The Role of Postal Networks in Expanding Access to Financial Services

Country Case: Kazakhstan's Postal Finance Services

The World Bank Group
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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

ATMs	automated teller machines
CIS	Commonwealth of Independent States
EBPP	electronic billing presentation and payment
EFT POS	electronic fund transfer at point of sale
EMS	express mail service
GDP	gross domestic product
KZT	Kazakh tenge
M1	transferable deposits and cash in circulation
MFI	microfinance institution
NGO	non-governmental organization
RSEMS	Republic State Enterprises of Mail Services
SME	small and micro enterprise
SWOT	strengths, weaknesses, opportunities, threats matrix
USAID	United States Agency for International Development
USD	United States dollar

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Summary

SWOT Analysis of Kazakhstan Postal Service

Strengths	Opportunities
▪ Unique dense network for providing financial services, communication, and retail trade; 3700 post offices versus 368 bank branches ▪ Nearly 3,000 post offices in rural areas (approximately 7 million inhabitants), compared to 70 bank branches ▪ More than 800,000 deposits accounts; average deposit is USD 26. (Deposits are not tax privileged but implicitly backed by the state.) ▪ 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. ▪ Post offices increasingly equipped with modern information communication and technology ▪ Has central management, supported by management information system (MIS) which also manages cash and liquidity ▪ Management skilled and trained in banking and finance. ▪ Several agreements with private-sector entities and profitable under government accounting standards ▪ Access to finance for development projects (Islamic Development Bank)	▪ 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 ▪ 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.) ▪ 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.) ▪ 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.)
Weaknesses	**Threats**
▪ Virtually all post offices operate on a fixed-cost basis, leading to a low flexibility to adjust cost to actual economic turnover. ▪ Growth perspective in traditional postal mail market is very limited and in some segments negative. ▪ 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. ▪ In spite of MIS, KazPost lacks transparent accounting and product profitability, with possible capital expenditure on projects that are not economically sustainable.	▪ 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. ▪ 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. ▪ Letter mail market is (strongly) in decline and distribution of newspapers is likely to be affected by new technologies (hybrid mail) and competitive distributors. ▪ It continues to offer incomplete package financial services, and non-competitive rates, KazPost may be perceived as inferior provider of financial services. ▪ Lack of separated accounts implies the risk that client deposits can still be used to cover operational deficits within KazPost.

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. Kazakhstan[2] 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

[1] “Estimate of Kazakhstan’s Readiness for e-Commerce,” report prepared by PRAGMA (USAID) for a project to develop trade and investments.
[2] As mentioned in a memo of Liudmila Skorynina, Global Internet Policy Coordinator Kazakhstan, January 23, 2004.

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 lead 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* [3] 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

[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 re-invested 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.

Overview	
Number of commercial banks engaged in microfinance	**7**
Number of commercial POS	**185**
KSBP microfinance loan portfolio	**USD 162 million**
Number of KSBP loans	**35,000**
Number of MFIs	**n/a**
Number of MFI POS	**n/a**
Number of clients (of 2 largest MFIs for which data is available)	**8,000**
MFI loan portfolio	**USD 3 million**

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 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

Product Joint Ventures	Postbank Subsidiary	Merger of PFS with a Bank	Merger of KazPost with a Bank	Incorporation of the Postal Retail Network
Creation of specific product joint ventures or agency agreements with licensed financial institutions could fill the gaps in the current products offerings.	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.	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.	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.	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
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.	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.	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 competetive. Part of the proceeds could also upgrade the post office network to attract other retail partners.	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.	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 s 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.
This might be effective as an intermediate, short-term step.	This might be considered as an intermediate step, to prepare the postal savings or KazPost for privatization, and would contribute to transparency.	It might be an effective option, but will require due care in preparation and structuring. It would help create transparency and competitiveness.	This might be an effective medium- term option and accelerate the restructuring process, but substantial follow-up will be required.	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.