the central level, both in cash and liquidity operations management, treasury, finance, accounting, research and development. KazPost has not structured its company in business units or profit centers, except for the mail sorting center and express mail courier services. There is no business unit or division for postal savings or postal financial services. Also, the marketing and commercial functions of KazPost are not clearly defined. There are no units explicitly in charge of marketing, products, or sales. General management also seems to be in charge of commercial management. This structure is reflected in its MIS, too, which does not provide the marketing and management data analysis needed to run KazPost as a company.

Regarding human resources, KazPost's senior management has been recruited from the private and financial sectors in recent years. Most of them have previous experience in these sectors, although their average age is below 40. A large part of the operations and counter staff is believed to be older and predominantly female.
Postal Performance

Quality of mail delivery is relatively good in Kazakhstan, in spite of the long distances that need be traveled to convey mail, parcels, and other items. The government has set a goal of reducing mail delivery time to less than three days within the country. A recent presidential decree in March 2004 mandates new mail delivery standards that are closer to EU standards of quality.

With a population of 15 million, the mail-per-capita demand in Kazakhstan is low and in decline. In 1997 the domestic letter mail volume amounted to 14.5 million, in 2002 this volume decreased to 10.5 million. Mail per capita decreased by 33 percent in five years, from about 1.5 items per capita to 1 item per capita. International mail volumes have also declined: outgoing mail dropped from 8 million items in 1997 to 5.3 million in 2002, and incoming mail from 9.4 million items in 1997 to 6.6 million in 2002. Registered mail has increased from 0.9 million items to 1.8 million in 2002.

Mail from person to person was estimated at less than 1 million items in 2002. The post offices collect, sort, and deliver the mail. The average number of mail items per post office per day was 16. This figure suggests that many of the 2773 rural postal outlets frequently had days with no mail letters at all to collect or to deliver.

In addition to mail, KazPost is the primary distributor of newspapers, periodicals, and journals. The volume of this traditional state function increased slightly from 86 million items in 1997 to 91 million in 2002. This is another Soviet legacy of the restriction of the press and of the freedom to print. In general postal systems are not intensively involved in newspaper distribution because private delivery (often through schoolboys) is more efficient or cheaper in urban areas.

Although no analysis of mail flows is available, it is assumed that, as elsewhere, mail is primarily generated by companies and public agencies. In Kazakhstan, mail is to a large extent business to business. Unfortunately, KazPost cannot rely on processing bulk flows of mail because it has no tradition of utilizing the postal system to distribute utility bills, tax bills, and bank account statements.

Under Soviet rule, bank accounts for individuals did not exist on a large scale except for savings pass books. Utility bills were not distributed on a monthly basis. For bills associated with the rent of an apartment, (rent, energy, water, garbage, etc.), the municipal housing agency provided preprinted payment vouchers in booklets for a year or more. The vouchers, printed with the apartment's address, were used to settle cash payments at the savings bank or post office. With this background, it is unlikely that the typical bulk mail flows will become a mail market growth opportunity, even if they get competition from electronic billing presentation and payment and other modern, efficient organizations.

A growth segment for KazPost, however, is direct mail and direct marketing. Sixty percent of retail trade currently occurs in bazaars and small individual shops. The offer and choice of consumer goods through nationwide retail chains is likely to be limited in the next five years, in particular in rural areas. Providing rural inhabitants and small shops access to a broader choice of consumer goods through printed mail-order catalogues may therefore present a direction for growth. In neighboring Russia, this has already proved to be successful, leading to the creation of Europe's largest mail-order houses and more recently to mail-order credit companies. Catalogue delivery, parcel fulfillment, payments collection, and consumer credit are areas where KazPost could grow.

The outlook for growth in the courier, express, and parcel market seems limited, because it is concentrated in the larger cities, with heavy competition from the private and foreign sector. A critical success factor in the courier, express, and parcel market is integrating the local express service into the global network and providing value-added services, such as warehousing, packaging, address management, and customs handling. KazPost's position is likely to better that some of the local courier, express, and parcel providers and logistics providers, but inferior to global players. This would yield moderate growth that required substantial capital expenditure and marketing.

The revenues generated by mail, parcel, and newspaper distribution amounted to 20 percent in 2002 of KazPost's total revenues (down from 26 percent in 2001, and down more than 50 percent in 1997). These revenues from core postal business are entirely insufficient to sustain the postal network. With the exception
direct mail and mail order fulfillment that offers some possibility of substantial growth, other mail market segments would stay stable or decline. This leads to the conclusion that KazPost is not a postal mail operator, from an economic point of view, but a primarily a network for financial services.

The balance sheets and income statements that KazPost publishes comply with the local applicable accounting standards for companies. It neither complies with, nor is comparable to, the balance sheets and income statements of banks or financial institutions. It has items of short-term liability that include, for example, client deposits and the accounts payable to KazPost’s suppliers. On the asset side, the balance sheet does not differentiate between money deposited in government bonds or accounts receivable from companies that use contract postal services. The income statement does not show the net interest margin income. Instead, interest revenues are recorded as part of operations revenues and interest expenses as part of operations expenditures. Also the revenues from other business lines are not separately, publicly reported.

From data sent by KazPost to the Universal Postal Union, a certain break-down can be derived, but the data series are incomplete and inconsistently defined. While KazPost recorded losses in 1999 of more than USD 1 million, KazPost reported pre-tax operational profits of USD 0.15 million in 2001, 2002, and 2003. Sales turnover grew with 5 percent in 2002 and more than 20 percent in 2003.

Development Plans

KazPost has initiated trials in express mail using EMS-KazPost, direct mail, hybrid mail, and implementing automated mail sorting centers (via a loan of the Islamic Development Bank). These plans helped KazPost improve the quality of its mail communications service. However, given the relatively low volume of use, it may have been difficult to justify a business rationale for significant capital expenditure in this area or investments in the postal mail markets with only a stable or small growth outlook.

In addition KazPost initiated a program to install VSAT terminals and internet connections at post offices. In the first phase of this network, 400 post offices were connected on-line. KazPost's intention is to provide further access to the Internet, which it already provides at several post offices. Within the next three years, 3,000 more post offices will be computerized and connected on-line. These investments are essential to develop and strengthen the postal network as a front-end for financial services and access to information and communications.

Diversification

KazPost has strongly diversified its services. Financial services nowadays are the main services provided through the post offices, and will be discussed in the next section of this report. KazPost has also developed as a nation-wide chain for retail services, selling lottery tickets, transport tickets and a wide range of basic consumer goods.

2—Postal Financial Services in a Market Perspective

History and Current Framework

Historically, the postal network in Kazakhstan has collected and delivered cash. It offers postal and telegraph money orders, which was an important instrument in channeling money home from workers and soldiers stationed elsewhere in the Soviet Union. The postal network and the state savings bank also traditionally disbursed cash for state pensions and social benefits.

In 1992 the postal and telecommunications authorities established a KazPostbank, following the example of several other countries in Eastern Europe and Central Asia. The initial capital of the bank was around USD 1 million, and its primary mission was to extend credit within the communications sector. It opened branches in the 14 main communications centers around the country. The bank was unable to develop the capability of
offering services across the postal counters, much to the dissatisfaction of the postal management. In 1995 the bank collapsed as the result of inappropriate lending policies.

In 1996 the National Savings Bank (or Halyk Bank) transferred its function of disbursing pensions to the postal service. For the postal service, this implied a substantial increase in cash turnover, and enabled Halyk Bank to close down branches and focus on higher-value clients.

In 1997, new management at the then-State Republican Enterprise for Mail Services (later to be KazPost) was appointed. The new management team was led by Orazaly Yerzhanov, a professor in finance with extensive experience in banking and finance management. In 1998 Yerzhanov announced that the post would be transformed into a postal savings bank. Although this has not actually happened, KazPost began to dynamically develop postal financial services.

One of the first steps in this development was to centralize the cash and liquidity management of the postal services. Prior to this, it had decentralized cash and liquidity management, with more than 700 post offices keeping sub-transfer accounts with nearby bank branch offices. These offices reported frequently to the regional centers, which in turn reported monthly to headquarters. Headquarters could determine the aggregate cash position within two-months. The centralization and active management of the assets of the system strongly improved risk control and the utilization of the funds within the postal system. The centralization was effected with the introduction of an Intranet solution in 1998, and has since evolved.

A second step was the preparation of a national postal savings system by launching simple postal savings products as an intermediate step towards a full range of postal banking services. The government and the National Bank of Kazakhstan endorsed the plan and granted to KazPost the status of non-bank financial institution and a license to take deposits. This plan was based on the assumption that KazPost would eventually develop into a financial institution and compete with existing banks. Given the gaps in the markets and the level of competition, it was considered as a better option to develop a postal savings system instead of linking the postal network with one of the larger state-owned banks.

KazPost’s earlier incarnation, as RSEMS, received the right to attract assets of the population and to invest them in the economy of the Republic via government decree in 1998. (There is no tax on the postal savings interest income earned by depositors.) Later, in a 1999 decree, RSEMS was licensed by the National Bank of the Republic of Kazakhstan to offer some kinds of banking operations in tenge and foreign currency, such as:

- personal deposits;
- cash operations (receive, recalculate, exchange foreign currency, sort, pack, and store notes and coins);
- money transfers for individuals and businesses;
- encashment and delivery of bank notes, coins, and valuables; and
- foreign currency cash transactions.

The government determined that any assets attracted by RSEMS would be placed only into the state securities of the Republic of Kazakhstan. The initial rationale of this decision was to ensure that depositors would not risk non-payment of their deposits and to ensure customer confidence. RSEMS also obtained a first-category license from Kazakhstan’s National Commission on Securities, which entitled them to broker, deal, and manage bookkeeping for its clients, and been recognized as a security dealer by the ministry of finance and the National Bank of Kazakhstan (NBK). These licenses were transferred by RSEMS to KazPost when it was established. The license from NBK allowed KazPost to create a correspondent account in the National Bank, transfer funds from the commercial Halyk Savings Bank of Kazakhstan, and join the electronic interbank payments system. The availability of a correspondent account in the National Bank is also an obligatory condition of working as a primary dealer of state securities. KazPost was thus able to offer securities issued by local, regional, and national government entities.

The Range of KazPost's Financial Services

Payments

- Receive and pay postal money orders (In general, the postal money orders are electronically processed.)
Receive and pay international postal money orders (KazPost has established electronic exchange of postal money orders with Russia and Ukraine.)

Disburse state pensions and allowances from the state budget

Pay salaries, scholarships, grants, and other allowances to employees of the state budget organizations

Collect public utilities charges and taxes

Act as service agent for settlement and cash services of legal entities for banks

Provide agency services to contract establishing and notice delivery for pension funds, savings banks, insurance companies and other companies

Provide foreign currency exchange for KZT with Russian ruble, US dollar, and the euro

Enable plastic card payments (electronic fund transfer at point of sale, or EFT POS);

Act as agent of Western Union for international remittances

**Deposits**

Offer demand deposits in local and foreign currency

Offer fixed term deposits in local and foreign currency

**Securities**

Act as broker and dealer in equity market for funds held by individuals in state securities

**Credit**

Consumer loans

As of 2004, KazPost signed an agreement with the Center Credit Bank to act as its agent for consumer loans, where applicants can get a decision on their application within 24 hours. It will start in some of the rural post offices in Konstantinsky oblast. In the first months, bank staff and postal employees will work shoulder-to-shoulder on new applications, intake, and verification. The Bank will handle credit scoring and credit assessment. After three to four days, KazPost presents the approved contract to the client and disburse the money. The installments are collected monthly at the post offices. If this pilot is successful, they will roll out this service to other post offices in the oblast, and eventually to all. Simultaneously with the roll-out within the oblast, KazPost will initiate the project and financial products in one or two neighboring oblasts, and begin nationwide roll-out from there. Within two years, the KazPost network will be the national agent for the Center Credit Bank.

Postal savings have rapidly grown and currently have nearly 1 million deposit accounts according to KazPost. Information on the number of transactions is not available and can only be estimated. The use of traditional payments instruments, such as postal money orders, has declined, but receipt of international remittances through money orders and Western Union has grown nearly 100 percent per year. Under a new five-year plan to further develop the postal and savings system, the government will increase the equity base of KazPost in several phases, from KZT 7 billion to KZT 9 billion. The aim of the injection of equity is to improve the capital adequacy ratio and solvency.

**KazPost's Role in the Financial System**

The financial sector of Kazakhstan underwent a rapid transition and ranks as one of the most advanced in the Central Asian region. Since 1993, the Kazakh banking system has been formally arranged into two tiers, with the National Bank of Kazakhstan comprising the first tier, and all commercial banks—both private and state-owned—comprising the second tier. The NBK divided all second-tier banks into two groups according to the date by which they were expected to meet international banking standards, which included capitalization, size, diversification of assets, management, and accounting. The first group was expected to participate in a deposit insurance fund. As a result of these measures and in particular the strict minimum capital requirements, the number of banks in Kazakhstan has declined significantly over time. Currently there are 38 banks, down from 71 at the end of 1998 and from over 200 at the peak in 1993.
The 11 banks in the first group were already required to reach international standards by 1998. In addition, 24 banks belonging to the second group had accomplished the same transition by the end of 2000. The sector remains concentrated, with the three largest banks (Kazkommertsbank, Halyk Savings Bank, and Bank Turan Alem) accounting for about 63 percent of total sector assets. Some foreign banks, most notably ABN AMRO, HSBC and Citibank have been aggressively entering the Kazakh market and have been successful in attracting blue chip corporations away from the local banks. Several other foreign banks, including Dresdner Bank, Deutsche Bank, CCF, and Commerzbank have offices in Kazakhstan.

Smaller Kazakh banks with limited capital resources and less expertise have seen their market shares decrease. Competition will continue to increase, particularly from foreign banks, but also from domestic private pension funds. This will create a strong demand for domestic bonds and thus compete with banks in lending. Competition is strongly focused on the corporate lending market, in addition to urban, high-net worth individuals and middle-income groups. Halyk Bank, for example, provides advanced retail banking services that are comparable to leading banks in the European Union or the United States. The scale of outreach is limited, however, and the branch network has been strongly reduced.

Despite rapid recent growth in bank assets, Kazakhstan remains underbanked in terms of the ratio of assets and loans to GDP. In particular, over the coming years a rapid increase is expected in retail and consumer lending, as well as lending to small and micro enterprises (SMEs). Banks are introducing new products, such as mortgages, leasing, and consumer financing. Further foreign investment is also expected in the sector as competition and consolidation proceeds. The number of safe and liquid assets is limited. The government bond and bill market is small and oversubscribed, due to excess demand from pension funds and now commercial banks. The corporate bond market is only now developing.

Due to the NBK’s reform-minded policies to consolidate and privatize the banking sector and improve the regulatory and accounting frameworks, Kazakhstan is regarded as one of the more advanced among the CIS countries in terms of progress in banking system transformation. The sector has proven its resilience by surviving the Russian financial crisis in the summer of 1998 and a major devaluation of the tenge in 1999.

**Physical and Electronic Infrastructure**

The 38 banks in Kazakhstan currently operate a total of 368 branches. Nearly 300 of them are located in the 14 largest cities, and 72 branches are in the rural areas where more than 40 percent (7 million) of the people live. At the end of 2002, there were 702 automated teller machines (ATMs), and 5,282 EFT POS terminals—all in the 14 largest cities. KazPost's network is about 10 times larger than the bank branch network, and in most rural areas is the only point of access into the formal financial system. It is an essential component in the national financial infrastructure and in providing access to financial services.

Developing a payment system has been a priority of NBK since 1994, and the current payment system is considered very advanced, compliant with core standards and principles for payments systems, and provides a broad range of electronic payments instruments. All 38 banks and KazPost are members of the interbank payment system.

The cashless component has gradually increased and as of mid-2004, is 11.4 percent of M1 (M1 as household transferable deposits and cash in circulation). The average amount held in cash by each citizen is USD 62 equivalent. This suggests that households keep a liquidity reserve of two or more monthly incomes. About 1.5 million Kazakhstani had payment cards at the end of 2002, and 2.2 million at the end of 2003. The total number of card transactions was 20 million in 2002, and 28 million in 2003. This means that cards were used for 12 transactions on average (mainly cash withdrawals at ATMs) in 2002–03. These figures suggest that 30–40 percent of the households have a payment card.

The total of cashless operations amounted to less than 20 million, with 16 million credit transfers. There are very few check operations in Kazakhstan. The semi-cash operations at KazPost offices were estimated at 80

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3 In reports of NBK, M1 also includes the corporate transferable deposits.
million transactions in 2003, which is two times more than the cashless payments handled by the banks. The banks also deal with cash payments and bill payments—but no data are available.

Although well advanced for company payments, the main payment instrument used by individuals remains cash. The retail electronic payment infrastructure is rapidly developing, but is centered in urban areas and department stores. Only a small part of the population uses electronic payment instruments, and more than 70 percent of retail trade is said to take place at bazaars and small shops that do not have EFT POS.

There are about as many EFT POS terminals as there are post offices. Post offices handle the bulk of small-value payments, and would be well suited to help the transformation to a cashless society. Many post offices are equipped with personal computer terminals and are intended to get smart-card readers that will facilitate the role of the post office in the transformation of the payment system.

**Deposits**

Since the Republic of Kazakhstan was established, savers have lost their money twice. As a result, consumer confidence in the banking system has remained at a very low level for a long time, and consequently savings-to-GDP ratios remain low too. Only recently, signs of improvement are becoming apparent. Deposits are 70 percent of the banks’ liabilities, and the savings-to-GDP ratio has doubled from 1998 to 2003 to more than 16 percent. The three largest banks hold more than 60 percent of all deposits. More than 70 percent of household deposits are held in foreign currency, a sign that confidence in the Kazakh tenge, the local currency, is relatively low.

The top-tier banks participate in a deposit insurance fund, established by the NBK. There are several positive effects from the Individuals’ Deposit Insurance System (i.e., the deposit insurance scheme):

- Twenty-one commercial banks originally participated in the scheme.
- It guaranteed deposits up to 60 percent.
- Beginning in 2004, only bank participants in the deposit insurance system could attract individuals’ deposits.

Deposits amounted to KZT 347 billion (USD 2.5 billion) as of June 2004. At the end of 2003, KazPost's balance sheet reported approximately KZT 2.3 billion client deposits, and more than 800,000 depositors—less than 1 percent market share of the value of deposits. Although this is less than the corresponding figures of the three largest banks, KazPost would still rank among the top 15 deposit-taking institutions in Kazakhstan. It mainly attracts very small savers, with balances averaging USD 26. The interest rates offered by KazPost are not competitive with those offered by commercial banks. The reason is that the deposits can only be reinvested in low-yielding state securities. There is no tax incentive for small savers to deposit money with KazPost.

To increase consumer confidence in depositing money, it is important for KazPost to be able to offer deposits at more competitive rates, to capture a larger market share, but this would also require restructuring KazPost into a banking entity that complies with the NBK requirements. If KazPost cannot comply with these requirements, it will continue to fall behind and might eventually lose its exceptional license to take deposits. At some point, an agency relationship with one or more of the 21 licensed deposit takers might be more effective for KazPost, especially for greater market transparency.

**Credit**

While the deposit market is growing, the retail and consumer credit businesses are lagging far behind. Loans to individuals amounted to KZT 33 billion (USD 239 million) in June 2004. Lending to consumers and SMEs is expected to be a main area of growth in the next few years. Some factors, however, could hinder the rapid growth of retail credit. Kazakhstan has neither large cities in which retail trade is concentrated nor nationwide retail chains that would typically provide or sell consumer credit. Almaty, the former capital, is the largest city with just over 1.1 million inhabitants, and Astana, the new capital, has just over 500,000 inhabitants. The
popularity of open markets (bazaars) and small shops is high and account for 70 percent of total retail turnover. These places typically do not have POS systems for credit or debit card payments.

In 2004, KazPost signed a contract with the Center Credit Bank to offer small consumer loans through the postal network. This may be a first step using the postal network to extend credit to individuals and individual traders.

**Pensions**

In 1998, a new multi-pillar pension system was introduced in Kazakhstan, based on the Latin American model (although Swiss and Singapore systems had also been studied). Pillar I was pay-as-you-go; pillar II was funded by a mandatory 10 percent levy on wages; pillar III was a voluntary pillar. The number of participants in the pension system grew significantly from 1999–2003, from 2.99 million people to 5.91 million. At the beginning of 2004, the assets of pension funds increased to USD 2.5 billion. KazPost plays a service function in collecting premiums for these pension funds, but reportedly does not offer such funds through the postal network.

**Securities**

The securities market has not effectively developed beyond state securities: stock brokering, securities, and mutual fund products are not yet in demand by the Kazakhstan population. The postal network could become a distributor of mutual funds, as an alternative to savings.

**Insurance**

The insurance market in Kazakhstan is just beginning to develop. There is no traditional demand for insurance products, and it is expected that the life insurance market will develop in the medium to long term. The development of the insurance market will depend on sales channels, and the postal network could sell standardized insurance products.

**Microfinance**

The potential for microfinance activities to expand in Kazakhstan is probably better than its status as a lower-to-middle income country with a gross national income of USD 1,720 (in 2001) would indicate. Although Kazakhstan is the wealthiest of the Central Asian republics and has made significant economic progress since independence, the historical legacies of authoritarianism, corruption, and disdain for civic action are still much in evidence. The large income and social disparities will continue to grow, even though more than 30 percent of the population lives under the poverty line.

Despite substantial economic transformation led by the oil sector, Kazakhstan’s experience has been one of non-inclusive growth, with many of the benefits being narrowly based and the economic growth not affecting severe poverty to much extent. Income inequality has worsened, as have regional disparities. The rural population is 44 percent, scattered over a vast space, giving Kazakhstan one of the lowest population densities. Employment statistics also point to the emerging disconnect between growth and poverty alleviation. The share of industry in GDP is increasing, and employment in that sector has trended downward to 30 percent, while agriculture showed increased employment to 35 percent. SME enterprises provide about 5 percent of employment. Although Kazakhstan reports an official unemployment level of around 4 percent, the real figure may be as high as 30 percent.

**Role of the Informal Sector**

Nearly one-third of the population is self-employed, but this number masks the fact that many of the self-employed are engaged in subsistence agriculture. The need for Kazakhstan to diversify away from the oil sector makes development of private activities in other sectors a key element for future economic stability and growth. The informal sector and SMEs account for a smaller share of GDP and employment in Kazakhstan.
than in many other transition economies. Of the 60–65 percent of the economy in private hands, 8 percent of GDP is attributed to SMEs and another 20 percent in the informal sector. There are government policies to encourage SME and informal sector development, but many impediments remain, including access to financial services. The new law creating legal and organizational structures for microfinance institutions (MFIs) was developed by the National Bank and is under consideration by the Kazakh parliament.

Comments on the Banking Sector

Although the country has made considerable progress in establishing financial policies, building a legal framework for finance, and developing the financial infrastructure, the sector still needs work. Some remaining problems include the legal status of collateral, access to leasing products, bankruptcy reform, and restrictions on lending margins. Insurance and leasing are still underdeveloped. The banking sector is characterized by concentrated ownership and concentrated lending. Additionally, the loans of the largest 20 borrowers of the biggest banks are 43 percent to 74 percent of the loan portfolios. The concentration of activities resulting from mergers and acquisitions in the sector has made the commercial banks anxious to seek new business alternatives.

The large commercial banks have made some effort to enter the informal sector via the Kazakhstan Micro and Small Business Program (KSBP) using a European Bank for Reconstruction and Development SME credit line as part of a project to promote financial market development. The program targeted clients who had never had access to formal bank loans, and 85 percent of the loans went to poor clients. Total portfolio under this program reached USD$ 162 million, and the program has grown to use 40 percent bank funding versus 60 percent ERBD funding for the portfolio. The success of the program seems to indicate that bank downscaling will continue, even after the ERBD program has finished.

<table>
<thead>
<tr>
<th>Overview</th>
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<tbody>
<tr>
<td>Number of commercial banks engaged in microfinance</td>
<td>7</td>
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<tr>
<td>Number of commercial POS</td>
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<td>KSBP microfinance loan portfolio</td>
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<tr>
<td>MFI loan portfolio</td>
<td>USD 3 million</td>
</tr>
</tbody>
</table>

Role of Donors in Microfinance Sector

The microfinance sector in Kazakhstan has largely been supported by aid agencies and donors since its inception. The United States Agency for International Development (USAID) has significantly supported the industry with investments designed to promote best practices in microfinance and to change the legal and regulatory environment. Additionally, it has worked to create a regional network of MFIs. The work of USAID and other donors laid a foundation for microfinance throughout the region. Donors and non-governmental organizations (NGOs) active in the region have included USAID, the Soros Foundation, Kreditanstalt für Wiederaufbau (KfW), Eurasia Foundation, Mercy Corps, HIVOS, Opportunity International, ACDI/VOCA, and the Microfinance Centre (MFC). Lenders and funds active in Kazakhstan include Dexi, Ecumenical Church Loan Fund (ECLOF), I&P Development, Microinvest, and Oikocredit.

Scope of Microfinance

Microfinance activities in Kazakhstan are still in a relatively early state, developing only over the last 7 years. Activities are split between the emerging downscaling by the commercial banking sector and the existing NGO MFI sector. Data on the NGO MFI sector is limited. There are more than 20 MFIs in the country: two of these MFIs report to the MicroBanking Bulletin, ACDI/VOCA, Asian Credit Fund (ACF, a non-bank financial
institution), and the Kazakhstan Community Loan Fund (KCLF, an NGO). KCLF is the only MFI in
Kazakhstan which has been rated.

The activities of KSBP have worked through seven private commercial banks, with in strong coverage in all
urban centers in Kazakhstan. The partner banks have opened MSE departments in 135 branches and an
additional 50 loan outlets in 39 different cities (some with populations as small as 20,000). Data on the size of
average loans indicates that the KSBP program has a depth of outreach of more than 160 percent, which places
it at the upper end reported by MFIs in the country. The depth of outreach by MFIs stretches from a 20 percent
average loan size per GDP to a 170-percent ratio. This translates to average loan sizes in the range of USD
300–4,400. The KSBP program focuses on individual loans. In other MFIs, solidarity models have been
supplemented by individual lending methodologies.

Improvement of legal structures is critical to the expansion of the existing microfinance sector. The legal status
used by most MFIs is a not-for-profit NGO, which does not permit them to either mobilize savings or issue
shares. Non-bank financial institutions are allowed and there is one, the Asian Credit Fund, but even this
structure does not permit savings mobilization.

Savings mobilization is lagging: NGO MFIs do not have the ability to mobilize savings, and KSPB focuses on
credit to SMEs. There is little data available on savings activities. The only deposits collected by MFIs in
Kazakhstan are mandatory savings.

Product development is also lagging, especially for the informal sector. Kazakhstan recently passed
amendments to the Law on Financial Leasing,4 which should provide a regulatory framework for leasing that
meets worldwide standards. The new framework will permit a leasing definition that conforms to International
Accounting Standards, provides appropriate tax treatment, facilitates re-leasing of repossessed equipment,
provides for subleases and lease-back arrangements, and simplifies non-court repossession rights for the lessor.

Implications for Microfinance

Given the emerging strength of the KazPost in broad-based access to small-value financial services, it should
be able to develop savings links to MFIs as well as supplement the savings activities of the banks. Given that
the combined commercial outlets from KPSB activities is a fraction of the postal network (at 185 urban
offices), there should be additional scope to address the needs of the microfinance client base. The urban
orientation of the KPSB program still leaves 44 percent of the population, which is rural, without similar
access to financial services. KazPost has real opportunities and development options:

- KazPost should be able to extend savings services to existing MFI customers through alliances or agency
  agreements with NGO MFIs.
- KazPost might usefully explore working with the banks in the KPSB program: the average loan size in
  the KPSB program is around USD 4,000, so it is clearly not reaching down far enough to meet the needs
  of smaller borrowers. Working as an agent for KPSB for smaller loan sizes (perhaps USD 100) might be
  another way to expand the outreach of the program and develop more capacity for KazPost.
- KazPost’s announcement of a credit alliance with one of the commercial banks is worth supporting,
  particularly if it works with the bank to develop appropriate credit capacity and an efficient delivery
  model. This could serve as a model for delivering credit products for other banks.
- Given the outreach of the KazPost, it could also become a credit agent for MFIs to expand outreach into
  the rural areas.

4 These amendments were developed with the support of the USAID-International Finance Corporation
Central Asia Leasing Project.
Assessment of the Postal Financial Services

The postal network provides approximately 10 times more points of access to the financial sector than the banks. Particularly in rural areas, the postal network—with 2,923 offices versus 72 bank branches—is essential to provide access to the approximately 7 million rural inhabitants. The post offices are being upgraded and equipped with modern, state-of-the-art communications technology that could be front offices for modern retail financial services.

Product expansion occurs gradually. The post offices play an important role in the distribution and collection of recurrent cash payments. This range has expanded from traditional newspaper subscriptions, state pension payments; collection of pension premiums, insurance premiums, and telephone bills; and other private agency payments as well as card-based payments. KazPost's market share in volume of payments is estimated to be greater than 40 percent, but its share in the value of payments is only a few percent.

Deposit-taking activities were launched in 1999. In 2003, more than 800,000 depositors held small savings with KazPost—about 25 percent of the adult rural population (who presumably deposit their money for security). Interest rates with commercial banks are significantly higher because they can re-invest the money in credit. KazPost deposits are perceived as secure because they are re-invested in state securities, but consumer confidence in banks that qualify for coverage of deposits under the deposit insurance has been rising since 1999. The market share of the household deposit market is insignificant, and KazPost's network could play stronger role in deposit mobilization if it could act as a commercial bank.

Small credit, to households, microenterprises, and small entrepreneurs is a very underdeveloped market segment. KazPost, through an agreement with Center Credit Bank, will enter this market soon as the delivery channel of the bank. Both demand and supply of other financial services are limited in Kazakhstan, but might develop in the medium to longer term.

KazPost has developed some retail trade through its post offices, but the scale and scope is limited. KazPost also has begun to offer access to the Internet at post offices, but it has not positioned this as a strategic step to develop e-finance, e-commerce, and e-government applications. Given the relative absence of nationwide retail chains, KazPost could reposition the post office network as chain of convenience stores that also provide access to Internet, mail order services, e-commerce, and financial services.

When KazPost was licensed as a non-bank financial institution to offer postal savings, it transformed from a postal mail operator to a financial institution able to competitively offer small-value financial services. Its course of development, however, has presented a mixed picture. The development of postal savings has been impressive, but fell short of expectations, particularly regarding revenues for KazPost. Complying with requirements of the NBK for banking license has not been pursued: it would need a transparent business model, where accountability for postal and financial services is clear. These business lines are still together, under ownership of the Agency for Communications.

Instead of developing as a financial institution, KazPost's management appears to have chosen an alternative road, to seek agency agreements from financial institutions throughout the country. So far this has generated substantial additional income flows, and made KazPost profitable and able to develop further, in spite of its declining mail business. Being an agent that provides a multi-purpose network as front end for a number of financial institutions may be the easiest way to achieve short-term positive cash flow and may exceed the value of developing its position as an operator of financial services and mail services, managing the business process and associated risks.

3—Options for Development

KazPost has a distinctly relevant role in providing access to the physical infrastructure of the payments system. This is important because cash is by far the most frequently used payments instrument. KazPost has also taken steps toward other lines of financial services, in particular mobilization of small household deposits. It has also
implemented management information systems (MIS), and accounting, centralized cash, and liquidity management. Financial services have become the single largest revenue component of KazPost.

KazPost has de facto progressed in the conversion from a mail service into a postal savings bank. It remains to be seen if KazPost can develop further into a financial institution itself, or if it will become a multi-purpose network that provides agency services for several financial institutions. From an institutional point of view, KazPost has become more commercialized through its incorporation of agency agreements with several private sector entities to add services. It also has an organizational structure at headquarters level, with some business elements, and has been able to attract external funding to finance its capital expenditure.

Its current institutional setting, however, has serious drawbacks, which hamper its commercial development and, in particular, undermine its potential to offer a broad range of competitive financial services in rural areas and to a large part of the population. This, in conjunction with the declining mail market; extensive capital expenditure in the liberalized but small courier, express, and parcel market; the fixed cost associated with the postal network; and the lack of transparently separated accounts for the different business lines, poses a threat to the medium-term sustainability of KazPost.

Its current business strategy would be enhanced if the institutional and organizational frameworks were made into clearly separated business units, and eventually incorporated operating companies as separate accounts, into a market-focused commercial entity. This would also help assess to what extent KazPost has the intrinsic strength to develop into a financial institution, to partner with an existing bank, or to become an agent for other financial institutions. The fixed cost associated to the postal retail network is converted in variable cost, mainly through transformation of post offices in franchises or agencies staffed with individual entrepreneurs. It will become essential for KazPost to operate a broader range of financial services (under a banking license) that generate revenues on a competitive basis. In this respect, it has a series of options. (See annex I.)

The assessment of these options is not necessarily dependent on the evaluation of its recently announced project in credit. The key question is whether KazPost can be a bank as its core business or a retail network acting as an agent for multiple retail and consumer services and goods. This question will determine the essential positioning; requirements for the institution; and qualification of its management, strategy, and structure; its income and expenditure structure; balance sheet; and risk profile.

It might be useful to further assess these options with the stakeholders involved in Kazakhstan. The assessment would have to be an in-depth field research of the market segments in which KazPost operates, with a refined quantitative and qualitative assessment of the growth potential of these markets and the competitive position of KazPost. The outcome of the assessment would transparently structure the business model for KazPost and set out a business strategy focusing on its core competencies.

Within Central Asia and the other countries of the former Soviet Union, KazPost is widely regarded as a leader and pioneer in postal innovation, setting an example for other postal operators in the region. An in-depth assessment of KazPost’s development options could also be a model to guide other postal networks.
### Annex I

#### Development Options for KazPost

<table>
<thead>
<tr>
<th>Product Joint Ventures</th>
<th>Postbank Subsidiary</th>
<th>Merger of PFS with a Bank</th>
<th>Merger of KazPost with a Bank</th>
<th>Incorporation of the Postal Retail Network</th>
</tr>
</thead>
<tbody>
<tr>
<td>Creation of specific product joint ventures or agency agreements with licensed financial institutions could fill the gaps in the current products offerings.</td>
<td>By separating postal financial services into a separate subsidiary company that complies with NBK requirements for a commercial banking license would allow it to operate through the postal network in more transparent conditions.</td>
<td>Separation of postal financial services in a business unit and sales of this business to one or more banks, under the condition that they continue to use all post offices exclusively for a long term.</td>
<td>Merger of KazPost with a licensed commercial bank, after which the new company will regroup the business activities in a postal business line, a retail financial services line, and the postal retail network.</td>
<td>Incorporation of the 3,000 post offices in a postal network company, that would conclude service level agreements with the mail service, the postal savings, the government, and other parties interested to access and sell through a nationwide network consumer goods or services.</td>
</tr>
<tr>
<td>This approach, which would continue current strategy, could help in the short term to fill gaps without major restructuring, but is unlikely to create the desired synergies. The real issue of underpriced postal savings remains unaddressed. One or more new products and subsequent relationships between clients and the joint venture partners might eventually lead to cannibalizing the postal savings.</td>
<td>A specific subsidiary for financial services, licensed as a bank, would remove some important hurdles. It would, however, require that NBK and the government approve the rationale to set up and capitalize a new state-owned bank, while its main policy has been to transfer ownership to the private sector.</td>
<td>KazPost could also consider selling its current financial services and proffer an exclusive long-term right or commitment to utilize all post offices to sell financial services. Subsequently, the financial services can be broadened and offered on a competitive basis. This option would generate significant cash flow for KazPost in the short term and long term revenues from post office transactions. This would enable KazPost to upgrade its postal business and make it more competitive. Part of the proceeds could also upgrade the post office network to attract other retail partners.</td>
<td>Merging KazPost with a licensed bank would allow them to offer a full range of competitive financial services. It could also help consolidate the financial sector and increase competition in rural and consumer segments. The merger would need extensive preparation, and a change of management post-merger to regroup and restructure the business lines. It would also require careful selection of the merger institution to ensure its competitive prospective, highlight complimentary strengths, and avoid unnecessary overlaps.</td>
<td>Incorporating the postal retail network would clarify its economic viability and trigger cost-efficiency (including the transformation of state-owned post offices in privately-managed postal agencies) and result in flexible cost savings and revenues. It would also help mail operations to implement a more efficient business process and structure. Similarly, it would make the performance of the postal savings more transparent and allow the postal network to enter into service level agreements with other providers of retail, financial, and information services.</td>
</tr>
<tr>
<td>This might be effective as an intermediate, short-term step.</td>
<td>This might be considered as an intermediate step, to prepare the postal savings or KazPost for privatization, and would contribute to transparency.</td>
<td>It might be an effective option, but will require due care in preparation and structuring. It would help create transparency and competitiveness.</td>
<td>This might be an effective medium-term option and accelerate the restructuring process, but substantial follow-up will be required.</td>
<td>In combination with, or as follow up to one of the other options, this might effectively enable the continuation of a commercially viable, dense postal network.</td>
</tr>
</tbody>
</table>
The Role of Postal Networks in Expanding Access to Financial Services

Country Case: Namibia’s Postal Finance Services

The World Bank Group
Global Information and Communication Technology
Postbank Advisory, ING Bank
Postal Policy
Author’s Note

This paper discusses the role of the postal network in expanding access to financial services in Namibia. It reviews the public postal operator within the postal sector and within the broader context of the communications sector. The roles of the postal network and the Namibia Post Bank are also reviewed from the perspective of the financial sector development, with particular focus on payments systems development and micro finance.

This paper was prepared with desk research in 2004. Field visits were not scheduled, but data was drawn from previous work with NamPost and its post office savings bank. Data on the payments system was available, including a Committee on Payments and Settlement Systems report from the Bank for International Settlements, a recent study on access to financial services conducted by FinMark, and several other sources. Unfortunately, access to recent annual reports of NamPost or the Namibia Post Office Savings Bank was not forthcoming.

While this country case on Namibia can stand alone, it is an integral part of this large study of the potential of postal networks to coordinate with financial service providers in 7 countries (Egypt, Kazakhstan, Namibia, Romania, Sri Lanka, Uganda, and Vietnam) and 5 regions (Africa, Asia, Eastern Europe and Central Asia, Latin America and the Caribbean, and the Middle East and Northern Africa).

Glossary of Abbreviations and Acronyms

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agribank</td>
<td>Agricultural Bank of Namibia</td>
</tr>
<tr>
<td>CSIB</td>
<td>City Savings &amp; Investment Bank</td>
</tr>
<tr>
<td>FNB</td>
<td>First National Bank</td>
</tr>
<tr>
<td>GDP</td>
<td>gross domestic product</td>
</tr>
<tr>
<td>GDS</td>
<td>gross domestic savings</td>
</tr>
<tr>
<td>NAD</td>
<td>Namibian dollar</td>
</tr>
<tr>
<td>M2</td>
<td>total deposits as a percentage of all physical money (coins and currency)</td>
</tr>
<tr>
<td>NAMFISA</td>
<td>Namibia Financial Institutions Supervisory Authority</td>
</tr>
<tr>
<td>NamPost</td>
<td>Namibian Post Office</td>
</tr>
<tr>
<td>NBFI</td>
<td>non-bank financial institutions</td>
</tr>
<tr>
<td>NCC</td>
<td>Namibian Communications Commission</td>
</tr>
<tr>
<td>NGO</td>
<td>non-governmental organization</td>
</tr>
<tr>
<td>NNAWIB</td>
<td>Namibia National Association of Women in Business</td>
</tr>
<tr>
<td>NPOSB</td>
<td>Namibian Post Office Savings Bank</td>
</tr>
<tr>
<td>SME</td>
<td>small and micro enterprise</td>
</tr>
<tr>
<td>SWABOU</td>
<td>South West African Building Society</td>
</tr>
<tr>
<td>SWAPO</td>
<td>South West Africa People’s Organization</td>
</tr>
<tr>
<td>SWOT</td>
<td>strengths, weaknesses, opportunities, and threats matrix</td>
</tr>
<tr>
<td>USD</td>
<td>United States dollar</td>
</tr>
</tbody>
</table>
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## Summary

### SWOT Analysis of Namibia Postal Service

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<tr>
<th><strong>Strengths</strong></th>
<th><strong>Opportunities</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Dense network with nearly 190 post offices and agents throughout the country (1 per 9,000 inhabitants); relative good counter automation and flexible cost structure (agents)</td>
<td>• Existing client database of savers can be broadened to possibly another 100,000 users, and product use considerably deepened with additional products, such as cashless payments, consumer credit, microcredit, and eventually other services.</td>
</tr>
<tr>
<td>• Strong growth in both domestic and international mail, express, and parcel flows; good quality of service</td>
<td>• Postal network can play crucial role in providing awareness and access to Internet-based services, including financial services and e-commerce, as well as e-learning.</td>
</tr>
<tr>
<td>• Significant position in distribution of savings and cash-based payment products; market share of 13% in deposits and nearly 50% share in number of savers</td>
<td>• Eventually, NamPost can become the link for Namibia’s small entrepreneurs and consumer access to international retail trade and payment systems.</td>
</tr>
<tr>
<td>• Economically viable, not dependent on tax privileges or subsidies; post has a diversified product portfolio</td>
<td></td>
</tr>
<tr>
<td>• Modern legal/institutional framework with regulator separated from operator, and postal sector policy addressed by the government</td>
<td></td>
</tr>
<tr>
<td>• Private sector management with marketing capability; and long-term foreign technical assistance to transfer knowledge</td>
<td></td>
</tr>
<tr>
<td>• Internal profit center-based organization with MIS</td>
<td></td>
</tr>
<tr>
<td>• Relatively good level of awareness of rural and remote communities</td>
<td></td>
</tr>
<tr>
<td>• On-going stream of customers using financial services and postal services</td>
<td></td>
</tr>
<tr>
<td><strong>Weaknesses</strong></td>
<td><strong>Threats</strong></td>
</tr>
<tr>
<td>• Narrow range of financial services: no cashless payments and no credit; not competitive with commercial banks; no banking license</td>
<td>• Policy and privatization process for the public postal operator is not clearly determined. Communications ministry remains influential through ownership of NamPost and Namibia Communications Commission (NCC).</td>
</tr>
<tr>
<td>• Balance sheet of NamPost Savings Bank not published; and internal product profitability not clear</td>
<td>• Policy of microfinance and role of NamPost Savings Bank has not led to consensus between Ministry of Finance, NCC, and Bank of Namibia.</td>
</tr>
<tr>
<td></td>
<td>• Protracted decision process decreases opportunities for NamPost Savings Bank as small market matures.</td>
</tr>
<tr>
<td></td>
<td>• Substitution impact of new technologies on postal turnover likely to manifest itself in the medium term.</td>
</tr>
<tr>
<td></td>
<td>• Re-mailing practice exposed to high risk of regulatory intervention or competition from Botswana-Lesotho-Swaziland postal services.</td>
</tr>
</tbody>
</table>
1—Postal Sector Development

Namibia's postal sector development is exceptional. NamPost is one of the few postal services worldwide, and the only one in Africa, that has been consistently profitable over the past 10 years as a commercialized state-owned enterprise. With its modernized and expanded infrastructure, NamPost has been able to help stimulate postal usage by the commercial and business sectors of the market. The steady increase in the number of mailed items handled each year by NamPost—both domestic and foreign mail—is substantially higher than all other countries worldwide. NamPost also plays a significant role in providing access to financial services.

Origin of Modern Postal Services in Namibia

The origin of modern "state" postal services in Namibia dates back to 1886 when German merchants and missionaries established a postal system based on the standards practiced in Bismarck's German Empire. Germany was among the few European countries that in those days had not introduced postal savings or postal giro services, so these services were not introduced in what was then South West Africa. After World War I, postal services in the Namibian territory were part of the South Africa Post Office, and remained so until 1991.

In 1991 independent Namibia inherited a postal system not much different than the one in 1921, which primarily served government communications. After independence, a vigorous postal reform was initiated. In 1992, the post office was transformed from a government department into an autonomous national enterprise, under the 1992 Post and Telecommunications Company Establishment Act. This same act also established Telecom Namibia, Ltd., and both companies were placed under the responsibility of a holding company called Namibia Post and Telecom Holdings, Ltd. The reform process had two objectives in mind regarding NamPost:

- **Mandate a postal service for the whole country at reasonable cost** to prevent discrepancy between the developed and the rural areas from increasing
- **Meet commercial demand with a modern and efficient service**, essential for the urban and industrial development of the Namibian economy

Pursuant to the Namibia Communications Commission Act of 1992, an independent regulatory authority was established, the Namibian Communications Commission (NCC). The commission granted NamPost, Ltd., a general mandate to offer postal services (the business of receiving, collecting, handling, conveying, and delivering postal articles; transmitting and delivering telegrams; and performing other services as prescribed by law), and money transfer services (money order and postal order services, and any other service that remits money through the postal company on behalf of the customer). The commission also directed that NamPost establish a post office savings bank. NamPost would own, control, and manage it, as well as have the authority to determine the interest rate on deposits (although consent of the Minister of Finance is required).

NamPost is governed by a board of directors, which determines the scope of postal services in the country. Pricing policy was delegated by the government to the NamPost Board of Directors, with the responsibility of fixing postal rates. The rates are cost-related and to a certain extent sensitive to market requirements and customer needs. NamPost effectively has full management independence to establish or abolish jobs. Employees of NamPost have their own status, and are governed by the terms and conditions of employment of NamPost. A managing director, or chief executive officer, accountable to the Board of Directors, heads Nam Post. The first managing director, with extensive experience in commercial banking and financial management, was recruited from the private sector to develop NamPost as a fully commercialized enterprise.

Although a broad monopoly was retained for the collection, handling, and delivery of letters, the NCC also grants licenses to private companies to operate courier, express, and parcel services. Interest from the private sector has been limited, though, and fewer than 10 private courier companies operate in Namibia.
Business

In order to meet the demands of the market, NamPost developed a business vision and a corporate plan. According to this plan, the mission of NamPost is to “…provide fast, reliable, affordable, and readily available postal, courier, savings bank, and money transfers services that exceed customers’ expectations. In doing so, NamPost operates as a profitable company and discharges [its] social obligations.” The company’s strategy has three objectives: profit, customer satisfaction, and staff satisfaction. To achieve its strategic goals, NamPost has focused on:

- knowing the market conditions in which the company operates;
- analyzing the product portfolio to identify weak and strong points and adopt appropriate steps to promote or correct them;
- customizing products to the needs of clients;
- identifying large customers (in the business sector); and
- developing customer service training programs for employees.

The first major reorganization was completed in 1995. In the years after, organization was further refined and professionalized to operate on the basis of commercial business principles. The current structure is a flat organization which is better responsive to the business requirements of modern management. Finance is a separate function that includes planning, budgeting, control, accounting, and the management information systems (MIS). Its regional offices are run as business profit centers, as is the new savings bank, which is already profitable. Marketing and public relations divisions have been introduced.

Namibia has seven postal areas, which have been zoned into three main control regions—northern, central, and southern. As business centers for profit, the managers must operate within their budgets and are fully accountable for operational and financial performance.

Postal Mail Operations and Traffic

NamPost mail operations consist of collection from and delivery to private letterboxes, i.e., post office boxes. In general, there is no home delivery, but it has been introduced for the business sector. NamPost has its own transport fleet with more than 50 vehicles, which has improved quality of mail delivery and security.

The number of posted items in Namibia increased from 26 million in 1992 to 108 million in 2002, an increase of 415 percent. This figure includes international mail, which has a larger volume than the domestic mail. (A large part of the international mail is said to stem from so-called "re-mailing" by South African companies to avoid the higher domestic postal rates.) The domestic mail flow (letters) reached 36 million items in 2002, an increase of 33 percent compared to 2001. The number of letters delivered per capita increased from 21 in 1992 to 60 in 2002. Per capita domestic mail demand was 20 items in 2002. The growth trend has significantly outpaced the economic growth, and figures are much higher than the average found in Africa (8 items per capita). Data on the subdivision of mail flows are not available. Such analysis would be useful to understand in which market segment demand and supply has grown most significantly.

NamPost saw a steady decrease in parcel post as a changing business environment required faster delivery services. After poor results from pilot programs with international courier services, NamPost introduced its own courier service in 1995. NamPost handled 117,600 parcels handled that year, and quickly established itself as the indisputable leader in the small parcel market. In 2002 the volume reached nearly one million parcels. NamPost has also positioned itself as an important postal gateway between southern Africa and Europe. Postal items from the Netherlands to countries in southern Africa are routed via NamPost which adds to the mail transit volume of NamPost.

Reportedly, customer satisfaction has increased substantially. Regular benchmark studies track NamPost's performance and show that NamPost consistently performs better than required
Post Office Network

Namibia needs extensive coverage by the postal service because of its extremely low population density—at 1.7 per square kilometer, it is one of the lowest in the world. Only 28 percent of Namibians live in urban areas, and the majority of inhabitants—72 percent—live in rural communities scattered around the country.

In 1991, an average of 30,000 inhabitants was served per postal point in the northern region. By 2003, the introduction of counter points of service and mobile units significantly reduced this discrepancy to less than 6,700, especially in northern areas. NamPost dramatically expanded the network through agency arrangements with small, private entrepreneurs that offer basic postal services, and reduced its proprietary network from 109 to 91.

Namibia still lags behind in the number of inhabitants with individual mail boxes. In 1992, there were only 41,490 post boxes or private bags (with approximately 42 inhabitants per post box). The number of mail boxes rose by 2002 to 130,000, or one box per 15 inhabitants. About 100,000 inhabitants and families have their own mail box.

The NamPost network has three types of postal facilities. Post-offices offer a full range of services and are staffed by NamPost employees. Postal agencies are staffed by people who are not NamPost employees. Mobile offices service people in the rural areas of Namibia. This post-office network offers four basic services. General postal services include selling postage stamps, accepting and delivering parcels and registered mail, etc. The financial service primarily issues and cashes domestic money orders and postal orders. Agency services cover the sale of television licenses, radio communications licenses, telephone cards, voter registration, plus it collects sales tax and customs duties and distributes state pension checks, among other services. The post-office savings bank, a unit of NamPost, offers savings accounts, savings-bank certificates, fixed-term deposits, and a “save as you earn” program.

In 1998, NamPost embarked on a major counter automation program. Currently, all 90 proprietary post offices are automated and on-line. This program enables NamPost to offer its customers an on-line banking system which speeds up transaction times and a more cost-effective banking service, which enables the delivery of new products and services.

### Distribution of NamPost Network

<table>
<thead>
<tr>
<th>Postal Areas</th>
<th>Post Offices</th>
<th>Postal Agencies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oshakati</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>Tsumeb</td>
<td>7</td>
<td>6</td>
</tr>
<tr>
<td>Otjiwarongo</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Swakopmund</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Windhoek</td>
<td>11</td>
<td></td>
</tr>
<tr>
<td>Mariental</td>
<td>15</td>
<td>1</td>
</tr>
<tr>
<td>Keetmanshoop</td>
<td>14</td>
<td>1</td>
</tr>
<tr>
<td>New postal outlets since 1995</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>79</strong></td>
<td><strong>19</strong></td>
</tr>
</tbody>
</table>

Per the NamPost 1995 annual report, postal outlets are evenly spread all over the country. Data sources with a more recent subdivisions are not available; it is assumed that the current postal network has a similar geographic distribution.
Financial Results and Management

In financial terms, NamPost has done very well. In 1992, the government gave NamPost five years to break even financially. It recorded operating losses of 9 million Namibian dollars (NAD) in its first year, but turned a profit in its third year of operation. Turnover jumped from NAD 30 million to NAD 160 million—an increase of more than 400 percent. In 1997 NamPost recorded a profit before tax of NAD 6.7 million (then approximately USD 1 million). In 2001 before-tax profit was NAD 2 million, and in 2002, NAD 3.9 million. NamPost converted to commercial accounting standards in fiscal year 2001.

Due to the changes in accounting standards, it is difficult to assess which product lines have most significantly contributed to the financial performance. Universal Postal Union statistics indicate that as much as 45 percent in 2001 and 48 percent in 2002 of revenues stemmed from “other” services. NamPost's own information recognizes “other” services to be approximately 11 percent of revenue. From the data available, it is not possible to conduct a product profitability analysis. Financial services appear to be an indispensable revenue stream for the economic viability of the postal network.

Breakdown of NamPost Revenue, 2002

<table>
<thead>
<tr>
<th>NamPost Services</th>
<th>Contribution to Revenue (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic letter mail</td>
<td>29</td>
</tr>
<tr>
<td>Parcels</td>
<td>3</td>
</tr>
<tr>
<td>Courier and Express</td>
<td>14</td>
</tr>
<tr>
<td>International mail terminal dues</td>
<td>11</td>
</tr>
<tr>
<td><strong>Total postal services</strong></td>
<td><strong>57</strong></td>
</tr>
<tr>
<td>Savings bank</td>
<td>15</td>
</tr>
<tr>
<td>Money transfers</td>
<td>5</td>
</tr>
<tr>
<td>Agency payments</td>
<td>12</td>
</tr>
<tr>
<td><strong>Total financial services</strong></td>
<td><strong>32</strong></td>
</tr>
<tr>
<td>Other services (lottery, radio, TV licenses)</td>
<td>11</td>
</tr>
</tbody>
</table>

As the public postal operator of Namibia, NamPost has successfully expanded accessibility, quality, and range of postal services. Demand for mail service has increased steeply, contrary to the global trend of stagnation and decline. NamPost has been converted from a government agency to a state-owned company, or parastatal, that operates with commercial principles and practices with private sector management. NamPost has been able to generate gross and pre-tax profits early on, which served as the funding source to upgrade and modernize its operations.

Namibia has separated the roles of postal-sector regulator and public operator in 1992. Although several segments of the postal sector have been liberalized, still further liberalization is desirable. In addition, the separation between regulator and operator is not fully effective as long as they report to the same ministry.

NamPost received multi-year technical assistance from the Netherlands in 1994 and 1997–99, consisting of on-site advisory help and extensive training on postal services. Telecom Namibia got help in telecommunications development, while NamPost Savings Bank was provided with several traineeships at the Postbank in the Netherlands.
Telecommunications and ICT

Because of Namibia's close economic and historic links to South Africa, its telecom sector has advanced at a rate on par with South Africa's. It now has one of the most modern and sophisticated telecom infrastructures in Africa, with fiber optic links connecting the country by north-south and east-west axes. The original departments of posts and telecommunications were abolished in 1992, and Telecom Namibia was created as a state-owned enterprise, owned by Posts and Telecom Holdings, with a monopoly over all basic telecommunications services. To promote decentralization and increase efficiency, Telecom Namibia was divided into four regions: Northern, Central, Windhoek, and Southern. Telecom Namibia served more than 114,000 customers, with 1,503 employees, and an annual revenue of more than NAD 896.2 million. Telecom Namibia runs the largest digital telecommunication network in Namibia.

Some telephone exchanges in Namibian towns are still manually switched via an operator, making data connections virtually impossible. A fiber optic cable was laid out, which considerably improved the reliability and availability of the primary international telecommunications route.

The Namibia Communications Commission was established as a quasi-independent regulatory body in 1992. The Commission reports to the Ministry of Information and Broadcasting, and is responsible for licensing, frequency management, and other regulatory functions. The Commission's first major licensing action was the approval of cellular service by Mobile Telecommunications, Ltd.

Mobile Telecommunications, Ltd., is a joint venture between Posts and Telecom Holdings (51 percent), Telia of Sweden (26 percent) and Swedfund International (23 percent). Telia has taken responsibility for the management of the operations.

The Namibian cabinet approved the Namibian telecommunications policy and regulatory framework in 1999. This is expected to pave the way for further liberalization of the sector, and open up the market to private companies and investors, including possible competitors to Telecom Namibia.

The density of telecommunications is relatively good with more than 6 percent for the entire country, above 30 percent in urban areas, and just above 3 percent in rural areas. Internet access was 24.6 per 1,000 inhabitants in 2001, which is the second highest figure in Africa, and is expected to rapidly increase.

The Namibia Communications Commission has recently circulated a draft policy paper on the development of the telecommunications sector. It acknowledges the need to accelerate the expansion of the communications infrastructure to provide 80–90 percent of the inhabitants with access to telecommunications. The commission wants to achieve this by opening the sector to private enterprises offering different types of telecommunications and Internet applications, to increase the number of public booths and access points, particularly in rural areas. It also intends to reduce state ownership in the two existing telecom companies and end their monopoly.

Improved access to telecommunications and the Internet will support social and economic development. It may reduce the demand for mail services, although early indications in 1999–2002, suggested that the communications market was underserved and immature. Impact on mail will probably come in the middle term, rather than short term. Telecommunications policy did not set out specific targets for the post office network in providing access to telecommunications or Internet, so NamPost essentially had the commercial freedom to find partnerships to sell mobile phone, phone cards, Internet access, etc.
2—Postal Financial Services in a Market Perspective

In the early 1920s, when South Africa imposed its rule over then southwest Africa, all operational regulations for the South Africa Post Office also governed the post offices and post office savings bank in Namibia. When Namibia gained independence, the post office savings bank had about 66,000 postal savings accounts on its books, a substantial number of which were dormant or not in use. Operations were manual and paper-based and service levels were low. More than 80 percent of the transactions took place in or near Windhoek, where the administration of the post office savings bank was based.

In 1992 the Namibian Post Office Savings Bank (NPOSB) became a division of NamPost. The Banking Act did not apply to it, but the NamPost savings bank's deposits were implicitly presumed to be guaranteed by the Namibian government, as owner of NamPost. Interest earned on NamPost Savings Bank accounts is tax exempt, and has no transaction costs. NamPost Savings Bank cannot lend to third parties; it can only invest in its parent companies and in government entities. The institutional framework mirrors that of the South African post office savings bank (which does not have to comply with the requirements of the Reserve Bank of South Africa).

However, as of 1992, NamPost Savings Bank substantially differed from the South African postal savings bank. While the latter remained a relatively small operation, NamPost Savings Bank soon became a fast-growing, highly profitable division of NamPost, serving the Namibian population through all post offices and mobile agents even in the most outlying rural and under-developed areas of the country.

NamPost’s finance department managed the savings bank until August 1994 when a bank manager was appointed for the first time. (The bank manager became NamPost's chief executive officer in 1996.) Bank staff increased from five members in 1983 to more than 30 in 1998. NamPost signed an agreement in 1995 with the German Savings Bank Foundation for International Cooperation to develop NPOSB into a full-fledged savings bank. In addition NPOSB management trained at the Postbank in the Netherlands to acquire skills in marketing management, product development, and client service.

NPOSB currently offers four savings products: savings accounts, savings certificates, “save-as-you-earn” accounts (launched in September 1997), and fixed-term deposits (launched in April 1998). Additionally, the savings bank offers two money-transfer options, postal and money orders, in addition to payment services for telephone and utility bills and distribution of pension payments. The bank’s client portfolio more than tripled in the first 10 years, attesting to its rapid growth. NamPost Savings Bank has more clients than any other financial institution in Namibia. (It has more than 230,000 account holders and approximately 500,000 savings accounts, the most widely used financial product.) However, it cannot offer transferable deposit accounts with cashless payment instruments. It wants to expand its services in this area, but is limited by its current institutional framework. NPOSB’s market share in volume of payments was estimated at less than 20 percent.

It is estimated that half of its customers would have stayed "unbanked" had it not been for the NamPost Savings Bank. The savings and investment portfolio increased by a staggering 500 percent—from NAD 50 million in 1992 to NAD 260 million in 2002. This represents a market penetration of the adult population of nearly 25 percent and a market share of 13 percent in household deposits. NamPost's financial services generate more than 30 percent of total revenues, but the details of product profitability and cost compensation for the use of the postal network are not known.

In a draft finance policy on small and micro enterprise (SME) in Namibia, the NPOSB was recognized as an important outlet to provide financial services to SMEs, especially in the rural areas of the country. Even Namibia’s current Postal Act foresees lending as a service that should be provided by the NPOSB. However, no conclusions have been drawn, and several sources point to NamPost's desire to conduct a feasibility study on transforming the NamPost Savings Bank from a division into a licensed banking institution under the Banks Law.
Financial Sector Development Perspective

The banking sector in Namibia currently consists of five commercial banks (Bank Windhoek, First National Bank of Namibia, Standard Bank Namibia, Commercial Bank of Namibia, and SWABOU Bank), an investment bank (Nedcor Investment Bank), and a savings bank (NamPost Savings Bank, which does not operate under the Bank Act).

Despite the uncertainty during the early nineties, after independence in 1990, the banking sector remained remarkably stable. In addition to the political turmoil, the central bank was established in 1990 and had a steep learning curve. Prior to independence, the banking sector was regulated by the South African Reserve Bank under South African laws and regulations, so it was necessary to enact appropriate legislation to take over regulation and define the responsibility of financial sector regulation. Over the last decade, there were no banking crises and no banks collapsed. City Savings & Investment Bank started operations in 1994, joining the NamPost Savings Bank. This bank was small compared to the other banks and struggled until its merger with SWABOU, the South West African Building Society. With this merger, SWABOU Building Society transformed itself into a fully-service commercial bank.

<table>
<thead>
<tr>
<th>Distribution Network of the Banking Sector</th>
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<tbody>
<tr>
<td><strong>Commercial Banks</strong></td>
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<tr>
<td>Standard Bank</td>
</tr>
<tr>
<td>Bank Windhoek</td>
</tr>
<tr>
<td>Commercial Bank of Namibia</td>
</tr>
<tr>
<td>First National Bank of Namibia</td>
</tr>
<tr>
<td>SWABOU Bank</td>
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<tr>
<td><strong>Government Banks and Credit Institutions</strong></td>
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<tr>
<td>Agribank of Namibia</td>
</tr>
<tr>
<td>Namibia Post Office Savings Bank</td>
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<tr>
<td>National Housing Enterprise</td>
</tr>
</tbody>
</table>

Like Botswana, Lesotho, and Swaziland, the Namibian banking sector is dominated by South African banks. First National Bank of Namibia and Standard Bank operate under their own brands, while Absa Bank and Nedcor Investment Bank have large shareholdings in Bank Windhoek and the Commercial Bank of Namibia, respectively.

Commercial banks are not “enthusiastically entrepreneurial,” especially in terms of extending credit to small and microenterprises. Despite excess liquidity in the financial system, credit extended to the private sector declined from 83 percent to 72 percent of total banking assets. Within the private sector credit, more than 30 percent went to mortgage advances, and this, together with other private loans like installment credit, made up less than 60 percent of total credit extended to the private sector. Within the private sector credit, more than 30 percent went to mortgage advances, and this, together with other private loans like installment credit, made up less than 60 percent of total credit extended to the private sector. Within the private sector credit, more than 30 percent went to mortgage advances, and this, together with other private loans like installment credit, made up less than 60 percent of total credit extended to the private sector. In comparison, the business sector received about 40 percent of available credit, which declined from 40 percent in 1996 to 36 percent in 2000. The credit, therefore, went increasingly toward less productive activities. In addition to less total credit extended to the private sector, there was also a rise in foreign assets held by the banking sector (as percentage of their total assets), which seemed to indicate that banks more and more were moving their funds offshore rather than providing credit to the local market.

Banks have been criticized for not having sufficient rural outreach. However, this criticism was based on the location of bank branches only and did not take into account the number of bank agencies. Other research has shown that, given the geographical spread of the population, there is reasonable access to banking across the country. Furthermore, in terms of bank density, Namibia (with 20,000 individuals per bank branch) is second
only to South Africa (11,000 individuals per bank branch) in the South African Customs Union region and is much better off than most other southern African countries. When one includes the postal network, the ratio is 1 physical point of access per 5,300 inhabitants, similar to medium to highly-industrialized countries.

Several issues, however, have made it difficult for commercial banks to extend access to credit:

- **Collateral:** Farmers in rural areas have difficulty in getting loans as they farm on communal land that cannot serve as a marketable form of security. This is less of an issue with urban mortgage bonds as most urban land has been proclaimed.

- **Transaction costs:** Commercial banks are seemingly reluctant to get involved with any ventures beyond the usual traditional credit evaluation process. The main reason for this is the implied transaction costs. The need to spend more time evaluating proposals and recovering non-performing loans is not cost-efficient for banks. The wide geographic dispersion of the population also makes it very costly to provide banking services to them. Using group-lending methodology or the cooperative model might be a possible solution. Group-lending has not been widely used in Namibia, and savings and credit cooperatives are still in development.

- **General economic growth and the lack of “bankable” projects:** Similar to Botswana, Lesotho, and Swaziland, the growth performance of Namibia has been moderate at best. Under such circumstances there is little room for establishing new businesses.

Despite these issues and the government's criticism, banks in Namibia are providing fair access to savings products, compared to Botswana, Lesotho, and Swaziland, due to the NamPost Savings Bank, which holds nearly 50 percent of all savings products. However, there is considerable room for expansion.

The access to transaction services—ATM cards and the ATM network—compares well with Botswana, Lesotho, and Swaziland, although usage of these services appears relatively low and there is room for expansion. There are reportedly more than 225,000 ATM cards (most of them issued by stores, not directly by banks), 12,000 petrol cards, and 20,000 credit cards. In total, more than 100,000 transaction and check accounts are kept in the banking system, which is a penetration of only about 10 percent in the adult market.

Total deposits as a percentage of all physical money (M2) could be used as an indicator of financial intermediation. This ratio should ideally be increasing as more people are exposed to the formal financial sector and decide to hold deposits with banks rather than cash. Another indicator of financial intermediation is monetary depth, measured as the ratio of M2 to GDP. This provides an indicator of the flow of funds available for loans relative to the size of the economy, and indicates a country's capacity to channel surplus savings into productive investment. In Namibia, deposits as part of M2 were above 80 percent in the past few years, which is high (although lower than in some other countries), and may be explained by the fact that unit trusts have gained popularity. Deposits as a percent of GDP grew gradually to above 30 percent in 2002, which is also high. Savings were also about three times higher than currency in circulation. Although this provides room for conversion from cash into transferable deposits, the ratio in Namibia is much better than in some other African countries.

Some other market segments are relatively underdeveloped. There were about 6,000 personal loans issued in 2002, 9,000 housing mortgage loans, and 5,000 hire/purchase contracts. These numbers are very low, even when compared to the under-developed market for microlending.

The NGO-MFI sector, which does focus on microentrepreneurs, is extremely small, with 17 MFIs and cooperatives. Many of the microlenders are small one-office operations. The sector has 200 registered microlenders and serves only 120,000 customers. Market penetration is low, at 30 percent.¹

**MFI Market**

The potential market for microloans, including both formal and informal sectors, in Namibia is estimated to be 400,000 clients, with a total loan potential of NAD 6.5 billion. Given that the existing level of lending to

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¹ Only incomplete data was available, based on five main MFIs and 12 cooperatives.
individuals in the country at year-end 2002, by all of the “deposit money banks” was NAD 8 billion, a full exploitation of the microfinance loan market would increase lending by 60 percent over existing levels provided by the commercial banking sector. The estimated demand for microloans, covering both formal and informal lending activities, is based on the following segments:

Self-employed individuals: NAD 1.5 billion
Government employees: NAD 3.0 billion
Non-government employees: NAD 2.0 billion

Microfinance products are primarily delivered by various commercial microlenders, as detailed below. Given the focus by commercial microlenders on loans to salaried employees, many of these borrowers also have access to normal bank credit. Over-indebtedness in this sector has been an ongoing concern and helped spur the development of registration procedures and credit-reporting agencies.

The few NGOs actively providing financial services have not achieved any significant scale. Most of their operations are small, and only a few are national in scope. Credit cooperatives are still at an early stage of development and have not played a role in the microfinance sector to date.

Non-bank financial institutions are regulated by the Namibia Financial Institutions Supervisory Authority (NAMFISA), which was established in 2001. Although the Namibian microfinance market consists of three segments, data is available only for the formal MFIs, which are registered with Ministry of Finance and NAMFISA. Little information exists on semi-formal MFIs, which are only registered with the Ministry of Finance for tax purposes, or informal microlenders, which are not registered.

3—Options for Development

With long-term assistance from international donors, Namibia has implemented a series of best practices, leading to growth in business, turnover, quality, customer and staff satisfaction, and bottom line profitability. Some of the best practices implemented are:

- Separation of regulator and operator, and separation of telecommunications and postal services
- Commercial (flat) structure, lead by private sector management with profit targets throughout the organization
- Separation of the postal accounting function (financial management/chief financial officer) from the postal financial services (client operations)
- Application of total quality management
- Implementation of marketing function and account relationship management for large customers
- Product development; service differentiation for different market segments
- Active international marketing as a regional (transit) hub or gateway
- Partnerships with international and/or private sector parties
- Strong human resources management, focused on motivation and training
- Computerized postal counters and creation of a local network for on-line transactions
- Flexible/variable cost, e.g. through the introduction of postal agents
- Product revenue diversification leading to less dependency on one or few markets
- Inclusion of international expertise and exchanges

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3 Much of the microloan market in Namibia is focused on salaried employees.
After more than 10 years of buoyant growth, NamPost has matured enough to enter a new stage in its corporate and business development. The objectives of the next phase should be the consolidation of the quick gains achieved and the construction of a stable and robust framework that assures the continued growth of the different business lines and enables the expansion and broadening of the scope of operations.

One of the most plausible steps is to reform NamPost into a group company where the different profit centers or business lines are incorporated entities with their own balance sheets and income statements. Within such structure, the position of the NamPost Savings Bank could also be better assessed, including the options to transform into a licensed bank. Depending on the actual assessment and valuation, one could consider in more details the pros and cons of a NamPost subsidiary or joint venture.

Any assessments would need to include these points:

- In-depth market analysis (including client demand analysis and competitor analysis)
- Assessment of NamPost’s current operations, including valuation of current business and assets
- Strategy and business plan, including blueprint of the desired organization, human resources, training, business process, information systems and technology
- Financial plan and action plan to set up the post bank
- Feasibility evaluation (including political, regulatory, market feasibility) of the selected reform options.

**NamPostbank Subsidiary**

NamPost Savings Bank could be transformed into a bank as a subsidiary of the NamPost (Group) Company, regulated by the Bank of Namibia. The intrinsic strengths, risks, and restructuring requirements of such a transformation should be analyzed and evaluated against the market and its potential development. With the bank as a separate entity within the NamPost group structure, the emphasis on synergy with other postal business lines and competition via low-threshold access could be assured. The hypothetical model below, of a restructured postal network, suggests that the NamPost Bank be responsible in principle for the postal retail network, as it is presumed to generate the majority of revenues and expenditure. On the other hand, it is also assumed that postal group companies will conclude service level agreements with the postal network unit for services to the retail and consumer segments. If the privatization of NamPost is resolved, the position of the Postbank could be assessed and privatized in advance of the postal mail services.
NamPost Savings Bank Joint Venture

NamPost Savings Bank, after being incorporated, could consider becoming a strategic partner through a strategic equity participation of one of the existing Namibian banks. With such transaction, the NamPost Savings Bank could gain access to new products/services to sell through the postal network, as well as diversify its asset portfolio. However, while this may be an efficient solution, the limited number of Namibian banks and their relative complacency, this partnership might not enhance competition and outreach. The risk is that such a joint venture could slow development of NamPost Savings Bank’s outreach and focus on select post offices to target higher-value consumers.

NamPost Savings Bank

Another option is to privatize NamPost Savings Bank itself, and operate under a long-term agreement with NamPost to provide financial services. At issue here is whether attracting sufficiently strong and strategically dedicated investors interested in expanding the business of the NamPost Savings Bank is feasible.

NamPost Financial Service Joint Venture or Concessions

Instead of the options above, the NamPost Savings Bank could stay as is, but add new products and services through specific arrangements. Cashless payments services might be contracted with one of the commercial bank or directly from one of the leading card payment houses. For small loans and microcredit, a specific arrangement could be established with a bank, a credit union, or microfinance institution, where NamPost would offer their product under a private label to the public. Although risk management would remain formally with the partner institution, in actuality NamPost would risk its popular reputation should the arrangement fail.

Conclusion

Namibia features a relatively successful, reformed public postal operator. Both the postal and financial sectors have rapidly developed and belong to the most advanced in Africa. Within this context, NamPost has achieved an impressive track record unique on the African continent, and perhaps even worldwide. Both the postal mail business and the postal financial services have a compound annual growth rate greater than 40 percent in the past 10 years. This is exceptionally high, and far exceeds GDP growth rate or regional or global industry growth rates. Most of these successes can be attributed to strong, visionary management, recruited from the private sector.
The Role of Postal Networks in Expanding Access to Financial Services

Country Case: Romania’s Postal Finance Services

The World Bank Group
Global Information and Communication Technology

Postbank Advisory, ING Bank
Postal Policy
Author’s Note

This paper discusses the Romania case study of the role of the postal network in expanding access to financial services. The paper provides a review of the public postal operator within the postal sector and the broader context of the Communications sector. Subsequently, the roles of the postal network and the Romanian BancPost are reviewed in the perspective of the financial sector development, with particular focus on payments systems development and microfinance.

This paper has been prepared through desk research in 2004. Field visits were not scheduled, but nevertheless we were in the fortunate position to have been able to draw from previous missions to and work with Posta Romana and BancPost.

We found much recent data available on the payments system (from the ECB Bluebook), and an overview of the postal operator in reports prepared for the EU and several other sources, including annual reports of the BancPost and ING reports from previous missions.

We believe that the paper comprehensively presents the issues that Romania faces in addressing the remaining gaps in communications and financial infrastructure and the role that the postal network could fulfill helping to bridge those gaps.

While this country case on Romania can stand alone, it is an integral part of this large study of the potential of postal networks to coordinate with financial service providers in 7 countries (Egypt, Kazakhstan, Namibia, Romania, Sri Lanka, Uganda, and Vietnam) and 5 regions (Africa, Asia, Eastern Europe and Central Asia, Latin America and the Caribbean, and the Middle East and Northern Africa).

Glossary of Abbreviations and Acronyms

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>acquis communautaire</td>
<td>total body of European Union law accumulated so far</td>
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<tr>
<td>BCR</td>
<td>Commercial Bank of Romania</td>
</tr>
<tr>
<td>BRD-GSG</td>
<td>Romanian Bank for Development–Groupe Société Générale</td>
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<tr>
<td>CEC</td>
<td>State Savings House</td>
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<tr>
<td>CU</td>
<td>credit union</td>
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<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
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<td>EU</td>
<td>European Union</td>
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<tr>
<td>EUR</td>
<td>euro</td>
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<td>GDP</td>
<td>gross domestic product</td>
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<tr>
<td>GE Capital</td>
<td>General Electric Capital</td>
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<tr>
<td>GSM</td>
<td>global system for mobile communications</td>
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<tr>
<td>ICT</td>
<td>information and communications technology</td>
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<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
</tr>
<tr>
<td>MCIT</td>
<td>Ministry of Communications and Information Technology</td>
</tr>
<tr>
<td>NBR</td>
<td>National Bank of Romania</td>
</tr>
<tr>
<td>POS</td>
<td>point of sale</td>
</tr>
<tr>
<td>PTT</td>
<td>post-telecommunications-telephone</td>
</tr>
<tr>
<td>PTTR</td>
<td>post-telecommunications-telephone-radio</td>
</tr>
<tr>
<td>ROL</td>
<td>Romanian leu, lei</td>
</tr>
<tr>
<td>SME</td>
<td>small and medium enterprise</td>
</tr>
<tr>
<td>SWOT</td>
<td>strengths, weaknesses, opportunities, and threats matrix</td>
</tr>
<tr>
<td>USD</td>
<td>US dollar</td>
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Country Cases of Postal Financial Services

Summary

SWOT Analysis of Romania Postal Financial Services

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<tr>
<th>Strengths</th>
<th>Opportunities</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Has a reliable but unsophisticated reputation in financial services delivery, while banking sector underwent serious crises in past years</td>
<td>▪ Market for modern cashless payments products and other financial services has only recently begun to gain momentum. The mass market—the typical clients of Romanian Post—is not yet served by banking institutions.</td>
</tr>
<tr>
<td>▪ Nearly 80% of the nation’s network of outlets for financial services with 7,135 post offices</td>
<td>▪ Privatization and liberalization in the banking sector has brought a broader diversity of potential partners that might enable Romanian Post to provide a much broader range of financial services through the post offices, as well as attain increased efficiency, prompt more investment in post office counters, share costs, improve risk control, and eventually create a stable source of revenues.</td>
</tr>
<tr>
<td>▪ Had more than 100 million payments transactions per year</td>
<td>▪ In the context of the intended liberalization of the postal sector, an overall transformation of the post office (counter) network will become feasible and necessary in the medium term, as the economic rationale and legal obligation to maintain such network from a postal perspective will fade.</td>
</tr>
<tr>
<td>▪ Offers postal money order and cash payments at post offices, which are the most important payments instruments for individuals</td>
<td></td>
</tr>
<tr>
<td>▪ Co-operates with major retail and savings banks in the country (BancPost and CEC, the State Savings Bank)</td>
<td></td>
</tr>
<tr>
<td>▪ Derives substantial part of total counter revenues from financial services (estimated at &gt; 65% as part of total revenues)</td>
<td></td>
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<tr>
<td>▪ Making progress via ongoing efforts in automation, but relatively slow</td>
<td></td>
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<tr>
<td>▪ Monitors staff performance (by a number of criteria)</td>
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<tr>
<td>▪ Has norms and standards to calculate workload and set operational organization</td>
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</table>

<table>
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<tr>
<th>Weaknesses</th>
<th>Threats</th>
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<tr>
<td>▪ Although postal financial services form a large part of the operation of Romanian Post, there is no business unit and specific accountability to operate and control the financial services on a nation-wide scale.</td>
<td>▪ Its narrow and antiquated range of cash-based, paper-based services is not competitive with modern account-based, card-based products.</td>
</tr>
<tr>
<td>▪ Although the vast majority of Romanians use postal financial services, Romanian Post cannot identify its clients or record their behavior (in a database) in order to market new services.</td>
<td>▪ Use of modern card-based and Internet payments applications is growing rapidly.</td>
</tr>
<tr>
<td>▪ Products and processes for financial services are not or are only partially computerized (only 450 post offices have on-line service). This results in high operational costs, and targeted quality levels and security are difficult to ensure.</td>
<td>▪ Revenues from financial services at post offices may fall as result of increased use of other payment instruments.</td>
</tr>
<tr>
<td>▪ Management has been rather unstable; nominations for executive posts are subject to political influence.</td>
<td>▪ Post office network is by far too large and too costly to be modernized and maintained by Romanian Post.</td>
</tr>
<tr>
<td>▪ Organization has an internal focus on operations and processes, rather than a market and customer orientation</td>
<td>▪ Murky privatization process may result in sub-optimum focus and/or postponement of investments, as well as hesitation by private sector parties to co-operate with Romanian Post.</td>
</tr>
<tr>
<td>▪ Potential of co-operation with BancPost is vastly under-utilized</td>
<td>▪ Partnerships with BancPost and other institutions are based on short term, narrow contracts only, rather than from competitive bidding. Termination by one of the parties could result in sharp loss of revenues, clients, and image.</td>
</tr>
<tr>
<td>▪ It has made several unsuccessful attempts to obtain a banking license, and aborted an initiative to set up its own giro system.</td>
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1—Postal Sector Development

Romanian state postal services date back more than 2,500 years, initially established for public transport and official correspondence between Rome and the new province. Postal services functioned throughout the Middle Ages to transmit landlords’ orders throughout the territory. By the second half of the 18th century, it was decreed that all postal couriers’ expenses should be borne by the state, including postal inns used by couriers, travelers, and clerks, and that the public be allowed to travel by postal transport for a fee.

Until the 1848 revolution, the postal services were commissioned to private individuals, usually for a period of three years. After 1850, in county towns, the postal stations were transformed into postal offices, and a mail service for individuals was established under the supervision of the Ministry of Finance. By 1864, a state monopoly over postal activities had been instated and postal and telegraph services (and later telephone) were combined as the PTT (post, telegraph, and telephone). Postal money order service was expanded to include telegraph money orders and money collection services. In 1925, the PTT administration extended its control over the new communication sector of radio-telegraphy, and became the PTTR.

In 1938, a law was passed separating PTTR’s management, operations, and control; and finance, accounting, and human resources were centralized. After World War II, a more decentralized, or regional, administrative organization was introduced, and the state monopoly over telecommunications and the post was reconfirmed.

In 1991 the Romanian post was split off from Romtelecom (telecommunications and other entities such as Rompet, radio, and television) as Posta Romana an autonomous national company, as opposed to a “commercial company.” (Its formal name is Compania Nationala Posta Romana S.A.) This entity later founded BancPost as a commercial banking subsidiary. Major changes during this period were the creation of a post vehicle fleet (to be able to operate more flexibly, more economically, and more reliably); installation of a new corporate and regional organization (based on postal market needs and cost-effective operations) to avoid greater bureaucracy; development of an information technology system to improve quality and reliability of operations; and promotion of an active international policy of co-operation and harmonization, ultimately to build strategic alliances. Between 1998 and 2002, several more changes in management and corporate governance were made to further the transition from a state utility service to a commercially managed company. The dense Romanian postal network is the country's widest network.

Legal Status and Subsidiaries

In 1998 Posta Romana was converted from a state enterprise into a joint stock company fully owned by the state to provide more opportunities for commercialization. Although organized as a joint stock company, some specific rules apply to this “national company” that are different from commercial company law and are set out by government decision. The Ministry of Communications and Information Technology (MCIT) manages the ownership rights, including appointing the managing director and setting overall financial and operational targets for Posta Romana. Posta Romana does not receive any financial support or subsidies from the government, and there is no value-added tax exemption for postal services in Romania.

Posta Romana became one of the founding members of PostEurop in 1993. Almost a decade later in 2002, Romania harmonized its national legislation on postal services with the *acquis communautaire* via Government Ordinance No.31/2002 (the basic postal law on postal services in Romania), which was approved, with amendments and completions, by Law No. 591/2002 and Law No. 642/2002. There is one implementing regulation issued by the national postal regulator (ANRC President's Decision No. 118/2003) on the procedure to authorize postal services providers. The Ministry of Communications and Information Technology mentioned above is responsible for postal affairs.

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1 Posteurop is the association of European public postal operators. See [www.posteurop.org](http://www.posteurop.org)
2 The term *acquis* (or *acquis communautaire*) is used in European Union law to refer to the total body of EU law accumulated so far (en.wikipedia.org/wiki/Acquis).
The National Regulatory Authority for Communications (ANRC) regulates both the telecommunications and postal sector. It became operative and was vested with responsibility for the postal sector by the postal law in 2002, and operates autonomously and independently from the post and the MCIT. This national postal regulator, which appears to be remarkably powerful in comparison to others, describes its general fields of responsibility (including those outside the postal sector) as follows:

“The main objectives that guide the activity of ANRC are to promote competition in all sectors of the electronic communications and postal services markets, to ensure the conditions for the Romanian citizens to exercise their right of access to the universal service, to protect the rights and interests of the users, to encourage efficient investments in infrastructure, to promote innovation in the electronic communications and postal services sectors, and to promote media convergence and technological neutrality.”

The national postal regulator implements general postal policy and is responsible for all major regulatory tasks, in particular, the definition of universal service requirements including access conditions and approval of geographical exceptions to universal service; the implementation and administration of licenses; tariff regulation; supervision of accounting separation and determination of accounting principles and cost allocation rules; and the establishment of quality of service targets as well as the monitoring of Posta Romana’s related performance. Furthermore, it is the national postal regulator’s decision to establish a reserved area if considered necessary. In doing so, the national postal regulator may not exceed the maximum limits prescribed by law but may set out a monopoly of a smaller extent.

According to the 2002 postal law, the reserved area may be changed—and is intended to be changed—by secondary legislation, thus allowing harmonization with the 2002 postal directive without legislative initiative. As pointed out by the national postal regulator, the government has thereby expressed its willingness to progress toward a gradual and controlled liberalization in the sector. According to the national postal regulator, a general strategy paper on postal policy is reportedly in an advanced state of development.

Posta Romana has been able to transform its operations without state intervention since 1998. The postal market has been de facto deregulated. There are more than 50 private operators, mainly in the courier, express and parcel segments, and Posta Romana holds no statutory monopoly. The postal market and Posta Romana, as universal service provider, comply with nearly all requirements from the European Commission for postal market deregulation.

**Access to Posta Romana and Postal Services**

The universal postal service provider in Romania is Posta Romana, with a total workforce of 34,097 (32,523 are full time). In tourist areas on the Black Sea, seasonal employees are hired during the summer. (Posta Romana has internally established a target of five minutes for maximum queuing time in post offices.)

Posta Romana provides a high level of access to postal services. It operates 7,135 postal outlets that are all run by directly employed staff, and 37,645 letter boxes. (Posta Romana does not have any postal agencies.) There are 3 post offices and 16.8 letter boxes per 10,000 inhabitants (28.3 outlets per 1,000 square kilometers), comparable to the averages of the historic EU countries. Also compared to other Central and Eastern European countries, the Romanian access network is remarkably dense.

In 2002, the total revenues of Posta Romana were EUR 145 million. Annual revenue growth between 1998 and 2002 was 9.3 percent.

The total market for domestic and outbound postal services in Romania is grossly estimated to be about EUR 47.5 million. The letter post segment is approximately EUR 20 million, less than half of the total postal market. This may be explained by the relatively poor development of the letter segment, as well as by the comparably highly developed competitive express segment.

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3 Source: WIK-Consult postal study for EC accession countries, www.europa.eu.int/comm/internal_market/post/studies_en.htm
As of 2003, 88 companies had been registered with the national postal regulator as postal service providers, indicating that competition may be emerging at least in the letter segment (part of this segment may be reserved by the national postal regulator). Posta Romana and the national postal regulator reported intense competition in the liberalized direct mail segment, and estimated Posta Romana’s market share to be approximately 60 percent. In the parcel segment, substantial competition was reported, while Posta Romana continues to dominate the market; its market share was estimated to slightly more than 70 percent. As in most countries, Posta Romana does not participate much in international express, which is dominated by international courier companies. However, and unlike many other public postal operators, the Romanian post was unanimously reported to be quite successful in domestic express mail, and was estimated to serve more than half this segment.

Service Portfolio

Romania Post has made significant efforts to introduce new services and currently provides a wide range of different services, including insurance and registration for universal service items. It offers a full portfolio of non-universal postal services. Several domestic express products (Priori-post, Ultrapost) guarantee national delivery from 6 to 36 hours, depending on the destination and the product type. Apart from express mail service, international express services are provided in co-operation with TNT (SkyPak). For direct mail, Posta Romana offers customized solutions, including printing, inserting into envelopes, customer reply items, and address labeling (if mailers select a target group from Posta Romana’s address database). Moreover, Posta Romana offers a hybrid mail product to business customers and residential clients in post offices. Posta Romana also has a guaranteed day (and hour) delivery for documents and goods.

Posta Romana provides several financial services in addition to traditional postal money orders, such as international money transfers through Western Union, online money orders, payment and bill collection services (taxes, utility bills, and TV subscriptions, etc.), and payment of social benefits. In this area, Posta Romana co-operates with BancPost, which extends other banking services at the post offices such as savings, deposits, checks, and applications for advanced financial services.

Various consumer goods are also sold in post offices, such as books, cosmetics, stationery, maps, lottery tickets, mobile and fixed phone cards, mobile phones, envelopes, leaflets, video tapes, non-alcoholic beverages, etc.
Postal Logistics Infrastructure and Automation

Romania Post appears to have introduced technology and automation into many of its operations. The company operates 9 main sorting centers, 113 local sorting centers, and has 6 sorting machines (2 for letters and 4 for parcels). In comparison to other countries, the total number of sorting centers appears rather high—particularly with respect to the low volumes processed by Posta Romana. Twenty-seven percent of all post offices are equipped with computers. Depending on the type of vehicle, the average age of Posta Romana’s fleet varies between 4 and 10 years.

Postal Market Development Discussed by Segment

Posta Romana’s position in the letter post market is dominant. In the courier, express mail, and parcel markets, however, it is less significant with an estimated 20 percent—this market is dominated by foreign and local private players. Revenues from retail financial agency services are the main source of income for Posta Romana, and only 19 percent stems from letter post services. Twenty-seven percent of all post offices are equipped with computers. Depending on the type of vehicle, the average age of Posta Romana’s fleet varies between 4 and 10 years.

Letter Mail

In general, the universal services market in Romania appears to be progressing fairly well. Domestic letter post volume grew by 11 percent from 1998 to 2002, while international letter post grew more slowly. The number of domestic letters per capita was about 11 in 2002, about 5 percent of the average of the historic EU countries. The number of letters per EUR 1000 in gross domestic product (GDP) was less than 6, compared to an average of 10 in the EU. These figures suggest that the Romanian letter market not only appears to be under-developed, but is also comparably less developed than expected, given the country’s general economic potential. In 2002 only about 5 percent of all letters delivered by Posta Romana (i.e., domestic and inbound international) originated from abroad. As a result, Posta Romana is not heavily dependent on the negotiations of terminal dues and foreign postal services. In addition, the outbound to inbound ratio indicates that Romania does not receive significantly more letters than it sends abroad.

Parcels

Domestic parcel traffic decreased 21 percent from 1998 to 2002. However, sharply increasing competition reported in the domestic parcel market likely indicates a loss of Posta Romana market share rather than a decrease of market volume. Conclusions concerning the development of the entire parcel segment cannot be drawn in the absence of private operator data. The massive growth, in particular since 2001, is most likely a result of Posta Romana’s increasing orientation towards business customers in the parcel segment and thereby proof of its success in this segment.

Courier and Express

Based on information from Posta Romana as well as from the national postal regulator, the Romanian domestic express market appears to have impressive growth rates between 1998 and 2002, increasing by 15 percent. Posta Romana states that it increased its efforts in this market segment during this period, and increasing competition was reported at the same time. Apart from Posta Romana, the most important players in the domestic express market were two international courier companies, DHL and TNT, plus several local companies.

As in most countries, the international express market is dominated by the major international courier companies DHL, FedEx (Romexpress), TNT, and UPS (Trans Courier Services). However, the Romanian

operator Pegasus Courier is providing international services successfully in co-operation with Airborne Express and the important Arabian courier Aramex.

**Bulk Mail**

Both the national postal regulator and Posta Romana report substantial competition in the bulk (unaddressed) mail market and estimate Posta Romana’s market share at 50–70 percent. The unaddressed volumes carried by Posta Romana drastically declined from 1998 to 1999, and have been relatively stable since then. However, Posta Romana’s revenues from bulk mail rose by 8 percent between 1998 and 2002, and increased by 9.5 percent in 1998–99. It thus appears that the market revenue did not decease although the volumes did.

**Universal and Reserved Services in Practice**

In accordance with the universal service obligation, Posta Romana provides service to all points in Romania for all types of letters, direct mail, newspapers, periodicals, books (up to 2 kilograms), and domestic parcels (up to 10 kilograms), as well as for incoming international parcels up to 20 kilograms. Registration and insurance are offered for all universal service items. Delivery service is provided five days per week as a standard, and letter boxes are cleared five times weekly. In some areas with exceptional geographic conditions, there is less frequent delivery (two or three times a week) and clearance (twice a week). This geographic exemption applies to 139 villages in total, less than 1 percent of the total population.

At present, no postal services are reserved in Romania. The postal legislation provides the possibility for the national postal regulator to introduce a reservation that may not exceed the limits stipulated in Directive 97/67/EC. Direct mail and document-exchange services may not be reserved. Competition for services that could be reserved under present legislation (domestic and international letters) is reported to be emerging. By contrast, competition in the liberalized direct mail segment is intense.

**Accounting and Quality of Service**

Posta Romana’s accounts (and accounting methodology and systems) do not provide separate measurement and assessment of profitability of the different business lines (reserved postal services, non-reserved postal services, non-postal services, and financial services). A new accounting system that will do so was reported to be under development.

Posta Romana has not met several norms in respect to quality of service yet. While it has service targets for domestic letters internally, there is no independent monitoring of service performance quality at present. There are no regulatory targets set neither. Consequently, there are no publications on quality of service performance.

Internally, Posta Romana has set a goal of delivering 60 percent of letters in day + 1 (D+1), 90 percent in day + 2 (D+2), and 100 percent within day + 4 (D+4). According to performance results derived from an internal measurement, Posta Romana achieved the targets in 2002 for the first time. However, no details about the measurement method were disclosed, so the validity of the performance results can hardly be assessed. As reported by Posta Romana itself, “the Romanian Post still has to improve the actual performance.”

**Post Office Network**

In 2002 the Romanian post had about 7,135 postal outlets, with approximately 2,700 post offices, 2,400 postal agents, and 2,000 rural postal outlets. The 2,700 post offices provide BancPost services. Postal agents and rural postal outlets are small, providing basic postal and communications services only, but are staffed by personnel of Posta Romana.

Initial capital expenditure was directed to building up the vehicle fleet and logistics infrastructure. This has effectively ensured that Posta Romana continues to play a significant role in the postal market, and in other

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5 The postal network comprises 7,135 postal outlets, compared to 2,253 bank branches and sub-branches. More than 50 percent of these branches belong to the CEC, the State Savings House which is being prepared for privatization.
segments that are competitive. This has, however, implied a lower priority or even backlog in capital expenditure to upgrade the post office retail network. Computerization of postal counter operations in Romania started relatively late. In 1999 only 41 post offices were computerized, providing on-line connections 24 hours per day. A data transmission network connected the head office in Bucharest with the nine regions, and the terminal offices from these. The first application introduced for the terminal network was the electronic money order. Modernization has now started to gain momentum, with more than 450 post offices redesigned and interconnected by 2004 year end, yet many post offices need to be upgraded and connected. In addition financial services provided through the postal network appear to be underutilized because both the scope of services and the number of post offices involved and electronically upgraded are limited.

As mentioned before, the share of letter mail revenues for Posta Romana is relatively small (19 percent) and revenues from other services (courier, parcels, express, international and unaddressed mail) is about 11 percent of total revenue. The main revenue stream for Posta Romana is generated through the postal retail network, estimated at somewhere around 70 percent, with financial agency services being by far the most significant component. Through its post offices, Posta Romana offers more than just traditional postal services, including such products as books, tobacco, cosmetic products, and stationery. These services generate some additional income. The annual report of Posta Romana does not provide insight into the relative share of the total revenues attributable to these extra services provided at the post offices, nor to the earnings from providing financial services, compared to mail and other services.

As a basis for cost calculation (and derived charges to external users of post office infrastructure), Romanian Post does use norms and standards - based on operational surveys - for the various counter transactions at the post offices. E.g. the payment of a money order takes 350 seconds.

**Telecommunications and Information Communications Technology**

The current state of Romanian communication markets has substantial potential for further development: there are 51 fixed telephone lines per 100 households (the average in the historic EU countries is 10), and mobile penetration was 21 percent in 2002, which is below the EU average of 73 percent. About 9 percent had Internet use in 2002.

The Ministry for Communications and Information Technology develops the strategy and plans for further closing the digital divide. The postal network has not been earmarked to fulfill a special role in providing access to internet or to telephone services. Through its own commercial initiatives, Posta Romana contributed not only access to postal communication services, but also to Internet access at specific connected post offices, and to telephone/data communication services through its joint-venture in this sector of the industry.

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**2—Postal Financial Services in a Market Perspective**

**Origin of Postal Financial Services**

As mentioned earlier, the origin of postal financial services can be traced back to the early nineteenth century when postal money orders came into circulation as a payments instrument. In 1883 the range of payment services was expanded. In the areas of present-day Romania which were a part of the Austro-Hungarian Empire, postal savings and postal giro services had already been introduced. This was not the case in the rest of Romania which had established the CEC as a state savings bank with a similar mission as the postal savings bank. The CEC continued to be the nation's savings house until 1991, when the introduction of a modern postal financial service marked the de facto monopolization of the retail financial market.

**Ownership and Legal Structure**

BancPost S.A. was created pursuant to Government Decree No. 448/1991, and in accordance with the stipulations of the Romanian laws on banking (Act No. 33/1991) and on commercial enterprises (Act No. 31/1990). In August 1991, BancPost was registered with the Romanian Chamber of Commerce. The creation
of the Romanian Postbank took place in the framework of reform of the state enterprises that fell under the supervision of the Minister of Communications of Romania.

From the state enterprise for Romanian PTT (RomPostTelecom), four autonomous companies were formed for post, telecommunication, newspaper publishing and circulation, and radio and television, plus BancPost. The government still had ownership in the form of two proprietary funds, the State Ownership Fund which held 70 percent of the stock, and the Oltenia Private Ownership Fund. The ownership fund shareholders agreed to capitalize the dividends over 1992 and 1993 to increase the bank's capital. In 1993 it was decided to privatize BancPost via a financial sector adjustment loan from the World Bank. In spite of further support from the International Finance Corporation (IFC) and the European Bank for Reconstruction and Development (EBRD), it took until 1999 before privatization started and was effectively implemented through sales to General Electric Capital. Further changes in 2002 were implemented and BancPost was the first 100-percent privatized bank within the Romanian system.

The year 2003 was a consolidation year for BancPost in many respects. The most significant development concerned the bank's shareholding structure: EFG Eurobank Ergasias from Greece became the majority shareholder in BancPost with 53.25 percent. Following its offer to buy shares from individual shareholders in 2004, EFG Eurobank Ergasias acquired an additional 5.34 percent stake in BancPost.

Since its first year of operation, BancPost adopted a bold and proactive strategy based on flexibility, quick response to the market needs and innovative solutions. BancPost grew rapidly to become one of the top banks in Romania, building and enhancing its good reputation both countrywide and abroad. Today the bank offers a comprehensive range of products and services to both individuals and corporate customers.

The 41 branches in Romania rapidly established a bank branch network which was included in its registration with the Chamber of Commerce. In 1991, the bank was also licensed by the National Bank of Romania (NBR) for banking operations. A general license for banking operations was obtained in 1993, and BancPost became responsible for the operations through the postal network.

BancPost concluded in 1992 its first agreement with Posta Romana (now a long-term agreement) to make it the agency of financial services at post offices. Prior to that, the founder entities (including Posta Romana) had charged BancPost with the management and keeping of several large accounts, including those for pension, social security, and children allowance payments, as well as for salary payments of staff in state enterprises, and collection of RomTelecom bills. This provided the new bank from the onset with significant banking assets, payment traffic, and potential for customer relationships.

In 1993, BancPost gained membership in World Savings Banks Institute, Society for Worldwide Interbank Financial Telecommunications (“SWIFT”), and Universal Postal Union/Commission for Financial Postal Services. BancPost has expanded its successful business strategy and performance, which in 2004 were recognized by the prestigious review *The Banker* (part of the Financial Times publishing group), with its “Bank of the Year in Romania” award.

**Products, Services, and Clients**

Within one year of operation, BancPost gained a portfolio of about 100 large companies and enterprises, about 30,000 private small and medium size enterprises, and more than 250,000 individuals as clients, mainly for deposits and credit products, which produced a balance sheet of around EUR 35 million. The basic range of products grown has rapidly becoming more sophisticated and well-rounded for the different segments. Currently, BancPost serves a diverse range of customers, offering products that fit the specific requirements of each group of consumers, be they large companies, private entrepreneurs, employees, schoolchildren, students, or pensioners.

BancPost’s customers represent more than 10 percent of the total population, or an estimated market penetration of around 20 percent of adults. As such, BancPost is second only to the CEC, which has nine times the number of accounts on its books (but it is unclear how many of these accounts represent actual clients). Deposits also significantly grew to more than ROL 22 trillion (approximately EUR 550 million), but it is not known what share originated through the postal network.
BancPost's loan portfolio has also rapidly evolved. As of mid-2004, its portfolio amounted to nearly 19 trillion Romanian lei (ROL), approximately EUR 480 million. Overdue and litigious loans have remained at a low level (0.97 percent), due to BancPost’s risk management measures, rigorous application of “know your customer” procedures, and strict loan monitoring. BancPost offers small and medium enterprise loans, and has obtained credit lines from EBRD and others to on-lend to such entrepreneurs. (Several initiatives to provide small loan products through the postal network were proposed to Posta Romana by BancPost between 1998-2001, but no agreement could be reached.)

BancPost was one of the first banks to introduce bank cards in Romania. In 1996 it issued ULTRA, the first VISA debit card in local currency, and in 1998 it launched the Millennium (Maestro) debit card in local currency, which was usable abroad, and marked the national premiere of ROL electronic convertibility. The first VISA credit card, Brilliant, was launched at the end of 2001, while the Taifun MasterCard became available in summer 2002. The size of the card business⁶ led to the development of the Total Account, an integrated service package that allows phone bills to be electronically paid directly at ATMs or to electronically pay an overdraft on the card account. Total Account includes SmartTel™, SMS, 3G, and WAP mobile banking services that enable the user to receive financial and banking information directly on a mobile phone display. A large number of BancPost’s retail financial services of are also provided through the postal network.

Current BancPost products include:

- ROL and foreign exchange consumer and corporate loans;
- Savings books;
- ROL and foreign exchange deposit accounts;
- Current accounts for pensioners;
- Traveler’s checks (American Express);
- Payment of state allowances for preschool and school children;
- Payment of salaries into current and card accounts;

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⁶ Total bank cards issued was 1,777,015. Of these, 1,346,102 were VISA credit cards; 20,061 were VISA debit cards; and 410,852 were Europay/MasterCards.
• Debit (VISA and EUROPAY/MasterCard) and credit cards (VISA);
• Total Account packages, SmartTel™, SMS, 3G, and WAP (mobile banking);
• Internet banking;
• eTax (electronic payment of local taxes and duties), capital markets foreign exchange transactions, and trade finance (discounting);
• Receivables from letters of credit with deferred payment, or letters of credit with payment by acceptance;
• Forfeiting (the no-recourse purchasing of export receivables resulting from exports of capital and consumer goods, raw materials, and services which are guaranteed by the importer's banks)
• Payment of fixed telephone and gas bills from subscribers' personal current accounts;
• Collection of phone bills from RomTelecom, Mobifon, Orange, Cosmorom, Zapp;
• Cash collection;
• Money transfers from Israel and Portugal;
• Pension transfers to Israel residents of Romanian origin;
• Western Union quick money transfers;
• Eurogiro transfers (Japan and Germany);
• Payment of international postal money orders;
• Depository services for investment funds and companies, special settlement services for securities companies, and clearing services;
• Trading and custody services for treasury bills;
• Payment of dividends to shareholders of commercial companies at BancPost units; and
• Safe deposit boxes.

The distribution infrastructure of BancPost has also evolved, and currently has 165 outlets. There are 55 branches which have the scope and focus to deliver corporate banking services for which post offices are not suitable. The 109 other outlets (subdivided into agencies and outlets) duplicate the available postal network. In addition there are more than 500 ATMs. The distribution infrastructure of BancPost also involves the Internet, telephone call centers, and direct mail.

**Human Resources and Management**

BancPost has recognized that developing its human resources is key to effective and successful growth of the bank. No institution can be successful without the commitment and professionalism of its personnel. At BancPost, the rigorous selection of key management skills, the continuous improvement of employees through training, and appropriate internal communication channels for sharing best practices are main priorities of its management.

Initially, the Bank's management mirrored key staff of the postal, telecom, banking, and private sectors. International training helped to professionalize the senior staff. In the privatization process, the new owners (initially GE Capital and later EFG Eurobank) also provided hands-on, day-to-day management, bringing international banking experience and practice and an influx of new knowledge into the bank.

BancPost was one of the first banks in Romania to adopt a code of conduct for staff who deal directly with customers. However, this did not include the post office staff. Starting from the BancPost strategy of encouraging all its employees to push for better and better performance, this code of conduct is based mainly on work ethics, therefore on fundamental ethical principles, and adds to their professional knowledge. Convincing employees to embrace a common business culture, the values of the group, and commitment to BancPost are key to BancPost's long term success.
Operations and Systems

At a very early stage, BancPost management identified the implementation of modern information technology (IT) as the basis for providing effective mass and small-value retail financial services. The first centralized client database and data processing center were operational in 1992. IT has been a determining factor in gaining market share and providing quality financial services. In specific comparison with the CEC, IT provided BancPost with a competitive edge to expand its client base and to reach further via modern means. Until the late 1990s, CEC services and operations remained fully manual and paper-based. Operations at the post offices remained paper-based as well. Several initiatives from BancPost to upgrade the post offices (and to share the cost) were not accepted, which made the postal network less optimal in offering modern financial services or providing greater access to them.

BancPost Partnership with the Postal Network

BancPost outlets and agencies have been cause for tension between BancPost and Posta Romana, as well as mutual dissatisfaction. As BancPost developed, the management teams of both institutions recognized that there was a sizeable opportunity to be gained by using the postal network to expand the relatively underdeveloped retail financial services markets of Romania. However, this opportunity has not been fully utilized.

From the perspective of Posta Romana, the argument has often been heard that the remuneration (commissions only, not sharing in the build up of value) from BancPost is not adequate. From BancPost’s side, the main argument is that costs are relatively high, compared to its own network, and for a substandard quality of service. BancPost has proposed in past years to co-finance or co-invest substantial amounts to improve the postal retail network in order to make it more suitable as competitive outlets for financial services, as well as proposing they consider creating a joint-venture to operate the retail network. Posta Romana has not done much with these propositions, although it has made efforts to upgrade the postal network through its own resources and partnerships with other providers. The biggest reason for the under-utilization of the postal network is the inadequacy of the long-term agency agreement as a basis for a postal financial services partnership. The partnership did not originate through a competitive process and is not currently considered exclusive.

BancPost was co-established by Posta Romana and the state. In the privatization process of BancPost, investors were mainly attracted its balance sheet and financial performance. The relationship with Posta Romana was not highlighted as a major asset or item in the strategic valuation. Therefore, the new owners have emphasized enhancing BancPost’s value by increasing its own network rather than prioritizing use of the postal network (whose performance, quality, and cost remained largely beyond control of the bank).

Without a transparent competitive bidding process for a joint operation with the bank, the postal service appears to assess the value of such a commitment as too low. Another major argument may be that Posta Romana does not want to share management and control of its postal network, although its core postal business cannot economically sustain such a network. The ineffective progress and development in a greater BankPost-Posta Romana partnership also implies that substantial market opportunities have not been (and are not being) taken advantage of, and that revenue streams have not been generated.

BancPost appears less critically dependent as its own growing network reaches a sizeable client portfolio. As the market, competition, and technology continue to develop, the strategic value and rationale for involving the postal network may also tend to decline. The strategic course of Posta Romana of not making optimum use of its network for financial services may be hazardous to the future of the postal network, as these services are a key source of revenue. Currently, revenues are partly generated by postal money orders, some payment services, and Western Union, while bulk payment services, savings, and other financial services are operated via an agency of BancPost. Neither the state (as owner) nor the regulator of Posta Romana has intervened regarding using postal network for its economic sustainability.
Other Posta Romana Partnerships

Western Union
Both BancPost and Posta Romana have agency agreements with Western Union for urgent cash transfers. There are Western Union agencies in around 550 post offices, 120 BancPost branches, and the volume of transactions is significant. It grew to more than 800,000 transactions in 2002, a flow of around USD 250 million. In addition, both Posta Romana and BancPost are active members of Eurogiro and other international remittance networks. The commission revenues for Posta Romana are relatively high, estimated at more than EUR 5 million, and are essential for overall profitability of the company.

State Savings Bank (CEC)
The second bank working with Posta Romana is the CEC, the state savings bank. The volume and range of services are of minor significance: clients can only deposit or withdraw money from their accounts at the post offices. Opening new accounts cannot be done in the post offices, but has to be done at a CEC branch. The actual volume of operations has declined to less than 50,000 transactions per year.

Insurance Companies
On a small basis, insurance is sold through the post offices. Insurers that Posta Romana works with are ASEROM, Garanta, and Concordia. Their co-operation is only on a small regional basis.

Mutual Funds
Posta Romana has a contract with Active International to sell a mutual fund. Taking part in this mutual fund is only possible at the biggest post offices in the country.

Financial Sector Development Perspective
Before 1989 there were five active banks in Romania. The most important of them, the National Bank of Romania, handled central bank activity as well as commercial banking. The other banks were specialized banks with monopolies in their field, running bank operations strictly for those areas: foreign trade financing, industry finances, agriculture and agribusiness finance, and personal savings and loans to individuals. Since the state was the sole owner of all these institutions, the main feature of the old banking system in Romania was no risk-taking.

The post-communist banking system has been restructured to support transition into a market-oriented economy. In this respect, two key elements were targeted: turning the NBR into a true central bank and developing a network of commercial banks. One of the most important steps was to divest the commercial business of the NBR to a new bank, the Commercial Bank of Romania (BCR). Now the NBR is now solely a central bank and is independent in the performance of its duties, with the governor and the board of directors appointed for a renewable eight-year period by the parliament, on the recommendation of the prime minister.

In the years since 1989, more banks beside the state banks became active in Romania. New private banks were started, and foreign banks came to Romania. In May 1999, restructuring the banking sector finally seemed to bear fruit, with two banks partly privatized and the Banking Assets Resolution Agency (AVAB) working on the bad loans of the rest of the state banks. The process of bank sector restructuring progressed between 1990 and 2000 much more slowly and with more difficulty than in most other Central and Eastern European countries.

Under the new banking legislation, commercial banks are allowed to freely compete for business in the general market place, offering a diversified range of services. At the end of the first quarter of 2004, there were 38 banks operating in Romania, and the total assets of the Romanian banking sector amounted to 33 percent of GDP. This is still significantly lower than in other Central and East European countries and indicates

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7 In 2004, the Banking Assets Resolution Agency (AVAB) was reorganized by merging it with the Authority for Privatization and Management of State Ownership (APAPS) to create the Authority for State Assets Recovery (AVAS). AVAS is a specialized body and reports to the government of Romania.
substantial room for growth in the banking sector. The banking assets of the three largest banks account for some 51 percent of the sector’s assets.

Raiffeisen Bank Romania, the local unit of Austria’s Raiffeisen Zentralbank, grew the most among local banks in 2003, pushing state-owned savings bank CEC out of third place. CEC in fourth place held 6.7 percent, while ABN AMRO in fifth place had 5.1 percent, ING in sixth place with 4.3 percent, and BancPost with 4.2 percent in seventh place.

<table>
<thead>
<tr>
<th>Banks</th>
<th>% Total Assets (2003 year end)</th>
<th>% Total Assets (2002 year end)</th>
</tr>
</thead>
<tbody>
<tr>
<td>BCR</td>
<td>30.8</td>
<td>31.4</td>
</tr>
<tr>
<td>BRD –GSG</td>
<td>13.4</td>
<td>13.6</td>
</tr>
<tr>
<td>Raiffeisen Bank</td>
<td>7.0</td>
<td>5.1</td>
</tr>
<tr>
<td>CEC</td>
<td>6.7</td>
<td>7.7</td>
</tr>
<tr>
<td>ABN AmroBank</td>
<td>5.1</td>
<td>5.1</td>
</tr>
<tr>
<td>ING Bank</td>
<td>4.3</td>
<td>4.5</td>
</tr>
<tr>
<td>BancPost</td>
<td>4.2</td>
<td>4.1</td>
</tr>
<tr>
<td>AlphaBank</td>
<td>3.6</td>
<td>3.1</td>
</tr>
<tr>
<td>HVB Bank</td>
<td>3.5</td>
<td>4.1</td>
</tr>
<tr>
<td>BancaTiriac</td>
<td>3.2</td>
<td>2.8</td>
</tr>
<tr>
<td>Citibank</td>
<td>2.7</td>
<td>4.0</td>
</tr>
<tr>
<td>BancaTransilvania</td>
<td>2.4</td>
<td>1.8</td>
</tr>
<tr>
<td>Eximbank</td>
<td>1.3</td>
<td>1.3</td>
</tr>
</tbody>
</table>

Notes: BCR (Romania Commercial Bank); BRD-GSG (Romanian Bank for Development–Groupe Société Générale)

Source: National Bank of Romania

The predominance of the state sector has declined and state banks have largely been cleaned up. The envisaged privatizations of the largest remaining state-owned bank, BCR, and the savings bank, CEC, would significantly reduce state ownership in the banking sector. The EBRD and IFC bought a 25 percent stake in BCR in 2003, and the government announced an additional stake of 25 percent would be sold before the end of 2004. CEC’s privatization process also began in fall 2004.

Recently NBR lowered the intervention interest rate, given the positive evolution of the disinflation process; economists expected it to result in a drop in interest rates for both loans and deposits. Sector specialists estimated that there was considerable room for rapid growth in the Romanian financial sector, driven by the banking sector in particular. The range of products was also likely to broaden steadily as clients' needs became more sophisticated, and as the market for plain vanilla banking services became saturated.

The consumer credit market is still in its early stages in Romania. The volume of outstanding consumer loans reached ROL 74.6 trillion (USD 2.3 billion or EUR 1.9 billion) in 2003. Following a sharp increase in consumer and mortgage credit in 2003, overdue credit has also risen at relatively higher rates as a natural feature. As a result, in February 2004, the NBR enforced tighter regulations in the sector to fight the accumulation of risks associated with non-performing loans. Examples of such regulations were down payments of at least 25 percent of the loan amount; monthly installments equal to a maximum of 35 percent of the applicant’s net income. A credit rating bureau was scheduled to start its operations in autumn 2004. The bureau will use the databases of its 24 bank members to monitor loans granted by banks to individuals.
Nine of the active Romanian banks offer mortgages. The most important players in the housing and mortgage credit market are the Romanian Commercial Bank, with a 33 percent market share, and the Romanian Bank for Development-Groupe Société Générale with 20 percent of the market. The volume of loans for housing purposes experienced strong growth in Romania in 2003-04, reflecting the emergence of the middle class and reaching ROL 19 trillion (USD582.3 million or EUR 477.2 million).

Payment Cards

The Romanian market for on-line commerce, evaluated at about EUR 2 million in 2003, significantly increased after the introduction of a security payment system through payment cards. The system called 3D Secure uses Visa and Master Card branded cards. Twenty-three Romanian banks offer 31 direct banking products or instruments, such as 15 Internet banking systems, 14 home banking systems, and 2 GSM banking systems. Mobile phone owners and internet users can obtain information direct from their bank accounts, execute bank transfers, and pay telecom and utilities bills through their mobile phones or the Internet. ATMs are also tools for on-line transactions. As an example, ING recently launched the SelfBank service, including use of ATMs for cash and deposits, and Multimat to handle individual accounts electronically and pay utility bills.

Romania has been experiencing one of the highest growth rates of payment cards in Central and Eastern Europe. Currently 16 banks issue payment cards. The number of payment card users increased by 25 percent in 2003, reaching five million holders, and the volume of transactions with cards rose by more than 50 percent. BCR alone has issued 1.3 million cards, and offers its customers 13 types of cards. The bank has 750 ATMs and around 2,900 point-of-sale devices (POS) installed with retailers. In 2003, 95 percent of card transactions were cash withdrawals, and the average value of card transactions was USD 50. The number of vendors who accept payments by card was 13,800 at March end 2004.

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2003 Year End</th>
<th>2004 Year End</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of cards issued</td>
<td>4,282,680</td>
<td>5,894,661</td>
</tr>
<tr>
<td>Amount of transactions (ROL billion)</td>
<td>27,987.8</td>
<td>44,652.4</td>
</tr>
<tr>
<td>Number of transactions in ROL</td>
<td>20,176,752</td>
<td>27,023,255</td>
</tr>
<tr>
<td>Amount of transactions (EUR 000s)</td>
<td>2,541</td>
<td>7,284</td>
</tr>
<tr>
<td>Number of transactions in EUR</td>
<td>14,118</td>
<td>50,393</td>
</tr>
<tr>
<td>Amount of transactions (USD 000s)</td>
<td>12,556</td>
<td>25,601</td>
</tr>
<tr>
<td>Number of transactions in USD</td>
<td>81,263</td>
<td>177,689</td>
</tr>
<tr>
<td>Number of ATMs</td>
<td>2,150</td>
<td>2,514</td>
</tr>
</tbody>
</table>

Source: National Bank of Romania

Access to Financial Services

The developments in the financial sector discussed above cannot but reveal that the financial sector is still in an early stage of development. As regards payments, there is indeed a fast growth in distribution of electronic and cashless payments instruments. With nearly 6 million cards (28 percent) issued in a market of 22 million, there is still considerable room for further growth before signs of saturation would appear. Usage of the modern payment instruments is relatively low. In 2001 the European Central Bank, in its Blue Book for Accession countries reported Romania as the country with the lowest number of cashless/electronic payments per capita, 3 compared to 22 in Hungary, 90 in the Czech Republic, and around 200 cashless transactions per
The role of postal networks capitá in France, the Netherlands, and Finland. The low usage appeared to be correlated with the smaller infrastructure for electronic payments in Romania than elsewhere in Europe. The recent growth in distribution of electronic payment instruments and its infrastructure leads to the assumption that usage will increase in the next few years.

The distribution of cards and the use of electronic payments, however, need a very dense and easy accessible infrastructure. The network for electronic payments, which has only recently started to develop, has 11 different networks, which is not suitable for standardization, cost efficiency, and accessibility. Apart from Bucharest with 2.2 million inhabitants, there are no other cities with more than 400,000 inhabitants. More than 60 percent of the Romanian population lives in rural areas and has low incomes, with very limited or no access to the financial services infrastructure. Many of them are confined to cash and making paper-based cash payments at post offices.

The Romanian postal network could play a role in providing access to electronic/cashless payments services, given its 7,135 postal outlets that far outnumber all bank branches and sub-branches (which are primarily located only in Bucharest and larger provincial towns). The postal network is estimated to have a 40 percent share of the volume of recurrent and bulk payment transactions and other post office-to-post office money transfers. If Posta Romana were able to build an effective partnership with one or more of the banks, the postal network could significant help expand the use of electronic payment services—as well as other financial services, such as savings, loans, insurance, and mutual funds.

Access to (micro, consumer, or small) credit has been difficult in post-communist Romania, although there is a positive trend evolving. The establishment of a credit bureau will actually facilitate the credit assessment for small borrowers, but the market is still young and small and better access to better microfinance services is necessary. Standards of living continuously eroded between 1989 and 1998 as has GDP, with high inflation rates and increasingly high rates of unemployment contributing to the pauperization of the population. The Romanian rural areas are amongst the poorest parts of Europe, with GDP per capita well below USD 1000 per year. Consequently the gap between the well off and the poor has widened and continues to grow. The hardest hit segments of the population are women and the elderly. Women are the first to be laid off and pensioners’ static incomes have been eroded by inflation. In addition non-ethnic Romanians, such as Roma gypsies and Hungarian minorities, have suffered badly. This has also created a strong demand for microfinance, as many of the unemployed had no alternative but to deploy new initiatives often through the setup up of a new small company.

The small and medium enterprise (SME) sector—of which microenterprises account roughly for 90 percent—has showed the greatest dynamism since the transition process began. It has been the most important contributor to the state budget and is the only sector in the economy that grew employment. The lack of enabling legislation and support at the macro-level has continued to block its development. Currently heavily recapitalized SMEs have great difficulty accessing financing. This is especially true for start-ups, self-employed people, and family associations. Romania’s low-income microentrepreneurs, and particularly female microentrepreneurs, have few to no viable sources of financing for their businesses and face other problems such as access to knowledge and practical support to set up and run a small business. Most of the new, small entrepreneurs had to start in an environment new to these initiatives.

The Romanian banking sector has been slow in responding to the needs of the SME sector. Many of the private banks did not regard extension of small credit as in their strategic interest, nor did they see the opportunity for profitability in this area. Most of the old state banks also refrained for SME lending, as they were directed to resolve the large number of non-performing loans of state-owned enterprises.

The first bank in Romania that seriously entered the SME lending sector was BancPost in 1998. BancPost has remained a significant player in this segment. Until its entrance, two small banks, Bank Ion Tiriac and MIND Bank, offered microfinance, with portfolios of less than USD 350,000. Other banks have gradually entered the market, spurred by initiatives from the development banks (including the EBRD) to provide credit lines for on-lending. Moreover, in 2002, MIRO Bank was established as the first bank that fully specialized in microfinance. Currently it has several operational branches, and more than 10,000 clients.
Credit unions (CUs) have a long tradition in Romania, dating back to the cooperative Raiffeisen principles of the early nineteenth century. However communist legislation made them unpopular and inadequate as vehicles for microfinance after 1989. Several adjustments have been implemented, and currently there are about 4,300 CUs serving about 1.6 million members. NGOs also provide another driver in microfinance development in Romania.

On the whole, demand for microfinance is not met by the financial sector, and for sustainable microenterprise development, more comprehensive support is required. The postal network does not have a role in this area, but as improvement of the post offices continues, they may become better suitable to become “small business bureaus” that provide a range of support to microenterprises.

3—Options for Development

Romania features a relatively successfully reformed public postal operator within a liberalized postal sector, and the successful development of BancPost as a significant player in retail financial services, able to attract foreign private investors. Both the postal operator and the postal bank operate without special privileges, and without state intervention or subsidies. From an economic point of view, Posta Romana primarily operates a dense financial service network with additional postal mail and express services that historically are considered the core business. Postal markets in Romania have shown attractive growth rates and are likely to see further development. However the markets for SME and consumer financial services have much higher potential growth rates, as do ICT-based services.

The strategic question for Posta Romana will be how to open up the scope and structure of its partnership with BancPost, which both feel is underutilized. Posta Romana is dissatisfied with the remuneration for its services on behalf of BancPost, while Banc Post does not consider the service level at the post offices adequate for its clients. The basic issue, however, appears to be control over the post office counter operations. Hence, Banc Post is only offering a few savings products at 2,000 post offices (savings books, savings certificates). From the start of its operations, Banc Post has chosen a dual distribution structure, in which the full and continuously expanding range of services is offered in its own branch and agency offices (numbering 155).

Developments in Romania’s financial sector over the past 15 years reflect the impact of the post-communist economic crises it experienced in the 1990s, which were aggravated by a hesitant reform process. Only in the late 1990s was bank privatization seriously embarked upon, with two privatizations successfully completed (BCR and BancPost). In the corporate banking sector, the entry of foreign institutions helped raise standards and service/product diversity, as well as competition. While the transition process has gained impressive momentum, the level of development particularly in the retail banking sector leaves much to be desired. Modern payment instruments are not widely used; although their availability has rapidly increased; and credit to SMEs and private consumers is considered too small. (The actual portfolio is EUR 1.9 billion.)

Despite many enabling regulatory and institutional conditions, the networks of the banks are small. Posta Romana, with its dense post office network, amongst others, has not stepped up to fill the void, particularly in rural areas, where banks are not represented at all, and counter computerization and interconnection needs to grow more quickly. Already today, Posta Romana handles more than 30 percent of all small value payment transactions; the bulk of which is made up by pension payments, child allowance payments, and money orders. It should be noted, however, that nearly all payments are paper-based cash transactions. Posta Romana has gained a strong position in the remittances market, mainly as the primary agent for Western Union. As agent for BancPost, it provides valuable agent services for savings and several payment instruments, through some 2,000 post offices.

The post office network of Posta Romana is costly to maintain, even considering the low staff salaries. The limitations in available resources imply that investments in automation, business-process engineering, and improvements to infrastructure can only be thinly spread across the network. Co-operation with one or more strong partners would therefore seem imperative, but in spite of a number of proposals, nothing has materialized.
Viewed against the above conclusions, the following priority areas need to be attended to in order to ensure the sustainability of the postal network and its sustainable role in providing broad-based access to financial services and other ICT based services.

**Partnership and Co-operation with Financial Sector Institutions**

For the development and optimum utilization of the payment system in Romania, it is of decisive importance that co-operation between Posta Romana and one or more financial institutions is firmly established, with a long-term horizon. As efforts for Romanian Post to obtain a banking license seem illusory, there are basically only two options:

- Reformulate and broaden co-operation with BancPost as the prime provider of banking products through the post offices. BancPost has both the product range that the mass market will increasingly expect to get, and the IT platform to provide it—in conjunction with increased automation of the post offices, the required back-office services. Moreover, through close co-operation with BancPost, Posta Romana can commensurately benefit from enhanced product know-how and staff training that the main private sector shareholder has committed to bring in.

- Should the recent history of relations between BancPost and Posta Romana (mutual distrust, incompatible character of top management) be insurmountable, the only alternative is to organize an international tender. The goal would be to select one or more licensed banks that wished to enter into a co-operative contract or partnership with Posta Romana and provide a full range of financial services through the post offices.

In either case, it would be sensible to thoroughly assess the facts of the current situation and assess the desired constellation of such a partnership. Since experience indicates that a contract-based relationship does not ensure adequate mutual commitment, it would be useful to explore the feasibility of a joint venture or other stronger form of partnership. The scope of the partnership could cover the provision of financial services through the postal network. In that case, Posta Romana would or should contribute its current payments business, international remittances, and access to the postal network as components to the joint venture. Another option would be to consider setting up a joint venture to modernize the postal network.

**Restructuring the Post Office and Its Network**

Posta Romana is still a joint stock company owned by the state, but its privatization, which is under preparation, should be speeded up and the date and means determined, so it can be more productive and free of the constraints of government priorities.

To become a competitive outlet for a broad range of financial services, large investments in front-office and back-office automation will be imperative for Posta Romana, and the overall appearance and functionality of the premises will have to be substantially upgraded. Posta Romana does not have the financial resources to make the required invests on its own, nor can it count on government support, nor can it assume that the postal business (mail, express, parcel) will generate the required revenues to justify the investments. Posta Romana would be able to construct a more viable business model if it could share overall cost and investment in the network with one or more large financial or communications institutions, and if it were able to gradually transform a number of the small outlets in agencies operated under agreements with individual private entrepreneurs.
The Role of Postal Networks in Expanding Access to Financial Services

Country Case: Sri Lanka’s Postal Finance Services

The World Bank Group
Global Information and Communication Technology

Postbank Advisory, ING Bank
Postal Policy
Author’s Note

This report discusses the role of postal networks in Sri Lanka and its current and potential role of providing access to financial services. The report reviews the postal sector development in the country and the role of the postal network in the development of the financial sector, with an emphasis on its accessibility to financial services. The report concludes with an evaluation of the Sri Lanka Post as a provider of financial services and highlights options that can be taken into consideration for further development of the postal financial services in Sri Lanka.

The case study has been prepared with desk research in 2004. The study benefited from information and an interview with the chief executive officer of Sri Lanka Posts during the World Post Congress in Bucharest in October 2004.

While this country case on Sri Lanka can stand alone, it is an integral part of this large study of the potential of postal networks to coordinate with financial service providers in 7 countries (Egypt, Kazakhstan, Namibia, Romania, Sri Lanka, Uganda, and Vietnam) and 5 regions (Africa, Asia, Eastern Europe and Central Asia, Latin America and the Caribbean, and the Middle East and Northern Africa).

Glossary of Abbreviations and Acronyms

- ATM: automated teller machine
- CRB: cooperative rural banks
- EBPP: electronic bill presentation and payment
- EFT POS: electronic fund transfer at point-of-sale
- ICT: information and communications technology
- IMF: International Monetary Fund
- LKR: Sri Lanka rupee
- MFI: microfinance institution
- NGO: non-governmental organization
- NSB: National Savings Bank
- RRDB: regional rural development bank
- SLT: Sri Lanka Telecommunication Corporation
- SME: small and medium enterprise
- SWOT: strengths, weaknesses, opportunities, and threats matrix
- TCCS: thrift and credit cooperative societies
- UAE Post: United Arab Emirates Post
- UPU: Universal Postal Union
- USD: United States dollar
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## Summary

### SWOT Analysis of Sri Lanka Postal Financial Services

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Opportunities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Has operated postal financial services for more than 125 years; currently 4,600 post offices spread across the country, including rural areas</td>
<td>• Postal banking offers potential to increase savings propensity, financialize savings, and provide banking services to the rural poor</td>
</tr>
<tr>
<td>• Mobilizes small deposits from a minimum of LKR 5; more than 4.8 million accounts, totaling LKR 12 billion (year-end 2002)</td>
<td>• With proper marketing and improvement in efficiency, postal banking can capture 15%–25% of incremental growth of domestic household deposits</td>
</tr>
<tr>
<td>• Processes some 17 million transfers per year (money orders, pensions, and electricity bills) with a value of LKR 13 billion.</td>
<td>• In the medium term, has potential to offer other products, such as life insurance, trust units, and microcredit, sold through the post offices (linked to existing savings/payments accounts)</td>
</tr>
<tr>
<td>• Has a non-bank status in the view of population; rural areas have a high level of personal trust in postmasters</td>
<td>• Transfer operations can grow rapidly to include direct credit transfers (salaries) into personal accounts and chip-card technology for small-value payments</td>
</tr>
<tr>
<td>• Has never defaulted in payments to depositors</td>
<td></td>
</tr>
<tr>
<td>Weaknesses</td>
<td>Threats</td>
</tr>
<tr>
<td>• Stagnant growth in number of accounts and deposits mobilization; since 1971, continuous decline in market share (from more than 25% in 1971 to less than 1.5% in 2002). More than 85% of accounts presumed to be dormant</td>
<td>• Complexity of overall postal reform distracts management’s attention and dilutes priority from this demanding project to implementing a postal financial services system</td>
</tr>
<tr>
<td>• Transfer services do not grow, but remain stable in a growing market.</td>
<td>• Labor, Treasury, and National Savings Bank potentially resistant</td>
</tr>
<tr>
<td>• Agency with National Savings Bank underdeveloped; potential of savings mobilization and retail banking underutilized</td>
<td>• Profit contribution may not be feasible because of high up-front costs to improve post office interiors, technology, and staff capability</td>
</tr>
<tr>
<td>• Management lacks marketing, banking, and technology skills; risk control and management accounting virtually non-existent; computerization in early stage only</td>
<td>• In Sri Lanka’s environment for consumer financial services, which features overbanking, and a near-saturation for the currently perceived profitable consumer market segments, other banks may effectively prevent Sri Lanka Post from capturing opportunities</td>
</tr>
<tr>
<td>• Heavily reliant on inefficient staff and operations in post offices, very limited training and no performance incentives to staff and management; inefficient, paper-based, manually-processed operations</td>
<td>• Sri Lanka Post may have to focus on its social dimension to reach out to the poor</td>
</tr>
<tr>
<td>• Operates as a government department, with bureaucratic management and procedures, and civil service practices</td>
<td></td>
</tr>
</tbody>
</table>
1—Postal Sector Development

Sri Lanka has a long and rich history in providing financial services through the post offices. In 1798, two years after the Dutch were expelled and the island came under British rule, five post offices were created in its main cities, marking the beginning of a state postal system. Postal money orders were introduced at an early stage, but became a nationwide system in 1877 when the Inland Postal Money Order System was inaugurated, and this service still functions—basically unchanged—today.

In 1885 Queen Victoria had passed the Ceylon Post Office Savings Bank Act, and the Post Office Savings Bank opened for business, offering easy access for deposits and withdrawals through the network of national post offices. In 1909, a telegraph money order service was launched between Colombo and India; this marked the beginning of rapid money transfer services as well as cross-border payment services, which continue to day. In 1936 the Post Office Savings Bank obtained authority to issue savings certificates and began offering them in 1938. Then, in 1941, governance of the Post Office Savings Bank was handed over to a board of trustees comprised of the Permanent Secretary to the Ministry of Posts, the Deputy Secretary to the Treasury, and the Postmaster General. (The last two officials sit on the board of directors of the National Savings Bank.)

The post office gained a leading position in mobilizing small deposits throughout the country. Its market share (value) in deposits exceeded 30 percent in 1970 with more than 4 million savers. But the Post Office Savings Bank was not the only state-owned savings institution. By 1970 there were three state institutions mobilizing savings, but they were limited in services. Even though the potential for savings banks was very high and the benefits to the economy were enormous, the existing Sri Lankan savings institutions did not exploit these opportunities. The government felt the need to follow the example of other countries and to create a stronger organization to fill the gap.

Thus, the National Savings Bank (NSB) was brought into the banking system in 1972 by an act of Parliament (in line with the economic thinking in that era), as a fully state-owned institution. It was charged by Parliament to channel the idle money lying in every corner of the island toward the development of the country. Links with between the NSB and the post office were maintained through an agency agreement and the Postmaster General as an ex officio member of the board of the NSB.

With the advent of social security, the post office was charged in 1947 with paying out monthly public assistance benefits. In 1949 the disbursement of government pensions also became a task for the post office. Gradually other payment functions were added in the 1960s and 1970s: payment services for the Electricity Board, the Water Supply Board, TV and radio licenses, and on-the-spot fines for the police. In the 1980s and 1990s, the post office took over payments for rural pensions and the collection of other bills, and more recently, collecting premiums for life insurance and pensions. In 1997, a new product, the fax money order was proffered (a sequel to the telegraph money order), and in 2004 the e-money order was added.

Until 1980 “Sri Lanka Post” was the parent institution for all forms of communications (telegraph, telex, telephone, etc.). Sri Lanka Post today has an extensive communications infrastructure and service network with real potential to “bind the nation together.”

Sri Lanka Post

Sri Lanka Post currently delivers to 99 percent of the addresses in the country six days a week. Postage tariffs on the island are uniform; essentially, business users in the more urban Colombo region subsidize rural users. Many of these post offices, particularly in rural areas, are presumed to operate at a loss. Sri Lanka has an active mail demand of 26.5 items per capita per year, comparable to other low- and middle-income countries. Each Sri Lankan post office serves around 4,160 people on average, on par with developed countries.

Prior to 1997, government funds were used to expand the postal network, but since then, it has been expanded through private sector participation in the form of agency contracts. In 1995 there were 181 post office agents; in 2000 they increased to 455, and in 2002 to 602. Since 1997, the number of government-owned post offices has remained level, at about 4,035, because every year 20–30 new post offices are opened, 20–30 closed, and
30–40 post offices renovated. The share of privately run postal agencies is nearly 15 percent (up from 4.5 percent in 1996). This has been achieved by opening new agencies, not through a transfer of existing state-owned post offices to private entrepreneurs.

Sri Lanka’s postal service is plagued with **several chronic problems**. There are no standards for mail service or for customer service. Two surveys conducted in the 1990s showed that only 34–50 percent of mail was delivered the next day. Public perception is that service is poor, which is supported by the large number of courier companies (currently more than 50, both licensed and unlicensed) that deliver mail in Colombo. There are no performance or market research data to help the postal service identify the causes of poor service and service failure (for example, rail transport failures), and the reasons underlying poor public opinion.

The **postal service’s budget for each upcoming financial year is determined by the Ministry of Finance**, based on a bid from Sri Lanka Post, which is then **voted on by Parliament**. In Parliament, the investment budget is often reduced due to limited public funds available, with little consideration of the investment needs of the post office. As a result, **investment decisions are short-term** and there is no medium-term or strategic planning by the post office. There is no operational requirements plan in the capital budget, or a capital priority list that ranks investment projects. The laborious tender process for capital projects plus limited power delegated to regional managers means an extremely slow process for needed capital investment.

Staff morale at Sri Lanka Post appears to be low, reflected in the support for reactionary and potentially militant labor unions. Staff sees their work as **completing a defined task** rather than **fulfilling a defined need**. Even though postal service is considered a public duty, strikes have occurred occasionally throughout the past seven years. **Politicians also interfere** in the affairs of the post office, and recruitment procedures are not always strictly applied. Work rules and practices are rigid and the design of many operational tasks leads to **overstaffing and high levels of inactivity**. Power to discipline staff is weak and disciplinary action is subject to lengthy appeal procedures.

Until 1997 all government departments and some other agencies were entitled to unlimited free postage. This led to a shortfall in revenues of approximately 15–20 percent. This privilege has gradually been discontinued over the past few years.

The price of an ordinary letter increased from LKR 1 to LKR 2 in 1995, and was increased again in 1997 to LKR 2.5, followed by several more rate hikes. In 2002 the government agreed with the International Monetary Fund (IMF) advice to raise the tariffs. In 1996 a World Bank study put the cost of delivering a letter at LKR 4, so there is little doubt that **current rates still do not cover the cost**. Increased mail volume is increasing losses, rather than increasing profits.

It is estimated that Sri Lanka Post has about 1 percent market share in express mail items, and very little presence in the parcels market segment. Market intelligence and analysis of demand patterns also indicate that there is growing competition in domestic letter mail delivery (especially to businesses) in western Sri Lanka, and perhaps in other major urban centers as well.

Sri Lanka Post’s continuing poor performance has been a significant financial burden to the government. The taxpayers have underwritten the post office’s significant losses for the past several years. Additionally, the government has also provided funds annually for capital expenditure. The **cumulative net cash drain** for the Sri Lankan government, in nominal terms, has exceeded LKR 10 billion over the past 15 years. If one added the cost of financing the losses at an average of 10 percent per annum, the accumulated loss amounts to nearly LKR 20 billion (USD 200 million). Operating losses over the past 10 years (excluding budget for capital expenditure and financing) amounted to more than LKR 5.2 billion.

Sri Lanka Post **would have been considered bankrupt long ago** by any commercial standards. In 1996, the operating losses of Sri Lanka Post were LKR 112 million; in 2003 they had increased to LKR 583 million. The annual losses vary 10–33 percent of total post office revenue, which has been major hindrance to sector development and network rehabilitation.

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1 For example, the 1997 Sri Lanka Post budget for 1997 was reduced by 20 percent—from LKR 2.4 billion to LKR 1.9 billion—before approval by Parliament. In 2003 the proposed budget was cut by 29 percent.
In a message to the press in January 2004, the Minister of Posts and Telecommunications stated that the post office should become financially self-sufficient. The management of Sri Lanka Post was directed to prepare a plan to bring the current operational deficit to break even. The draft plan is currently being reviewed at the ministry.

**Current Institutional Framework**

In 1980 the Department of Posts and Telecommunications was split into two departments. Government ownership was significantly reduced by the privatization of Sri Lanka Telecomm, the participation of the Japanese telecommunications company NTT, and the subsequent floatation of Sri Lanka Telecomm stock on the Colombo stock exchange. An independent regulatory commission for Telecomm was established, and licenses awarded to various operators. With the advent of the Internet, a growing number of internet service providers have also entered the market.

**The postal sector has not evolved like telecommunications.** The Ministry of Posts and Telecommunications houses the owner, operator, and regulatory functions of the postal sector. Sri Lanka Post is formally the Department of Posts in the government, and subordinate to the ministries of Finance, Posts and Telecommunication, and Labor. The **policy staff of Posts and Telecommunications generally oversees the running of Sri Lanka Post, and its budget is set by the Ministry of Finance** (for approval by Parliament). Individual members of Parliament and ministers continue to interfere in the running of the postal service.

It is clear that the current institutional framework handicaps Sri Lanka’s postal sector. Too much political interference, too many actors involved in operational decisions, too rigid a civil service regime, inability of post office to allocate resources optimally, and a bureaucracy that hinders commercial responsiveness and capital investment all contribute to the poor performance of Sri Lanka Post.

**Postal and Telecommunication Reforms in Sri Lanka**

In a letter to the IMF in March 2002, the government pledged to reform the post office and bring in private sector participation. Although outright privatization was considered too sensitive, greater collaboration with the private sector to expand services was considered a feasible option. Reform of the Sri Lanka Post has been on the legislative agenda for more than 10 years, and finally in September 1994, reform of Sri Lankan Post was included in a new economic strategy and elaborated in subsequent policy statements and annual budget speeches.

**Telecommunications Sector Reform**

The Ministry of Finance and Planning designed a public investment program for 1996–2000. The postal sector was part of the development of the infrastructure, which had high priority. Investments in power, roads and highways, telecommunications, and transport amounted to some 33 percent of the government’s capital budget from 1995 to 2000. The investments in the post and telecommunications sector mainly expanded telecommunications infrastructure; investments in the postal sector were marginal (0.21 percent of LKR 71 million), which was not enough for Sri Lanka Post to introduce new services or improve service.

In 1991 Sri Lanka Telecom Corporation (SLT) was licensed (per the Telecommunication Act No. 25 of 1991) to provide both domestic and international telecommunication services, as a government-owned but autonomous enterprise headed by a board of directors and chairman appointed by the government. The Act also designated Sri Lanka Telecommunication Authority as the regulatory authority under a director general of telecommunication within the Ministry of Post and Telecommunication. (It later became an independent regulatory authority.) With rapidly increasing demand, funding to upgrade the telecommunications infrastructure was difficult to meet from public resources. **Through the government privatization program, the SLT was transformed into Sri Lanka Telecom, Ltd., in 1995, and took over all assets, liabilities, and personnel of SLT.** After a strategic alliance with NTT of Japan in 1997, an initial public offering of stock in 2002 put the majority of ownership in private hands.
Sri Lanka counted only 326,000 telephone subscribers in 1996; in 2003 the number of fixed-line and cellular telephones had passed the 2.3 million mark. Yet, an estimated 50 percent of households does not have telephone service. For them, public telephone booths (in most post offices) remain the only way to access telecommunications.

**Information and Communications Technology Policy**

In the late 1990s, the focus of the post and telecommunications sector shifted to information and communications technology (ICT). Sri Lanka has an explicit government policy to enhance access to ICT as a means of reducing poverty and closing the “digital divide.” Among the programs initiated by the Telecommunications Regulatory Commission, “e-Sri Lanka” features prominently. In June 2004, the newly-elected government announced higher priority for the program. It is unfortunate that the postal system with its extensive network and its traditional role in providing access to communication and information did not implement the “e-Sri Lanka” program.

ICT and the Internet are relatively new in Sri Lanka. The number of Internet users in Sri Lanka is estimated at 150,000—a small number but growing quickly. Many Sri Lankans do not have access to the Internet at home or at work, and access will remain technically or economically difficult for the next decade. While Internet cafes and similar outlets mushroom in Colombo and other cities, the postal system has the initiative (“Community Locale”) and provides a full range of Internet access facilities at 150 post offices. These post offices are also interconnected for other applications.

**Postal Sector Reform Program**

A comprehensive reform program for the Postal Sector was finally initiated in 1996 after consultation with the Ministry of Posts and Telecommunications, Sri Lanka Post, and the Public Enterprise and Reform Commission, and support from the World Bank. In March 1997, a World Bank report (“Reforming Sri Lankan Postal Service, Phase I Results of the Postal Sector Reform Initiative”) highlighted the drain of the postal system on the Sri Lankan treasury and identified the main elements of structural change for the postal sector:

- Commercialize the operations
- Increase private sector participation
- Develop competition
- Institute regulation

The overall objective was to transform Sri Lanka Post into a profitable, high-quality service provider and a good employer that would be able to attract and retain qualified staff. Specifically, Sri Lankan Post needed to:

- provide an enhanced portfolio of market-driven services and products, for greater choice of communication services (including traditional mail service) to all residents of Sri Lanka;
- set and meet standards of high quality in the provision of basic products and services;
- provide core services at low cost;
- attain financial self-sufficiency, and be able to finance new investments, service expansion, renewal, rehabilitation, and new product development within four to five years; and
- continue to offer universal service with a uniform tariff structure for regulated service and products.

The program identified developing delivery of financial services at postal counters as a key area to initiate postal reform and to generate revenues.

**The government attempted a strategic partnership between a strong, competent financial institution and the Sri Lanka Post**, but resistance from politicians and labor unions, culminating in strikes, aborted this at an early stage. As a result, Sri Lanka Post continued to provide existing financial services and added new versions...
of existing products supported by new technologies. In 1998 the fax money order was added and in 2004 a pilot for the electronic money order\textsuperscript{2} was launched and then rolled out to 75 post offices.

**Postal Network Development**

Even though the investment budget available to the postal system in Sri Lanka has traditionally been small, until 1997 investment mainly focused on expanding the post office network, without analyzing the expected return on investments. This misdirected capital expenditure should have been used to increase efficiency, such as computerizing the post offices.

When analyzing the correlation between the expansion pattern of the post office network and the development of the financial results of Sri Lanka Post (see tables below), then the impact of this expansion policy becomes clearer. Although current financial data do not provide full evidence that the growth in postal network could be the main cause of the increasing deficits, there are sufficient reasons to point out the growing negative financial burden resulting from the development of this post offices infrastructure.

**Financial Results Sri Lanka Post 1992 -2002** (in 000s of LK rupees)

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Operating income</td>
<td>1,130,167</td>
<td>856,304</td>
<td>1,320,943</td>
<td>1,402,640</td>
<td>2,125,000</td>
</tr>
<tr>
<td>Operating expense</td>
<td>1,032,702</td>
<td>1,397,216</td>
<td>1,557,915</td>
<td>1,713,200</td>
<td>2,819,000</td>
</tr>
<tr>
<td>Capital investment</td>
<td>138,933</td>
<td>124,121</td>
<td>168,845</td>
<td>150,700</td>
<td></td>
</tr>
<tr>
<td>Profit/loss</td>
<td>(41,468)</td>
<td>(665,033)</td>
<td>(405,817)</td>
<td>(461,440)</td>
<td>(694,000)</td>
</tr>
</tbody>
</table>


**Financial Impact of Post Office Network Development** (in 000s of LK rupees)

<table>
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</tr>
</thead>
<tbody>
<tr>
<td>Operating income</td>
<td>1,130,167</td>
<td>856,304</td>
<td>1,320,943</td>
<td>2,125,000</td>
</tr>
<tr>
<td>Number of post offices</td>
<td>4043</td>
<td>4058</td>
<td>4151</td>
<td>4452</td>
</tr>
<tr>
<td>Income per post office</td>
<td>279.54</td>
<td>211.02</td>
<td>318.22</td>
<td>477.31</td>
</tr>
<tr>
<td>New post offices</td>
<td>27</td>
<td>15</td>
<td>93</td>
<td>34*</td>
</tr>
<tr>
<td>Capital expenditure</td>
<td>138,933</td>
<td>124,121</td>
<td>168,845</td>
<td></td>
</tr>
<tr>
<td>Capital expenditure per post office</td>
<td>34.36</td>
<td>30.59</td>
<td>40.68</td>
<td></td>
</tr>
<tr>
<td>Operating expense</td>
<td>1,032,702</td>
<td>1,397,216</td>
<td>1,557,915</td>
<td>2,819,000</td>
</tr>
<tr>
<td>Operating expense per post office</td>
<td>255.43</td>
<td>344.31</td>
<td>375.31</td>
<td>633.20</td>
</tr>
<tr>
<td>Loss per post office</td>
<td>(10.25)</td>
<td>(163.88)</td>
<td>(97.77)</td>
<td>(155.90)</td>
</tr>
</tbody>
</table>

* Agencies only

The lack of a business process that questions or reviews how the individual post office manages its primary business of collecting, processing, and sorting mail has also exacerbated the tendency to expand the network. Post offices and sub-post offices feature separate counters for each type of transaction, and only a few post offices (less than 150) have automated counters. This results in a high number of underutilized staff and

\textsuperscript{2} The electronic money order is a creative alternative available to people who cannot afford, or do not have access to, credit cards. The e-money order is a standard money order enhanced by an electronic aspect to allow faster, reliable, and more convenient service to a wider section of the population.
inconvenience for clients because they must queue for each transaction. The lack of other projects (e.g., sorting centers, computerization), however, suggests an investment policy directed at expanding the postal infrastructure and increases of fixed cost (to maintain the post office and to hire staff) without business rationale.

The privatization of the ownership and management of a significant number of the 3,500 sub-post offices is expected to have a dramatic impact on the Sri Lanka Post, its culture, quality of service, and financial performance. The transformation could release a sizeable amount of cash currently tied up in non-earning fixed assets that could be redirected into commercially/economically sensible projects. The Sri Lanka Post would also see a sharp reduction in fixed cost (related to employment and maintenance of the postal offices), and would have to deal with flexible cost related to earnings. Private entrepreneurs would commercially manage the small post offices, challenge government-owned post offices to match quality and customer-oriented services, and broaden sales with other products and value-added services to generate sufficient turnover per square meter or per person employed. The postal network would need to increase overall cost-efficiency and, most of all, implement commercial management and MIS.

2—The Financial Services Market and the Role of the Sri Lanka Postal Network

While the existing postal financial services have seen little change over the past decades, the financial sector in Sri Lanka has been undergoing quite a metamorphosis, and has developed into a relatively sophisticated, competitive, and diverse sector of industry. The banking system includes the Central Bank of Sri Lanka, two large state-owned banks, and more than 20 privately-owned commercial banks. Moreover, there are more than 10 regional rural development banks plus co-operative lending societies, development finance institutions, and a state mortgage and investment company, as well as the National Savings Bank. In addition, 13 insurance companies (all private), pension funds, and employee trust funds have begun to mobilize large pools of long-term resources.

In spite of the diversity of the banking sector, the government-owned institutions (Bank of Ceylon, People’s Bank, and NSB) still dominate the financial system. Private banks do compete, but not through aggressive pricing—they prefer to increase their margins, which are quite wide because the government-owned banks suffer from many inefficiencies and weaknesses in their operations. (These are being addressed through specific programs and measures, under the supervision of the Central Bank). Private banks offer a range of sophisticated, up-to-date services for those people with higher incomes. The services packages include high-tech features, such phone banking, mobile banking, electronic banking, debit and credit cards, as well as personal banking relationship officers and private bankers and advisers. It is estimated that these banks serve more than a half million individuals, mainly in urban areas.

The banking sector operates through nearly 1,200 outlets. For commercial banking purposes, this may arguably be a high figure; for consumer banking, it indicates a low level of “bankarization.” A ratio of 1 outlet per 16,700 inhabitants is low compared to developed countries where the ratio varies in the range of 1 outlet per 1,000–5,000.

The Payment System

The payment system in Sri Lanka is relatively well developed. For cashless payments, the Central Bank of Sri Lanka developed payment systems and instruments that comply with the core principles for payment systems defined by the Bank for International Settlements in Basel. The payment system consists of a real-time gross settlement system, (mainly for large payments), the Sri Lanka interbank payment system (mainly for credit transfers, direct debit transfers, standing orders, and paperless payment instructions), four check clearing houses, and several smaller regional check clearing houses.
Although critically important steps have been implemented to ensure a sound payment system, the system is essentially paper-based and check-based. A project to image-process checks is underway, but most checks require manual data entry and processing.

The volume of (retail) cashless payments in Sri Lanka in 2003 was:
- 36.5 million checks;
- 2.1 million direct transfers (SLIPS);
- 33 million cash withdrawals at automated teller machines (ATM); and
- 7.7 million electronic fund transfers at point-of-sale (EFT POS).

Total cashless payments were below 80 million in 2003, and translated into slightly more than four cashless payments per capita. This is relatively very low, especially if GDP per capita is taken into account. Fewer than 500,000 credit/debit cards were issued in Sri Lanka as of year-end 2003 (mainly credit cards, and relatively few debit cards.) Approximately 528,000 customers made use of other options, such as Internet banking, mobile banking, and telebanking. The total number of these transactions was 293,812 in 2003, suggesting that these advanced payment instruments were actually used by a privileged group of about 500,000 Sri Lankans—about 10 percent of the population. At 2003 year-end, this group had about LKR 76 billion in transferable deposits, or an average of USD 1,347 per account.

The other 90 percent of Sri Lankans is essentially excluded from cashless payments instruments and are confined to using cash, since they do not qualify for checking accounts or credit cards. The cash component in M1 (currency in circulation with the public) amounted to LKR 85 billion and represented 52 percent of M1 at the end of 2003, the equivalent of USD 39 per capita. Sri Lanka has not significantly progressed in transforming M1 from cash to cashless: at the end of 1996, the cash component was 55 percent (then LKR 47 billion).

Sri Lanka had 721 ATMs at the end of 2003, increasing by 20–25 percent per year. Currently there is 1 ATM per 27,000 inhabitants. There were 5,114 EFT POS terminals in Sri Lanka at the end of 2003, a significant increase from 4,250 at the end of 2002 (1 terminal per 3,800 inhabitants).

The post office fulfills a valuable function in the payments system of Sri Lanka. It processes about 2.2 million (inland) postal money orders, a person-to-person money transfer instrument. The averaged payment was USD 31 in 2002, and increased by 20 percent in 2003. Telegraph and fax money orders also increased in demand and value. Total value of money orders processed in 2003 exceeded LKR 13 billion (USD 11 million), or about 15 percent of cash in circulation. The post offices processed 15 million other payments, such as pensions, social benefits, collection of utility bills, collection of spot fines, and fees for radio and television licenses. These transactions are a small part of the total operations volume of Sri Lanka Post, compared to mail, estimated at about 600 million (mail) pieces in 2002. However the financial service transactions are a significant flow of business, estimated to be 30 percent of total over-the-counter transactions. The 17 million financial service transactions per year translate into an average of 13 transactions per day per post office.

Recurrent payments (for utility, rent, taxes, etc.) can also be made at bank branches and the NSB. The volumes and value of these payments are not reported by the Central Bank, but it suggests that the postal network processes a significant number of the bulk small-value payments and person-to-person payments, more than 10 percent of the overall market. There also appears to be a tendency by commercial banks to outsource cash-based, small-value payments to Sri Lanka Post, and other retail networks.

It is widely accepted that the use of cashless payment instruments contributes to financial sector stability and efficiency and economic growth. For rapid (i.e., within 7 to 15 years) transformation from cash to a cashless payment system, a dense network with easy access to cost-efficient payment products, such as offered by Sri Lanka Post, is a prerequisite. Also, economies of scale need to be achieved to earn back the capital expenditure in a payments infrastructure including ATMs, EFT POS, and EBPP (electronic bill presentation and payment) terminals.

The post offices could build upon its existing competence and reputation in payments processing, and add modern ICT to provide an accessible and economical infrastructure providing payments services that do not
include individual credit risk assessment, such as debit cards, and (giro) credit transfers. The current infrastructure of bank branches, their location, and profile in the market are unlikely to contribute to rapid transformation from cash to cashless payments. **Commercial banks are unlikely to consider low- and medium-income visitors for cash payments as attractive business,** and these individuals are unlikely be comfortable enough to request account and payment card products. Alternative networks—retail chains, petrol stations and micro finance outlets—should be considered too. However none of these networks have the density, standardization/uniformity of service, and low threshold profile of the postal network, which is, already significantly involved in payments processing.

Even though the use of the financial services at post offices is not intensive, it appeared from previous visits and interviews that most adult Sri Lanka citizens are aware of the existence of these products, and the role of the post office. This awareness is not created by advertisement campaigns, but stems from visits to the post offices. If marketing were applied, the profile of the post office and the usage could be increased.

### Savings and Deposits

Sri Lanka’s low savings quote, 12 percent of GDP in 1996 which improved to 14.4 percent in 2002, is significantly lower than in neighboring countries (more than 20 percent) and is a major constraint on economic development. As a consequence, Sri Lanka relies on more costly finance from abroad.

The inefficiency of the state-owned banks and the focus of private banks on widening margins explain in large part the **absence of true competition for the deposits of the mass of consumers with average and below average incomes.** Unattractive pricing and inadequate products do not promote a demand for services, which explains to a certain extent why a large percent of the working population still receives regular income in cash, rather than in an account, and why a significant large part (greater than 52 percent) of M1 remains in cash, unlike other countries where only 20–30 percent of M1 is cash.

Sri Lanka Post's role in mobilizing savings has gradually been marginalized as shown in the table below. Market share of household deposits held in the post offices has declined from more than 25 percent in 1971, to less than 3 percent in 1995, to 1.5 percent in 2002.

<table>
<thead>
<tr>
<th>Postal Savings</th>
<th>1995</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Postal savings accounts (in millions)</td>
<td>4.3</td>
<td>4.7</td>
<td>4.7</td>
<td>4.8</td>
</tr>
<tr>
<td>Total savings accounts NSB (in millions)</td>
<td>11.6</td>
<td>12.9</td>
<td>13.1</td>
<td>13.5</td>
</tr>
<tr>
<td>Share of post office (in NSB)</td>
<td>37.2 %</td>
<td>36.4 %</td>
<td>35.9 %</td>
<td>35.6 %</td>
</tr>
<tr>
<td>Postal savings balances (in LKR billions)</td>
<td>7.2</td>
<td>7.4</td>
<td>6.6</td>
<td>7.1</td>
</tr>
<tr>
<td>Total NSB balances (in LKR billions)</td>
<td>60</td>
<td>105</td>
<td>118</td>
<td>134</td>
</tr>
<tr>
<td>Share of post office (in NSB)</td>
<td>12 %</td>
<td>7.05 %</td>
<td>5.59 %</td>
<td>5.30 %</td>
</tr>
</tbody>
</table>

From NSB annual reports; UPU Statistics; Central Bank of Sri Lanka annual reports 1995–2002

Currently, **more than 4.8 million people (about half of the adult population) have a savings account with the post offices.** With 2 million transactions per year only, and an average balance per account of USD 11.29 (down from USD 30 in 1995), one can presume that a large number (greater than 80 percent) of the accounts are dormant. This points to about 900,000 active savers, who make two or three deposits or withdrawals per year and have an average balance of USD 75–100. The active client group is probably made up of small rural savers and senior poor urban citizens who would not have access to other financial outlets, and who continue using the post offices as a matter of habit.

**NSB figures suggest that 2 of every 3 Sri Lankans are depositors with NSB.** However, it is also assumed that **many of the 8.7 million accounts of this group are dormant or inactive.** Fitch Ratings—on the basis of information provided by NSB—reported that about 50 percent of the accounts are dormant. This still seems an
optimistic estimate. If the same of other savings banks that provide pass books and certificates (i.e., 85 percent inactive) also apply to NSB, the number of active savers would be around 1.3 million. This figure matches the actual size of the NSB network, with 101 branches and 245 school branches.

The continuous decline of postal savings should be attributed to the weak marketing strategy of NSB that tends to ignore the benefits of postal network and to focus only on sales through its own 101 branches that are mainly located in urban areas. There are no products geared to the needs of the visitors of the postal network, and no advertisements or promotions to attract potential clients to NSB services at post offices. Apparently to appease the post office, in the late 1990s, NSB established seven bank branches in the largest post offices.

**NSB has very limited products for the retail clients** because it is basically a savings bank. It does not widely offer payment products although it is involved in bill collection, transfers, and issues cards. It does not offer consumer credit, microenterprise credit, insurance, securities, or mutual funds. Deposits coming through the postal network are relatively insignificant for NSB, and from interviews it was learned that NSB views the quality of service at post offices as poor and inadequate compared to its own levels of service. Given its own constraints, NSB cannot upgrade the operations at post offices or provide staff training and incentives either. In a strategic review of NSB, one might question why NSB should continue the operation through the post offices.

The NSB—as a narrow state savings bank with its own branch network—is possibly not the most suitable partner for the Sri Lanka Post to develop and modernize its financial services and to provide financial services through its dense network. The current agency agreement is a historic legacy. Moreover NSB’s own institutional weaknesses and need to modernize preclude an effective and innovative process with Sri Lanka Post. NSB’s unproductive relationship with the post actually contributes to the drain of the Post on the government budget and effectively prevents the introduction of competitive and attractive financial services to the post.

If the postal network with its 4,600 outlets were to effectively provide access to financial services, and contribute to greater efficiency in the financial intermediation, terminating the exclusivity in the arrangement with the NSB is the first prerequisite step. The Sri Lanka Post has the market penetration to capture a larger part of the idle money by collecting deposits on a competitive basis. To this end, it should be able to conclude a partnership with a different financial institution that has a strategic interest in marketing through the post office. The combination of cashless payments instruments (cards, accounts), particularly, and deposits could form the basis for the postal network to re-enter the financial infrastructure, by providing low-threshold access to basic financial services.

**Remittances**

The remittance flow from the approximately 1 million Sri Lankans abroad was estimated at more than USD 1 billion in 2003. About 800,000 of the expatriots are women employed in Middle East as domestic help. The remittances are critically important, and funded about 73 percent of Sri Lanka’s trade deficit in 2003. Over the past 10 years, the flow of remittances has been consistently larger than aid and foreign direct investment in Sri Lanka. Global operators, such as Western Union and MoneyGram, have a relatively small share of this business, less than 15 percent of the total.

**It is remarkable is that NSB is not involved in capturing these international remittances.** NSB would be the obvious vehicle for this, allowing overseas workers to send money home to a savings account of the beneficiary family member. This could be a convenient solution for the postal savers as well. NSB reportedly has considered linking up with international providers of remittances, but has not concluded any arrangement yet. If NSB entered this business, it would probably introduce a stand-alone product, because it cannot comply with IT and operation requirements for such service.

Sri Lanka Post has had a long-standing though relatively insignificant role in processing remittances. It deals with about 20,000 remittances, mainly from India and the U.K. per year, with a value of LKR 400 million in 2003 (about USD 4 million)—less than 0.5 percent of the market. Sri Lanka Post has been approached by
representatives of MoneyGram and Western Union among others to become an agent, but contracts have not been signed.

On a bilateral basis, Sri Lanka Post has struck an agreement with the United Arab Emirates Post to exchange postal money orders electronically. UAE Post will help Sri Lanka Post with the installation of necessary software and training. This appears as a useful step to improve the level of service with one of the key markets from whence remittances originate. Eurogiro membership might also be helpful and implementation of the newly developed tele-money order might provide much better coverage.

**Insurance**

The Sri Lankan insurance industry was nationalized in 1961, liberalized in 1987, and is now almost entirely run by the private sector. There are a total of 13 insurance companies, two of which deal solely with life insurance. The sector accounts for around 2.5 percent of total financial sector assets, and is becoming increasingly competitive as a larger number of market participants appear. In 2003, premiums written grew by 16 percent. Despite its strong growth and improving penetration levels, the Sri Lanka insurance market is still small in scale with total gross premiums written amounting to LKR 24 billion (USD 250 million) split between life and other insurance premiums. Access to insurance products seems to be very limited.

Sri Lanka Post has concluded agency agreements with several of the smaller insurance companies to collect premium payments. One approach to utilizing the postal network to sell insurance products could be to launch innovative, yet very simple standard “sure savings” plans that promote savings propensity and usage of life insurance.

**Credit**

Like other sophisticated retail banking products, the portfolio of consumer credit appears very limited in Sri Lanka. It stood at approximately LKR 40 billion at the end of 2003. Credit extended by commercial banks to individuals for consumption equals USD 21 consumer credit per capita. Although detailed data is lacking, it is assumed that only a portion of the 500,000 Sri Lankans that have check books and/or credit cards actually qualify for consumer loans from commercial banks. In that case, the total consumer credit portfolio would include 200,000–250,000 contracts with an average value of USD 2,000 per loan.

The Sri Lankan experience with microcredit or microfinance differs substantially from Indonesia and the Philippines. Dominated by co-operatives and government microcredit programs, it also has a long history of subsidization—about 33 percent of microcredit comes through government programs, which are supply driven and not sustainable. Because microfinance is highly subsidized, only a few private commercial banks have entered the sector. Outreach appears broad although commercialization is still in early stages. The types of institutions engaged in microfinance include cooperative rural banks (CRB) and their branches, registered primary societies of the thrift and credit cooperative societies (TCCS), and non-governmental organizations (NGOs) and microfinance institutions (MFIs).³

While these organizations have a commercial orientation to microfinance, there are substantial disincentives for much of the private financial sector pursuing microfinance. Less than one-third of the credit provided is estimated to come from commercial programs. Non-commercial providers of microfinance include unsustainable government microfinance programs, many poorly performing CRBs and TCCSs, and 200 or more small or medium-size NGO MFIs that are weak. Co-ops provide 50 percent of the microfinance loans, with another 42.5 percent coming from government and quasi-government sources. NGOs provide only 5 percent of the loans, and the private sector only a bit more than 1 percent.

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³ Data and comments on Sri Lanka have been drawn from Stephanie Charitonenko and Dulan de Silva, “Commercialization of Microfinance: Perspectives from Sri Lanka” (Manila: Asian Development Bank, 2002).
Constraints to commercialization and sustainability in microfinance stem from a lack of standard accounting and best-practice management principles, and co-operatives ownerships which put the microfinance activities under the ownership and management of multi-purpose co-op societies, which often absorb the profits of the CRBS into their other loss-making activities. High costs, along with weak administrative and financial controls, are common throughout the MFI sector.

Unlike the experience in India and other Asian countries, the Sri Lankan market is considered to be approaching saturation with nearly 80 percent of potential demand for microcredit being satisfied. Based on household data and the current average outstanding microloan (USD 193), demand is estimated to be around USD 259 million, with 2.3 million loans. Although explicit data regarding points of service are not available, there are 8,000 registered TCCSs, as well as more than 200 NGO MFIs, the networks of the CRBs, and a few commercial banks engaged. This compares well to the dense postal network, which is not active in microfinance. A deeper assessment would be useful to compare the TCCSs to the post offices with an eye to strengthening and commercializing the provision of microfinance.

If the postal network were to offer an enhanced portfolio of financial services and provide outreach to rural area through its network, the inclusion of standard credit products (linked to the actual usage of payments and savings and/or insurance accounts) would be a logical step. If Sri Lanka Post were partnered with a commercially-driven private-sector institution, it could contribute to the competition and commercialization of the microfinance industry in Sri Lanka.

**Assessment of Sri Lanka in Providing Access to Financial Services**

As the previous sections have shown, Sri Lanka Posts has been a national channel for payments and savings collection for more than 125 years. Today, it provides a limited range of basic financial services in a competitive environment, but they are a marginal, loss-making element in both the postal and financial sectors. One might therefore expect that postal financial services will be gradually phased out, unless Sri Lanka Post replaces the current, antiquated operations, develops cost-effective and efficient services, and eventually links up with private-sector, market-driven, capable financial institutions.

The rationale for Sri Lanka Post to do this should be the draw of additional income that it could realize by exploiting its network and infrastructure. It could become financially self-reliant and be able to upgrade its overall service level. It would also contribute to employment and to improve labor conditions. For the government of Sri Lanka, the rationale to promote postal financial services is wider, not restricted to only transforming Sri Lanka Post into a financially self-reliant company. The postal financial services could also support the government’s intent to:

- broaden access to ICT;
- make the transformation to a cashless payment system and thus support financial sector stability and efficiency;
- provide more formal channels for remittances; and
- provide wider access to financial services and the formal financial sector to more of the population, including those people living in rural areas and low-income segments, whom banks do not target.

The business mission of Sri Lanka Post regarding financial services should be to actively position itself as a national channel for payments and transfer instruments among all sections of the population, and eventually become a full-fledged distribution channel for a range of financial services for mass consumers.

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4 CRBs are part of multi-purpose co-operative societies and as such do not have separate financial statements. Their profitability is difficult to estimate although their potential is regarded as quite good with revised practices. About 80 percent of the portfolios of CRBs are microfinance.
Assessment of the Current Condition of Sri Lanka Postal Financial Services

<table>
<thead>
<tr>
<th>Aspects</th>
<th>Focus/Capabilities</th>
<th>Weaknesses</th>
<th>Improvements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marketing</td>
<td>• Post office location policy</td>
<td>• Absence of client orientation</td>
<td>• Market and business oriented approach required</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Market performance responsibilities</td>
<td>• Commercial management needed</td>
</tr>
<tr>
<td>Management</td>
<td>• Budget oriented</td>
<td>• Procedure oriented</td>
<td>• Postal reform may offer rehabilitation</td>
</tr>
<tr>
<td></td>
<td>• Increasing momentum for change</td>
<td>• Lack of market orientation</td>
<td>• Labor unions more open to overall change program</td>
</tr>
<tr>
<td>Organization</td>
<td>• Organic structure without clear accountabilities</td>
<td>• Bureaucratic</td>
<td>• Total restructuring required</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Not market oriented</td>
<td>• Need for 5-year program of change</td>
</tr>
<tr>
<td>Human resources</td>
<td>• Under-developed</td>
<td>• Urgent need for professionalization</td>
<td>• Training must have priority</td>
</tr>
<tr>
<td></td>
<td>• Serious cultural lag and quality gap with business sector</td>
<td>• Need for upgrading program which covers all aspects of HR</td>
<td>• Review of curricula for training together with main clients</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Need for external trainers</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Need for “training-the-trainer” program</td>
</tr>
<tr>
<td>Financial accounting</td>
<td>• Mainly cost accounting</td>
<td>• Urgent need for professionalization</td>
<td>• Computerization of money orders</td>
</tr>
<tr>
<td></td>
<td>• Poor level of performance</td>
<td>• Priority commercial accounting</td>
<td>• Computerization is high priority for administration and improvement of MIS</td>
</tr>
<tr>
<td></td>
<td>• Serious backlog in processing money orders</td>
<td>• Priority financial and cost accounting</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• MIS non-existent</td>
<td>• Set up management accounting</td>
<td></td>
</tr>
<tr>
<td>Technology</td>
<td>• Under-developed</td>
<td>• Poor performance of front office and back office services</td>
<td>• Technology at lower cost available in the future</td>
</tr>
<tr>
<td></td>
<td>• Need to review mail and counter processing and upgrade to postal technology</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Finance</td>
<td>• Increasing deficits</td>
<td>• Review of investment priorities is needed</td>
<td>• Need for franchising of post offices and</td>
</tr>
<tr>
<td></td>
<td>• Budget deficits absorb much management attention</td>
<td>• Upgrading core post offices is a priority</td>
<td>• Full cost coverage of services</td>
</tr>
</tbody>
</table>

3—Options for Development

Sri Lanka Post should try to conclude more arrangements with overseas postal entities to capture a bigger slice of the remittance flows, such as joining the Eurogiro network (more than 41 countries participate) and implementing the new tele-money order service. Also, Sri Lanka Post should seek to capture more business by offering its services to various institutions, such as Bank of Ceylon, the Sri Lanka National Insurance Corporation, to collect bills and premiums on their behalf. Most of these institutions are interested
in the dense post office network as a low-cost channel for collection of bills from people who do not have an account or an established relationship with a bank or financial institution.

Eventually, these collection services could be offered to all financial institutions, as well as to government departments (e.g., tax collection), which presently maintain their own collection mechanisms and networks.

For various reasons, cooperation with the Bank of Ceylon would be a particularly interesting option to generate more business in the short term. Bank of Ceylon is the state-owned commercial bank, which services the current accounts of most state enterprises, including public utility enterprises. Therefore, it deals with bulk flows of small value transactions. Currently, these payments are settled through its own network of approximately 300 outlets. Expanding this network is not foreseen in the short term, and the Bank of Ceylon may want to consider transferring the less attractive, costly operations and non-clients to the post offices, which could act as an ancillary network for the banks. This would be particularly realistic if Sri Lanka Post continues to computerize its counter operations at main post offices, and if the terminals at counters communicate with the computer systems of the Bank of Ceylon (or other banks). Alternatively, the post office computer terminal could transmit payment data into the banks’ automated clearing house.

It should also be noted that the revenues from these services are not likely to be sustainable in the medium and longer term. As the development of the financial sector continues, increasingly more people will establish a banking relationship (including a current account and a credit or debit card), so the need for an ancillary network for bill collection may gradually diminish. Sri Lanka Post needs to pursue a veritable partnership with a banking institution as low-cost distribution and retail outlet channel for basic financial services, as well build up a profile and position as a key network for consumer banking. It could also support direct banking or direct marketing through its post office network.

If Sri Lanka Post partners with the banks, the 19.5-million people in Sri Lanka would have access to the formal financial sector through more than 5,800 points rather than the 1,200 bank branches and agencies. However, at this moment the gap between current operations and management culture is very wide, and Sri Lanka Post would need to meet a number of minimum requirements before inviting such institutions into such a partnership, such as:

- An accountable entity within Sri Lanka Post with responsibility for the execution of the postal financial services, and which can introduce new products. This could be realized by setting up a specific management team for the business of postal financial services.
- Recent, consistent, externally audited and certified accounts (balance sheet, income statement, annual report) of the Sri Lanka Post, which the partner banking institution could check as a matter of due diligence, and which would give reliable insight into the market and financial performance of the Sri Lanka Posts, and its financial condition. Currently, Sri Lanka Post only produces an “administration” report with very limited information.
- A minimum degree of financial management and management accounting, including product profitability analysis and planning based on a detailed cost study, and including a cost allocation model.
- More efficient accounting procedures for customer transactions, supported by computerized counter transactions. Where computerization will not occur in the near future, a higher level of efficiency, timeliness, and reliability should be attained. The current practice, in which all operations are manually processed at different counters with a large number of forms, is inefficient and at high risk for inaccuracy and fraud.
- New post office “retail” formulas, defined for the approximately 3,800 sub-post offices and agencies, where existing staff or local private entrepreneurs operate under performance-based franchise agreements. This is essential to reduce the high number of fixed cost and fixed assets within Sri Lanka Post and to enhance customer orientation. The post office agents may need SME loans to train managers and sales staff, install IT equipment, and refurbish the post office. It is estimated that the transformation might take 7–12 years.

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5 The Central Bank of Sri Lanka has prohibited the state commercial banks from opening any new branches unless satisfactory profits are attained.
One or several small-scale demonstration projects to showcase the potential of Sri Lanka in providing better, and new, client services, such as extending the e-money order to include international e-money orders.

**Summary of Roles, Responsibilities, and Tasks for Sri Lanka Post and Partner Financial Institutions**

<table>
<thead>
<tr>
<th>SRI LANKA POST</th>
<th>PARTNER FINANCIAL INSTITUTION</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Marketing and Sales</strong></td>
<td><strong>Marketing and Sales</strong></td>
</tr>
<tr>
<td>• Promotions in post offices (posters, displays, brochures, etc.)</td>
<td>• Marketing strategy and planning</td>
</tr>
<tr>
<td>• Opening of accounts (intake of application forms)</td>
<td>• Product development, product definition</td>
</tr>
<tr>
<td>• Advice and information on product features</td>
<td>• Communications campaigns in public media and direct mail</td>
</tr>
<tr>
<td>• Cross-selling between postal and financial products</td>
<td>• Pricing for clients and end-users</td>
</tr>
<tr>
<td><strong>Operations</strong></td>
<td><strong>Operations</strong></td>
</tr>
<tr>
<td>• Front office operations, cashier/teller</td>
<td>• Back office operations</td>
</tr>
<tr>
<td>• Acceptance and handling of forms and cash</td>
<td>• Computerization/application of Information technology</td>
</tr>
<tr>
<td>• Reporting to bank, data communication with bank on transactions</td>
<td>• Determination of procedures and processes</td>
</tr>
<tr>
<td><strong>Staff</strong></td>
<td><strong>Staff</strong></td>
</tr>
<tr>
<td>• Recruits and employs staff at post office counters</td>
<td>• Determines staffing requirements for post office clerks</td>
</tr>
<tr>
<td>• Manages and controls staff</td>
<td>• Develops and provides training</td>
</tr>
<tr>
<td>• Counterpart staff for co-operation with bank</td>
<td>• Develops performance measurement instruments</td>
</tr>
<tr>
<td>• Counterpart staff for co-operation with bank</td>
<td>• Provides incentive schemes</td>
</tr>
<tr>
<td><strong>Finance</strong></td>
<td><strong>Finance</strong></td>
</tr>
<tr>
<td>• Charges for work performed on a full-cost basis</td>
<td>• Remains fully responsible for asset and risk management of funds attracted or extended through the post office network</td>
</tr>
<tr>
<td>• Charges for sales performance</td>
<td>• Determines accounting procedures, processes, and systems</td>
</tr>
<tr>
<td>• Charges for promotions in post offices</td>
<td>• Compensates SLP for costs made for promotions, administration, sales, processing</td>
</tr>
<tr>
<td>• Charges for investments in post offices, specifically made for financial services</td>
<td>• Co-fines investments in the post offices related to the execution of financial services</td>
</tr>
<tr>
<td>• Charge for availability of the network</td>
<td>• Provides cash management</td>
</tr>
</tbody>
</table>

**Partnership with Private Sector Financial Institutions**

Linking Sri Lanka Post with privately owned financial institutions for a stable and sustainable platform to create a postal financial services system still seems a somewhat distant option, given the failure of the attempt to establish such partnership in 1999–2000. Reputable institutions would probably not want to associate their image with the poor service quality and unreliable and untimely accounting procedures at the post offices, and risk their client relationships and financial performance. Co-operation with a private sector financial institution would necessitate significant reform and modernization of the post offices (including performance management and commercial accounting systems). Should pilot projects achieve tangible progress—presumably after 1–2 years—this option could be reassessed and might have a better chance. In the meantime, Sri Lanka Post could continue to cooperate with various private sector financial institutions (e.g., SANASA) to franchise postal agents in the bank’s branches, to reduce the proprietary network of the postal system and better utilize the unprofitable bank sub-branches. Partnerships with privately owned financial institutions are
the most preferable option, as it would keep the division between the postal and financial sector distinct. There are several modalities for this partnership: it could be a long-term agreement, a concession styled agreement, or a “build-operate-transfer” (BOT)-style operation.

**Partnership with a State Commercial Bank**

To link Sri Lanka Bank with one of the state commercial banks (Bank of Ceylon or the People’s Bank) would not seem a desirable option because this might complicate or protract the reform of these banks into more cost-efficient and profitable institutions. Moreover, these two state commercial Banks dominate the banking scene with strong, extensive branch networks (together some 800 outlets). They also have many government/public enterprise accounts and a market share in assets of more than 45 percent. Access to the postal network would actually lead to further market concentration in these banks and they could prevent competitors from gaining instant access to widespread network. However, in the short term, Sri Lanka Post’s agency agreements for bill collection for the Bank of Ceylon may be an opportunity worth continuing and expanding to produce more revenues for Sri Lanka Post.

**Partnership with Other Banks and Finance Companies**

The State Mortgage and Investment Bank is a relatively small bank, specialized in long-term lending for housing purposes. This bank presumably lacks the orientation, mission, and financial capability to set up a postal financial services system with Sri Lanka Post. The same applies to various other financial institutions, such as the Development Finance Corporation of Ceylon, and the National Development Bank, both of which are primarily interested in long-term resources to match their long-term lending. Taking the differences of finance companies, leasing companies, merchant banks, and venture capital companies into consideration, there seems to be little or no common business interests for joint venture with a postal bank. Venture capital companies perhaps might co-invest in a postal bank program, provided the expected rate of returns is attractive enough.

**Partnership with Regional Rural Development Banks**

There might be common business ground with the various rural and cooperative lending institutions. The regional rural development banks (RRDBs), which undergoing reform and privatization, operate in similar client segments as does Sri Lanka Post in its current operations. The RRDBs would be interested in low-cost resource mobilization, including demand deposits, and in expanding their branch networks, especially in rural areas. One could therefore imagine a partnership between RRDBs and Sri Lanka Post, in which Sri Lanka Post’s role would be savings mobilization, payment processing (including collection of loan installments) while the RRDBs would focus on client data base management, client acquisition, credit analysis and loan processing. Although it might be worthwhile to explore the possibility further of such a partnership, there are a few drawbacks in the development of a long-term, sustainable, joint operation of a postal financial services system.

Most of the RRDBs operate in specific regions or provinces only, whereas Sri Lanka Post operates nationwide and manages its operations from a national perspective. Regionalizing the postal services has not been contemplated, and from a managerial point of view, a relationship with the RRDBs would be more difficult to manage than with one national institution. Moreover, the operation volumes of the RRDBs are relatively small compared to Sri Lanka Post, and would not substantially contribute to Sri Lanka Post revenues. RRDBs are dependent on donor funding and government subsidies, especially now as they are undergoing reforms toward privatization, and are unlikely to have the necessary financial and managerial capability to develop a modern, efficient postal financial service system with Sri Lanka Post.
Partnership with Insurance Companies

The insurance market in Sri Lanka is growing rapidly, but is still very small in absolute terms. Sri Lanka Post might over time develop into an attractive channel for private insurance companies to sell policies and to collect premiums. To this end, Sri Lanka Post would need to explore the interest of the insurance companies in repackaging life insurance products into affordable, easy-to-understand products that can be sold over the post office counter. Sri Lanka Post would act as a sales agent for the insurance companies. The introduction of insurance products in post offices would also require investments in human capital, and proper and timely accounting procedures for the premiums collected.

Moreover, if an insurance company allied with a bank, a full range of financial services could be developed. It is noteworthy to mention neither direct writing nor bank assurance has been tested in Sri Lanka. If Sri Lanka Post was successful in forging relationships with both one or more banks and an insurer, it actually could emerge as an innovator in providing access to small-value, basic financial services.

A partnership with the Sri Lanka (National) Insurance Corporation could also be considered, but it already has a large established network of agents and the additional value of the post office network would be limited. The role of the post office network, though, in collecting premiums for the Sri Lanka Insurance Corporation, would be well within the current scope and capability of Sri Lanka Post, and could generate substantial additional revenues.

Rehabilitation of the Partnership with the National Savings Bank

Sri Lanka Post has had a working relationship with the National Savings Bank for more than 100 years. Moreover the postmaster general is a statutory member of NSB’s board of directors, and post offices are statutory outlets of the NSB. Sri Lanka Post provides a valuable service for the NSB with relatively low administration costs: only 0.3 percent of total collected deposits as compared with 1 percent for deposits through NSB’s own branches.

Nearly 4.8 million, mostly adult inhabitants of Sri Lanka have a postal savings pass book, which represents a market penetration of nearly 45 percent, even though its market share though has declined to less than 1.5 percent. NSB’s own position has come under increasing pressure due to its continual decline in market share and more alternatives available to consumers for banking their savings. There are an increasing number of competing financial institutions who offer a more and more competing products, including life insurance, pension plans, trust units, and modern deposit products.

Moreover, the function of the NSB as a low-cost funder of the Treasury, which bypasses the capital and money market, should become less relevant with the liberalization of the capital market and an open treasury bill market. This should undoubtedly add to a greater efficiency in the mobilization and allocation of financial resources.

Transforming NSB into a full-fledged commercial bank is a huge task and not feasible in the short or medium term. It would not only require additional capital injections but also reinforcement of management with a strong commercial orientation and a far-reaching recruitment and training program for staff in commercial bank operations and retail efficiency. A program that would transform NSB into a market driven, efficient, consumer-bank operation, which could later link with a private commercial bank (or be privatized) would be a more effective, sustainable and less costly course to pursue.

In this context, it is more a fall-back option for Sri Lanka Post—if a partnership with a private sector bank isn’t feasible—and taking the steps in the coming years to improve the intrinsic strength of Sri Lanka Post as an intermediary sales network for financial services would be more productive and have a more positive financial impact on Sri Lanka Post. It would be a most difficult task to transform and commercialize two public enterprises, Sri Lanka Post and NSB, than Sri Lanka Post only in conjunction with a private, competent

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6 It has dropped from more than 47.5 percent in 1986, to 32 percent in 1988, to 24 percent in 1996, to 17 percent in 2002.
institution. Intervention and supervision through outside catalysts (external consultants, central bank, and financiers) could be highly supportive to keep momentum in the process.

Annex 1

Outline for Developing Financial Services Delivery in Sri Lanka

This is a preliminary road map to develop and expand the financial service delivery through Sri Lanka Post. The development could be subdivided into three major phases:

A. Preparatory and pilot phase (1–2 years)
B. Implementation phase (2–3 years)
C. Roll out and expansion phase (3 years)

The first phase should aim at preparation and implementation of:

- Financial service business unit management;
- Financial accounting processes;
- Marketing and management information systems;
- Business process redesign for postal counters;
- Pilot projects; and
- Preparation of partnership agreements.

Focus should be on repositioning the post office retail network to provide broad-based access to simple, standardized financial services, as well as other services that make use of information and communication technology. In phase 1, Sri Lanka Post should also expand its services in electronic international remittances and bill collection with support of counter automation and on-line data communication. The network that has been created for the e-money-order service could be used as an initial platform for remittances and bill collection, and gradually more post offices could be involved. In addition, networked post offices could function as "hubs" for data entry of bills paid at other post offices in the same area, and for hybrid money orders, to be disbursed at the post offices in the area or district of the connected post office.

A second phase could introduce card-based payment services, including accounts that can be linked to deposit accounts, credit accounts, and insurance policies.

As a follow-up phase, the information and communication technology infrastructure could be further expanded and applications expanded to make the post office a central access point for a broad range of financial and other services, such as e-government, e-learning and e-commerce.

Gradually expanding the network and applications makes allowance for a learning curve for the organization and its staff, clientele, and stakeholders. Another suggestion is that network development start with upgrading and expanding those existing business flows where Sri Lanka Post has a certain amount of competence and turnover. It should not start by entering new markets, with their higher hurdles and new requirements.

Starting with international remittances and processing bill payments could lead to a positive cash flow within a relatively short time. It is assumed that positive operational results and subsequent profitability will be re-invested into expanding the network, through a separate accountable entity. Earnings should not be absorbed by the deficits in the mail section, and capital expenditure should become a function of business performance and prospects rather than being part of the annual government budget.

If the option of developing partnerships with the private sector is pursued, it will require engineering a specific public-private sector partnership. A possible constellation is depicted in the chart below, in which a new company for e-services (through post offices) is the vehicle for the public-private sector partnership.
Annex 2

Matrix of Options for a Postal Financial Services System in Sri Lanka

<table>
<thead>
<tr>
<th>Option 1 Posts</th>
<th>Option 2 Private Sector Bank</th>
<th>Option 3 Private Sector Insurance Company</th>
<th>Option 4 National Savings Bank</th>
<th>Option 5 a State Commercial Bank</th>
<th>Option 6 Sri Lanka Insurance Corporation</th>
<th>Option 7 Other Financial Institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory Framework</td>
<td>No license for banking or insurance</td>
<td>Under license of the private sector bank</td>
<td>Under license of the insurance company</td>
<td>Under the 1971 National Savings Bank Act</td>
<td>Under license of the bank</td>
<td>Under license of the insurance corp.</td>
</tr>
<tr>
<td>Institutional Arrangement</td>
<td>Not applicable; service agreements with various entities possible</td>
<td>Contract; future joint venture and/or specific business units with Sri Lanka Post and bank</td>
<td>Contract; future joint venture and/or specific business units</td>
<td>In accordance with the 1971 NSB Act; organizational interfaces need to be strengthened</td>
<td>Contract, on non-exclusive basis</td>
<td>Contract on non-exclusive basis</td>
</tr>
<tr>
<td>Product Portfolio</td>
<td>Confinement to money orders, bill collection, disbursement of pension payments</td>
<td>Can develop a full package of consumer and retail banking services, targeting different age groups, income groups, etc.</td>
<td>Can develop as an attractive service in addition to banking</td>
<td>Can gradually evolve from current savings products with existing 4.3-million client base to full range of banking services</td>
<td>Can develop from bill collection service to a package of basic services</td>
<td>Might develop from premium collections service to sales of some policies</td>
</tr>
<tr>
<td>Managerial Capabilities</td>
<td>Limited capabilities required</td>
<td>Recruit from private sector and banks; five competent managers to be responsible for a business unit</td>
<td>Recruit from private sector, see option 2</td>
<td>Already available to a certain extent, with NSB; needs further strengthening; for Sri Lanka Post, see option 2; technical assistance needed</td>
<td>See option 2</td>
<td>See option 2</td>
</tr>
<tr>
<td>Technological Requirements</td>
<td>Limited, can be restricted to back-office data entry and some communication</td>
<td>To be agreed on or determined by the bank; ascertain state-of-the art applications (chip cards)</td>
<td>To be agreed on or determined by the insurance company; ascertain state-of-the art application</td>
<td>Available for a few areas, needs considerable development; determine in joint project</td>
<td>To be agreed on with the bank, and/or provided by the insurance corporation</td>
<td>To be agreed on and/or provided by the insurance corporation</td>
</tr>
<tr>
<td>Human Resources Development</td>
<td>Within existing HR; further attention to timely processing</td>
<td>Program to be agreed on, and implemented by bank; might imply skilled banking officers in main post offices to supervise</td>
<td>Program to be agreed on, and implemented by insurance company; might imply insurance officers in main post offices</td>
<td>Program to be jointly implemented with NSB; 3 years technical assistance needed</td>
<td>Program to be determined with the bank and implemented by the bank</td>
<td>Program to be determined with the insurance corporation; training provided by the insurance corporation</td>
</tr>
</tbody>
</table>
The Role of Postal Networks in Expanding Access to Financial Services

Country Case: Uganda’s Postal Finance Services

The World Bank Group
Global Information and Communication Technology

Postbank Advisory, ING Bank
Postal Policy
Author’s Note

The paper provides a review of the public postal operator within the postal sector and the broader context of the Communications sector. Subsequently, the roles of the postal network and the Postbank are reviewed in the perspective of the financial sector development, with particular focus on payments systems development and micro finance.

This paper has been prepared from desk research in 2004. Field visits were not scheduled, but nevertheless interviews were held with some of the key managers of Postbank, and data was exchanged through conference calls and e-mails. Previous working experience with Posta Uganda and Postbank were useful in preparing the paper. There was limited data available regarding the financial sector (e.g., branches, outlets, ATMs) and the postal operator's annual reports.

While this country case on Uganda can stand alone, it is an integral part of this large study of the potential of postal networks to coordinate with financial service providers in 7 countries (Egypt, Kazakhstan, Namibia, Romania, Sri Lanka, Uganda, and Vietnam) and 5 regions (Africa, Asia, Eastern Europe and Central Asia, Latin America and the Caribbean, and the Middle East and Northern Africa).

Glossary of Abbreviations and Acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>BOT</td>
<td>build-operate-transfer</td>
</tr>
<tr>
<td>EDI</td>
<td>electronic data interchange</td>
</tr>
<tr>
<td>EFT POS</td>
<td>electronic fund transfer at point of sale</td>
</tr>
<tr>
<td>GDP</td>
<td>gross domestic product</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>M1</td>
<td>transferable deposits and cash in circulation</td>
</tr>
<tr>
<td>MFI</td>
<td>microfinance institution</td>
</tr>
<tr>
<td>NGO</td>
<td>non-governmental organization</td>
</tr>
<tr>
<td>PERD</td>
<td>Uganda Ministry of Finance</td>
</tr>
<tr>
<td>PTSP</td>
<td>private telephone service provider</td>
</tr>
<tr>
<td>SWOT</td>
<td>strengths, weaknesses, opportunities, and threats matrix</td>
</tr>
<tr>
<td>UCB</td>
<td>Uganda Commercial Bank</td>
</tr>
<tr>
<td>UCC</td>
<td>Uganda Communications Commission</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Programme</td>
</tr>
<tr>
<td>UGS</td>
<td>Uganda shilling</td>
</tr>
<tr>
<td>UPL</td>
<td>Uganda Post, Ltd.</td>
</tr>
<tr>
<td>UPOS</td>
<td>Uganda Post Office Savings Bank</td>
</tr>
<tr>
<td>UPU</td>
<td>Universal Postal Union</td>
</tr>
<tr>
<td>USD</td>
<td>United States dollar</td>
</tr>
<tr>
<td>VSAT</td>
<td>very small aperture terminal</td>
</tr>
<tr>
<td>WAN</td>
<td>wide-area network</td>
</tr>
</tbody>
</table>
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Summary

SWOT Analysis of Uganda Postal Service

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Opportunities</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Dense network with 320 post offices throughout the country</td>
<td>• Has used privatization as a means of attracting funding, human capital, and</td>
</tr>
<tr>
<td>• Growth in mail volume</td>
<td>new services and applications to provide competitive postal services</td>
</tr>
<tr>
<td>• Modern legal and institutional framework and postal sector policy</td>
<td>and transform post offices into a nationwide chain that provides access</td>
</tr>
<tr>
<td>being addressed by Uganda government</td>
<td>to ICT, telecommunications and basic financial services</td>
</tr>
<tr>
<td>• Relatively good level of awareness of rural and remote communities</td>
<td>• If restructures or upgrades its network could fill in voids in access</td>
</tr>
<tr>
<td>• On-going stream of visitors to pick up or bring mail, or to make a</td>
<td>to diverse financial services, payments, inter-national remittances,</td>
</tr>
<tr>
<td>phone call</td>
<td>savings, small credit, and insurance.</td>
</tr>
<tr>
<td>• Informal, familiar setting of postal network</td>
<td>• Given the small size of the organization and operation, a turnaround</td>
</tr>
<tr>
<td>• Relatively small operation (320 offices with less than 600 staff)</td>
<td>should be feasible in the short-term through relatively small-scale</td>
</tr>
<tr>
<td>presumed to break-even on operational revenues against operational</td>
<td>investments and new services and applications.</td>
</tr>
<tr>
<td>expenditure</td>
<td></td>
</tr>
<tr>
<td>• Positive connotation by the elderly generation of a tradition of a</td>
<td></td>
</tr>
<tr>
<td>post office savings bank before 1980</td>
<td></td>
</tr>
<tr>
<td>• Has used privatization as a means of attracting funding, human capital,</td>
<td></td>
</tr>
<tr>
<td>and new services and applications to provide competitive postal services</td>
<td></td>
</tr>
<tr>
<td>and transform post offices into a nationwide chain that provides</td>
<td></td>
</tr>
<tr>
<td>access to ICT, telecommunications and basic financial services</td>
<td></td>
</tr>
<tr>
<td>• If restructures or upgrades its network could fill in voids in access</td>
<td></td>
</tr>
<tr>
<td>to diverse financial services, payments, inter-national remittances,</td>
<td></td>
</tr>
<tr>
<td>savings, small credit, and insurance.</td>
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</tr>
<tr>
<td>• Given the small size of the organization and operation, a turnaround</td>
<td></td>
</tr>
<tr>
<td>should be feasible in the short-term through relatively small-scale</td>
<td></td>
</tr>
<tr>
<td>investments and new services and applications.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Weaknesses</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Narrow menu of services: mail, parcels, and express only; very low</td>
<td>• Policy and privatization process for the public postal operator is</td>
</tr>
<tr>
<td>demand for these services</td>
<td>not clearly determined, and is dependent on the Uganda Communications</td>
</tr>
<tr>
<td>• Very poor quality of services: no delivery of mail to home, shared</td>
<td>Commission and Uganda Ministry of Finance (PERD) which have to deal a</td>
</tr>
<tr>
<td>letter boxes, theft of mail</td>
<td>wide range of other priorities; also risks a protracted, unresolved</td>
</tr>
<tr>
<td>• Poor quality of postal network: minimal capital expenditure to</td>
<td>restructuring process.</td>
</tr>
<tr>
<td>maintain or improve the post office for more than 20 years</td>
<td>• Valuation of assets and current business volume is likely to be very</td>
</tr>
<tr>
<td>• Low pay scales leading to poor quality of staff</td>
<td>low or negative, and therefore not generating adequate private sector</td>
</tr>
<tr>
<td>• Financial services through Post Office Savings Bank (POSB) and</td>
<td>interest.</td>
</tr>
<tr>
<td>Postbank basically terminated</td>
<td>• There is continued resistance and interference from politicians,</td>
</tr>
<tr>
<td>• No strategic alliances with retail trade or communications suppliers</td>
<td>trade unions, and public opinion.</td>
</tr>
<tr>
<td>• Technology and management information systems not available</td>
<td></td>
</tr>
<tr>
<td>• No access to funding or finance to upgrade services</td>
<td></td>
</tr>
<tr>
<td>• Policy and privatization process for the public postal operator is</td>
<td></td>
</tr>
<tr>
<td>not clearly determined, and is dependent on the Uganda Communications</td>
<td></td>
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<tr>
<td>Commission and Uganda Ministry of Finance (PERD) which have to deal a</td>
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<td>low or negative, and therefore not generating adequate private sector</td>
<td></td>
</tr>
<tr>
<td>interest.</td>
<td></td>
</tr>
<tr>
<td>• There is continued resistance and interference from politicians,</td>
<td></td>
</tr>
<tr>
<td>trade unions, and public opinion.</td>
<td></td>
</tr>
</tbody>
</table>

1—Postal Sector Development

Uganda faces many challenges, but the main ones include restoring peace to parts of northern or north-eastern Uganda, combating HIV/AIDS, and eradicating extreme poverty. Despite many reforms and advances, Uganda remains one of the poorest nations in the world. For the rural people, particularly women and small-scale farmers, supporting themselves and their families remains a daunting task. Lack of sufficient access to appropriate financial services is one of their largest problems, and there remain many improvements needed to facilitate outreach to the population of Uganda, which is considered to be one of the most severely under-banked societies in Africa.
Origin of Modern Postal Services in Uganda

As in other parts of the world, written messages in Uganda were conveyed by mail runners stationed at various points along a given route until 1895 when Rev. Earnest Miller of the Church Missionaries Society introduced modern postal services in the country. He designed and produced the first postage stamp on his typewriter (the only one in the country at the time). Postal services were then mainly used by the colonial government to distribute documents to and from the various administrative centers inside and outside the country.

In 1933 the postal and telecommunications services of Kenya, Uganda and Tanganyika were merged with the establishment of the East African High Commission. In 1948, the Posts and Telegraphs Department became a High Commission service. When the East African Community (EAC) was established in 1968, the East African Posts and Telecommunications Corporation (EAP & TC) was formed to manage postal services in the region. EAP & TC maintained the services until 1977 when the EAC collapsed and a caretaker organization, Uganda Posts and Telecommunications Corporation (UPTC), was formed by Decree No.15/1977, to take over EAP&TC affairs in Uganda. Postal sub-sectors started opening up when UPTC licensed DHL and other international couriers as early as 1987.

In 1987, under its Economic Recovery Program, the Uganda government recognized the need to comprehensively reform its public sector, in order to reduce the financial and administrative burden of managing state-owned enterprises. The objectives behind this policy were:

- To reduce the direct role of government in the economy;
- To promote a greater role of the private sector in the economy; and
- To improve the efficiency and performance of private enterprises.

Following this liberal policy, in 1993 the government set up a multi-sectoral, inter-ministerial committee on investments in telecommunications, which was charged with the primary responsibility of making recommendations to the government on what reforms were needed in the communications industry. The report of this committee was adopted by the government in 1994 and was the precursor to the subsequent reform program in the communications sector. In 1996 a World Bank-funded program helped the Ministry of Finance's Public Enterprises Reform and Divestiture Unit prepare a postal sector development strategy, and a business plan for UPL, the postal network, and the Post Office Savings Bank. This led to inputs for a new communications bill, the Uganda Communications Act No. 8/1997, which provided for:

- a legal and policy framework for the development of the communications sector;
- the creation of an independent regulator, the Uganda Communications Commission; and
- the unbundling of the Uganda Posts and Telecommunications Corporation and creation of three new enterprises, Uganda Telecom, Ltd., Uganda Post, Ltd., and Post Bank, Ltd.

Since the liberalization of the communications sector, one national postal operator, Uganda Post, Ltd. (UPL), and several private operators have been licensed to operate in the postal sector. In spite of growing interest by private operators in the industry, there seems to be no clear policy on postal sector development. From 1996 to 2003, total licenses for private international and regional couriers, and domestic post (including UPL) increased from 8 to 17. The bulk of postal services are still being offered by UPL, which is wholly owned by government and still enjoys an extensive monopoly on the market.

Liberalization of the Postal Industry in Uganda

UPL was incorporated in 1998 as a limited liability company (renamed as Post Uganda) and now holds a major operator’s license with the mission “to provide universal, efficient, competitive, viable, and customer-oriented postal services at affordable charges” along with 16 licensed private courier companies. The three-year,
Reserved Services

The major operator’s license issued to UPL gave it exclusive rights to deliver letters up to 1000 grams (at affordable and uniform tariffs) throughout Uganda, and a monopoly to issue postage stamps, pre-stamped envelopes, aerogram forms, and international reply coupons. UPL is also required to accept, convey, and deliver all postal articles weighing up to 10 kilograms countrywide. Mandatory services also include serving private letter boxes, as well as remittance and philatelic services. The other services included in the major operator license include express mail, registered mail, parcel services, courier services, e-mail, Internet, and other agency services. Except for these “other” services, postal services are reserved or qualified as mandatory in the Uganda Communications Act\(^3\) to enable UPL defray some of the costs associated with providing universal service. The scope of the reserved area appears to be very broad and extensive and to formally limit the liberalization of the postal sector.

Private Courier Services

The need by customers for faster, more secure, and more efficient distribution and delivery of goods has become more demanding. Whereas a substantial volume of mail is still delivered via the traditional postal system, customers expect same-day or overnight door-to-door delivery services. In order to fill this void, a number of private courier operators have been licensed and more are expected to be licensed. The courier license authorizes operators to carry and convey articles by land, air, and water within Uganda for local licensees, and beyond Uganda for regional and international licensees. The articles include time-sensitive business documents, data and legal documents, financial and accounting information, cancelled checks, construction plans, specification tenders, shipping documents, samples, spare parts, computer tapes, films, advertising data, and small parcels and letters above 1 kilogram.

Outreach of Services

Services of the private couriers are mainly centered within and between the major urban centers, while UPL covers a much wider area of the country. Currently UPL has a network of 11 regional head post offices, 51 departmental post offices, 255 sub-post offices, over 1623 stamp vendors, and 70,865 installed “private” post boxes. While only a small proportion (less than 5 percent) of UPL mail is delivered to home or office addresses, the rest of the deliveries are made through private letter boxes located at post offices. This situation is opposite that of most industrialized and medium-developed countries where more than 90 percent of mail is delivered to individual homes or company/agency offices.

Although it is normal for a private letter box to be shared by several individuals or households, installed capacity gives an average of approximately 300 inhabitants per letterbox (this compares 207 for Tanzania). There are many parishes without a single private letter box; implying that their residents do not access to postal services. The limited availability of letter boxes does not only occur in rural areas but also in Kampala, where demand for letter boxes by the private business sector cannot be met. This increases the demand for services from private courier firms.

Potential for Expansion

There is a big challenge for Uganda not only to improve the postal infrastructure but also the ratio of mail per capita, which is 0.59 letters per inhabitant, compared to 8 for Africa. Domestic mail demand is only 0.33 letters per capita. While the total mail volumes for Uganda are comparatively very low, the average annual growth

\(^3\) Uganda Communications Act, Sections 85 (3) and 86.
rates are encouraging when compared to Africa and the rest of the world. Given sustained economic growth coupled with improved access to the services, the mail growth rates in the country should continue rising.

The mail volume statistics also indicate that composition of the mail flows is very different from that in industrialized and medium developed countries. The international mail flow accounts for more than 60 percent of total UPL mail volume. The growth recorded by UPL does not include the mail volume processed by private operators, so overall growth rates in the postal sector may have been more impressive. International mail, in particular business-to-business, increasingly belongs to the liberalized domain of the postal sector, and private global operators. The heavy dependency on growth of international incoming mail also implies that the major factor in growth is not a result of domestic marketing management or of management in general. The growth in the domestic service lags somewhat behind the growth rate of GDP and does not therefore hint of a particularly strong marketing effort to grow mail volume.

**Justification for Postal Policy**

Public sector reforms have transformed numerous inefficient, unprofitable public enterprises into dynamic businesses in Uganda. While economic reform has reached nearly every public enterprise, intervention in Uganda’s postal sector has been limited. The lack of institutional progress and reform along with a changed environment within the postal sector has inevitably led to retarded growth in postal services in Uganda, at the very time when the rest of the communications market experienced explosive growth and expansion. Furthermore, the absence of effective competition has encouraged little innovation and diversification of services in the postal sub-sector, which has adversely affected service delivery to the public.

In order to reverse these trends and ensure that the postal sub-sector responded to the changing environment, it was critical for the government of Uganda to set strategic objectives, guide key players in the industry, and develop appropriate policy to facilitate the development of a strong and dynamic postal sector that provides effective support to other sectors of the economy.

Drop-in domestic letter-post traffic did not begin until 1998 in Africa, and the volume of international mail had been falling for years. It was also noted that the large declines in mail volumes in Africa occurred in countries suffering from social and political crises. In comparison with the majority of both African and low-income countries, in the Universal Postal Union (UPU) mail trends study, Uganda recorded positive growth in both the domestic and international service. This is mainly attributable to steady economic growth and international trade that led to corresponding demand for postal services in the country during the period of the UPU study. Putting an appropriate postal policy in place should further enhance development in the sector.

It appears that the postal services have a very limited outreach and penetration as a form of communications. The government of Uganda, through its Uganda Communications Commission, is optimistic about the development of mail per capita demand. For the medium term, it has set as a policy objective to increase the mail per capita up to 4 items per year. This would imply a strong growth, and it remains somewhat unclear what factors would support the increase in demand of domestic mail in rural areas. Market research data that explain the rationale for such increase are not available. A priori, in view of the level of poverty and illiteracy, and substitutes available, one would expect low mail demand, but on the other hand a relatively strong demand for affordable access to telecommunications and the Internet.

**Post Offices and Services**

Although the postal network is relatively small to some other African countries, Ugandan post offices appear to be an integral part of the basic communications infrastructure. The network has been slightly changed in the past few years and eight post offices have been added.

Many post offices are basic outlets without special equipment, information and technology communications, data communications, or security facilities. In 1994 a report of the then-UPTC stated that 47 post offices were non-operational. The current number of post offices actually in operation is not known. Several post offices have been upgraded in the past 10 years and equipment has been added, but precise data on the quality of the post office network are not available. Nevertheless, within the network of rural sub-post offices, one may
encounter postal buildings with damaged walls, broken windows, leaking roofs, disconnected from any power supply.

The average number of staff per post office is 1.7. This is considerably lower than in many other countries, where staffing ranges between 3 and 6 per post office. This can be explained by the fact that the most labor-intensive part of the mail process is not executed by the UPL: less than 5 percent of mail is delivered to homes or offices of the addressees. The last mile of mail delivery tends to absorb 60 percent or more of staffing in industrialized and developing countries.

Quality of the postal work is elementary. Post office staff is mainly occupied with pre-sorting mail, filling mail boxes, etc. Salaries are very low, and staff is qualified if they have completed “O-level” secondary education. The staff received skills and job training at the UPL training center. In some cases, morale plummets and mail and parcel fraud and robbery—particularly from mail coming from abroad—occur occasionally. In addition, letter boxes make it difficult to prevent individuals from stealing each other’s mail.

The post offices provide a range of other services at the counter, but this volume tends to be small. The most frequent service is providing access to the telephone (in booths) and selling telephone tokens to users. The second is the sales of “aerograms,” and financial transactions are the third largest transaction flow. This volume has declined, however, to less than 200,000 transactions per year. Mail productivity in Uganda seems relatively good, with 31,000 items handled per staff member per year, but this does not take into account that most mail is not delivered. Current staffing level is high if this fact and low mail volume are taken into account.

### Telecommunications and Information Communication Technology

Uganda’s telecommunications market is also regulated by the UCC. There are two national network operators, Uganda Telecom, Ltd., the historic incumbent operator, which is now partly privatized and operates both fixed-line and mobile networks; and MTN Uganda, a South African-owned company implements its national network license through GSM wireless technology. A third mobile operator, Celtel, is also operational. There are 59,729 fixed-line subscribers, more than 320,000 MTN mobile lines, approximately 75,000 UTL mobile lines, and more than 100,000 Celtel mobile lines—a total of 565,000 telephone subscribers.

Uganda’s telephone service provision is largely and increasingly supplied by mobile networks using GSM technology (which is less suitable for the Internet than fixed lines). The fixed-line network has poorly penetrated Uganda with access to telephones and the Internet; and MTN’s GSM network offers most of its coverage around Lake Victoria and more inhabited areas. Most of Uganda has no access, especially in the northern and southern-central areas.

The government of Uganda included universal access targets in licensing both UTL and MTN, but the target figures have been easily exceeded through mobile service. A rural telecommunications development fund has been established, derived from a levy on operator profits and World Bank support, to provide subsidies for telephony and internet network roll-out into areas that cannot provide sufficient economic return for operators at present. This fund made its first tranche of allocations through a reverse auction process.

### Tele-density in Uganda

Individual tele-density measures the level of ownership, rather than usage, of telephony and is therefore closely correlated with per capita GDP. In most societies, average household expenditure on telecommunications (ownership and/or usage) is between 2 percent and 4 percent of income. In the context of universal access, therefore, individual tele-density gives evidence of the propensity to purchase private access to telephony rather than rely on public facilities.

### Tele-densities of Fixed-Line, Mobile, and Public Pay Telephones

<table>
<thead>
<tr>
<th>Telephony Tele-densities</th>
<th>Botswana</th>
<th>Ghana</th>
<th>Uganda</th>
<th>Average (unweighted)</th>
</tr>
</thead>
</table>

The Role of Postal Networks
Fixed and Mobile Telephone Use

According to the table below, an average of 82 percent of all respondents in the three countries use a telephone on a regular basis. This is a high percentage of respondents, reflecting the sample’s weighting in favor of locations with better access, but suggests that, if telephone service is accessible, some four out of five potential users will use a telephone on what they consider a “regular” basis. Although the statistical basis of the research is insufficient to suggest this 80 percent has general applicability, it nevertheless indicates likely substantial demand for telephone usage in most communities.

Usual Phone Use by Technology

<table>
<thead>
<tr>
<th></th>
<th>Botswana</th>
<th>Ghana</th>
<th>Uganda</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Any type of phone</td>
<td>78%</td>
<td>87%</td>
<td>81%</td>
<td>82%</td>
</tr>
<tr>
<td>Fixed-line phones</td>
<td>67%</td>
<td>85%</td>
<td>36%</td>
<td>63%</td>
</tr>
<tr>
<td>Mobile phones</td>
<td>45%</td>
<td>20%</td>
<td>68%</td>
<td>44%</td>
</tr>
<tr>
<td>Mobile/Fixed ratio</td>
<td>0.67</td>
<td>0.24</td>
<td>1.89</td>
<td>0.70</td>
</tr>
</tbody>
</table>

Fixed and Mobile Telephone Use in Rural and No-Access Areas

Respondents living in rural areas and in areas without coverage will use public access points almost as regularly as respondents from the whole sample. It suggests that a significant percentage in unserved areas will take the time and spend the money to travel to public access points outside of the areas where they reside in order to make and receive telephone calls.

Usual Phone Use in Rural and No-Access Areas

<table>
<thead>
<tr>
<th></th>
<th>Botswana</th>
<th>Ghana</th>
<th>Uganda</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Any type of phone</td>
<td>76%</td>
<td>80%</td>
<td>73%</td>
<td>76%</td>
</tr>
<tr>
<td>Fixed-line phones</td>
<td>76%</td>
<td>79%</td>
<td>29%</td>
<td>61%</td>
</tr>
<tr>
<td>Mobile phones</td>
<td>29%</td>
<td>6%</td>
<td>63%</td>
<td>33%</td>
</tr>
<tr>
<td>Mobile/fixed ratio</td>
<td>0.38</td>
<td>0.08</td>
<td>2.17</td>
<td>0.54</td>
</tr>
</tbody>
</table>

Given the relatively low fixed-line and mobile phone tele-density, it is not surprising that the table below shows that public access booths and “tele-shops” (private telephone service providers, or PTSPs) are the main points of telephone access. In this context, the term “booth” refers to public facilities provided by the
telecommunications company; and tele-shops are facilities provided by an intermediary reselling access. Post offices are considered public booth facilities.

Means of Access to Telephones

<table>
<thead>
<tr>
<th></th>
<th>Botswana</th>
<th>Ghana</th>
<th>Uganda</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public booth</td>
<td>77%</td>
<td>52%</td>
<td>46%</td>
<td>57%</td>
</tr>
<tr>
<td>Public tele-shop</td>
<td>51%</td>
<td>76%</td>
<td>58%</td>
<td>59%</td>
</tr>
<tr>
<td>Home</td>
<td>29%</td>
<td>11%</td>
<td>31%</td>
<td>23%</td>
</tr>
</tbody>
</table>

The Gamos research shows that the quality of a public telephone facility is important to consumers. Respondents in Uganda expressed a strong preference for intermediated tele-shops over public telephone booths because the former offered greater privacy or a quieter calling environment. These findings also point to post offices as being less preferred as public telephone facilities. Strategies to increase PTSPs are likely to be more successful than those increasing the number of booths (especially in post offices), unless new booths can be designed to provide a greater degree of privacy and placed in quieter locations.

Email and Internet Usage

In contrast to the widespread regular use of telephones, email, and Internet use is very low. The total number of people with regular access to Internet is estimated at less than 100,000. The level of education, the high cost of Internet use, and its slow speed (mainly due to the use of satellite connections with the rest of the world rather than submarine cables) appears to be a particularly significant barrier to 25–40 year olds in Uganda.

Postal Network Development

Ugandan telecommunications pose several implications for development of the postal sector and the postal network as a delivery channel for financial services. The ICT and telecommunications infrastructure is very weak. In the short-term, the impact of e-mail may be limited, but as the rollout of GSM and mobile phone expand this will likely effect domestic mail demand. Even though facilities are limited, the strong preference for privately managed tele-shops (and better service and privacy) may also impact use of post offices as telephone access points. Too few of Uganda's post offices have been transformed into tele-centers or internet access points. These limitations in ICT and telecommunications will also slow attempts to roll out financial services, particularly money transfer services. Moreover, the policy of UCC for ICT and telecommunications does not seem to include using the postal network as a basic infrastructure to provide access to ICT and phones. A rural communications development fund, with participation of the World Bank, was set up to help improve access to ICT and telecommunications in remote areas through private agents. These are some of the deep and complex issues that the UCC must deal with to ensure universal access to communications and to close the digital divide.

Even though these issues could have entirely absorbed the UCC, the UCC recognized that the absence of a national policy for the postal sub-sector as an issue it must address. In 2003 the government of Uganda, through the UCC, initiated a consultative and participatory process including key stakeholders to draft a postal sector policy centered on these objectives:

- To encourage private investment to improve the postal services and infrastructure
- To encourage and support the commercialization of UPL to improve the company’s efficiency and effectiveness
- To promote competition in the sector to improve quality of services through innovations, and introduce new postal products
• To increase accessibility to postal services in rural areas by locating at least one postal service outlet per sub-county
• To increase the annual per capita mail demand

The ultimate goal is to stimulate growth in the postal sub-sector comparable to other countries in the region within the next five years.

In order to achieve the above objectives, the UCC drafted strategic guidelines for each objective. The guidelines address a number of shortcomings in the postal sector. After reviewing the sector and market, it will adjust and redefine universal postal services, and issue new legislation to encourage competition and further liberalization. The reserved area is likely to be redefined, and financing universal service should be supported by the rural communications development fund, in which both public and private operators will have to participate. Critical issues will be the definition of the levy mechanism, the tariff policy of the public postal operator, and the measurement of revenues and cost. In addition the UCC would set clear quality standards for the postal sector and introduce periodic measurement of finances, performance, and quality. It also would support strategic alliances both among postal operators and between postal operators and other entities, to create healthy, strong operators that can indeed provide quality.

The guidelines suggest that the national postal operator be restructured and privatized (phasing out government subsidies), with the necessary management autonomy and financial flexibility to operate as a successful commercial enterprise while meeting the universal service obligation. They encourage entry of more private operators by issuing more operator licenses, and opening up the industry for competition by removing tariff and non-tariff barriers. They support extending remittances and other postal services into the rural areas to improve accessibility.

These strategic guidelines are a useful starting point for policy making, but it remains difficult to qualify them as a medium term sector strategy. The process of restructuring the public postal operator, providing it with more management autonomy, access to technology and finance, is not necessarily the most effective option. It actually might not lead to the desired economically viable operator, which acts transparently in a level-playing field and could be transferred to the private sector. Because the government intends to finance the considerable restructuring of the Ugandan postal operator from the rural development fund, as well as from other resources, loans, and other agencies (private postal operators, development banks), the requirement of an outwardly transparent business model and strategy become pressing.

The guidelines focus primarily on mail, courier, and parcel services, and do not appear to consider transforming the network into a multi-purpose network that serves a broader set of public and private sector interests, including the rollout of access and awareness of ICT and telecommunications services or retail trade and financial services. An evaluation of the cash-flow (impact on the government budget) and the long-term strategic value gained by such restructuring versus the options of involving the private sector at an early stage (e.g., through a BOT-based concession) should be UCC’s first step in determining how it will execute its postal sector strategy.

Moreover, restructuring the postal operator appears to be an issue within the postal sub-sector and ultimately within the communications sector. There appear to be only few links between the ICT policy and the postal sector policy, and no specific market preference in favor of post offices as the front end of ICT/Internet and

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4 Build-operate-transfer (BOT) sometimes is the best option for governments to invite private-sector investments. Under this system, it is the private sector, instead of the government, that designs, finances, constructs, and operates vital facilities. After a specified concession period, the ownership of such projects is transferred to the government. The approach offers private entrepreneurs the opportunity to profit from financing, developing, and managing major projects. The government, for its part, benefits by eventually acquiring ownership of projects in which it has not put money into. The BOT approach is gradually becoming very popular in developing countries. Ghandi Pandit, “Significance of BOT Concept to Infrastructure Projects,” Spotlight 22, no. 10 (August 30–September 5, 2005): Viewpoint.
phone access. A cross-link between ICT development for access to communications and ICT-based financial sector development also does not appear. Such a cross-link may be necessary to achieve commercial and economic viability. Moreover, a privatization strategy that does not consider a fundamental repositioning of the postal network as an access point for ICT services, financial services, and retail trade is likely result in a smaller postal network.

3—Postal Financial Services in a Market Perspective

Origin and Overview of Postal Financial Services

The origin of the postal financial services in Uganda dates back to 1926, when the Ugandan Post Office Savings Bank (UPOSB) was established by ordinance as a department of the post office under an agency agreement with the Ministry of Finance. Eleven years later the Post Office Savings Bank Act of 1937 became the statutory basis for postal savings in Uganda for more than 60 years. As in other countries under British rule, the UPOSB's main features were:

- post office savings passbooks, offered through 129 Ugandan post offices (only some of which had a facility for safekeeping cash);
- deposits guaranteed by the government; and
- deposits reinvested under the supervision of the Ministry of Finance in gilt-edged titles.

Postal savings enjoyed great popularity from the 1940s to the 1960s. Low deposit requirements, a simple straightforward product, a government guarantee of deposits, and access to 129 post offices made the postal savings popular. At that time, commercial banks had only small branch networks and set high initial deposit requirements. Because there also were bank failures in which savers lost their money, the UPOSB functioned as a safe and accessible haven for small savers in Uganda.

In the late 1970s, problems in post office operations and administration severely plagued UPOSB, and it was unable to keep its administration up-to-date or to make interest calculations for its clients. In 1982 problems in the operation and management of UPOSB had accumulated to such an extent that it could only accept deposits, and could not honor requests for savings withdrawals until further notice. In exceptional cases, however, requests from clients for withdrawals were honored at UPOSB headquarters in Kampala, and this situation remained until 1997. The UPOSB had channelled only part of its money into Ugandan government securities and had actually re-invested a large part of client deposits in European banks and government securities (where they made substantial gains in foreign currency exchange).

By 1989 UPOSB had become insignificant in mobilizing household savings. Market share (in value) dropped to barely 1 percent. Of the 350,000 postal savings accounts kept on UPOSB books, at most 15,000 passbooks showed new deposits. These were mainly generated by an autonomous demand to keep money safe and the tradition of saving there that was passed on to younger generations, who were ignorant of the fact that the UPOSB would be unable to process withdrawals.

UPOSB reported losses, but these were offset by gains made with its USD 2.5-million off-shore deposits invested in European money and capital markets. These deposits accounted for more than 80 percent of total assets. In the period 1982–96, much of the value of the postal savings deposits was eroded by high inflation rates which were substantially higher than deposit rates. UPOSB became an insignificant division of UPTC, generating less than 1 percent of transaction volumes at postal counters and producing less than 1 percent of UPTC post office revenues.

Under a World Bank program in 1996, the owner of UPOSB, the Ministry of Finance (PERD), adopted the recommendation of transforming UPOSB into an incorporated entity operating under a license of the Bank of Uganda. Postbank of Uganda incorporated in 1998 as an independent entity following the enactment of the 1977 Uganda Communications Statute, but it operated with the same balance sheet of the old UPOSB. This
meant that no assets and liabilities with the postal services were divided up, and the agency agreement with the UPL was not substantially revised.

Few real changes took place—the old POSB management continued to lead the Postbank—although modern technology introduced at the Postbank head office solved the backlog of administrative problems. Postal savings were again offered through the 129 post offices where UPOSB services had been. (The impact of this improvement was an immediate 50 percent increase in the value of postal savings between June 1998 and June 1999.) Postal savings continued to rise sharply until June 2002, increasing the 1998 deposit balance eight-fold.

In terms of market share, this was still very modest—an estimated 3 percent of the private savings and deposits in local currency—but it was perceived as a highly promising development and put postal savings back on the map of the Uganda financial markets. Further in-depth analysis might have revealed that market share in growth of small deposits was above 10 percent per year. However, after 2002, growth stagnated.

The new Postbank launched ambitious plans, targeting low-income depositors, the majority of whom lived in rural areas. Moreover, Postbank intended to operate where traditional banking was unprofitable, using the post offices through its agency agreement with the UPL. There also seemed to be substantial opportunity to become a main actor in the nation's payment system as the processor of bulk flows of recurrent payments, such as tax, telephone, school fees, electricity, and water. This could make the Uganda payment system more efficient, as well as liquidity management in the main entities that distributed or collected small-value payments. It would certainly benefit the postal network with new transaction flows and higher revenues. A preliminary plan projected that postal network revenues would increase 30 percent within three years.

Postbank was constrained by its low level of computerization, poor communication infrastructure, and a narrow product base. It planned to alleviate some of these constraints by diversifying its product portfolio (e.g., fixed deposits, certificates of deposits, foreign exchange trading, salary accounts, and utilities payments), establishing a country-wide computer network, and introducing a giro account system. The plan was well received by stakeholders (Bank of Uganda, UPL, and others), but unfortunately remained merely a good intention.

Using the postal network did not turn out successfully: the Postbank-UPL relationship went sour through mutual exchanges of disappointment and dissatisfaction. The bank did not invest in the postal network, to upgrade technology, training, advertising, and security, but instead pursued developing a network that would be independent of UPL. Postbank services in the postal network were reduced year-by-year, dropping from 129 in 1998 to less than 20 in 2003.

Postbank did not use the postal network as outreach to rural and remote places. It established its own bank branch network in Uganda's main cities, separate from the post offices. As of 2003, services were provided through post offices on a tenancy basis (i.e., renting space but Postbank staff provided the services). The focus in the branches was on serving companies for credit, payment, and payroll services. The credit license of Postbank was revoked in 2003 due to inadequate credit policy.

Postbank suffered pre-tax losses in 2000 and 2001 due to its heavy capital expenditure on developing a branch network, but regained profitability in 2002 (leading to a return on equity of 19 percent). The profit, however, was lower than the gains made in foreign exchange of its off-shore deposits.

Commercializing Postbank did not lead to the desired results for UPL or for the remote and rural inhabitants. In fact, after the branch networks of StanBic Bank and Uganda Commercial Bank (UCB) closed, many of the inhabitants resorted to keeping their valuables at home or banking with informal entities.

Postbank has now been earmarked for privatization. The preliminary schedule indicated that such transformation might happen in 2006 at the earliest. Until that time, Postbank is not likely to gain access to new funding sources to develop its operations or to regain its credit license. The means of privatization envisaged is sale of a 49 percent stake to a strategic shareholder. This may not be very attractive because the Ugandan government would retain the majority. Interviews with Postbank management indicated that their priorities are still to expand the ATM network and start new with credit.
Reportedly, Posta Uganda has initiated a new launch of financial services through its wide network. It hopes to do this through outsourcing agreements with financial institutions or insurance companies, for example, and has commenced explorative negotiations with both domestic and international financial institutions (including international money transfer agents).

Postbank’s history highlights several weaknesses:

- **Postbank drifted away from its original and unique mission to develop broad-based access to basic financial services through the wide postal network.** Instead, it attempted to develop into a different commercial branch bank and left a deep void in the market.

- Key elements that led to this were (a) the absence of a joint strategy and partnership between Postbank and UPL; (b) the absence of committed financial resources to develop the postal network and its human resources; (c) weak management structure with political interference; and (d) unclear control of capital expenditure, and lack of accountability to meet certain quality standards or performance targets.

- Postbank has set a new course with hardly anything but its name relating to the post. The relationship between Posta Uganda and Postbank is de facto terminated, but the pretense has been kept up for 20 years. Postbank’s solo privatization may finally and overtly sever the relationship, leaving it to operate in a strategic vacuum.

- **Posta Uganda is contemplating offering financial services independent of Postbank.**

**Financial Sector Background**

The financial sector in Uganda began developing in 1986 when the Museveni government came to power. Determined to reverse the Amin legacy of limited public confidence, insolvency problems, high inflation, and currency devaluation, the Museveni government began reforming the sector by restructuring weak banks, closing insolvent banks, and strengthening regulation and supervision by the central bank.

Although the formal sector included about 20 foreign and indigenous banks, as well as Postbank, along with numerous insurance companies, foreign exchange bureaus, and a National Security Fund, it has offered very few products and has been characterized by a shortage of building societies, mortgage financing, merchant banking, and discount houses. The banks operate through 144 branches, a low number in comparison to the population, indicating that the formal financial sector does not reach many rural and remote communities. The total of individual clients is estimated to be less than 700,000—more than half of them concentrated in Kampala. The banking sector, with strong presence by South African and British banks, provides advanced services, but requirements for individuals are high.

Several of the indigenous banks, including UCB and the Co-operative Bank, closed many of their rural branches because they were not profitable. Only Stanbic seemed be have interest in expanding into the rural-low-income market. Although the commercial banks offer check books, ATMs, credit cards, and electronic payment services, and efforts to bring the payment system up to international standards, the payment system is predominantly cash-based. Access to cashless instruments remains very limited. Additionally, the volume of check payments in Uganda is low, estimated at less than 1.5 million and meaning that they are mainly used for commercial payments and rarely for household payments.

Although the Bank of Uganda records that M1 consisted of UGS 529 billion (USD 293 million) in circulation, and UGS 814 billion (USD 452 million) in private demand deposits, one expects that only a small part of the private demand deposits are transferable deposits held by households. For retail payments, Uganda is a cash society.

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5 Electronic payments services (including ATMs, electronic fund transfer at point of sale or EFT POS, and direct debit) were only introduced three or four years ago, and actual transaction volumes are believed to be very low. A central switch for ATMs and bank cards has been developed.
In addition the Bank of Uganda recorded M2 as UGS 596 billion (USD 331 million) in savings and term deposits from the private sector. These figures demonstrate how small the market is, and particularly the potential of the postal banking operation that could convert the relatively large amount of cash (UGS 529 billion) to postal giro and savings accounts.

International remittances to and from Uganda are sizeable compared to the monetary aggregates mentioned. Studies by Bancock Consulting on migrant remittances in Africa estimate the incoming flow at USD 400 million and the outgoing flow at somewhat more than USD 100 million. The cost is relatively high, and few networks, including some MFIs, are active in this field. The postal network's role is insignificant, but it is evident that if the postal network were equipped with on-line EFT POS to process recurrent bill payments, distribute social benefits, and process remittances could revolutionize the payment system in Uganda and help mobilize savings into the formal financial sector.

Informal and Microfinance Sectors

The informal sector in Uganda, by contrast, has been strong, and its role has been critical in serving the rural financial markets. Informal financial institutions consist of non-governmental institutions (NGOs) and microfinance institutions (MFIs), which have been supported by foreign donor organizations. It also includes co-operatives which are very strong, with almost 6,000 registered cooperatives. Most of these are organized under the Union of Savings and Credit Cooperatives of Uganda and Uganda Cooperative Alliance.

Although the microfinance sector is relatively young in Uganda, it is one of the largest and most dynamic in Africa. After the civil war (1981–86), a large number of NGOs were created to support the reconstruction of the economy. These NGOs eventually included microfinance in their programs, frequently transforming these activities into microfinance institutions. At present there are an estimated 500 MFIs operating in Uganda, including NGOs, limited liability companies, co-operatives, licensed commercial banks, and one non-bank financial institution. However, most of the MFIs are far from being sustainable: fewer than 10 are reaching financial self-sufficiency.

Despite the proliferation of informal financial institutions, there is still a highly unmet need for financial services in rural areas. Most MFIs are not regulated institutions, and even with the potential to change into regulated institutions under new legislation, most will remain unregulated. As such, they will not be able to take deposits, and many will continue to depend on funding from donor agencies or specific refinancing arrangements.

### Basic Microfinance Data in Uganda

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<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td><strong>No. of MFIs</strong></td>
<td>500</td>
</tr>
<tr>
<td><strong>Outreach</strong></td>
<td></td>
</tr>
<tr>
<td>• Borrowers</td>
<td>330,000</td>
</tr>
<tr>
<td>• Savers</td>
<td>800,000</td>
</tr>
<tr>
<td><strong>Loan portfolio</strong></td>
<td>USD 57,360,000.00</td>
</tr>
<tr>
<td><strong>Savings</strong></td>
<td>USD 86,200,000.00</td>
</tr>
<tr>
<td><strong>Average loan size</strong></td>
<td>USD 175.00</td>
</tr>
<tr>
<td><strong>Points of service</strong></td>
<td>n/a</td>
</tr>
</tbody>
</table>

Microfinance in Uganda is highly competitive and viewed by many as nearing saturation in urban areas. Most MFIs use a blend of Grameen and village banking methodologies, providing basic loan products that feature weekly payments, 4–6 month loan terms, group lending, compulsory savings, and a focus on the trade or

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in Expanding Access to Financial Services
commerce sector rather than agriculture. With few voluntary savings services, there has been increasing pressure to provide savings services to poorer populations and to provide more services in rural areas. Donors and practitioners alike are concerned about the risks of oversupply and overlap, especially in the urban regions.

The success of microfinance in Uganda is widely attributed to a number of factors, among them:

- The government stopped its initial direct provision and interference in the microfinance market.
- The Microfinance Forum was created and backed by CGAP, practitioners, donors, and the Ugandan government who worked together to effectively develop the sector, establish best practices, etc. This facilitated development of a consensus vision for the industry in the country. Among other achievements, their activities directly led to the establishment of the Association of Microfinance Institutions in Uganda (AFMIU).
- The involvement of a number of international networks helped to give a solid footing to several major MFIs, which are now in the forefront of those seeking regulated status.
- Substantial donor funding flows were directed to the sector, including guarantee programs to encourage commercial bank lending to MFIs.
- The development of a standardized donor-reporting tool in Uganda, which has increased donor collaboration and transparency.
- Uganda has developed a supportive legal and regulatory environment, including regulatory reform that has given some structural options to those MFIs that can qualify.

The issues facing the expansion of outreach by the microfinance sector are derived from the continuing domination of the financial industry by urban-based financial institutions, whose outreach is limited to less than 10 percent of the Ugandan population. Highly liquid (only 26 percent of assets were represented by loans in 2002), and favoring the trade and manufacturing sectors (only 8 percent of loans were to the agriculture sector), the commercial banking sector has not met the general financial needs of the country or the needs of the rural poor. In addition, the Uganda’s economy continues to be cash-oriented, with 30 percent of the money supply in cash (compared to 12 percent for Kenya). The result of all of these constraints is that a large unsatisfied need for financial services continues to exist, particularly in the rural areas, which are home to over 96 percent of the poor population of Uganda. Until recently, only CERUDEB among the Ugandan banks reached out to the rural areas. CERUDEB’s rural activities have had a high level of donor support, which has permitted them the luxury of “affording” the outreach.

**Impact of Donors and International Investors**

The microfinance sector has directly benefited from donor activities, particularly AMFIU support, capacity building, and regulatory reform initiatives. NGOs, networks, and other types of facilitators have also played a large and extremely important role in the development of the sector. Networks present include ACCIÓN, CARE, CRS, FINCA, FFH, FTC, Opportunity International, GF-USA, WOCCU and WWB. As the sector has grown and matured, a number of international quasi-commercial and commercial investors have entered the Uganda microfinance sector with debt and/or equity investments.

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8 CERUDEB was founded and is largely owned by the Catholic dioceses of Uganda, from which it has drawn support. It also has received substantial international donor support.
9 ACCIÓN, CARE, CRS (Catholic Relief Services), FINCA, FFH (Freedom from Hunger), FTC, Opportunity International, GF-USA (Grameen Foundation-USA), WOCCU (World Council of Credit Unions) and WWB (Women’s World Banking).
Regulatory Environment

In December 2002, a new law regulating micro deposit-taking institutions (MDIs) was passed. MDIs can accept deposits from the public and on-lend them, but cannot engage in foreign exchange transactions, operate current accounts, on-lend compulsory savings, or use the word “bank” in their name. For those qualifying as MDIs, benefits will include funding diversification, greater financial viability, and a competitive edge over the non-regulated MFIs, and their clients will gain savings services. For the MFI industry, the presumption is that it will facilitate outreach to the rural areas.

AMFIU, the representative body for MFIs in Uganda, is generally well regarded by donors now, after an overhaul several years ago, which included a new chair and a permanent staff. AMFIU is seen as one example of progress in the Ugandan microfinance industry, providing information and capacity to existing MFIs and linking the sector with important policy makers.

Technological Innovation

MFIs in Uganda critically need to develop technological solutions to reduce operational overheads, to improve business practices, to increase revenue, and especially to scale up and solve rural outreach problems. Given the infrastructure problems that plague Uganda, any systems need to be able to work with limited or no infrastructure, as well as illiterate populations. End-to-end solutions are needed which emphasize client level data collection and industry standardization/access while leveraging existing MIS capabilities.

Three MFIs in Uganda have been participating in a pilot program for a “remote transaction system,” with a team of technology specialists and networks. Hewlett Packard is the lead partner in the project. Each of the MFIs requires different solutions: FOCCAS needs to empower loan officers and to capture individual data; FINCA wants to develop a low-cost rural branch office; and Uganda Martyrs University seeks to empower clients and build an agent network. The project hopes to demonstrate the viability of technology in rural environments, build capacity within the partner MFIs, demonstrate a positive business model, and link the MFIs to the Uganda financial systems as they develop (central financial switch, credit reference bureau). The remote transaction system will use mobile devices (personal digital assistants and POS terminals) with wireless connections to the remote transaction server.

4—Options for Development

Uganda has deeps gaps in both in communications and financial services infrastructures. The existing large network of postal offices and the Uganda Postbank should or could have provided an additional delivery channel for outreach to rural and remote (poor) areas. However, the many structural and organization problems that developed have made this less likely in the short term:

- Postbank lacks a workable microfinance strategy or focus, and no longer has a strategic alliance with Posta Uganda.
- Postbank’s potential geographic coverage was much reduced when the country-wide agency agreement with Posta Uganda was terminated. Only about ten post offices currently sell financial services, reducing Postbank’s total network to 20 offices. Postbank prefers to expand its activities by opening of its own branches and or agency offices;
- Postbank is capital-constrained and its inability to open additional branches or develop adequate products makes it difficult for it to meet the competition posed by the commercial banks.
- Regulations currently constrain Postbank from lending which, combined with lack of a strong credit culture and management capacity, makes them an unlikely candidate to develop credit services for this sector. (Postbank has currently has a restricted license, which prohibits lending activities until it has sufficient and human resource capacity.)
Postbank has an inadequate technology capacity, and it is focusing on capital-intensive technology (ATMs) in stead of low-cost technology (EFT POS).

Moreover, Postbank seems to suffer from a paralysis induced by the ongoing pre-privatization process.

Competition from other regulated institutions is increasing, which poses further problems for Postbank’s ability to capitalize on a potentially unique advantage of rural locations. StanBic Bank (which still has 10 percent of its shares held by the Ugandan government) has recently announced that it has revised its urban strategy to include expansion into rural regions. However, it is unclear what that means in terms of a microfinance strategy or how far into more remote regions their expansion will carry them, given their commercial orientation and their past policy of closing non-profitable rural branches.

The most reasonable strategy for Uganda Postbank, given the factors above, would be to develop a strategy developing co-operative ventures with unlicensed Tier IV MFIs to facilitate mobilizing their clients’ savings. The most sensible strategy for the owners of Posta Uganda might be to terminate its relationship with Postbank, and replace it with a strong, long-term alliance with one of the larger financial institutions in Uganda, such as StanBic. The strategic partner would have to meet managerial, technological, and financial qualifications to effectively help reposition the post offices as a nationwide channel for convenient, efficient, basic small-value financial services.

A consortium between a strong financial institution and a private ICT/telephone provider with modern Internet facilities might be ideal. This could lead to developing a grass-roots network that acts as a front-end for accessing financial services and communications—two important areas that are underdeveloped in Uganda.

The government and international financial institutions will have critical roles in this process, creating favorable conditions to attract the private sector to step in and to fill in the voids that the public sector has been unable to satisfactorily develop.

One option that the government has before privatization of the postal operator is to separate the postal network from the postal (mail and parcel) operator. It would be highly unlikely that any private postal operator would want to continue working with a network of nearly 320 dilapidated post offices. The typical response would be to close down many of the offices and retain only the centers for mail and parcel processing and sorting, and delivery locations for the private mail boxes.

By splitting off the postal retail network from mail and parcel operations, private sector interest for the remaining assets and business flows of the postal (mail and parcel) operator might substantially improve. Prospective investors would not face the political and financial burden of having to restructure the postal network. A privatized postal operator might be better off with a service-level agreement with the separate postal network company to sell stamps, and collect and pick up parcels and registered mail.

This option assumes that the main entity leading the modernization would be a bank or a consortium focused on developing ICT-based basic financial services.

Another option is to incorporate the post office network in a company that either (a) becomes a joint venture (51 percent/49 percent) with a consortium of investors and application providers in the field of ICT and financial services. The alternative to this option is to offer a selected consortium the chance to build-operate-transfer under a long-term concession agreement.

The first step in transforming the postal network into a grass-root front-end for information and communication and basic commoditized financial services would be to link the 62 regional and district post offices in a wide-area network (WAN) connected by the Internet, and offer:

- applications to pay utility bill;
- deposits to savings accounts, payment accounts, and third party accounts; and
- international remittance services by connecting the WAN to international networks.

Capital expenditure for such network technology and communication should be limited (in the range of USD 0.3–1 million), and that revenues from domestic payments and international remittances would generate
sufficient payback on investment within two years. Capital expenditure to ensure that post office buildings meet minimum security standards can not be estimated at this stage, nor can the cost of training staff. It is recommended that these scenarios be further discussed and that taking the following steps be seriously considered before choosing either option:

- Perform quantitative and qualitative market analyses (including field interviews with representative samples of the adult population) to assess the actual usage of financial services and the potential of ICT-based financial services
- Make a preliminary valuation of the post office network
- Outfit two model post offices
- Detail a business case including a cost-benefit analysis
- Preliminarily explore potential investors or participants
The Role of Postal Networks in Expanding Access to Financial Services

Country Case: Vietnam’s Postal Finance Services

The World Bank Group
Global Information and Communication Technology

Postbank Advisory, ING Bank
Postal Policy
Author’s Note

This paper discusses the role of the postal network in expanding access to financial services in Vietnam. It reviews the public postal operator within the postal sector and within the broader context of the communications sector. The roles of the Vietnam postal network and post bank are also reviewed from the perspective of the financial sector development, with particular focus on payments systems development and micro finance.

This paper was prepared with desk research in 2004. Field visits were not scheduled.

While this country case on Vietnam can stand alone, it is an integral part of this large study of the potential of postal networks to coordinate with financial service providers in 7 countries (Egypt, Kazakhstan, Namibia, Romania, Sri Lanka, Uganda, and Vietnam) and 5 regions (Africa, Asia, Eastern Europe and Central Asia, Latin America and the Caribbean, and the Middle East and Northern Africa).

Glossary of Abbreviations and Acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Definition</th>
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<tbody>
<tr>
<td>ATM</td>
<td>automated teller machine</td>
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<td>BIDV</td>
<td>Bank for Investment and Development of Vietnam</td>
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<td>CBPS</td>
<td>Commercial Bank Payment System</td>
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<td>EFT POS</td>
<td>electronic funds transfer at point-of-sale</td>
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<tr>
<td>Eximbank</td>
<td>Vietnam Export and Import Commercial Joint Stock Bank</td>
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<tr>
<td>IBPS</td>
<td>national inter-bank payment system</td>
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<tr>
<td>ICB</td>
<td>International Competitive Bidding</td>
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<tr>
<td>Incombank</td>
<td>Industrial and Commercial Bank of Vietnam</td>
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<td>ITDB</td>
<td>Informatics Technology Department of the Bank (SBV)</td>
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<td>JSB</td>
<td>joint-stock bank</td>
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<td>Kampo</td>
<td>Japan’s postal savings institution</td>
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<tr>
<td>M2</td>
<td>total deposits as a percentage of all physical money (coins and currency)</td>
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<tr>
<td>Maritimebank</td>
<td>Vietnam Maritime Commercial Joint Stock Bank</td>
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<tr>
<td>MFI</td>
<td>microfinance institution</td>
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<td>MOF</td>
<td>Ministry of Finance</td>
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<tr>
<td>NDAF</td>
<td>National Development and Assistance Fund</td>
</tr>
<tr>
<td>NPC</td>
<td>National Payments Council</td>
</tr>
<tr>
<td>PCF</td>
<td>Peoples’ Credit Fund</td>
</tr>
<tr>
<td>PPC</td>
<td>Provincial Processing Center</td>
</tr>
<tr>
<td>PTT</td>
<td>Provincial enterprise for Post, Telegraph and Telephone Service</td>
</tr>
<tr>
<td>ROSCA</td>
<td>rotating savings and credit association</td>
</tr>
<tr>
<td>RSHBs</td>
<td>Rural Shareholding Banks</td>
</tr>
<tr>
<td>SAPS</td>
<td>settlement account processing system</td>
</tr>
<tr>
<td>SBV</td>
<td>State Bank of Vietnam</td>
</tr>
<tr>
<td>SOCB</td>
<td>state-owned commercial bank</td>
</tr>
<tr>
<td>SOE</td>
<td>state-owned enterprise</td>
</tr>
<tr>
<td>SWIFT</td>
<td>Society for Worldwide Interbank Financial Telecommunications</td>
</tr>
<tr>
<td>UPU</td>
<td>Universal Postal Union</td>
</tr>
<tr>
<td>UNDP</td>
<td>United Nations Development Program</td>
</tr>
<tr>
<td>USD</td>
<td>United States dollar</td>
</tr>
<tr>
<td>VBARD</td>
<td>Vietnam Bank for Agriculture and Rural Development</td>
</tr>
<tr>
<td>VBP</td>
<td>now known as the Credit Policy Bank</td>
</tr>
<tr>
<td>VDC</td>
<td>Vietnam Data Company</td>
</tr>
<tr>
<td>Vietcombank</td>
<td>Bank for Foreign Trade of Vietnam</td>
</tr>
<tr>
<td>VND</td>
<td>Viet Nam dong</td>
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## Summary

### SWOT Analysis of Vietnam Postal Financial Services

<table>
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<tr>
<th>Strengths</th>
<th>Opportunities</th>
</tr>
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<tbody>
<tr>
<td>• Since 1999 going through a rapid and successful expansion; financial services already present in 920 post offices (of 2,946), as of 2004. This is effectively the second largest network for financial services in Vietnam. If/when all post offices are involved it would be the top network providing access to financial service. Post offices are located both in areas where many bank branches are present, as well as in areas where only informal channels and agents act as competitors.</td>
<td>• Postal banking offers the potential to increase savings propensity, savings, and provide banking services to the rural poor.</td>
</tr>
<tr>
<td>• Mobilizes small deposits with a low minimum deposit requirement and has nearly 400,000 savers with a total balance of VND 3.8 trillion. Would rank in the 10–15 largest financial institutions in Vietnam.</td>
<td>• With proper marketing and improvement in efficiency, postal banking should become a much more significant force in retail banking and could be a major force in the transition from cash to cashless small-value payments. Opportunities present to develop into a channel for remittances, savings, credit.</td>
</tr>
<tr>
<td>• Processes a considerable volume of payment transfers per year (money orders, pensions, electricity bills) and is setting up new services (debit cards, payroll).</td>
<td>• In the medium term, products, such as life insurance and trust units, could potentially be sold through the post offices, linked to existing savings and payments accounts.</td>
</tr>
<tr>
<td>• Is perceived as a non-bank by the population; there is a high level of personal trust in postmasters/post offices in rural areas.</td>
<td>• Transfer operations can grow quickly (if technology infrastructure is available) to include direct credit transfers (salaries) into personal accounts and chipcard technology for small-value payments.</td>
</tr>
<tr>
<td>• Has no non-performing loan portfolio and has never defaulted in payments to depositors.</td>
<td>• In the longer term, synergies could be achieved if postal network were to develop ICT, Internet access, and a platform for e-government and e-commerce (fulfillment).</td>
</tr>
<tr>
<td></td>
<td>• Post office could become the country’s first chain of convenience stores providing basic financial services, communications, and retail trade.</td>
</tr>
<tr>
<td></td>
<td>• Vietnam has a relatively large number of medium-size banks with small networks, that might be a partner for VPSC</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Weaknesses</th>
<th>Threats</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Relationship with VPS for use of postal network is not transparent.</td>
<td>• Postal reform strategy has not been determined—relationship of VPSC with the postal network may come under pressure as a result of separating Post from Telecommunications and subsequent need to boost revenues. Current position of VPSC within VPS, without banking license, is a risk to sound continuity of postal savings.</td>
</tr>
<tr>
<td>• Reporting and governance framework is not transparent and not compliant with the Law on Credit Institutions; hence cannot offer lending.</td>
<td>• Regulatory reform of VPSC requires support from Ministry of Finance, which currently funds NDAF and government bonds.</td>
</tr>
<tr>
<td>• Not connected to interbank payment system.</td>
<td>• Large part of the operation is paper-based, manually processed, lacking the support of computerization, oversight and MIS.</td>
</tr>
<tr>
<td>• Coverage to all post offices progresses slowly due to investment requirements in IT and HR, and training.</td>
<td></td>
</tr>
<tr>
<td>• Integration with VPS payment services will absorb management capacity.</td>
<td></td>
</tr>
<tr>
<td>• Legal framework limits commercial flexibility and asset management.</td>
<td></td>
</tr>
<tr>
<td>• Management controls only basic marketing, banking, and technology skills; risk control and management accounting virtually non-existent.</td>
<td></td>
</tr>
<tr>
<td>• Progress in computerization has limited functionality; is in early stage only.</td>
<td></td>
</tr>
<tr>
<td>• Has inefficient staff and operations in post offices; staff has limited training, and there are no performance incentives for staff or management.</td>
<td></td>
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</tbody>
</table>
1—Postal Sector Development

Origin, Data, and Features of the Postal Sector in Vietnam

Vietnam’s postal services date back to when the French ruled Indochina and set up a mail system. The lengthy conflicts since Vietnam’s proclamation of independence in 1975 have had a deep impact on the postal services and their infrastructure. The unification of Vietnam under socialist rule gave the postal service the opportunity to restore and rehabilitate itself into a single postal network. From 1987 to 2002, the Vietnam Postal Services renovated its operations and expanded its network to ensure that people had access to basic communications facilities. Considering that 80 percent of the Vietnamese (i.e., more than 60 million people) live in rural areas, the dense postal network truly can link the nation.

The Vietnam Postal Service provides a high level of service with reportedly 99.83 percent of the population receiving mail at home, six days a week. In urban areas, Vietnam Post provides mail delivery twice daily. This is a huge benefit for the business sector, but also very costly. Although no research is available on the quality of service of the mail delivery, it is believed to be good in general. Various independent publications and web sites focused on the international business sector recommend the use of Vietnam Post; in particular its express mail service is praised.

Vietnam Postal Service has a uniform tariff—this is important for its community service—which allows rural users to pay the same price as urban users of mail. The average number of citizens served by each post office is around 6,350. This is somewhat lower than in developed countries, but better than that found in many developing countries. Moreover, post offices in general are located within a radius of 2.8 km, which situates the postal network close to its users. The postal network is state-owned and offers both postal and telecommunications operations. It has rapidly expanded during the past years, including new outlets, such as kiosks.

The mail-per-capita demand in Vietnam is not known. Data on the primary mail flow (letters) are not reported to the Universal Postal Union or other entities, but it was estimated to be in the range of 7–12 items in 2002. This mail volume includes the delivery of 285 million newspapers.

Although Vietnam Post has recorded impressive achievements, it has identified—in its long-term plan to 2020—objectives for further development. These objectives deal largely with ongoing and anticipated changes in the postal sector and address various weaknesses and problems:

- Institutional and regulatory reform
- Commercialization and diversification (financial services)
- Partnership building with local and international institutions
- Human resources development

One of the key issues for Vietnam Post is separation from the Vietnam Post and Telecommunications Corporation (VNPT), which acts as a broadly diversified conglomerate in the field of communications. VNPT claims to have 90 percent of the market share in the postal, telecommunications, and information technology (IT) sectors.

The entities within VNPT have different structures, ranging from incorporated (joint stock) companies to state enterprises (non-productive units), and PTTs (provincial enterprises for post, telegraph, and telephone services) that provide the postal and telecommunications services locally. VNPT is 100 percent owned by the government, with the responsible Ministry of Posts and Telematics also in charge of regulation, policy, and management. The Vietnamese Parliament, too, is involved in operation and management decisions of VNPT and sets tariffs. Vietnam Post has limited managerial autonomy to pursue changes, as well as limited authority to enforce changes. It is dependent on VNPT and the Ministry, and it has no direct control over its operations which are regionally organized, together with telecommunications.
VNPT resembles a state holding company that dominates the entire communications sector. It is involved not only in postal, telecommunications, and IT operations, but in manufacturing postal/telecommunications equipment, construction, consulting, building design, as well as in human resource training and trading (import and export) postal/telecommunications equipment. The individual companies in these activities have their own management and accounting, and follow government accounting principles. There may be intra-company debt relations between the entities of the VNPT holding company.

Separating Vietnam Post from VNPT is a target for the next few years. As examples from countries of the former Soviet Union have shown, the process of restructuring and transforming the sector is complex and needs careful preparation to assess the actual value and viability of the involved entities. Vietnam will be able to draw on the lessons from other countries that unwound their state communications industry into a diversified, competitive sector. In Vietnam, the ownership allocation of the postal network should be critically reviewed. Currently the postal network is made up of provincial enterprises, the PTT network, which is essential in providing rural access to telecommunications and mail.

Vietnam Post itself is also organized in subsidiaries, business units, and joint ventures—including relations with the 61 provincial entities. Due to this structure, several of the subsidiaries have been able to develop their business rapidly (e.g., express mail, data post, logistics company); it is a managerially decentralized postal operation, with possibly a high degree of autonomy within separated entities. In building an effective postal operator, a higher degree of centralization may be required.

VNPT is regulated by the Ministry of Posts and Telematics, one of the ministries under the auspices of the prime minister in Vietnam. The Ministry of Posts and Telematics—whose function is drafting acts and policies, setting strategies for all posts and telecommunication activities, providing licenses to operate, open, or close national and international posts and telecommunications services—was reorganized from the Directorate General of Posts and Telecommunication in 2002. There are also other state-run companies parallel to VNPT, such as Viet Tel and Saigon PostTel, etc., but they have very limited and specialized market positions.

VNPT has a “board of management,” the highest decision-making unit, consisting of a board of directors and an inspection committee, in addition to so-called “member units,” such as non-productive units, joint stock companies, their own companies or enterprises (member companies), and 61 PTTs.

VNPT has internal departments (so-called “functional divisions”) under the control of its board of directors. Functional departments consist of the following 15 departments and organizations: administration; VNPT representative office (in Ho Chi Minh City); planning; finance and accounting; investment; science, technology, and industry; international co-operation; postal; telecommunications; personnel; marketing; security; investigatory; audits; and rural post and telecommunication development. Their own companies, the “member companies” are Vietnam Telecom National, Vietnam Telecom International, Vietnam Data Communication, Vietnam Telecom Services Company, Vietnam Mobile Telecom Services, Vietnam Postal Service (VPS), Vietnam Postal Savings Company (VPSC), Vietnam Stamp, and National Newspapers Distribution.¹

Vietnam Postal Service has 26,000 full-time employees and 5,500 part-time employees. It is assumed that the staff of post offices is included in these figures. A very rough subdivision of staff would put 18,000 in collection and delivery of mail, parcels, and newspapers, and about 12,000 at postal counters to sell stamps, collect parcels, and process payments and savings.

¹ Other companies under VNPT are: Posts and Telecommunications Finance; Telecommunications Manufacturing and Research Enterprise 1; Telecom Manufacturing and Research Enterprise 2; Vietnam Telecommunications Equipment Company; Posts and Telecommunications Construction, Investment, and Development Consulting Company; Posts and Telecommunications Equipment Import-Export Service Corporation; Posts and Telecommunications Material Supply; Posts and Telecommunications Engineering; Posts and Telecommunications Construction; Postal Construction Material Company; Post and Telecommunication Equipment Factory; Printing Manufacturing; and Stamp Manufacturing. Joint venture member companies are: Vietnam-Korea Exchange, Ltd.; VinaDaesung Cable; Optical Fiber-Cable Manufacturing; Alcatel Network Systems Vietnam; Fiber Optical Cable, Ltd.; Telecommunications Equipment, Ltd.; VNPT-FUJITSU Telecommunication Systems, Ltd.; and VNPT-NEC Telecommunication Systems, Ltd. Joint-stock companies are: Cable and Telecommunications Material Joint-Stock Company; and Posts and Telecommunications Joint-Stock Insurance Company (handles non-life insurance products).
The post office network hierarchy is made up of three levels: PO Level 1, PO Level 2, and PO Level 3. There are 64 Level 1 post offices, consisting of 3 zone centers (north, south and central), which are mail sorting centers, and 61 province or city mail centers. These 64 offices are the backbone of the mail logistics system in Vietnam. They are connected by air and trucks routes, with no dependence on railways.

The other post office levels represent the “retail network” of Vietnam Post. There are 542 Level 2 post offices (similar to district post offices), and 2,404 Level 3 post offices (i.e., the postal outlets or postal stations). Below this hierarchy, the VNPT has 4,100 postal agencies and postal-telecom-cultural stations in rural areas, and 340 multi-service agencies mostly located in cities.

**Postal Services**

<table>
<thead>
<tr>
<th>Type of Service</th>
<th>Revenue Share in %</th>
<th>% Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic letter post</td>
<td>18.0</td>
<td>26</td>
</tr>
<tr>
<td>Newspapers</td>
<td>10.0</td>
<td>-15</td>
</tr>
<tr>
<td>Express</td>
<td>16.8</td>
<td>13</td>
</tr>
<tr>
<td>International</td>
<td>20.0</td>
<td>3</td>
</tr>
<tr>
<td>Money orders</td>
<td>14.5</td>
<td>+</td>
</tr>
<tr>
<td>Savings</td>
<td>8.70</td>
<td>++</td>
</tr>
<tr>
<td>Other (hybrid, logistics)</td>
<td>11.0</td>
<td>+</td>
</tr>
</tbody>
</table>

Data: VNPT, UPU

The revenues cover about 40 percent of costs. This figure may be underestimated, as it is not known to what extent cost for amortizations and other provisions are included under Vietnamese government accounting standards.

**Vietnam Postal Service losses have been chronic:** they have substantially increased from USD 30 million in 1999 to USD 75 million in 2002. The accumulated losses over the past five years are estimated at more than USD 200 million. Vietnam Post has an ambitious policy objective to turn itself around and become a profitable enterprise, but this would require in-depth analysis and diagnosis of its current financial condition and the preparation of a business plan based on product and customer profitability. This will be far from easy, as cost and asset allocation for the postal services still needs to take place. The objective is also challenging given the public service mission of Vietnam Post.

**Becoming profitable would need to be supported by a larger degree of commercial freedom.** Postal tariffs are low, about USD 0.05 for a letter up to 20 grams, which is unlikely to cover associated costs of restructuring, and the achieved rapid growth in mail volume may actually increase losses. A turnaround implies an increase in postal rates and a lower level of service. (A second delivery round in cities would not be affordable, for example.) The size and structure of the postal network also needs review in order to decrease costs or make them more flexible. One solution might be to transfer ownership of post offices to private agents as a franchise.

Investments have been made in the postal network, but in the past years quantity has prevailed over quality. The network expanded rapidly, with more than 900 postal stations added between 1999 and 2002, outpacing the growth rate of business. With business volumes for the network insufficient to cover costs, the main driver for expansion seems to have been providing better outreach for services, and not modernizing operations. Most post offices are not equipped with ICT or even a stand-alone computer, and still rely on manual, paper-based processing.

According to the long-term plans, investments will be made to install ICT in post offices, which eventually will help to improve access to Internet. Details about sources of funding and viability are presently not
available. At this stage, investments are determined on a year-by-year basis by the ministry, in accordance with the afore-mentioned plan.

Post offices provide access to telephone services. Vietnam has about 2.6 million fixed-line connections, or 32 fixed-line subscribers per 1,000 inhabitants. In addition, nearly one million mobile phones are in use. Vietnam is making a strong effort to increase the number of telephone connections rapidly, with a sustained growth rate of more than 25 percent per year. In practice, though, most villages and households have no phone and must go to the post office to make calls.

The Ministry of Post and Telematics (MPT) has a policy for ICT, to improve the telecommunications and postal sector, access to the Internet, and e-government. The Ministry receives assistance from the World Bank and several bilateral programs, e.g., Korea. There were about 7.5 personal computers per 1,000 inhabitants in Vietnam in 2002. The number of home Internet users is estimated at less than 400,000 or less than 2 percent of all households. Access to the Internet is relatively expensive, and not very attractive to most Vietnamese given the relatively small number of Vietnamese-language web-sites. E-commerce does not exist yet.

According to an announcement by the MPT, the postal network is likely to be the basis for rolling out an e-Vietnam program. The post offices would provide electronic and Internet access to many households, which are unlikely to have a PC or telephone line any time soon. An upgraded ICT infrastructure in post offices would also facilitate delivery of financial services and play a role in the promotion and fulfillment of e-commerce.

The roles of the postal network need to be taken into account when its services are separated from telecommunications. A separation could spur the commercialization and effectiveness of the mail business, and it might be considered fair to let the telecom operators maintain an economic and financial responsibility for the postal network as long as there is no alternative access to these services.

Also the relationship between VPSC—the postal savings corporation—and the postal network would need to be reviewed prior to separating Vietnam Post from VNPT. Lessons from other countries show that a dense postal network cannot be (economically) maintained with just mail services. In fact, from a strict business point of view, the mail operator would not need the postal network, as its logistics infrastructure with mail processing hubs could be sufficient. But conversely, the postal savings and telecommunications/ICT operators cannot exist or develop without a dense postal network. Vietnam would therefore have to engineer the break up of VNPT in such way that the postal network can be sustained as the basic infrastructure for access to financial services and communication services.

**The Role of the Postal Network in Financial Services Delivery**

The Vietnam Postal Savings Corporation, VPSC, is one of the youngest postal savings institutions in the world. Initial steps to establish it date from early 1990s, it began operations started in 1999, and has rapidly developed since then.

Since 1993, Japan—via bilateral assistance programs—has intermittently provided expertise and training from its postal savings institution (Kampo) to assist in the set-up. The assistance ranged from support in drafting the regulatory and institutional framework, designing the products and systems, designing the organizational structure, and training key staff (in Japan). VPSC’s business model resembles Kampo in certain key features, and differs in others. Since 1999, as VPSC’s development progressed, these differences have become more apparent.

VPSC was established via special decree by the prime minister (No. 215 of November 1998) as a subsidiary company of VNPT to provide postal savings services to the public in Vietnam, and actually began providing services in mid-1999. VPSC, however, is not licensed as a bank under the Law on the Credit Organizations. The Ministry of Post and Telecommunication of Vietnam regulates the postal savings service, with the consultation and approval of the State Bank and the Ministry of Finance. The owner and regulatory functions of the VPSC are essentially combined within the VNPT. The State Bank of Vietnam is reportedly responsible for monitoring deposit interest rates, money remittances, and the safety of all the funds of the postal saving
service system, and assisting the VNPT in training staff members of post offices participating in the postal savings service system.

Deposits in VPSC are implicitly presumed to be guaranteed by the state, and the investments are made in state assets only. The registered capital of VNPT was VND 50 billion (about USD 4 million). VPSC is also presumed to be a company (a commercial entity) within the VNPT structure, which is state-owned.

The Vietnamese government’s rationale for setting up the VPSC was very much in line with the ideas behind the “savings for national development”, i.e., pooling small deposits and channeling them to government funds which are used to finance the (long-term) development of the country. In the case of VPSC, the postal savings collected at post offices are pooled and invested mainly in the National Development Assistance Fund (NDAF) owned by the Ministry of Finance which lends mainly to long-term projects relevant to national development.

VPSC became an official member of the World Savings Banks Institute\(^2\) in 2002. VPSC’s membership in this international body gives it access to bank-specific publications, literature, conferences, and training sessions to augment its development. Meetings with overseas postal savings banks also provide the opportunity to exchange experience and ideas.

**VPSC started its operations by launching simple savings products**, such as passbooks and certificates. As in some other countries (e.g., Czech Republic and Brazil), beginning with a limited range of products appears to be effective for building a database of customers to whom other products can eventually be sold.

There are now three types of postal savings products: time deposits, utility deposits (to install service), and standard deposits. Initial savings deposits—VND 634 billion in 1999—soared to VND 3,166 billion in 2001, and VND 3,800 billion in 2003, representing a market share of more than 1 percent of total M2, including corporate deposits. This is an impressive result. Newspaper articles in August 2004 mentioned that VPSC ambitiously aimed to hold deposits of VND 10 trillion by the end of 2004. The number of postal savings accounts reached 381,735 at the end of 2003. According to the State Bank data, this is 42 percent of the market covered by credit institutions. It suggests that credit institutions and banks have only recently, and on a limited scale, begun marketing individual accounts.

The number of post offices handling postal savings increased from 202 in 1999 to 710 in 2002, and has been gradually increasing since then. VPSC announced that it would expand its network to 920 this year and be present in 52 of the 61 provinces and cities.

Post offices comply with several standards outlined by Vietnam Post and VPSC. Each must have five staff members, including a head and one supervisor, and one computer, which limits the expansion rate. VPSC operations at the post offices are handled by post office staff, not VPSC staff, such that VPSC uses only about 10 percent of the counters of the entire postal network. There is room for VPSC to increase its presence and activities considerably, especially if it involves more post offices.

**VPSC has launched payroll services**, providing accountholders with debit cards. This is a very useful product, but not yet widely used in Vietnam. Focused on individuals, the number of these accounts currently stands at 26,000 in only three provinces, with a total amount of VND 86 billion (USD 5 million). In addition, 77 post offices are connected on-line in a pilot program to offer payroll services to specific companies and to sign up employees as clients of VPSC. This service is convenient for the individuals, but also efficient for the company. Unfortunately, VPSC is unable to offer the company other banking services, such as deposits, overdrafts, commercial payments, and loans.

The number of non-cash transactions processed by VPSC reached 812,173 in 2003, representing 3.6 percent of the total volume of Vietnamese non-cash transactions (excluding ATM operations).

In 2003, the Ministry of Posts and Telematics made the decision to integrate the postal payments service of Vietnam Post into VPSC, beginning in 2005. It appears to be a sensible step to consolidate all financial services under one roof, create synergies and greater transparency, and avoid potential frictions between the payments services of the post and the payments and savings services of VPSC.

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\(^2\) The World Savings Banks Institute is a platform to promote the interests of savings banks.
Money Orders and Money Transfers

There are three types of domestic money orders offered by Vietnam Post:

- letter (standard) money order;
- telegraphic money order; and
- express money order.

There are two types of international remittance services: international money orders through 11 postal systems (including France, Switzerland, Japan and Canada); and a money transfer service as an agent of MoneyGram—an international remittance company. A connection to the Eurogiro network for international postal payments is under consideration.

In the case of domestic money orders, the volume of transactions increased from 4.3 million in 2000 to 4.9 million in 2001, and the amount of these transactions increased from VND 9.5 billion in 2000 to VND 10.1 billion in 2001. By contrast, the volume of international money orders through MoneyGram agents decreased from 34,291 in 2000 to 30,164 in 2001. The amount of these international money orders and remittances also declined from VND 190.5 billion in 2000 to VND 173 billion in 2001. This trend is the opposite of the market trend which shows fast growth in remittances. Causes for this decline might be the limited number of post offices with international capability and inadequate marketing. A considerable opportunity for the postal network appears to be underutilized.

The VPSC has agreed within VNPT to implement the following services as part of their strategy:

- Pension payments
- Life insurance
- Postal checks
- Tax payments
- Telephone bill payment
- Electricity bill payment
- Water bill payment

This is a basic expansion of current services and could be in operation within the next 2–3 years. In this way, VPSC is positioning itself as the entity for deposit mobilization and (cash) payment processing.

Organizational Structure

Under the supervision of a director and deputy director, the VPSC organization includes specific internal divisions at headquarters, such as human resources and administration, accounting and finance, research and development, business planning, payments, investments, postal savings, and auditing. It is responsible for a unique post office (located in the VPSC headquarters building) which only provides postal savings services, and a branch office in Ho Chi Minh City.

VPSC headquarters centrally manages all postal savings transactions of the provincial and district post and telecom, and post offices providing postal savings throughout the country in conjunction with VNPT. Postal savings services are currently provided in 30 provinces and cities (of 61 provinces and cities) in Vietnam, and are being expanded to 52 provinces and cities.

VPSC can determine its own interest rates on deposits mobilized from customers, in compliance with interest rates on deposits in private financial institutions. Postal savings funds deposited by the public are usually re-deposited by VPSC in the NDAF as long-term loans at one-year, two-year, three-year, and five-year maturity options. The annual amount of funds to be transferred to NDAF is determined by the Ministry of Planning and Investment. The interest rates for these funds are decided in negotiations between NDAF and VPSC.
The interest rate for loans, namely the sum re-deposited in NDAF, is determined by the Ministry of Finance, based upon coupon rates of government treasury bonds with similar terms.\(^3\) The money invested by VPSC in NDAF amounts to about 10 percent or less of the total funding base of NDAF. For NDAF, the cost of funding through government bonds seems lower and more efficient than through VPSC. This should highlight the necessity of analyzing or evaluating the rationale of VPSC’s funding NDAF and looking at alternative options for VPSC.

**Network Expansion of Postal Savings**

VPSC launched its services at 240 post offices in 61 provinces and cities in 1999. By the end of 2002, VPSC had services in 709 of about 3,000 post offices, and in 920 at 2004 year end. In addition, 78 post offices were connected to the individual savings account service and 100 post offices were computerized. In 2002, VPSC offered these products and services:

- Time savings: 3 months, 6 months, 1 year, and 2 years
- Collection savings: 6 months, 1 year, 1.5 years, 2 years
- Individual savings accounts: 26,000 accounts
- Payroll service to 43 companies with the total transfer sum of VND 21 billion (USD 1.4 million)

**Computer Network**

In order to achieve such objectives as providing higher-quality service and universal deposit and withdrawal services at different locations throughout Vietnam, further development of VPSC, survival in the increasingly competitive financial market, and an on-line network was mandatory and was constructed in two phases. VPSC developed its own software, in 2001, in cooperation with Getronics. They established a data-processing center in Hanoi and launched an individual savings account service for customers in 2002. A network center was established in Ho Chi Minh City a short time later to offer similar services. The first phase of constructing the computer network (pilot program) was finished by 2002, and roll-out to the public continued throughout 2003 and 2004. VPSC goals for the computer network were capacity to manage three million accounts and some 500,000 transactions in a regular time period (per day).

The computer network centers in Hanoi and Ho Chi Minh City were equipped with data servers (with brands such as Cluster, Unix, and Oracle), as well as web servers, e-mail servers, network management servers, and so forth. For the network, Public Switch Telephone Network and X-25 were utilized as communication circuits. Meanwhile, the on-line system for the post offices was equipped with a passbook printer, a personal identification number (PIN) pad, and other network equipment. Services introduced via the computer network were said to be well designed, not only for the basic savings products and services, but for new, future services.

Phase 2 of constructing the computer network will include expanding the network (bringing more post offices on-line), introducing telephone and mobile banking, and developing chip cards.

**Business Performance**

In 2002 VPSC managed more than 276,656 passbooks and certificates with a balance of deposits reaching VND 3.8 billion (USD 248 million). By comparison, the total balance of the funds transferred to NDAF stood at VND 3.8 billion (USD 243.8 million).

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\(^3\) For example, in December 2003, the deposit interest rate was 7.8 percent, with the return interest rate set at 7.0 percent. Such negative differentials spelled trouble for the operational management of VPSC. The below-market rate compensation of NDAF is likely to continue to burden VPSC’s development, to impose risks in asset/liability management and to negatively influence the competitiveness of the products.
VPSC Revenues and Expenditures, 2002

<table>
<thead>
<tr>
<th></th>
<th>Amounts (VND billion)</th>
<th>Amounts (USD million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Revenue</td>
<td>221.3</td>
<td>14.4</td>
</tr>
<tr>
<td>Total Expenditure</td>
<td>219.6</td>
<td>14.3</td>
</tr>
<tr>
<td>Operational Expenditure</td>
<td>15.6</td>
<td>1.0</td>
</tr>
<tr>
<td>Total Amount of interest paid</td>
<td>204.0</td>
<td>13.2</td>
</tr>
<tr>
<td>Profit (or Loss)</td>
<td>1.7</td>
<td>0.1</td>
</tr>
</tbody>
</table>

VPSC estimated that the 2003 results will show some loss due to a negative gap between the interest rate offered to customers and the return interest rates on funds re-deposited in NDAF. More recent data were not available. Although it is not exceptional for savings banks’ greenfield operations to show operational losses in their first 2–3 years of start-up, the 2002 results do not bode well for VPSC’s financial sustainability. Financial institutions are supposed to record profit and to be able to re-invest part of their profit into innovation and development. **VPSC’s results seem to provide very little room to self-finance its modernization.**

A component of the operational cost relates to the compensation of VPSC to Vietnam Post for utilizing the postal network. Reportedly, the fee per transaction is VND 1,800 plus 0.08 percent of the value. Although a breakdown of costs at each post office is not available, this appears adequate to cover the directly-associated labor cost per transaction.

It is **unclear what contribution VPSC makes toward the infrastructure and its development** (e.g., investments to upgrade computerization and security at post offices, or training postal staff). Without such a contribution, **it appears as if Vietnam Post subsidizes the operations of VPSC.** Government limitations on VPSC’s ability to determine and self-finance its own investment strategy toward the postal network make it dependent on government priorities for improving the post offices.

It should be a point of concern that VPSC could operate without attaining adequate profit levels and with a favorable cost treatment from Vietnam Post. This would not enhance the level-playing field with other deposit-taking institutions in Vietnam.

**VPSC’s Assessment of Its Business**

The Vietnam postal savings system has proved to be one of the **most efficient capital-mobilizing channels of the Vietnamese government**, by effectively utilizing the nationwide postal network in Vietnam. It is a mark of its success that the Vietnamese people have trust and confidence in VPSC as well as in postal savings services.

Despite the above positives, **VPSC sees several limiting factors**. The number of post offices handling postal savings services is still limited. The amount of money collected through postal savings network is still relatively small. The manual operation of the system and the limited types of services provided make postal savings facilities less attractive when compared with commercial banks.

VPSC itself recognized that it **offers a limited range of services**. It needs to overcome the structural obstacles to determining profitable interest rates offered to customers versus the return interest rate on loans to NDAF. Its investment targets and capital are limited because VPSC is not allowed to freely invest money mobilized from the public. On top of this, VPSC lacks experienced personnel.

**Strategies**

VPSC developed a plan for 2003–05, with targets and goals to achieve:

- Transfer VND 1.800 billion to NDAF
- Expand the current network of postal savings account service to 61 provinces and cities
- Offer new types of savings to the public
• Provide payment services to the public
• Research such modern financial services as telephone payment, e-commerce, Internet banking, chip cards, and life insurance

VPSC and VNPT have already applied for approval of the State Bank to offer payment services. In these discussions with the State Bank, it has floated the idea of providing microloans through the postal network.

Risks

In its current environment, VPSC appears to be exposed to a range of risks, and what measures it intends to take to mitigate these risks are not clear. A number of risks have been identified:

• **Interest margin risk:** There is substantial disequilibrium between client deposit interest rates and terms and the assets held at NDAF and in government bonds, leading to interest-rate and interest-term risk, and risk of negative interest margin income.

• **Market and sustainability risk:** As a wholesale funder more or less confined to government entities (in particular NDAF and government bonds), VPSC is bound to offer client interest deposit rates which are not competitive and/or to accept lower profitability levels. Not allowing VPSC to self-finance its development and build reserves undermines the market as well as the economic sustainability of the VPSC.

• **Liquidity and operational risk:** Because of the periodic, manual, and paper-based settlements between the post offices providing the postal savings and the VPSC headquarters, there may be a substantial lag between the deposits and disbursements made at post offices and the recording and management of these funds at the VPSC headquarters. These procedures increase the chances of client and staff fraud.

• **Operational risk:** Funds are lacking to upgrade to modern technology and train skilled staff. Paper-based, manually-processed business procedures are more open to fraud and delay of information needed to manage VPSC’s financial position.

• **Settlement risk:** There is settlement risk on payments to and from other banks because VPSC is not connected to the Interbank Payment System and has to deal directly with a large number of bank branches.

• **Regulatory compliance risk:** VPSC’s regulatory environment (regulation, supervision, reporting) does not appear to be transparent, and it may not be compliant with the instructions from the various regulators involved.

• **Loss risk:** VPSC is an affiliate of Vietnam Postal Service, which is said to be a heavily loss-making operation and which will not be separated from VNPT for the next few years. Within this corporate governance setting, VPSC is subject to Vietnam Post management. The current financial relationship between VPSC and Vietnam Post is not fully transparent. In particular, it appears that Vietnam Post subsidizes VPSC, although Vietnam Post may be using VPSC’s liquidity as own working capital. Pressure to increase the cost compensation from VPSC to Vietnam Post will happen only when Vietnam Post is separated from VNPT. In addition, it is unclear if and how risk is mitigated, whether VPSC’s client deposits would be used to finance or cover the postal operational deficit.

In the current constellation, VPSC is highly dependent on its relationship with the Vietnam Bank for Agricultural and Rural Development (VBARD). In addition to VBARD, which has computerized about 115 branches (out of 1,900), VPSC with the post offices could provide low-threshold access to basic financial services in rural areas and under-served urban communities. However, this would require a clear institutional framework for VPSC, so it could operate through the post offices and to finance improvements to the business processes and technology in the post offices.
2—Vietnam Postal Financial Services in Market Perspective

Since opening up to the world in the late 1980s, Vietnam has embarked upon a long-term development strategy to modernize its economy and to integrate itself into the international community. Extensive efforts and actions on many fronts supported the country's transition from a centrally-planned economy to a market-oriented one. One of the most important sectors to be developed and modernized was the country's financial sector to support economic growth and the smooth transition to a market economy. The government's development strategy for the financial sector was formulated around the following objectives:

- Developing a market-based monetary system
- Fostering efficiency and competition in the financial sector through equal treatment of all participants and through modernization of banking systems
- Promoting public confidence in the banking system

The government tackled areas of immediate concern first, keeping to the philosophy of a gradual, and sustainable reform process with broad consensus among stakeholders.

Access to the Payment System

In the early 1990s, the payment system needed improvement to offer effective and efficient service to the banking sector. For example, in the absence of non-cash payment instruments, cash was the predominant means of payment in Vietnam; without electronic transfer of funds, government payments between agencies, as well as other expenditures, were handled outside the banking system; and payroll payments were done in cash.

Under a World Bank program, the payment system has been substantially improved. A national inter-bank payment, clearing, and settlement system (IBPS) has been implemented. This IBPS has modules for large-value payments as well as for small-value credit transfers. The IBPS was designed to handle intra- and inter-provincial domestic inter-bank payments in Vietnamese dong, with a currency conversion facility for non-dong-denominated payments.

Settlement banks have direct access to the IBPS, with a single centralized settlement account at the State Bank of Vietnam and the IBPS interacted with the settlement account processing system. The State Bank established the criteria for settlement banks to participate in the IBPS, such as financial strength, conformity with technical standards, and risk management ability. A bank without a settlement account could participate indirectly through a correspondent relationship with a settlement bank. The IBPS was designed to allow access by settlement banks through six provincial processing (clearing) centers and through the banking centers in Hanoi and Ho Chi Minh City.

Any commercial bank that met the participation criteria set by the State Bank could participate. VPSC (and Vietnam Post) is not a commercial bank and does not meet the criteria, and therefore has to partner with settlement banks. For VPSC to play a role in bulk small-value payments, exclusion from the IBPS implies inefficiencies, delays, and additional risk in settlements. Although VPSC would seem to be at a competitive disadvantage with banks that already have implemented computerization for payments processing, few to none of these banks are set up to process bulk volumes of payments. VPSC could leverage its postal logistics process, which reportedly is in good shape, and could support the transport of payment slips or vouchers to selected post offices where data entry and data communications are available. It would clearly depend on VPSC's business process design, and its capability to distinguish between document flow, data flow, and money (cash) flow—and to design controls and checks for each of them—to be able to cross-check the consistency of each flow.

The number of non-cash payments rapidly rose, reaching more than 22 million transactions in 2003. It is assumed that a large number of these transactions were commercial payments and government transfers.
However, with 0.26 cashless transaction-per-capita in 2003, and an additional one million ATM transactions, the market for payment instruments for the population has been virtually limited to cash. The pilot projects undertaken by VPSC and several banks show that there is demand for cashless payments instruments, and it appears that VPSC with the wide postal network could play a significant role in developing the market for standardized small-value payment instruments.

Although data on the banks’ branch networks were not extensively available, it appears that there are more post offices than bank branches. VBARD reportedly has a network of 1,900 outlets with many located in rural areas to give farmers access to finance. The other large banks have much smaller networks, e.g., the Bank for Investment and Development in Vietnam has 160 branches, Incombank 124, Vietcombank 53, Eximbank 9, and Maritime Bank 7. These banks have branches only in cities and the branches are focused on public and corporate sector clients. Some of the foreign banks or joint venture banks have entered the high-end retail market.

Regarding access to (cashless) payment services, VPSC and the postal networks seem positioned to fill a large part of the void left by the commercial banks. Given the institutional and technical support rendered to these banks to improve their intra-bank payment systems and operations, it is likely that in the next few years they will be able to serve even more individuals in urban areas. Several of these banks have developed ATM networks, and there might be already 300 ATMs active in Vietnam.

Remittances

The net inflow in Vietnam of private transfers showed a rapid growth from USD 0.7 billion in 1998, to USD 1.5 billion in 2005 forecasted by the International Monetary Fund. Banks, agents of Western Union and Money Gram, private money remitters, and informal channels are the key players in this market. With a flow of less than USD 12 million, or less than 1 percent of the market share, the postal network has not been a major channel in spite of its dense network. It mainly processes international postal money orders to and from France, Switzerland, Japan, and Canada.

The postal network could play a valuable role as the last stop in the intermediary chain between sender and recipient. The postal networks in the countries from whence the money is sent could also play a more active role. In several of these countries, use of the traditional postal money order has greatly declined. At the same time, postal networks, and their associated postal banks or postal giro services, offer easy access to postal giro accounts from which payments can be made. Connecting Vietnam to the Eurogiro network would enable account holders to send money rapidly and reliably, at very low cost. Although this would not be a complete solution for Vietnam Post or VPSC, it would add to their strategy to grow the volume of remittances.

This could change if product development and marketing were introduced, and if post offices were equipped and trained to provide timely remittance services. This would require upgraded technology at post offices and dedicated marketing toward recipients and Vietnamese diasporas outside the country.

Savings

Through its operations, VPSC has shown a successful entry into the savings market, and should now find ways to consolidate and to expand in other areas. With the data currently available, it is difficult to assess the merits of the growth of the savings. First of all the size and break-down of the relevant market of households deposits is not known, and analyzing the growth rate of VPSC deposits within this market cannot be done. It would be important to see if, and in which segments, VPSC’s growth rate exceeded the market growth rate. Secondly, it would be useful to evaluate the reasons for success in more depth, e.g., through customer field research; to assess the level of trust in the postal network (or VPSC); and determine the competition with informal and formal alternative savings/investment opportunities.

In view of further stabilization of the market and the dong, VPSC could benefit from an accelerated conversion from informal dollar savings to formal local currency savings. This, however, would require competitive products and conditions.
It would also be **important for VPSC to offer a complete package of financial services rather than only savings or cashless payments instruments.** To effectively provide standard financial services to households, small enterprises, and others, VPSC needs to gradually develop a complete spectrum of services.

**Microfinance**

Prior to 1990, formal credit institutions provided credit only to state enterprises and production cooperatives. Non-governmental organizations (NGOs) were not allowed to operate in Vietnam, and individual farmers and households could not access credit from formal institutions. The Doi Moi policy, started in 1990, radically altered the nature of the microfinance structure. By year end of 1997, 47 percent of rural households were served by formal credit institutions, NGOs, and other social organizations; credit schemes met the needs of 3 percent of households through semi-formal services; and the remaining 50 percent relied upon informal and private credit sources.

The Vietnamese microfinance market is segmented into three main categories: formal, semi-formal, and informal microfinance.

- **Formal microfinance** is provided by four key players: Vietnam Bank for Agricultural and Rural Development (VBARD), VBP (now known as the Credit Policy Bank), Peoples’ Credit Fund (PCF), and Rural Shareholding Banks (RSHBs), which serve a combined market of 8.3 million rural households. The formal sector provides about 70 percent of microfinance services.
  - VBARD is state-owned and the largest financial institution, providing rural services through a nationwide network. At the end of 2001, it had 60-percent share of the microfinance market, and 35 percent of low income households.4
  - VBP focuses on poor households.
  - PCF is a network of cooperative and social financial institutions, which perform an active financial intermediation function.
  - RSHBs resulted from the reorganization of rural credit cooperatives and have a 10 percent government shareholding, but a minor share of the market.

- **Semi-formal microfinance** is provided by three main groups including national programs, financial services from social organizations, and international NGO microfinance schemes.

- **Informal microfinance** providers include private moneylenders, relatives, and traditional rural credit associations, similar to rotating and savings co-operatives, or ROSCAs.

Microfinance is seen as an important strategy to reduce poverty and promote economic growth in Vietnam. Not surprisingly, the role of the state in the expansion of financial services has played an important role in shaping the environment and context of service delivery. **The legacy of state domination of the microfinance sector has impeded its development as a commercially viable industry.** Policies that have impacted sustainability include the socially-motivated use of client loan rates, which were not commercially sustainable (including policies requiring a small spread between the savings and the lending interest rates); dependence on subsidized or quasi-commercial funding; and a lack of emphasis on savings mobilization.

**Informal sector lending is hugely important in rural Vietnam.** Informal lending comprises group lending, the co-operative People’s Credit Fund, credit schemes from joint stock banks and foreign NGOs, as well as some government-subsidized lending schemes targeted for specific purposes. Interest rates on loans in the informal sector were typically two or three times that of the government bank. The government seemed to have been meeting much of the demand from credit-worthy households, even if doing so with low rate loans, but there is a persistent level of high-interest informal sector lending in Vietnam.

A significant portion of the households in Vietnam get little or nothing from the formal financial sector. A combination of factors have perpetuated the continuing use of the informal sector by poorer segments of

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Vietnam including lack of collateral, remote locations, loan restrictions on use of proceeds, and small loan sizes, among others.

Although market distortions have resulted from the prevailing market structure and government policies, the government policies have had a substantial impact because of the large volume of funds that have been directed into rural microfinance since the mid-1990s. The role of the VBARD and VBP in financing a majority of the creditworthy rural households and crowding out some of the informal moneylenders has to be viewed as a positive achievement.

There is no clear regulatory framework for microfinance institutions (MFIs), although Vietnam is working on a possible framework with assistance from the Asian Development Bank. The draft decree recommended a two-tiered regulation system for MFI programs with and without savings mobilization. Co-operatives serving mainly rural areas would fall under separate legislation. There have also been a number of notable policy and legal reforms since 1996 that have had an impact on the microfinance environment, including the trend towards positive real interest rates over the last three years, greater flexibility for commercial banks in deciding loan guarantee requirements, the switch to a base-rate method of setting interest rates, and others.

Defining the size of the Vietnam microfinance sector can be distorted by the dominance of large government bank sector and activities. Total NGO rural microfinance lending is estimated to amount to 7 percent of formal government schemes or about 4 percent of total rural microfinance lending\(^5\) (USD 377 million compared to USD 1.9 billion for the government bank programs). Ten large NGO schemes account for 90 percent of NGO activities. Basic data on the industry taken from a 1999 PlaNet Finance\(^6\) publication indicated that there were some 6.1 million clients, with a loan portfolio outstanding of USD 1.76 million, and an average loan size of USD 150. There were estimated 2700 points of service or outlets, based on the 1999.

Savings mobilization has lagged in Vietnam, and fewer than half of the microfinance schemes or organizations in Vietnam reported collecting savings from households. Various studies cite the traditional policies of setting low lending interest rates as the primary disincentive to savings mobilization. NGOs in general have not shown great interest in providing savings services to the poor in Vietnam. Other government policies have contributed to the lag in savings mobilization, including the minimum deposit levels accepted by BVARD branches and by other commercial banks. VBARD deposits are overwhelmingly urban rather than rural. A lack of well-designed savings instruments for mobilizing public savings contributes to the problem.

In this context, the postal network and VPSC could fill a gap in the market and contribute to a further shift from the informal to the formal sector. An essential condition for undertaking such a mission in the microfinance sector is the design and implementation of transparent and intrinsically strong institutional framework for VPSC.

### 3—Options for Development

Five years after its introduction, the Vietnamese Postal Savings Corporation can look back on an impressive record of successes. With its 920 post offices (of 3,000), VPSC operates the second-largest financial service network in the country. It developed as a channel for mobilizing small household deposits, nearly 400,000 individuals keep accounts with the VPSC, and it has mobilized about 1 percent (VND 4 trillion) of the nation’s savings. It has also pioneered modern cashless payment services, and provides payroll and card-based services. The next step in its development is the integration of the postal payment services into its operations. However, after an initially fast growth track, VPSC currently faces increasing stagnation in its growth, mainly due to government limitations on its institutional and regulatory framework. Changes are

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required to enable sustainable growth of VPSC and including the post offices in its provision of low-threshold access to basic financial services.

VPSC has some significant limitations facing it:

- VPSC is not a licensed bank, but operates on the basis of a special decree from the prime minister. Essentially, it can take deposits only in certain post offices that meet certain requirements. VPSC can not develop a complete package of financial services for its clients.
- The deposit-to-asset conversion is not at the discretion of the management of VPSC. Pursuant to instructions by the minister of finance, the largest part of its assets is redirected to NDAF, which remunerates the funds at below-market rates as developmental loans.
- VPSC has privileged access to the post offices, but cost allocation and compensation, its investments in the post offices, responsibilities, and reporting procedures and systems do not seem to have been agreed upon in a transparent fashion, and may include mutual cross-subsidizing. On the other hand, VPSC’s rapid growth has generated substantial additional revenue for the postal system, contributing to covering its fixed costs.
- VPSC is not connected to the inter-bank payment system, although the postal network processes a considerable volume of semi-cashless payments, and could play a significant role in the transition from the current cash society to a cashless payment system in the next 10–20 years. To connect, VPSC needs to be a licensed bank.
- VPSC has no access to funding and finance sources to upgrade the postal network and to efficiently involve a larger part of the postal network. VPSC, within the VNPT structure, also has limited access to skilled and trained banking staff.
- VPSC's profitability is unlikely to be sustainable, as a result of below-market rates from NDAF, and the required cost and investment levels to operate through the post offices.

With this set of limitations, the future development of VPSC is likely to meet obstacles that will slow down the pace of its development. Given the vibrant development of the Vietnamese financial sector, it seems imperative that consideration be given to transforming the regulatory and institutional framework of VPSC. The transformation should serve the following objectives:

- Continue and expand VPSC's services under a banking license and insist on compliance with the regulations of the State Bank of Vietnam; operate VPSC service on a level-playing field with other commercial banks in Vietnam
- Make VPSC's payment operation join the inter-bank payment system
- Diversify VPSC's asset portfolio and redirect funding to VBARD, to other banks, financial institutions, and eventually credit clients
- Insist that the relationship of VPSC and the post offices be transparent in terms of responsibility, liability, reporting procedures and systems, technology, equipment, training, marketing and advertisement, and the related costs and financing of capital expenditure.

These are fundamental and structural issues. It would useful to undertake a more in-depth analysis of these issues before restructuring the VPSC. In addition, it would be helpful if the reform of VNPT and the postal (sector) reform were prepared and clarified in parallel with the transformation of VPSC.

Issues that need clarification in the process of developing VPSC are:

- the separation of VNPT, intended privatization, and its relation to the 61 PTT enterprises and their (postal) networks;
- the commercial viability of Vietnam Postal Service; the outline of its economic turnaround, and the role of postal financial service delivery in that context, as well as the envisaged relationship between Vietnam Post and the 61 PTT enterprises; and
- the actual information and communications technology and e-programs that will be installed and implemented, and the role of the 61 PTT enterprises.
A key issue here is whether the more than 3,000 post offices within the 61 PTT enterprises will eventually fall under the management of the unprofitable Vietnam Postal Service—with the consequent threat of closing a large number of post offices.

Or—alternatively—what if the 61 PTTs become a separate company responsible for managing the PTT retail network; are given the management, mission, and discretion to develop new retail communication and e-businesses; and given service level agreements with its historical users (namely Telecom, Vietnam Post, the press publishers, VPSC, and the government); along with reforming the post offices and transferring the ownership and management of small and medium-size post offices to the private sector under agency or franchise agreements?

The issues above appear to lead to the conclusion that a viable development of VPSC requires an updated and in-depth diagnosis of the entity, its market position, and its legal and institutional environment. A key question will be whether VPSC can develop into an institution that qualifies as a bank or whether it would have to do so through strategic alliances or partnership. Given the breadth and depth of issues that VPSC has to deal with, it makes sense to initiate a step-by-step approach to prepare and develop VPSC and to prepare the key stakeholders to make the required basic decisions for the future positioning and development of VPSC.

One option is to arrange a strategic technical or management partnership in which VPSC would be twinned with a savings bank or postal bank, and accelerate the process through management support, training, and advisory assistance. Such a program should lead to the eventual restructuring of VPSC as qualified or licensed credit institution or to a long-term strategic alliance with a licensed credit institution.