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## **Contingency and Management Control Tools for Municipal Public Services of Cameroonian Cities: Interpretation of Practices**

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### **ABSTRACT**

*This research aims to examine the perceptions of both the elected officials and the department managers of the contingent determinants likely to influence the performance of the municipal public services of Cameroonian cities. Moreover, it presents the types of control exercised by the municipalities and their frequency. To reach these objectives, we conducted a survey involving 102 Cameroonian municipalities. More specifically, 102 (one per municipality) and 148 quantitative questionnaires were sent to elected officials and department managers, respectively. From this, 50 usable questionnaires were returned by elected*

*officials and 60 by department managers, for an overall response rate of 44%. Among the core results of the study, we found positive relationships between the degree of decentralization of the municipal structure and both the size and the performance of the municipal public services of the Cameroonian cities. We also observed that the larger the size of a municipal service, the more the performance is likely to be better (improved). On the other hand, we do not found any relationship between the use of control panels and the size of the municipal service.*

**Keywords:** Contingent determinants, Municipal public services, Performance

## INTRODUCTION

The effectiveness of management control is actually raising many questions. Its application in a complex environment, such as those found in rural localities, stresses us to further reflect on its originality and its innovative approach. Indeed, it has been necessary to wait until the 1990's before seeing the development of a real management control of cities, which first appeared slowly during the years 1977-1980. Management control has two dimensions: a technical-economic dimension of accounting and finance, as well as a humane-psychological dimension based on the behaviors of control and influence (Naro, 1995). The practice of management control highlights the importance to motivate the human resources. In fact, to ensure a good functioning of an enterprise, all people must be involved and properly motivated. The autonomy of the department managers is also supposed to be developed (Gervais, 1997; Lord, 1998). However, the use of the term *control* remains ambiguous. With financial basics such as

verification, with some nuances, we can also add or substitute from the initial research by Fayol (1916) or Taylor (1965) the idea of short-term planning proposed by Roussarie (1994). As the organizations become more and more complex, it is no longer sufficient to simply ensure compliance with rules and standards, but also to develop the capacity to follow the plans, and even to embrace them. Observing this evolution, Anthony (1965) identifies three levels of control: (1) the *management control* allowing managers to make sure that the resources are got and used effectively and efficiently in the pursuit of the organizational objectives; (2) the *strategic control* allowing senior managers to define specific objectives and the necessary resources to reach them; and (3) the *operational control* allowing the department managers to ensure the proper functioning of the daily tasks.

The objectives of this paper are not only to present the method and the frequency of management control in Cameroonian municipalities, but also to provide insights on the determinants likely to influence the municipal performance. The study is based on a survey involving quantitative questionnaires administered to 50 elected officials and 60 department managers. The remainder of the paper is organized as follows: first, we present the theoretical foundations on the types of control and we formulate the research hypotheses; second, we describe the methodology followed to conduct the study; third, we report and discuss the main results; and finally, we test the hypotheses.

## **THEORETICAL FOUNDATIONS AND HYPOTHESES**

### **Dependent Variables**

The dependent variables were chosen in taking into account the organizational specificities of the African municipalities. As the African municipal actors are generally reticent to

communicate the financial reports, and particularly in Cameroon, we measured the performance using a set of six criteria<sup>1</sup>. These criteria were assessed and estimated personally by the department managers according to their importance on a five-point Likert-type scale.

### **Independent Variables**

The determinants of the municipal performance are regrouped into two independent variables. For each of these two explanatory variables, we present the theory and we formulate some related hypotheses.

#### ***Municipal decentralization***

Decentralization must be supported by strong structured activities and a precise definition for each task and role in order to maintain the control. According to Brown and Waterhouse (1975), “In a decentralized and structured organization, the activities are clearly defined, the areas of responsibility and authority are clearly delimited, and the control is essentially impersonal.” The decisions can then be delegated since the organizational control is maintained. “Decentralization also refers to the degree of autonomy left to the various department heads”, state Chenall and Morris (1986). The explanatory variables related to autonomy and decentralization were measured by Brown and Waterhouse (1975) using the scales proposed by the ASTON group. The liberty of action of the different people responsible of the organization was defined at different

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<sup>1</sup>These criteria are: Q371\_IMO (importance of the objectives 1 = users satisfaction); Q372\_IMO (importance of the objectives 2 = to ensure the garbage collection); Q373\_IMO (importance of the objectives 3 = to ensure recording birth and marriage certificates); Q374\_IMO (importance of the objectives 4 = staff satisfaction); Q375\_IMO (importance of the objectives 5 = drinking water supply); Q38\_RO: to reach the objectives.

hierarchical levels for a certain number of decision-making responsibilities. As shown by some works referenced above, it is very clear that the organizational structure was the subject of numerous empirical studies within the organizations in the past. Consequently, it would be interesting in the present study to see if the local structure can influence the performance of the municipal services of the Cameroonian cities. To that end, we formulate the following hypotheses.

H1. There is a positive relationship between the degree of decentralization of the municipal structure and the performance of the municipal services of the Cameroonian cities.

H2. There is a positive relationship between the degree of decentralization of the municipal structure and the size of the municipal services of the Cameroonian cities.

### *Size-effect*

The work of Pugh et al. (1969) is often associated to those of pioneers which propose that the 'size' influences organizations and notably that the goal of comparative analysis is to discover the common and specific problems of organizations of every types. The main results of this work reinforce the idea that "... the size of the organization constitutes a major predictive factor in its structuring" (Desreumaux, 1992). Regarding the relationship of size versus structure, numerous empirical works support the results of the ASTON group (Blau & Schoenherr, 1971; Child & Mansfield, 1972).

However, a study conducted by Meyssonier (1993) on the use of control panels in 82 French municipalities showed that a large majority of the cities do not use any control panels to control the functioning of the departments and to manage the municipal

activity. Using the khi square test to evaluate and quantify the hypothesis of independence between the use of the control panels<sup>2</sup> and the size of the municipalities, the author finds a khi square of 4.59 with 2 degrees of liberty and a probability of 9.85%. According to this author, "... one cannot affirm therefore, with certainty, that the size and the use of the control panels are correlated, especially since the nature of these control panels can be variable." Considering the previous research, the size of the organization appears as a variable susceptible to influence the features of the performance of the municipal public services of the Cameroonian cities. So, inspired by these previous works, we formulate the following hypotheses.

H3. The larger the size of a municipal service, the more the department manager is likely to make use of control panels.

H4. The larger the size of a municipal service, the more the performance is likely to be better (improved).

In the next section of the paper, we describe the methodology followed to conduct the study related to this research.

## **METHODOLOGY**

In this section, first, we begin to develop and pre-test the instrument used to conduct the study; second, we describe the sample and data collection of the study; and finally, we test the

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<sup>2</sup>The control panel is a tool to aid decision-making and forecasting a set of indicators (five to ten) designed to assist administrators assess the state and the evolution of the systems that they manage and to identify the tendencies which they influence on a coherent horizon in the structure of their functions.

validity and reliability of the instrument used to conduct the study.

### **Development and Pre-test of the Questionnaire**

To answer the problematic posed and to verify the hypotheses formulated in the study, we decided to adopt the quantitative questionnaire as the main instrument to collect data. The reliability of this technique seemed appropriate and essential to us given the exploratory character of the research was not allowing us to get as much information required without going first through the administration of a questionnaire. Thus, during the first quarter of 2006, a first pre-test questionnaire was administered to about 20 people responsible of the different services in the city of Douala. The particular questions that seemed problematic due to misunderstandings were rephrased. And the initial mistakes detected in the pre-test were corrected and the questionnaire modified accordingly. This new questionnaire was then still pre-tested by about 20 elected officials and department managers in the city of Yaounde. This second pre-test did not detect any major anomalies in the questionnaire, thus validating the survey questions. The administration of the questionnaire could therefore start.

### **Sample and Data Collection**

The choice of the sample was very difficult. Our investigation has been made between November 2006 and March 2007. During this period, the Cameroonian cities represented a set of 339 local municipalities distributed in 2 urban communities (Douala and Yaounde) with 11 urban municipalities from districts (5 from the Douala's district and 6 from the Yaounde's district), 20 urban municipalities of which 11 are from a special administrative region, and the remaining 308 local municipalities being rural

municipalities. Table 1 summarizes the different types of municipalities and services which participated in the study.

Table1 Types of Municipalities and Services Involved in the Investigation.

| Types of municipalities                                   |            | Types of services       |            |
|---|------------|-------------------------|------------|
| Rural municipalities                                      | 84 (82%)   | Financial services      | 56 (38%)   |
| Urban municipalities                                      | 05 (5%)    | Technical services      | 40 (27%)   |
| Urban municipalities from districts                       | 11 (11%)   | Administrative services | 52 (35%)   |
| Urban municipalities from a special administrative region | 02 (2%)    |                         |            |
| Total   | 102 (100%) | Total                   | 148 (100%) |

With regard to the quantitative investigation, 250 questionnaires were distributed at the same time to the elected officials and department managers of different municipal public services. Of the 250 questionnaires, 102 were addressed to the elected officials and 148 to the department managers. The details of the data collection are provided in Table 2.

Table 2 shows an overall response rate of 44%. So, we are very satisfied about this response rate considering the exploratory character of the research and especially the hostility we encountered with municipal staff in developing countries like Cameroon.

Table 2 Questionnaires Sent and Received.

|                          | Elected officials | Department managers | Total      |
|--------------------------|-------------------|---------------------|------------|
| Questionnaires sent      | 102 (100%)        | 148 (100%)          | 250 (100%) |
| Questionnaires received  | 62 (60.78%)       | 88 (59.45%)         | 150 (60%)  |
| Questionnaires withdrawn | 12 (11.76%)       | 28 (18.91%)         | 40 (16%)   |
| Usable questionnaires    | 50 (49%)          | 60 (40.54%)         | 110 (44%)  |

### Test of the Validity and Reliability of the Questionnaire

While recognizing the necessity to adapt the rule to the specific context of every research, Perrien et al. (1984), Evrard et al. (1993) as well as Usunier et al. (1993) estimate that, in the case of an exploratory research, a Cronbach's alpha coefficient between 0.5 and 0.6 is acceptable. Thus, in this research, all elements which could not reach this threshold were withdrawn in order to get more reliable measurements. Then, this method of internal consistency has been selected to measure the reliability of the instrument used for the quantitative investigation. The Cronbach's alpha coefficient was therefore estimated to verify the homogeneity of the items in each variable chosen to assess the performance of the municipal public services of the Cameroonian cities. The Cronbach's alpha coefficients got in the reliability analysis are presented in Table 3.

As shown in Table 3, all of the Cronbach's alpha coefficients got in the reliability analysis have values superior to 0.6, thus meeting the reliability criteria generally accepted. Only the coefficient related to the variables Q52\_EDVO, Q53\_DVO and Q57\_CP have a very weak value (0.371).

Table 3 Cronbach's Alpha Coefficients Got in the Reliability Analysis.

| Variables  | Cronbach's alpha |
|--|------------------|
| Q371_IMO: importance of the objectives 1 = users satisfaction<br>Q372_IMO: importance of the objectives 2 = to ensure the garbage collection<br>Q373_IMO: importance of the objectives 3 = to ensure recording birth and marriage certificates<br>Q374_IMO: importance of the objectives 4 = staff satisfaction<br>Q375_IMO: importance of the objectives 5 = drinking water supply<br>Q38_RO: to reach the objectives | 0.753            |
| Q46_EFO: mayors' educational level<br>Q47 ETF: mayors' type of education   | 0.797            |
| Q40_CM: conflicts between the mayor and the municipal employee   | 0.754            |
| Q09_NPO: level of computerization of the activities  | 0.572            |
| Q46_ANA: appreciation of the level of absenteeism  | 0.614            |
| Q28_UTBM: use of control panels in the city hall<br>Q29_TAIMAI: size of the city hall (number of employees)  | 0.721            |
| Q52_EDVO: existence of voluntary departures<br>Q53_DVO: voluntary departures<br>Q57_CP: job changes  | 0.371            |

Similarly, related coefficients are also obtained between these variables and the performance of the municipal public services. And, a correlation analysis between these variables and the other variables susceptible to influence the performance of the

municipal public services has also been performed. All variables of the model have been measured according to a five- or seven-point Likert-type scale. As Kinnear and Gray (2005) noted, if the data in the first place are measurements at an ordinal level as for a ranking series or nominal data, the non parametric test becomes the only possibility. Consequently, in the setting of this research and, considering the small size of our sample and the stated objectives, we opted for non parametric tests. Finally, we used the Statistical Package for the Social Sciences (SPSS) software version 10.0 to analyse the survey data.

Now that we have described the methodology followed to conduct the study, in the next section, we present the main results and we discuss about the more important.

## **RESULTS AND DISCUSSION**

This section presents the main results got from the quantitative investigation. First, we discuss about the type and frequency of controls in our sample of 50 municipalities. Second, we compare the perception of the contingent determinants likely to influence the performance of the municipal public services.

### **Type and Frequency of Controls in Our Sample of 50 Municipalities**

The results of the quantitative investigation show that three types of control mechanisms exist in the 50 municipalities representing our sample. They are: (1) *lawful procedural control*, (2) *financial control*, and (3) *management control*.

Lawful procedural control is a type of control exercised by the state representatives on the municipalities themselves to ensure that lawful procedures are respected and that the interests of the

state are preserved while avoiding abuses of any kind. As well, control over the realization of all works is integrated according to the hierarchy as described by Bouquin (1991) because it allows the municipal directors (municipal magistrates, staff, and territorial agents) to ensure that actions that are taken as a result of their authority are actually carried out in accordance with the stated objectives, while allowing the directors to manage themselves the authorized work. Management control is executed, in this case, by officials of the Ministry of Finance and Economic Development and their financial controllers. As pointed out by Anthony (1965), management control has an essential place since it is the pivot between the general politics of the organization and the daily operational tasks. Unfortunately, the results of our quantitative investigation show that only 10% of the 50 municipalities in our sample have an appropriate management control versus 90% who did not have, as shown in Figure 1. The controls exercised (lawful procedures and finances) are generalized throughout the communities and the municipalities.

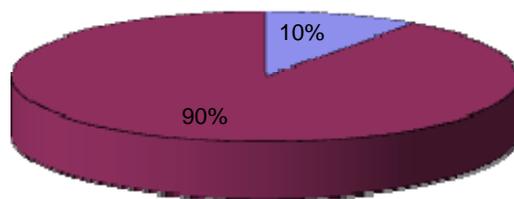


Figure 1. Management Control in Our Sample of 50 Municipalities.

Otherwise, the frequency of controls refers to the in-person control exercised by the municipality. The results of the quantitative investigation indicate that 36% of the municipalities in our sample are visited by the representatives in a frequency varying from 4 to 6 times during a same budgetary exercise. On the other hand, 28% of the municipalities had less than 3 controls and 8% of the municipalities had more than 10 controls per year. Figure 2 shows the frequency of oversight control exercised within the Cameroonian municipalities, or at least those which are part of our sample.

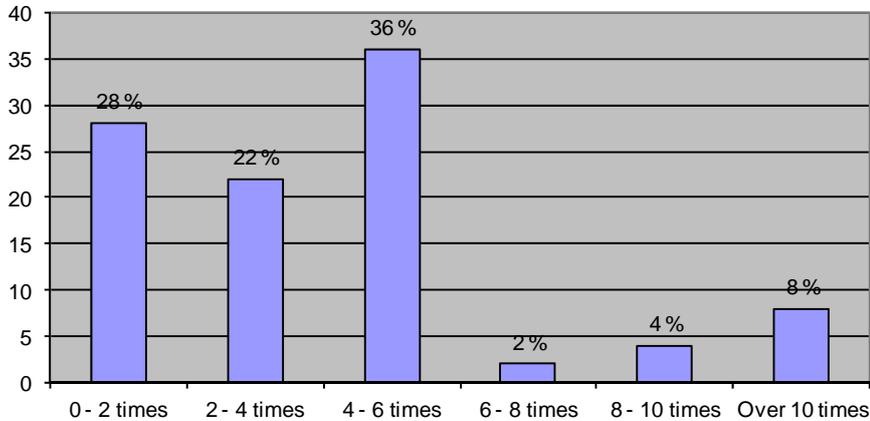


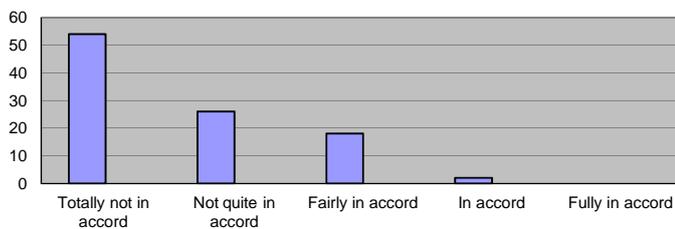
Figure 2. Frequency of Controls in Our Sample of 50 Municipalities.

### **A Comparison of the Perception of the Mayors and Department Managers on Some Factors Likely to Influence the Municipal Performance**

We kept the 50 municipalities and 60 municipal services of the sample to measure the degree of decentralization of the municipal services. We consider decentralization to represent both legal autonomy and a genuine functional autonomy or authority to operate from day-to-day.

#### ***The perception of decentralization as viewed by the mayors***

The question asked to measure the degree of decentralization of municipal services was developed on a five-point Likert-type scale from ‘totally not in agreement’ to ‘fully in agreement’. The respondents had to indicate if the municipal structure of their municipality was completely decentralized. The results of the quantitative investigation are presented in Figure 3.



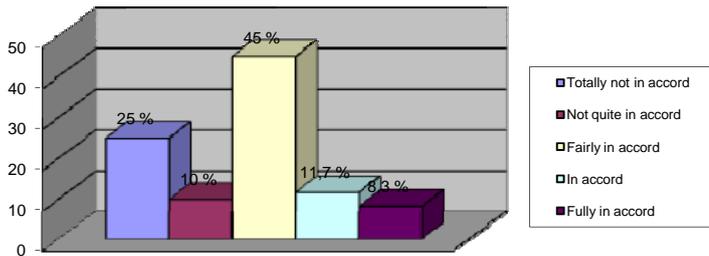
Mean: 10; Standard Deviation: 10.95; Maximum: 27; Minimum: 0; Median: 9

Figure 3. The Degree of Decentralization as Viewed by the Mayors in Our Sample of 50 Municipalities.

It appears in the results of the observations shown in Figure 3 that there is an anomaly in the first column given 27 mayors, representing 54% of the sample, are not at all in agreement with the opinion that their municipal structure is completely decentralized. We therefore find a very disparate distribution between the 50 mayors in the sample. Furthermore, 26% agree, but only slightly, that their municipality is completely decentralized, another 18% agree, but to a lesser extent, while only 2% are in agreement. On the other hand, none of the 50 mayors fully agree with a total decentralization of their municipality. These results are consistent with those of Roussarie (1994) which also shows an irregular distribution of opinions by department service managers regarding the decentralization of some activities. Finally, with a mean of 10 and a standard deviation of 10.95, it is very easy to see that an important divergence of opinions exists regarding the degree of decentralization of municipal public services in Cameroonian cities.

***The perception of decentralization as viewed by the department managers***

When asked to measure their autonomy, the question was of a general nature and subjective. Indeed, we asked directly to the people responsible of the municipal public services if they belonged to an overall decentralized municipality. Here again, the perception must be taken into account. But this 'feeling' is inevitable since they are the ones responsible for establishing the management tools necessary for controlling the performance of municipal public services of the Cameroonian cities. As the mayors before, the department managers had to answer on a five-point Likert-type scale from 'not at all in agreement' to 'fully agree'. The results observed are distributed as shown in Figure 4.



Mean: 12; Standard Deviation: 5; Maximum 27; Minimum: 5; Median: 7

Figure 4. The Degree of Decentralization as Viewed by the Department Managers in Our Sample of 60 Departments.

As shown in Figure 4, the results of the quantitative investigation indicate that 15 (25%) department managers questioned are not at all in agreement that they belong to a completely decentralized municipality. Six department managers (10%) agree only slightly, 27 (45%) agree to a lesser extent, 7 (11.7%) agree, and finally, 5 (8.3%) fully agree with decentralization.

Overall, the knowledge gained from the comparative analysis of the perception by the mayors and the department managers on decentralization is explained in the statements that follow. The mean score is higher among the department managers (12) than among the mayors (10). The median score, however, is 9 among the mayors while 7 among the department managers. The standard deviations of 10.95 among the mayors and 5 among the department managers allow us to note that

there is a strong scattering of the scores between these people who took part in the investigation. Moreover, the median scores indicate that half of the respondents scored lower than 7, whereas the other half scored 9 or more. Finally, we see similar results concerning the most elevated scores since these are the same 27 respondents in both cases, while the weakest score is zero (0) among the mayors and 5 among the department managers. It should be noted that the maximum scores among the mayors correspond to 'not at all in agreement', whereas they are related to 'agree to a lesser extent' among the department managers. However, the feelings towards decentralization remain heterogeneous, with a mean score of 11 based on 110 observations of 50 mayors and 60 department managers. Furthermore, the total median score is 8 and the standard deviation is 9.62 with a maximum of 27 versus a minimum of 0. In the final analysis, autonomy is certainly a question of perception. Thus, it was imperative for us to evaluate, as objectively as possible, the liberty of action of each department manager. Therefore, we questioned every senior manager about his/ her degree of autonomy relative to some types of important decision-making, as performed by Roussarie (1994), himself inspired by the works of the ASTON group.

***The perception of the department managers on the decentralization of some activities***

We analysed the decentralization of some activities according to 7 types of fundamental decision-making for the appropriate functioning of a municipal service, that is purchasing small items, purchasing edible foods, increasing credits, budgetary decisions, recruitment of agents, defining work methods, and distribution of tasks. Figure 5 presents a summary of this analysis.

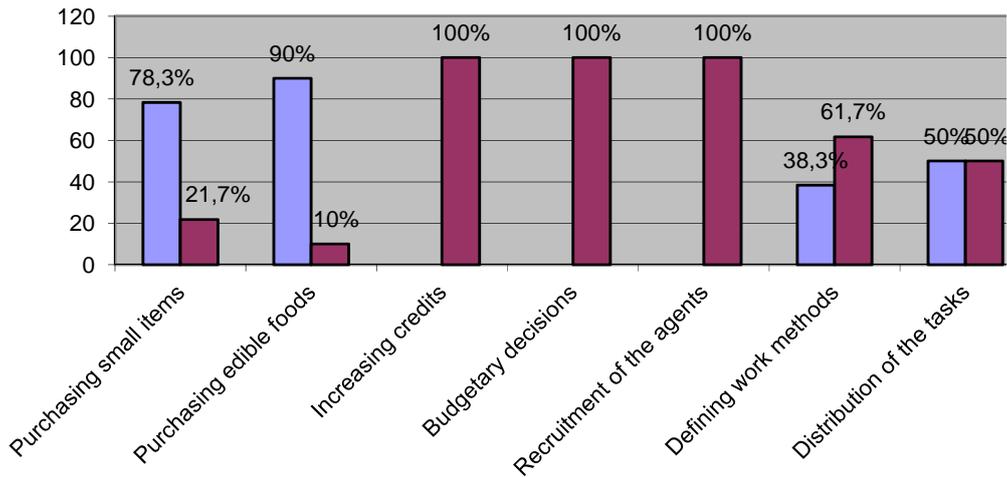


Figure 5 The Perception of Autonomy on Some Activities of the Department Managers in Our Sample of 60 Departments.

For each type of activity, we asked to our participants not to use a scale, but rather to indicate us in which of the above activities he/she had autonomy in the decision-making. As seen in Figure 5, the results of the quantitative investigation show that a large majority of the department managers of the municipalities examined exercise a real autonomy over the purchasing of small items and edible food products. More specifically, 78.3% and 90%, respectively, exercise autonomy, and only 21.7% and 10%, respectively, do not exercise autonomy in these two activities. As stated by Roussarie (1994), the purchasing of small items or edible food products represent major actions for the appropriate working activities within a department. Outside of the large investments that are the prerogative of political decision-making and therefore the responsibility of the mayors, the results of the quantitative survey show very well that the elected officials of the

50 municipalities investigated left a great liberty of action in those activities to their department managers of the different municipal services.

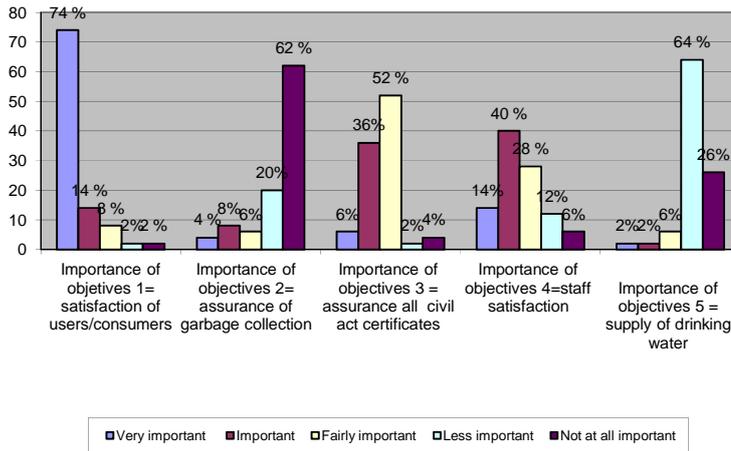
Regarding the increases in credits, the budgetary decisions or the recruitment of agents, the results of the study clearly show that the liberty of action by service managers is practically non-existent. The 60 department managers in our sample answered succinctly that they had no liberty of action since these different activities, in the whole, require political oversight and therefore are the responsibility of the elected officials, especially considering difficult budgetary decisions. As for the recruitment of agents, according to the results of our study, the possibilities of intervention by the department managers are non-existent. These results are not consistent with those of Holzer and De Lancer (2001) as well as Roussarie (1994), while the department managers are increasingly participating in the recruitment commissions in order to judge the technical expertise of the candidates. In fact, our results are totally in contradiction. Here, the recruitment is the only responsibility of the mayor. He/she is the only one, the unique, to judge the expertise and the technical abilities of the agents that he/she wishes to recruit in order to fill the needs of the various services. Even the general secretary is not consulted for this important and delicate task. The agents are imposed to the department managers either by the elected officials or by the recommendations emanating from politicians or others. Concerning the definition of the working methods and the distribution of the tasks, 61.7% and 50% of the service managers, respectively, are responsible and autonomous for defining the working methods and the distribution of the tasks. Here again, we observe a mass of power belonging to a 'super department manager' who is also the mayor for some services in particular situations. So our results are not consistent with those of

Roussarie (1994) where the autonomy of such activities is practically absolute. Finally, the results indicate that the decentralization is much less efficient when compared to the decisions in which the department managers are actively contributing, but they are also subject to strong legal constraints (such as budgetary decisions or increases in credits) and they also have real consequences in the mid and long term priorities and operations of various services (e.g., staff recruitment).

***Degree of importance and achievement of the municipal objectives by the 50 mayors***

A precise definition of organizational objectives is essential to fill the needs of the population, even if such an exercise remains difficult for elected local and territorial authorities. Measuring the performance of municipal public services provides an objective and realistic assessment of the achievement of the goals. This method allows the general secretariat to follow the execution of the decisions and established goals, and to ensure compliance between the strategy and the daily work. In which follows, we measure the degree of importance of the 5 municipal objectives: (1) users/consumers satisfaction; (2) assurance of garbage collection; (3) assurance of all civil act certificates (birth and marriage, etc.); (4) staff satisfaction; and (5) supply of drinking water. For each of the stated objectives, the respondents had to answer on a five-point Likert-type scale from 'very important' to 'not at all important'. The results are presented in Figure 6.

The results of the quantitative investigation indicate that 74% of those questioned considered that objective 1, ensuring the satisfaction of the population, is very important with a mean score of 1.44, a median score of 1 and a standard deviation of 0.88. The maximum score is similar for the five objectives, 5, as well as the minimum score, 1.



Mean: (1) 1.44; (2) 4.20; (3) 2.62; (4) 2.56; (5) 4.10  
 Standard Deviation: (1) 0.88; (2) 1.14; (3) 0.80; (4) 1.07; (5) 0.76  
 Median: (1) 1; (2) 5; (3) 3; (4) 2; (5) 4  
 Maximum: 5; Minimum: 1

Figure 6. The Degree of Importance of the Municipal Objectives for the Respondents.

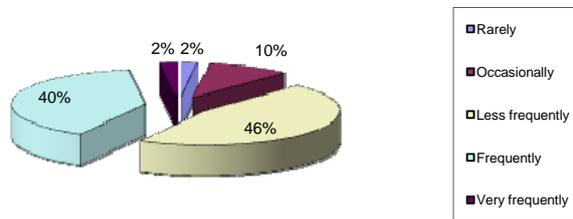
Regarding the importance of objective 2, to ensure garbage collection, only 4% of those questioned considered this to be very important, 8% considered this to be important, 6% fairly important, 20% less important, and 62% not at all important. The mean score is 4.2, with a median score of 5, a standard deviation of 1.14, and a maximum of 5. The standard deviation of 1.14

shows a strong scattering of opinions of people questioned on the degree of importance of the municipal objectives of the municipalities. The management of the civil status service presents a mean score of 2.62, with a median score of 3; this means that half of the scores of the respondents are lower than 3, whereas the other half are superior or equal to 3. The standard deviation of 0.8 shows that a weak scattering of scores exists between those who judge that ensuring birth and marriage certificates are 'very important', or 'fairly important' along with 'less important' or 'not at all important'. Of those questioned, 36% of the people consider that this objective is 'important', whereas 52% find it 'fairly important'. With a mean score of 4.10 and a standard deviation of 0.76, the respondents who consider that the objective 5 (supply of drinking water) is very important seem very few. Given 64% among them find this objective of few importance with others stating even 'not at all important', a reason that we can give to explain this is the fact that providing drinking water is a very expensive activity for the Cameroonian municipalities and their respective populations. Thus, they are in the obligation to share the management of this activity with the national entity NSWC (National Society of the Waters of Cameroon). The scattering of the scores for this objective remained nonetheless weak.

When it comes to achieving these objectives, we asked the respondents to rate their view according to a five-point Likert-type scale from 'rare' to 'very frequent' (see Figure 7).

The results of the investigation indicate that the realization of the municipal objectives is considered rare, with a frequency of 1, by only 2% of the respondents, while 10% of them said occasionally. On the other hand, 46% of the respondents believed that the municipal objectives are less frequently achieved, with a frequency of 23. Inversely, 40% of the people which took part in

the study declared a realization rate of 'frequently', while 2% believed that they are very frequently achieved.



Mean: 10; Standard Deviation: 10.67; Maximum: 23; Minimum: 1; Median: 5

Figure 7 Achievement of the Municipal Objectives.

With a mean of 10 and a maximum of 23, the number of people questioned who estimate that the realization of the five municipal objectives occurs frequently (40%) is relatively high. In the final analysis, if these objectives are achieved as predicted at the beginning of every electoral mandate, it seems that the waiting period or the time for completion meets, more or less, the expectations of the population at large. A mean score of 10 and a standard deviation of 10.67 indicate that some divergence exists between the opinions of the people questioned and the performance of the municipal public services of the Cameroonian cities. As stated earlier, the methods of control existing within the Cameroonian local collectivities are said to be of 'lawful

procedural control', that is, the control exercised by the representatives of the ministry. The execution of local services is not necessarily better delivered by the private sector compared to the existing public sector, with regard to costs and quality (Hoffmann-Martino, 1988). According to Terny and Prud'homme (1986), when the services are poorly managed and the objectives are ill-conceived, it is sometimes required to privatize them or even to concede them. However, the author considers it necessary to continually oppose the privatization of the public management system. The remarks of these authors forced us to question if the controls exercised by the representatives of the Cameroonian municipalities are frequent. Indeed, we must understand if these same controls can influence the performance of the municipal services in Cameroon. To that end, we asked the respondents to evaluate, on a five-point Likert-type scale from 'very rarely' to 'very frequently', if the Ministry of Economy and Finances adequately controls the objectives fixed at the municipal level. Figure 8 shows the opinions collected regarding the degree of control of these objectives.

It appears in Figure 8 that the frequency of control of the objectives by the representatives of the Cameroonian municipalities is not at all frequent. Indeed, according to the results, 12% of the respondents estimated that the control of these objectives is either rare or very rare, and 68% believed that it occurs less frequently. On the other hand, 20% declared that controls over the objectives occur frequently by the representatives. And no respondent found that the frequency of control of the objectives occurs very frequently. These results lead us to conclude, as stated by (Chaudemanche, 1995), that one of the problems in exercising control over local municipalities is that they are both atypical and complex organizations.

One can even wonder if it is possible to reconcile the notion of control with public service. The simple questioning of such an idea has serious ramifications, specifically concerning the legitimacy of the oversight.

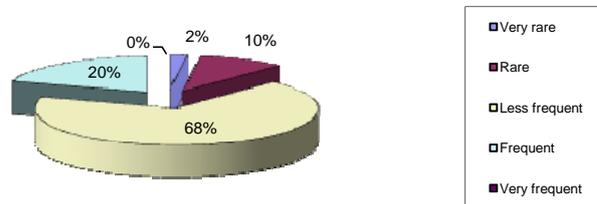


Figure 8. Summary of the Control Frequency by the Ministry of Economy and Finances.

In order to achieve solid benchmarks to fill the needs of the population, the various control mechanisms and their tools to ensure proper decision-making and/or management must be subordinate to the collective interest. According to Chandler (1989) and Mussche (1979), the concept of control that one intends to dispense must be capable of resisting to the inherent constraints of three important factors: the structure, the environment, and the politics. So, examining the results in relation to the control mechanisms, the Cameroonian local collectivities do not escape these constraints as seen by the weak degree of control within these public entities observed in Figure 8.

In the last section of the paper, we test the hypotheses in order to verify whether the contingent factors have an influence or not on the performance of the municipal public services of the Cameroonian cities.

### TEST OF HYPOTHESES

The empirical validation of the main hypotheses formulated in this research is confirmed by the existence of positive correlations between the structural contingency variables and the performance of the municipal public services

Table 4 Correlations Between Variables to Test the Hypotheses.

|   |     | <i>SMS</i>              | <i>UCPMS</i> | <i>DDMS</i> | <i>NCMS</i> |          |
|---|-----|-------------------------|--------------|-------------|-------------|----------|
| Spearman's<br>Rho   | AO  | Correlation coefficient | 0.305        | 0.206       | 0.293*      | 0.388*** |
|   |     | Sig. (two-tailed test)  | 0.144        | 0.152       | 0.039       | 0.005    |
|   | SMS | Correlation coefficient | 1.000        | 0.132       | 0.277*      | 0.870    |
|   |     | Sig. (two-tailed test)  | 0.000        | 0.575       | 0.051       | 0.567    |
|   |     | N                       | 60           | 60          | 50          | 60       |
| AO: Achievement of the Objectives (municipal performance).<br>SMS: Size of the Municipal Service.<br>UCPMS: Use of Control Panels in the Municipal Service.<br>DDMS: Degree of Decentralization of the Municipal Service.<br>NCMS: Number of Computers in the Municipal Service (measured in terms of computerization of the activities).<br>*The correlation is significant at $p < 0.05$ (two-tailed test).<br>**The correlation is significant at $p < 0.01$ (two-tailed test).<br>***The correlation is significant at $p < 0.005$ (two-tailed test). |     |                         |              |             |             |          |

Table 4 summarizes the tests performed for the verification of the hypotheses applied to the appropriate structural contingent factors.

**Hypothesis 1:** *There is a positive relationship between the degree of decentralization of the municipal structure and the performance of the municipal services of the Cameroonian cities – Supported* ( $r = 0.293$ ;  $p < 0.05$ ). **Hypothesis 2:** *There is a positive relationship between the degree of decentralization of the municipal structure and the size of the municipal services of the Cameroonian cities – Supported* ( $r = 0.277$ ;  $p < 0.05$ ). The analysis of the relationships between the decentralization of the municipality and the achievement of the objectives and the size of the municipality shows significant interdependences at the level of  $p < 0.05$  (see Table 4). The first explanation that we can give regarding such interrelationships is to observe that the more decentralized is the municipality the better is the municipal performance, and that the greater is the size of the municipal service the greater is the degree of decentralization of the municipality. In other words, it indicates that the more the municipality is decentralized, the more the services are decentralized and the objectives are thus more easily reached. We observed that the municipal services that centralize certain decisions (e.g., purchasing small items necessary for operating a service) result in services which are rather more difficult to operate. Our results are consistent with the findings of the research conducted by Roussarie (1994). The author looked at the degree of autonomy in relation to some decisions and came to the conclusion that department managers had more liberty of action concerning purchases. He got 35 out of 37 points higher than the mean. In addition, the results of the quantitative investigation already showed that a great majority of the department managers in the municipalities examined had a real autonomy regarding small purchases and edible food products, to the order of 78.3% and 90%, respectively. It shows the positive influence that decentralization can have on the performance of municipal public services.

**Hypothesis 3:** *The larger the size of a municipal service, the more the department manager is likely to make use of control panels – Not*

**supported** ( $r = 0.132$ ). The Spearman's correlation coefficient does not revealed any significant relationship between the size of the municipal services and the use of control panels in the municipal services (see Table 4). Our results are consistent with those of Meyssonier (1993) which showed on a survey sample of 82 French municipalities, the size and the use of control panels were not correlated, specifically considering that the nature of these control panels may be variable. On the other hand, we can note a significant relationship in the opposite direction between the achievement of the objectives and the use of control panels in the municipal services. This means that the more often one uses control panels, the more often one reaches the objectives.

**Hypothesis 4:** *The larger the size of a municipal service, the more the performance is likely to be better (improved)* – **Supported** ( $r = 0.388$ ;  $p < 0.005$ ). The positive correlation between these two variables indicates that the municipalities having a larger number of computers achieve more often their objectives (see Table 4). As we observed in the quantitative analysis, over 76% of the services had only between 1 and 5 computers. This is quite small if we are taking into account the number of activities which a municipality can undertake. So the positive correlation between these two variables underlines the necessity to computerize the activities in the Cameroonian cities. Even though there is a few research on the relation between computerization and service performance, two studies conducted by Kalika (1987) and Chapellier (1994) are supportive of similar arguments while they establish a meaningful link between the degree of computerization of activities and the development of accounting information systems.

## CONCLUSION

This paper provides the reader with the results of an empirical study made in 102 municipalities of the Cameroonian cities. More specifically, the paper highlights the methods and the frequency of the existing management

controls in these municipalities. As shown, the controls are, for the most part, exercised by the city halls of the Cameroonian municipalities. From our comparison of the perception of some determinants by the mayors and the department managers which can influence the municipal performance, we can draw the following conclusions.

Among the main municipal objectives, 74% of the people questioned (e.g., the mayors and the department managers) consider that the most important objective is the people's satisfaction in the municipality. The recruitment of the personnel is exclusively the mayor's responsibility. He/she is the only one to judge the technical abilities and the expertise of the people that he/she wishes to recruit. The liberty of action of the department managers is limited with regard to the increase of credits. And finally, we think that a genuine desire from the part of the municipal participants in the Cameroonian cities to establish a real system of control of the fixed objectives as well as an increase in frequency and a more democratic recruitment could assuredly ensure some improvements in the municipal performance. For example, to establish benchmarks as a policy could be a very good initiative in a context of north-south cooperation. Such a system could then complement the existing relations between Bordeaux (France) and Douala (Cameroon) or Quebec (Canada) and Douala (Cameroon), for instance.

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## A Consulting Case of Rural Development Project in Korea

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### ABSTRACT

*With digital convergence era, spreading trends in terms of green management in the agricultural sector has rapidly developed with various fusion technologies. Consulting industry has not neglected to take actions into flow of rural development as*

*alternative engines of green growth policy. Thus, this study intends to introduce a successful consulting case of rural development project in Korea. This study summarizes how the actual consulting project afferent to reduce the waste of time centered on the background, difficulties and key success concepts. Some contributions of this study are first the article is a good benchmarking practice for other local governments and Non-Government Organizations. Second is to prove that the consulting practices are also applicable in the agricultural section as well. Third, the study improves the general prejudice with respect to rural development projects caused by aging tendency of farming population. In the future studies, more focus on the role of consulting firms and their continuous support would advance the literature.*

**Keywords:** Agricultural sector, Consulting case, Consulting project, Rural development project

## INTRODUCTION

The 21st century poses new challenges to mankind. Alvin Toffler describes three types of societies based on the concept of “waves”, each wave pushes the older societies and cultures aside. He heralded the age of Knowledge Based Information Society through agrarian and industrial revolution. Now, those who live in the new society must prepare for new challenges and tribulations

With the introduction of computers in the mid 1940s, business paradigm has changed in the way of emphasizing on effectiveness-centered rather than on the initial efficiency-centered. New Innovation techniques and methods then followed.

With digital convergence era coming through combination of 6T, green management has become one of the major trends based on the sustainability.

Currently, many industrial sectors of the green management area in Korea show an increasing rate of interest in new growth energy. Especially, technology, which has developed from manufacturing technology to information technology and now to convergence technology. This trend is now spreading to the agricultural sector and has rapidly developed due to assimilation with various fusion technologies.

According to this flow of rural development, consulting industry, as well as manufacturing and service sectors, is interested in the development of alternative engines focused on green growth policy. It includes keywords such as 21st century well-being culture, tourism, and 6th industry in agriculture with the convergence technology. Thus, this study intends to introduce a successful consulting case of rural development project in Korea, driven by the Ministry of Food, Agriculture, Forestry and Fisheries. A local government and Non-Government Organization had submitted proposals. This study summarizes how the actual consulting project afferent to reduce the waste of time centered on the background, difficulties and key success concepts.

## **BACKGROUND OF THE CONSULTING PROJECT**

Since 2004, the Korean Government had enacted the Special Act Article 38 to improve the quality of life of farmers by developing the rural areas. This was undertaken through promoting projects in accordance with the enforcement procedure(Rural Renewal Development Act Article 24 and Article 39) depending on the region, supporting 4 to 7 billion won by 2017. Since 2004 to 2010, a total of 301 rural development projects(17,538 hundred million

won supported) had been selected out of business promotion. The three steps for selection are as follows: The first step is to assign a preliminary plan approval, which takes steps to start the business with budget. The second step is to perform the basic plan for the business over a five year course. The last step is to encourage sustainable rural development. Urban-rural exchanges activate persistent operation of each areas and creation of business models improve farm income. It appears that about 70 percent of the project selected in 2004 & 2005 had been completed by 2009 & 2010 respectively. Most of these projects are almost complete in the hardware section, but had shown insufficient in the software part.

Since 2004, these government-sponsored projects have supported organizations that apply for the rural development fund wherein excellent proposals are accepted. This project was also submitted in 2004 to get a fund support for D county from Non-Government Organization called by Rural Development Committee. Due to a lack of requirements, the government rejected a proposal applied for the project to receive fund. It was resubmitted and in 2006, the government rejected D county's proposal for the second time.

At the request of D county, a consulting firm(the author of this paper as CEO) has performed consulting services for them to receive approval from the Ministry for Food, Agriculture, Forestry, and Fisheries. Starting January 2008, the consulting firm carried out the project called 'Rural Development Project in D county'. Urban-rural exchange activation, historical and cultural tourism, tourist farms, and a concrete action plan to increase farm income comprised the main contents of the ongoing rural development project.

## PROJECT ANALYSIS

This consulting project was designed to analyze and address the issues of rejected proposals because of incomplete requirements. In order to meet the desired requirements, concrete action plans with realistic examples were demonstrated and practical challenges were presented. The current situation was analyzed based on difficulties of rural villages in order to check out the major application requirements for the rural village development projects. The following list shows the major difficulties for rural villages derived from the interview analysis by the related key interest groups.

- 1) Lowered proportion of agricultural policy after transferred to metropolitan city of region based residents.
- 2) The lack of requirements for promoting rural co-development intended for Administrative units of three or more.
- 3) Areas of 12 natural villages make it impossible to prove a single district.
- 4) Business Promotion Council's difficulties for fundraising which includes business expenses and visiting advanced counties
- 5) Poor composition of empathy in the area due to lack of arbitration for the gap among stakeholders' opinions
- 6) Limitation exposure for large amount of money of government support for business persistence
- 7) Reduction of agricultural land capacity due to residents' acceptance of land

## KEY SUCCESS CONCEPTS OF CONSULTING

As described earlier, a consulting project focusing on current situation analysis for rural development was performed. The following information provided the appropriate success concepts and specific details were used to acquire the business.

Reverse discrimination suffered by rural village that had transferred to metropolitan city.

Since the case village was administratively switched into Daegu metropolitan city from Dalseonggun Gyeongbuk province, business approval for metropolitan city became impossible. This caused difficulties in the Urban-rural complex. For example, difficulties in the Urban-rural complex's characteristics can be solved through the practical experience of consulting by steps as follow.

1. At first, the citizen needs to pay taxes as metropolitan citizen and raise the problem of difficulty in small rural village. Therefore, they can specifically present the reality of reverse discrimination.
2. Homogeneity problem was proved among the related groups (fraternity, supporters, and agricultural successors etc.). When they embarked on the rural co-development, they tried to fulfill the basic requirements of proving that three or more administrative sections are one by activating organizations such as fraternity, supporters association and agricultural successors.
3. Composing an organization to support Business Promotion Council's activities. In order to promote the business, we organized Business Promotion Council which represents the citizen. We helped BPC support the financial problem and difficulties in performing the business by organizing consultation body as well.

4. An arbitration for the gap among stakeholders' opinions  
To form a consensus, we work out a plan and prepared measurements for members who have passive attitude with the project due to a lack of promotion will. Thus, they played roles as adjustments controllers who lead members into a common interest and understanding. In addition, we made fraternity play the coordinating role in terms of reconciliation.
5. Continuous push with the government policy supporting business. Due to the uniqueness of rural development, sustainability with aging society in rural area appeared as the limitation. Moreover, the problem of wasting the national budget, approximately millions of won, highlighted, so it became reality. To solve the problem of fraternity in securing long-term finances by fundraising, the fraternity and supporters association have developed programs that aim at discovering and training the next successors of agriculture. In addition, training policy for long-term agricultural successors had been planned and worked on.
6. Solving reduction problem of agricultural land capacity and fallow farmland. Reduction of agricultural land capacity and lowered income caused by construction of infrastructure raised increased concerns and worries of residences. Set-aside, as well as productive farmland's can be efficiently utilized by making it tourism farmland as benchmarking case is written in advance. This is concretely explained not only with the ideal plan but also with the achievable cases. Impression-experiencing and learning farmland, as described above, has developed for 20 years and the writer operates a total of 1.6ha. Thus, this model became one of the representative models that

realizes high value-added farmland in Korea by operating programs such as rose, oriental medicine, fruit-bearing trees section and experiencing and learning program.

7. Achieving the feasibility of projects by visiting advanced organizations to give a conversion of stereotypes. We encouraged continuous interests and participation to residences and stakeholders of the rural areas to make a sustainable development and business practices. We also implemented training and business trips to develop organizations in spreading people's sympathy. As a result, a common consensus was drawn to induce.

## CONCLUSION

This case study is based on the two-time rejected proposals and the project report called the 'Rural Development Project in D county' performed by the author's consulting firm. Minister for Food, Agriculture, Forestry, and Fisheries sponsored the funds so as to receive government funding, who performed the project called 'Rural Development Project in D county'. Moreover, this study attempts to introduce successful consulting case of rural development project in Korea, driven by The Minister of Food, Agriculture, Forestry and Fisheries, proposals of which were submitted by the local government and the Non Government Organizations. This study summarizes how the actual consulting project attempts to reduce the waste of time centered on the background, difficulties, and key success concepts.

The following attributes comprise the expected effects of the case.

First, this study could be a good benchmarking practice for other local governments and Non-Government Organizations, that may attempt to promote rural developing projects sponsored by Ministry for Food, Agriculture, Forestry, and Fisheries. This study could be a role-model, for organizations facing difficulties in the planning stage.

Secondly, one of the paper's utmost contributions is that the needs for professional consulting practice in business process can be emphasized in agricultural section as well.

Thirdly, the findings of this study can relieve a negative view of rural development projects caused by aging tendency of farming population. Furthermore, having high-end industry through scientific farming, tourist farms etc., the study gives a greater opportunity to increase value in the agricultural sector. Further study of this case and future research should focus on the role of consulting firms and their continuous support in the further business process.

Lastly, this consulting case can be a good benchmarking practice for many other Asian countries, especially those of societies based on the agriculture. It can be utilized by those countries as a political guideline in the agricultural sector.

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## Entrepreneurship and Economic Globalisation in Primorsky Region: Problems and Decision Ways

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### ABSTRACT

*Present article examines the nature and the essence of economic globalization, its contradictions, positive and negative sides of its appearing, and also analyzes the participation of the enterprise activity subjects in the processes defined by the term «economy globalization», in Primorsky region of the Russian Federation. The problems, available by the current moment come to light, and search of possible ways of their decision are carried out.*

**Keywords:** *Entrepreneurship, Enterprise Activity, Globalization*

### INTRODUCTION

For present time the discussion about the role of economic globalisation, whether positive or negative, is not ended. In particular, bears the given phenomenon the threat of suppression of separate national economic structures or, on the contrary, serves as the considerable and effective factor of economic

development. However, estimating globalisation comprehensively, objectively, it is necessary to recognise, that the account and rational use of world experience form a basis of progress and is necessary for any country.

## **GLOBALISATION**

Analyzing globalisation as a phenomenon, which separate aspects, at least, having economic character, have arisen in antiquity, in the Middle Ages, and brightly shown already in XIX, XX centuries, and, in particular, last 20-30 years when there was promptest increase in rates of the given phenomenon, it is easy to notice: it captures the most different parties of human activity, the most various spheres of public life.

The globalisation question became rather actual already in 1990th years, though separate parties of the given process were actively discussed by scientists, beginning already from the second half of XX-th century.

However, despite the urgency of the problem of globalisation, today still there is certain vagueness concerning that it is necessary to understand as the phenomenon and the process defined by the term "globalisation". Therefore, in our opinion, analyzing the specified processes, to begin with it makes sense to understand the terminology characterising investigated sphere of relations a little.

The modern model of economic, in our opinion, should be considered as a natural result of economic development, the certain global economic mechanism characterised by a continuous deepening of the interrelations and the interdependence between developed and developing countries of our planet, a growth of the processes of internationalisation of manufacture, capital, technological innovations, the liberalisation of the interstate

financial sphere, the formation of influential international structures regulating the economic interaction between countries which, in turn, is an objective consequence of the natural aspiration of managing subjects to the maximum profit and riches, a constant search of new spheres for even more effective use of capital, new resources for the manufacture of material benefits, new commodity markets of goods and services that is caused by going deep processes of the division of labour at a world level, the occurrence of modern systems of communication, fast and effective ways of moving capital in space.

To the greatest degree the occurrence and functioning of the processes of economic globalisation were influenced by the international economic integration processes.

The international economic integration can be defined as an activity of the states, economic agents (enterprises) and other subjects of the economic and other activity, directed towards the interaction (the mutual adaptation and penetration) between separate national economies that generates the association of the economies of co-operating states in a single whole for the decision of specific targets and their integration in a uniform production within the limits of the countries included in integration processes.

On W. Beck, as the globality it is necessary to understand a phenomenon of formation of a uniform world financial, information and industrial-technological economy [1].

What, eventually, is it defined by the concept "globalisation"? At the present stage there is a set of definitions of the specified phenomenon, any of which is not standard, not saying also that researchers frequently put diversified meanings into this concept.

In scientific works the first mention about the globalisation has appeared in 1961 in Webster dictionary which was defined as

the beginning of clear comprehension of increasing value of the interrelation of social events and relations to all world [10].

In a modern context, the globalisation phenomenon is considered as a process of the world economic, political and cultural integration, owing to what are shown the division of labour at the international level, the continuous moving of capital, industrial resources in the scales of all the planet, the unification of legislation, economic and also technological processes, the rapprochement and merge of cultures of the most various states. Globalisation is an objective process having a system character and covering all spheres of a public life. As a result of the globalisation the world becomes more connected and more dependent on all its subjects, there appears as an increase in the quantity of the general problems of group of states, and also an expansion of the number and types of integrated subjects [2].

However, following logic, in the course of globalisation, considering actual transfer of the separate part of national sovereignty (sovereign powers) by national states to the system of transnational interactions, there is a distribution of the capitalism of the free market to all the regions of the world and a submission of sovereign states to its rules, that, in turn, is accompanied by a decrease in their independence [6].

In a case with economic globalisation it is necessary to talk about the process, in which course the world is transforming into a certain uniform global economic system.

In some scientific works authors bring an attention to the question on legitimacy of the use of such term as «glocalisation» which, in turn, expresses the parity of the processes of globalisation and localisation [10, 11].

Certainly important point characterising the processes, named as economic globalization, is the fact, that the economic interaction between developed and developing states is carried

out on the model «the centre – the periphery» which is characterised by an unequal economic exchange and getting considerable material benefits by the "centre" at the expense of the "periphery".

The processes of the integration of certain countries, including being at enough low level of social development, into international cooperation, interaction has essentially changed the sight of individuals at their place in the world, gradually displacing "obsolete" patriotic ideologies, fairly giving way to cosmopolitanism - up to state level.

A large quantity of international structures, formations, both state and not state character, even for today, though their quantity increases every year, with which help an effective interaction is carried out in the most various spheres - economic, political, legal, scientific, social, serves as a proof for this.

It doesn't have any sense to talk about the economic globalisation in positive or negative way as growing processes of the international economic cooperation and integration, despite the fact that they have some negative consequences, are objective, how much it is possible, a consequence of the progress- as scientific and technical, so, including, and social (in a smaller measure), mentioned human society in the XX-th century. Economy globalisation, despite the complexity inherent in it and discrepancy, is one of the natural laws of world economic development.

So, it is possible to name the following among the positive sides of the processes of economic globalisation: the deepening of fundamental economic processes, lifting of the process of the division of labour at the world, international level; the formation of a favorable economic space, the decrease in the trading barriers between countries; the simplification of the economic interaction between states (including the invention of the newest systems of

communication); the simplification of the processes of the realisation of foreign investments; the creation of conditions for an access of countries to the advanced achievements of mankind in the most various areas; the maintenance of economy of resources; the stimulation of world progress (including, by the formation of a global competitive environment).

And among negative consequences of economic globalisation we can name the following: as a process globalization is used in interests of the several most developed postindustrial states, frequently to the detriment of the majority of the countries of the planet (including, manufacture and sale monopolisation, redistribution of resources in advantage of "world ruling class»); frontiers are washed away, the role and influence of national governments is weakened, limited or even national sovereignty disappears at all, making way for the power of influential international economic organisations, transnational corporations, the mass media, the largest proprietors of financial capital.

The loss of the resources of less developed (in economic sense) countries, whose economy, basically, is focused on import;

The distribution of the globalisation of competition in weak countries (though under present circumstances the global competition is carried out not between countries, but between transnational corporations, those form the centre of world economic system and supervising more than the half of the turn of international trade and finance, and also the most profitable branches of the economies of various countries);

The ruin of the certain kinds of small-scale business (including, economically developed countries);

contribution to the growth of the rate of unemployment in postindustrial countries where so-called «capitalism without effort» already becomes a mass phenomenon;

the newest information communication systems have immeasurably strengthened the ability of financial capital to move really fast (as R.A.Kuchukov, A.V.Savka write, «speed of the turn of capitals has reached a monstrous size - billion dollars a minute, or one and a half billion a day ... now speculative financial operations are capable to make profit much faster and bigger than the investments of capital into manufacture, even then, when we talk about innovative technologies» [6]), that potentially creates a possibility for the destruction of steady economic systems; aggravation of ecological accident on the planet.

But if all is, more or less, clear about the theoretical aspects of the processes defined by the term "globalisation", despite the fact that there is a considerable quantity of contradictions, disagreements, there are, in turn, enough problematic questions on the globalisation of our domestic economy, its positive and negative sides, about the role of Russia in system of the international economic interaction on the model «the centre - periphery», about arising difficulties during the realisation of the present external economic tactics and strategy of the Russian Federation, and also about the possible ways of their overcoming.

Russia is the country which is extremely rich with natural resources and which territories have such quantity of the minerals, renewed raw materials and other natural values, that, proceeding from the criterion of the quantity of resources, the Russian Federation has a planetary value.

Russia has not less than 50 % of the cumulative world natural resources, and the amount of natural resources for one inhabitant in our country exceeds the world indicator almost in 18 times, owing to what the world community looks at Russia as at a resource pantry of the nature, and some states with developed economy try to use the period of economic difficulties in our

country to leave Russia for long time only as a resource appendage of the developed states [5].

However, despite the objective laws of world historical experience say to us, that for an effective economic development it is necessary to limit the exclusive position of the exporter of raw materials, to develop manufacture and export of an actual industrial output, the Russian Federation remains to stay as one of the main suppliers of natural raw materials in the world market which national interests go only for the capital increase of "the big seven», leaving Russia a "periphery" role in the world market.

In the given research it would be desirable to analyse and generalise the separate displays of the globalisation in the Far East of the Russian Federation, especially in Primorsky region, the participation in these processes of the subjects of small business as one of the most considerable factors of domestic economic, to designate the tendencies available for the present moment, the interaction problems, to offer the possible directions of their overcoming.

The history of the participation of the Far East of Russia in the processes of economic globalisation had begun simultaneously with its economic development. So, in the end of the XIX-th century the Far East actively took part in the trade on the foreign market. Within the limits of the concluded trading agreements of Russia with the USA (1832), Japan (1855), China (1858), Korea (1884) the Russian Far East exported gold, furs, seafood, herbs, and also wood export had accepted a regular character since 1907 [3].

The Far East of the Russian Federation, including Primorsky region, is situated enough far from the central part of Russia, actually it is cut off from its home market, that, certainly, makes the Far East production much more expensive. All of it has

generated the formation of the following important feature of the development of business: anyway, for Far Eastern businessmen it was more favourable and easier to co-operate with the foreign structures from the Asia-Pacific region countries, than with the Russian partners from other subjects of the country. The given circumstances, and also the fact, that Primorsky region is situated on the frontier territory and borders with some foreign states at once, had given a considerable push for the development of international joint business in Primorsky region.

Primorsky region, partly because of the favorable geographic location, partly because of the rich and various natural resource potential, was extremely attractive to foreign investors. So, during 9 years, with 1992 till the end of 2000, the quantity of the joint enterprises, made with foreign investments and operating in Primorsky region, had increased almost in 10 times. The main part of the international joint enterprises had been created and functioned with the assistance of the Chinese capital - 38 %, Republic Korea - 14 %, the USA - 9 %, Japan - 6 %, the total authorised capital of all the operating enterprises with foreign investments in Primorsky region totalled 3,6 billion rbl. by the end of 2000 and had increased in 2,7 times comparing with 1999, and the share of foreign partners in it totalled 56 % [7].

On the amount of foreign investments and the joint enterprises created with foreign investors Primorsky region was the leader among other regions in the Russian Far East up to 1998, when it had lost the investment appeal and in 2004 in the investment rating of regions PA "Expert" had been ranked in the group «with high risk and lowered potential». Nevertheless, according to the Primorsky committee of state statistics, 395 enterprises with foreign investments, including 175 small sized firms, operated in Primorsky region on 01.01.2005 [8].

So, according to the data of the territorial body of the federal service of the state statistics in Primorsky region for 2009, the receipt of the foreign investments into Primorsky region totalled 80,7 million US dollars, while the given indicators were considerably higher in the other regions of the Russian Far East. For example, into Sakhalin area - 5768,7 mln. dollars of the USA, into Sakha Republic - 1117,7 million, into Chukotsky autonomous region - 468,8 million, into Khabarovsk region - 265,1 million, and into Amursky area - 212,1 mln. USA dollars. And the total of the operating enterprises with the participation of foreign capital numbers 344 units.

As it is possible to see, despite the favorable geographic location and economic potential of Primorsky region, foreign investors avoid from serious investments into the Far Eastern commercial enterprises that is caused by the adverse investment climate in the region, expressed in the imperfection of the legal base, the opacity of the Russian business, the intense criminal situation, corruption and bureaucracy of the officials, controlling the enterprise activity in the region and the whole list of other factors. And anyway, the biggest amount of the foreign investments is received by the big and medium sized business.

It is necessary to tell also about natural consequences of such conditions, for example, all negative characteristics of the investment climate and entrepreneurship environment in Primorsky region, the Far East and Russian Federation as a whole, and also about the integration of Russia into the business world, the opened possibilities of moving capital: such circumstances frightens off not only the foreign investors, but also the domestic businessmen. In the process of economy globalisation, instead of a desirable inflow of foreign investments, the country had received only a large-scale outflow of the Russian

capital abroad, and the tendencies of the given phenomenon keep their force on the present day.

Moreover, the economic interaction of domestic businessmen with partners from the Asia-Pacific region countries carries, generally, a trading character, and the cooperation in the sphere of the exchange of production factors, technologies, innovations has an extremely insignificant character.

For example, in 2008 the foreign trade activities of Primorsky region were carried out with 84 countries, comparing with 81 country according to 2007, and the greatest amount of foreign trade operations was traditionally realized with the Republic of China, Japan, Korea and the USA [4].

According to data of territorial body of the federal service of the state statistics in Primorsky region for 2009, the export of the production of Primorsky region totalled 1158300 thousand USA dollars, and import - 2979300 thousand USA dollars. The export of services, in turn, numbered 466886,5 thousand dollars USA, and import - 113213,4 thousand USA dollars. It says about the negative balance of the foreign trade activity of Primorsky region and the actual outflow of the domestic capital abroad.

Thus, talking about the small sized business role, the most considerable contribution of small sized enterprises into the industrial output is realized in the form of the manufacture of a foodstuff, the wood building materials production[4].

Besides, both in the pre-revolutionary, and during the Soviet historical periods of the life of our country, and also at the present stage, the external economic cooperation of the regions of the Russian Far East is carried out, basically, in the form of foreign trade, and the specialisation of the Far East in the processes of the international division of labour continues to have a resource character.

So, for example, the economic cooperation of the regions of the Russian Far East and China is carried out, basically, in the form of trade in natural resources. Energy, wood, forest products, machine-building production, black and nonferrous metals, oil and mineral oil, fish and seafood are exported to China while the import is presented by foodstuff and consumer goods (usually with high added cost) [9].

## **CONCLUDING REMARKS**

Doing conclusions, in our opinion, it is necessary to paraphrase and add a little to the already told.

Economic globalisation is only a consequence of the deepening of economic development, scientific and technical progress which has essentially simplified the ways of the communications between the people, organisations which are in thousands of kilometres from each other, considerably increased the mobility of individuals within all the globe. Economic globalisation is an extremely rigid process, having the natural selection character, in which course only the strongest can survive. But the investigated processes are objective, natural, and, despite all the described above numerous contradictions, the counteracting to the processes of the international economic integration is simply senseless. In our opinion, it is necessary to create new and to modernise already existing international power-holding structures, which will be able (including, by working out and acceptance of the international legal certificates) to regulate the processes of the globalisation of economy, doing it impartially, on the basis of humanistic principles and ideals, effectively using the advantages and smoothing the possible contradictions of the investigated phenomenon, protecting economic stability of many

states, always looking for the mutually advantageous compromises for co-operating countries.

Telling about the consequences of prompt involving of Russia into the business world, the liberalisation of the sphere of the external economic cooperation of the Russian Federation, we can say that they are extremely adverse for today. Against the numerous internal difficulties and contradictions in the country, the increase of the active business cooperation with foreign partners, usually in the sphere of trade in natural resources (including, not renewed), we can see the decrease and disintegration of the industrial production, the growth of the import of industrial goods with high added cost, that, as a result, is one of the reasons of the subsidence of the Russian resource capital abroad, of the actual plunder of the natural resource sale incomes, which should help the creation of new modern industrial productions and the modernisation of the industrial productions created for the moment.

In our opinion, for the development of more effective external economic cooperation, in Primorsky region, also in Russia as a whole, it is necessary to correct the administrative situation, to counteract the corruption, bureaucracy, to improve the legal base, to develop the small sized business, to create the favorable entrepreneurship environment, that, in aggregate, will make the foreign investors confident in safety of their investments. The cooperation with foreign partners (including, the sphere of an exchange of manufacture factors, technologies) will allow to raise the amount of goods with high degree of processing and hi-tech production in the export of Primorsky region, that, in turn, will allow Russia to be released from the role of the resources appendage of the developed countries.

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## Development of Inter-bank Foreign Exchange Market in Mongolia

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### ABSTRACT

*Inter-bank markets are very limited in Mongolia, even for the basic instrument of money market placement. There is slightly more activity in foreign exchange markets—but the market is still very limited—with the basic instrument being purchases and sales of USD against MNT. Many of the banks have no need, or are not in a position, to use interbank markets. Banks are overly liquid, a reflection of the level of economic activity and the more restrictive credit stance being taken by banks in the aftermaths of widespread banking failures. This, in turn, has led to banks being much more selective with respect to counterparties, with an obvious impact on the demand for interbank products. The most effective way is the use of financial derivatives. It is a very frequently case for business organizations to be effected by the currency rate risk but it can be protected by the operation through banks. One possible way protect from currency rate change in the country is to use a new kind of markets (futures, forward, options etc.) that should be established, and it is important to liberate inter-bank FX market. In conclusion, this paper will define how it will influence the economy and monetary*

*policy of the country. In addition, the Mongolian banking sector is an important in the Mongolian financial sector.*

**Keywords:** *Bank management, Financial derivatives, FX market, Inter-bank activities, SWIFT*

## INTRODUCTION

Inter-bank markets are very limited in Mongolia, even for the basic instrument of money market placement. There is slightly more activity in foreign exchange markets—but the market is still very limited—with the basic instrument being purchases and sales of USD against MNT<sup>3</sup>. The lack of activity reflects a number of factors. Many of the banks have no need, or are not in a position, to use interbank markets. Banks are overly liquid, a reflection of the level of economic activity and the more restrictive credit stance being taken by banks in the aftermaths of widespread banking failures. This, in turn, has led to banks being much more selective with respect to counterparties, with an obvious impact on the demand for interbank products.

This structure of the banking sector is also having a significant bearing on the emergence of inter-bank markets. The industry is quite fragmented, which is not surprising given the widespread solvency problems that confronted the industry and the substantive restructuring that is still underway. The upshot is that there are few financially sound established banks, and one of them is Trade and Development Bank of Mongolia (TDBM). It dominates the industry, with 24 percent of industry assets. TDBM, Khaan bank, Savings bank and Golomt bank account for

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<sup>3</sup> MNT is Mongolian currency (Togrog).

almost from 60 to 70 percent of industry assets between them as would be expected.

Influence of banking and financial sector to the development of Mongolia is enormous. This is due to coordinating role of banking and finance sector in the financial inflow and outflow in the economy. In order for successful completion of these functions, banks carry out a wide scope of activities under the special regulations. One of the aspects is the activity of the FX market. Since the time Mongolia was transformed into market economy, the country has expanded its foreign relationship. Therefore, it is predictable that demand for foreign currency will be increased. As a result, it appears a need for FX. In order to satisfy this demand and increase their profits, banking and financial institutions should participate in the FX activities. In relation to it, I have started a research study on the development of inter-bank FX market in Mongolia. Since the time of their foundation any businesses encounter many kinds of risks. Among them, currency risk causes particular difficulties in the economic activities. Currency fluctuations or changes can cause considerable losses. There are many ways to protect from these losses.

The most effective way is the use of financial derivatives. It is a very frequently case for business organizations to be effected by the currency rate risk but it can be protected by the operation through banks. One possible way protect from currency rate change in the country is to use a new kind of markets (futures, forward, options etc.) that should be established, and it is important to liberate inter-bank FX market. In conclusion, the research will define how it will influence the economy and monetary policy of the country.

Nowadays, looking at the FX activities can reveal the following:  
Activities of commercial banks are limited in purchasing and

selling currency in cash, and using unofficial currency exchange activities. These are mostly spot exchange activities in which uses spot rates that they hardly use financial derivatives. This has many deficiencies. Because, although there is an intensive need for businesses to purchase and sell currencies there is not any currency available at proper time which increase the possibility to be effected by the risk. Therefore, in order to decrease this risk, it is required to develop FX market in its full sense, which is very significant in protecting businesses from any risks and increasing their profit.

The following goals and tasks are set within the framework of the research work: The main goal of this research work is development interbank foreign exchange markets, to define in real term possibilities for effective use of financial derivatives in Mongolia.

In order to reach this goal the following tasks are required:

1. To define present conditions of FX market in Mongolia.
2. To refine alternatives of development of an interbank FX market.
3. To evaluate alternatives of developing interbank FX market.
4. To improve regulations of interbank FX market.
5. To develop the rules for interbank FX markets activities.

## **LITERATURE REVIEW**

The part of main activities has been carried out by the BOM (Bank of Mongolia) to fulfill the objectives of the State Monetary Policy is exchange rate policy. Within the framework of protecting instability of domestic currency, BOM has conducted exchange rate policy aimed at expanding an inter bank FX market in

Mongolia. It can be perceived that the dollarization process is increasing demand of foreign currency exchange. Therefore, it is vital to investigate an inter bank FX market in Mongolia.

The activities of inter bank foreign exchange market in Mongolia since 1990 is evaluated as unsatisfactory. [David Mitchem, IMF advisor on foreign exchange, *Foreign Exchange and Mongolia Working Paper*, October, 1997]. The activity of Curb market and commercial banks in Mongolia is only buying and selling of exchange currency. Curb market trading in total trading is comparatively small. [G.Tumurkhuyag, Director, of FX Department, BOM, *Curb Market in Mongolia Working Paper*, 1999]. One the one hand, it is directly related to the people's confidence in banks and on the other side, a poor curb market operation in Mongolia.

A curb market still runs in Mongolia though there has not adequate monitor and control over the market. Such constraints cause the impediment for the development of an interbank FX market in Mongolia. As many banks and dealers trade foreign currency in cash there is a common deficiency in commercial banks for keeping their current position in FX and to influence in exchange currency reserve of banks [Vinstar Consulting International, ADB RSC C00466-Mon *Development of an Interbank Market, Final Draft Report*, 2009]. With the intention of eliminating above-mentioned defects, a scope of regulatory actions had been taken. Through it had not worked successfully. Regrettably, Mongolians have pessimistic mentality that "Mongolian laws are in three days". For example, according to the legislations trading in restaurants, shops, hotels shall be dealt in togrog. For such reasons, based on the research papers of those advisors and bankers, I have chosen my research work on "Development of the interbank FX market in Mongolia". As an

inter bank FX market develops, a curb market will be slightly drawn out.

#### **THEORETICAL FRAMEWORK<sup>4</sup>**

The exchange rate is the price of one currency in exchange for another - the amount of currency that can be bought or sold with another currency. Demand and supply for the currency in the open market determines this price, but it can also be influenced by the intervention of governments through their central banks. The bank will convert assets held in one currency into funds in another currency. This conversion can take the form of either a "spot" or a "forward" transaction. We will discuss the differences between these transactions. Banking activities in the foreign-exchange field invariably tend to establish a uniform price range for a particular currency throughout the financial centres of the world. If, at a given moment, the market rate in one centre deviates too far from the average, the balance will soon be restored by arbitrage, which is a process of taking advantage of price differences in different centres.

The core of the FX market is an inter-bank market, through which most of the dealing is directed. Non-bank participants generally find it useful to deal with banks, because they have developed dealing rooms over the years and have created an efficient market through good or bad times.

How is foreign exchange rates quoted? Most countries use direct quotation, which means that the exchange rate gives the equivalent of a certain quantity of foreign currency quoted.

Foreign-exchange activity starts at 08:30. A number of telephone calls are placed among Mongolian banks; gradually

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<sup>4</sup> SA Financial Sector Forum: *The Foreign Exchange Market*

foreign markets enter the scene; foreign dealers in Frankfurt enquire about the USD/MNT rate, while Mongolian banks will ask them about a first EUR/USD rate; banks in London, Brussels, Paris, and other cities are called, or they contact Mongolian banks on their own. International and local brokers participate in this rate-finding process. If news has come in overnight that the United States authorities expect US inflation to remain relatively high for several more months and there are widespread doubts that the US trade deficit will narrow, the dollar is likely to weaken.

A critical issue under the fixed-rate system in the fifties and sixties was whether a country in a bad balance-of-payments situation would have to devalue, or one in a strong payments situation would have to revalue. (With countries with weak currencies increasingly unwilling to devalue their currencies in the sixties, pressure on the surplus countries was mounting to revalue their currencies instead.) Under a generalised system of clean floating exchange rates, rates should - according to the purchasing power parity theory - respond primarily to inflation differentials. High inflation, often the result of too generous a growth in the money supply, would lead to a weakening of the currency to the point where the rate was again in equilibrium, reflecting purchasing power parity.

While this theory is relatively accurate in explaining at least long-term exchange rate movements (over periods of several years), it has some shortcomings. For example, it is debatable how best to measure inflation and purchasing power. Second, the only prices of significance are those of goods and services that are, or can be, traded internationally. Third, experience shows that competitiveness in international trade (of goods and services) is not only a matter of price but also of quality, prompt delivery and after-sales service. Finally, the purchasing power theory does not

take into account capital movements as a potentially important determinant of exchange rates. Today, one of the most important developments in the currency market is the move towards a single currency in Europe. Some background on the European Monetary Union will explain why it is such an important factor in the currency markets.

FX can be bought and sold, not only on a spot or cash basis, but also on a forward basis (for delivery on a stipulated future date). In the spot markets, currencies are exchanged on a fixed delivery date, usually two working days. In the forward markets, delivery dates are pushed beyond spot value dates. Except for the time dimension that is introduced in forward transactions, the principles are the same, regardless of whether the delivery date is spot or forward: a buyer will wish to purchase as much of one currency as he can for the lowest cost in terms of another currency.

Apart from the forward market discussed above, foreign-exchange futures (i.e. the so-called currency or FX futures) and currency option markets have, since the seventies, developed abroad to complement the existing hedging instruments (e.g. the traditional forward contract), thereby providing even greater financial flexibility. Currency futures and currency option contracts allow new strategies in hedging operations, which are of particular interest to importers, exporters, investors and, at least abroad, currency speculators.

This section will discuss only briefly the technical aspects of FX futures and currency option contracts, as the contract principles are the same whatever the market. For instance, the principle behind an interest rate futures contract is the same as in the case of a FX futures contract. [For more detail, see Falkena et al., *The Futures Market*, 1989, and Falkena et al., *The Options Market*, 1989.]

A currency futures contract, like any other financial futures contract, is a legally binding agreement between two parties to take or make delivery on a specified date(s) in the future of a given quantity of a currency at an agreed price, established in a regulated market place, on the date the contract is entered into.

The foreign-exchange option market has experienced rapid growth in the last few years, and now accounts for approximately 7% of the daily global foreign-exchange turnover. Options are available on many traditional "physical" products such as equities (i.e. stocks and shares), commodities (e.g. gold, silver, coffee and other agricultural products), interest rate products (e.g. bonds and swaps) and FX. More recently, options have become available on futures where delivery results in a future contract rather than cash. Because of their contingent nature, options are not a suitable replacement for classical forward trading. Although they offer the holder greater leeway, there is an additional premium above the costs of a forward contract. The buyer's risk is, however, limited to the total premium, payable when the contract is made.

Therefore, important considerations in deciding between options and forward contracts are the costs involved and the additional profit potential.

## **SITUATION ANALYSIS**

### **Experience of Foreign Country<sup>5</sup>**

The FX market in Tokyo, London, New York, Frankfurt, and Paris has been expanding along with the economic development of the country. The Tokyo FX market is the third largest in the world, behind the London and New York markets. The FX market in Thailand has grown rapidly in the line with the liberalization

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<sup>5</sup> <http://www.emcap.org>

of FX control, in Australian has considerably grown since the Australian dollar was floated and exchange control. An Indonesian FX market started to grow considerably with the adoption of a free FX system. The Hong Kong FX market has grown and the fifth biggest FX trading center in the world.

The Tokyo inter-bank FX transactions are settled according to market practice. Banks confirm their transactions with the counter-parties first, and then deliver cash on the value date. Confirmation used to be made by exchange of slips. More recently, many banks use SWIFT for confirmation. Through their computer network, the two banks involved in the transaction can confirm contract details such as the amount, exchange rate, settlement date, and payment method. Along with many other traders in the Australian FX market, is a member of SWIFT accord. This system allows all trade details – for example, the currency code, amount, counter-party and date of trade – to be confirmed automatically between participants prior to settlement. Settlement for transactions in currencies other than the Australian dollar is usually arranged through correspondent banks participating in the relevant local clearing system overseas. The Australian market is the first major FX market to open (see [Chart 1](#)) for the overseas customers of Philippine banks, the bulk of the transactions are settled through SWIFT. Some big banks settle their transactions through their electronic in-house settlement system. For the Hong Kong dollar portion of trades, settlement is made through the inter-bank payment system. Payment of the foreign currency portion of a transaction is settled in the country of the respective foreign currency through presence of correspondent banks in that country. The payment message is transmitted through SWIFT or tested telex.

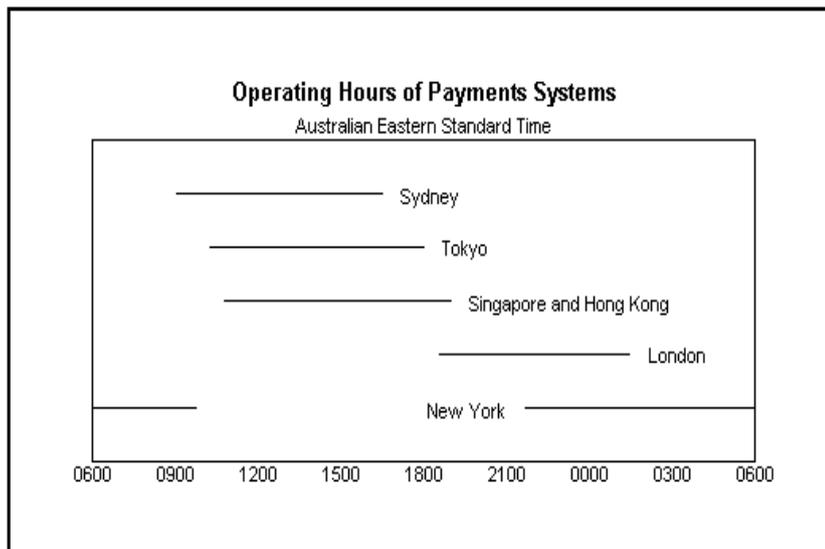


Chart 1. Schedule of World FX

Source: *BIS survey*

## SITUATION OF INTER-BANK FX MARKET IN MONGOLIA

Financial markets, be they money markets, FX markets or securities markets share a number of common features. These are provides the basis for reviewing the constraints to the development of inter-bank markets in Mongolia and the strategy for overcoming these constraints. The general framework is

illustrated in Figure 1. Any analysis of the market can be reduced to the familiar supply and demand approach. Figure 1 is an attempt to diagrammatically capture the interactive nature of the marketplace and the factors influencing these interactions. The diagram illustrates that the existence of both a means for market interaction and instruments, which can be bought and sold, while clearly crucial for the existence of financial markets, are not in themselves enough. For markets to function smoothly there must be some rules and procedures, or supporting systems, that allow for already interaction. For example, buyers need to be sure that they will have legal ownership of the instrument they have purchased and sellers need to be sure that they will receive payment. These rules and procedures exist at various levels, from laws to operating procedures such as cut-off times for settlement. Special emphasis is being given in this technical assistance to the importance of the legal system to market development and a legal expert was also fielded as part of this assignment.<sup>6</sup>

Mongolia operates a managed floating exchange rate regime whereby the Government, through BOM, is concerned with maintaining reasonable stability in the external value of the Togrog. BOM transacts in the marketplace to smooth seasonal fluctuations in the exchange rate. But this is a second order priority to maintaining togrog domestic stability. BOM conducts these transactions around an indicative BOM rate, which is updated each week on the basis of commercial bank rates prevailing in the previous week.

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<sup>6</sup> Mr. Henry Schiffman was the legal expert. For a detailed discussion of the legal issues impacting interbank market development see his report *Mongolia: Legal and regulatory reforms for Interbank Markets*.

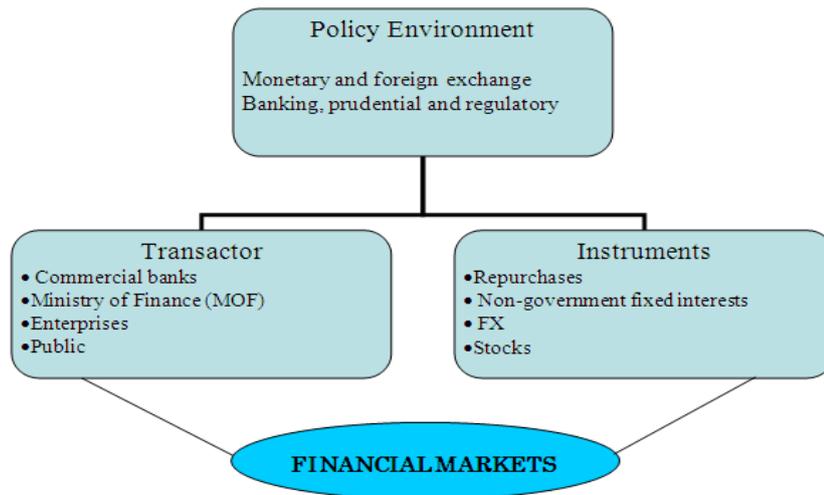


Figure 1. A Framework for Financial Markets Development<sup>7</sup>

| Support Systems   |   |   |  |   |
|---|---|---|--|---|
| Risk management   | Legal   | Trading, settlement, and payment  | Market conventions   | Information   |
| <ul style="list-style-type: none"> <li>Managing counter-party risks</li> <li>Adequate liquidity</li> <li>Cash management</li> </ul> | <ul style="list-style-type: none"> <li>Legal basis for instruments</li> <li>Legal foundation for transferability and negotiability</li> </ul> | <ul style="list-style-type: none"> <li>Trading systems</li> <li>Means of payment</li> <li>How to handle large value transactions</li> </ul> | <ul style="list-style-type: none"> <li>Means of communications</li> <li>Pricing conventions</li> <li>Times for dealing and settlement</li> </ul> | <ul style="list-style-type: none"> <li>Market communication systems</li> <li>Reporting to the central bank</li> </ul> |

<sup>7</sup> ADB RSC C00466-MON *Development of interbank markets*

The level of this rate is important to inter-bank activity, and this is one of the reasons that BOM remains the dominant player in the FX market<sup>8</sup>. There is a licensing regime for FX but, on the whole, FX is freely available through banks and exchange points, subject of course to overall supply and demand conditions in the wider marketplace. The domestic currency is widely used although USD also used in transactions. There are no FX controls and parallel markets are not features of the system<sup>9</sup>. Banks maintain foreign currency current accounts at BOM.

The Mongolian FX environment is BOM's presence in the gold market. BOM buys unrefined gold from Mongolian producers, which increases reverse money supply, requiring the sale of additional BOM bills to offset the monetary impact. At a later stage the FX receipt from the sale of refined gold can be sold against togrog monetary impact. To being a source of FX, the gold transactions can also be an alternative monetary instrument<sup>10</sup>. But they will not promote inter-bank markets in the same way as other instruments that are transacted directly with banks.

## **INSTITUTIONS, INSTRUMENTS, AND MARKETS OF FX IN MONGOLIA**

*A. Institutions of FX.* The financial system in Mongolia is dominated by commercial banks, but non-banks play also

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<sup>8</sup> ADB RSC C00466-MON *Development of interbank markets*

<sup>9</sup> Mongolians often refer to the exchange points as the curb market, or the parallel market, or black market but, strictly speaking, none of descriptions apply. The points are licensed nonblank FX outlets and banks very close to those offer the rates. Any premium is more in the nature of a convenience premium and does not reflect pressure in the FX market.

<sup>10</sup> There is an obvious conflict here and the costs of issuing BOM bills consequent to the gold purchases should be netted off the sales of refined gold to get the effective net margin on gold sales.

a significant role in the development of inter-bank markets, as well in the security industry. The banking sector is quite fragmented, which is not surprising given the widespread solvency problems that confronted the industry, and the substantive restructuring that has followed.

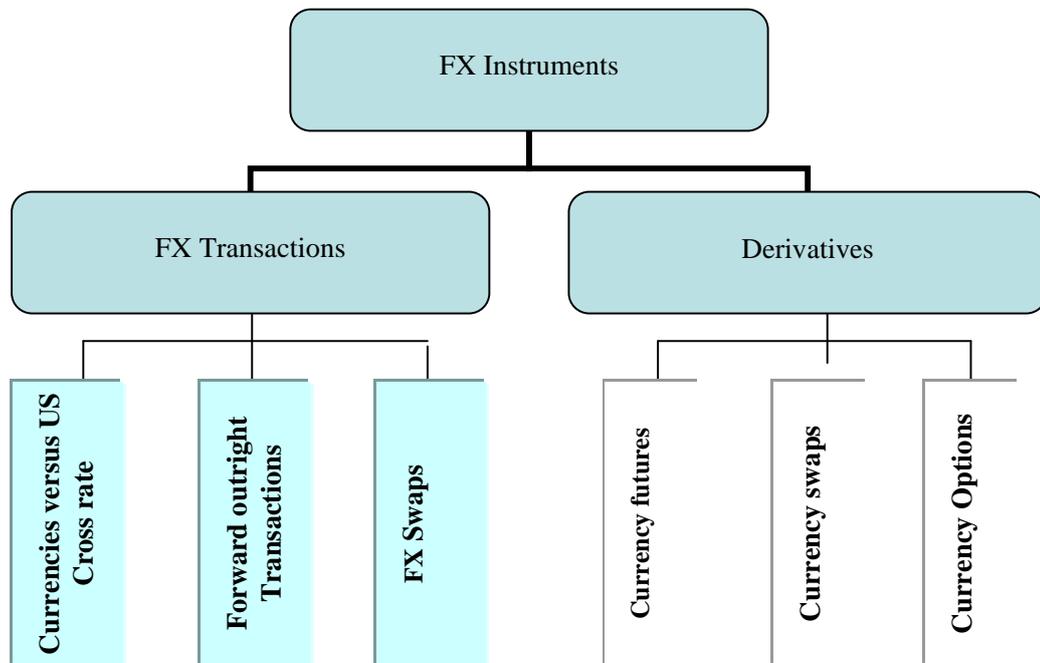


Figure 2: Foreign Exchange Market Instruments<sup>11</sup>

<sup>11</sup> Reuters, An Introduction to FX Markets, 1999

Several institutions are still working through the restructuring process. Furthermore, there are several smaller banks that have commenced operations in recent years. Many of the banks have no need, or are not in a position, to use inter-bank markets. In terms of structure, at least, the security industry is quite well established in Mongolia, although it is plagued by the general weakness in economic activity and lack of companies' quality.

Table 2. Clearing and Settlement for FX transactions in Mongolia

| Type of Transaction                       | Funds Transfer Mechanism  | Ownership Transfer  |
|---|---|---------------------|
| Togrog against foreign currency           | Mostly through bank togrog and foreign currency current accounts at BOM, but can also be done through correspondent accounts. | Not available (N/A) |
| Foreign currency against foreign currency | Mostly through foreign currency current accounts at BOM, but can also be done correspondent accounts.                         | N/A                 |

The Financial Regulatory Commission of Mongolia (FRC) regulates the industry, which comprises of the Mongolian Stock Exchange (MSE), about 40 broker dealers, as at end of April 2010, and several investment funds. These institutions will have an important role in the development of non-equity markets as well, since the legislation governing FRC and MSE is quite broad in terms of the definition of securities, permitted activities, and markets.

*B. Instruments and markets.* In reviewing instruments and markets in Mongolia, it is useful to do this against some form of standard classifications. One of the classifications is that used by Reuters and this is shown in Figure 2. This classification will also be used in later discussions on the development of instruments and markets in Mongolia.

The policy framework adopted by BOM narrows down the options available for benchmarks for domestic instruments. BOM does not provide a financial facility for clearing and settlement, nor does it use an official cash rate. This is in keeping with using bank reserves as the operational target for monetary policy<sup>12</sup>.

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<sup>12</sup> Alternatively, the central bank may target short-term interest rates and transact in the market place to bring about the change it wants in short-term rates. Other interest rates would adjust accordingly. This second approach amounts to the central bank setting a base rate. A central bank rate can be set in various ways. It could be deposit rate, a discount rate, or some other refinancing rate. It could be for overnight maturity or some other maturity. It could be penalty rate. The central bank cash rate is commonly used and there are two broad approaches: the cash corridor approach or the discretionary approach. With cash corridor the central bank sets a corridor, or band, for overnight rates and undertakes to transact at the upper and lower rates on demand. Interbank rates are tied closely to these rates because there is no incentive for market participants to transact above rates at which they can source funds from the central bank. Banks will not normally make inter-bank deposits at rates lower than they can receive from the central bank. Canada and Australia use this approach.

## OPTIONS FOR DEVELOPMENT OF AN INTER-BANK FOREIGN EXCHANGE MARKET IN MONGOLIA

This section will focus on the following incremental actions.

- I. Development of alternatives for interbank markets in Mongolia
- II. Evaluation of potential alternatives;
- III. Selection of the potential alternatives; and
- IV. Development of selected alternatives

**Stage-I:** Based on the research work, I have proposed the following alternatives for development of an interbank foreign exchange market in Mongolia. These would include:

1. Foreign exchange transactions will be settled within commercial banks through Reuters systems;
2. Internet Explorer Dealing System should be adapted for the settlement of foreign exchange transactions among commercial banks. It is very essential to apply electronic system as well as to purchase high-tech online software.
3. Establishment of foreign exchange units under the Stock Exchange is vital. It would be responsible for the exchange transactions between commercial banks. Operation of the Clearing unit for Stock Exchange is practical.
4. Establishment of a Clearinghouse. This in turn would assist in foreign exchange transactions.
5. An application of SWIFT system for the foreign exchange transactions.

Due to the following reasons the operation of Inter-bank foreign exchange transactions in Mongolia is not conducted effectively.

1. There is not adequate self-assurance between commercial banks;
2. The clearing and settlement system is fragile. Due to the poor interbank settlement system, promptness is the major constrains for failure of interbank settlements as well as limitation work hours of commercial banks creates more hurdle.
3. The majority of banks are anxious of risk. Hence, they have a preference to keep their current position in the foreign exchange and engage a specific number of inactive banking services rather than generating enough profits.
4. In addition, there are no substantial qualified dealers for foreign exchange transactions. Professional trainings are needed in preparing specialized dealers at internationally accepted standard.

The following alternatives were proposed with the intention of developing an interbank foreign exchange market in Mongolia, reducing the constraints, enhancing exchange transactions as well as to support the participation of the commercial banks in the exchange market.

**Alternative 1:** The Reuters dealing system for interbank foreign exchange markets;

The Reuters is a trading system that is being applied throughout the world. With the assistance of Reuters Company, advanced and electronic software has been installed in 10 commercial banks in Mongolia at the end of June, 1997 in order to encourage the development of viable domestic interbank

exchange market that meets international standards as well as to drive steadily out an informal exchange market in the economy of Mongolia. Basically, this would give commercial banks and their corresponding institutions more opportunities to see the bank–bank transactions at the same time in the screen. However, as a consequence of certain constraints and reasons in the economy, the utilization of dealing system has been stopped. The constraints would include: (i) Insolvency of commercial banks; (ii) Due to the shortage of foreign exchange supply in the market, commercial banks do not carry out foreign exchange transactions; (iii) Market sensitive of bank for exchange rate is low; (iv) The operating cost for system is more expensive etc.

Even though, Reuters dealing system has not been used successful in the market. It is being considered as one of potential alternatives for development of an interbank market in Mongolia. Comparing to the situation of commercial banks during that time, considerable improvements have been occurred in commercial banks in terms of solvency, operation, framework and participation of commercial banks in the foreign exchange transactions. In addition, mutual confidence<sup>13</sup> for commercial banks has significantly increased. A survey result indicates that it is premature for the majority of commercial banks to move to Reuters dealing system for interbank exchange transactions. With the aim of standardizing interbank transactions, Bank of Mongolia (BOM) has connected commercial banks to Reuters dealing system through a branch office of Reuters firm in Hong Kong at 50 percent discount<sup>14</sup>. Somehow, too high operating costs of system caused commercial banks to stop the trading system. Today, commercial banks are not able to re-use previously

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<sup>13</sup> It can be proved by the cooperation of commercial banks

<sup>14</sup> Reuters representative office in Mongolia.

installed system. If they wish to connect to Reuters, it is available. However, they are fully responsible for installation and monthly payments. Usage of Reuters trading system in current situation costs more and a possibility of effective use a comparatively low in an attempt to develop interbank foreign exchange market in Mongolia.

**Alternative 2:** Internet Explorer dealing system for interbank foreign exchange markets

An electronic dealing system is the fastest growing and new type of system. Internationally, the system is being used broadly. For Mongolia, several companies that engage in foreign exchange transactions were established. One of them is MFX Capital Company. Initially, it has started its operation since 2000 and it mostly transacts foreign exchange transactions through FX Capital system all the way through the world. However, it is not likely possible for Mongolian commercial banks to settle FX transactions by a system. Since an Internet explorer system is just at the beginning of development in Mongolia, it has too high risk for transaction participants. In addition, the consistency of electronic dealing system is very low.

**Alternative 3:** Establishment of Foreign Exchange Department in the Stock Exchange

With respect to current foreign exchange transaction of the Stock Exchange of Mongolia, it is recommended to establish Foreign Exchange Department by integrating all exchange transactions. The Department would be responsible for interbank foreign exchange transactions. However, I have conducted a research work to determine if foreign exchange transactions are

being settled at the Stock Exchange in other countries. A result of research work indicates that a foreign exchange market of former Soviet Union countries is located at the interbank foreign exchange stock while only in Kazakhstan; foreign exchange is transacted at the Stock Exchange. In contrast, shares trading are conducted at the same time in the interbank foreign exchange stock in Moscow, Russia. Broadly speaking, it is common experience that interbank foreign exchange stock was established as a department or division of central bank. Despite the fact that this gives approach for replication in the future, it always has consequences of creating free or floating exchange rates.

#### **Alternative 4: Establishment of a Clearing House in BOM**

According to the Banking Law of Mongolia, all interbank settlements shall be transacted through a clearing center at the BOM. While BOM has taken its activities and responsibilities in line with a law, it always conflicts with market changes and causes delay in the settlements. Hence, as to meet clearing center activities the market requirements a project for establishing a clearinghouse is being implemented at the BOM. In case of successful implementation of the project, it will provide an opportunity in dealing with interbank payments promptly and in turn it will be allowed dealing with interbank foreign exchange transactions. Since it will be operated by special computerized software it can be fully protected from any risks such delay in making payments other problems. However, payment risk in togrog will be reduced while risks in payment of other currencies still remain. For example: Let's assume that a dealer of Golomt Bank issued to a dealer of TDBM to buy in total 10000 US dollars at rate of 1329 togrog. Current economic situation, foreign exchange transacts as hand-to-hand principle. TDBM account

transfers US \$ 10000 from its fund to Golomt bank. Golomt transfers 13290000 togrog to TDBM account through a clearing center at the BOM. However, transactions are recorded next day. With the establishment of a clearing house, above transactions will be settled through it and transactions will be recorded at the same time. Due to the time differences, foreign currency transaction may take longer time since it will be transacted through a clearinghouse in the USA. It can be concluded that foreign currency payment risk will still remain and this alternative is not effective as other alternatives.

**Alternative 5:** Application of SWIFT system for the foreign exchange transactions

The global interactions on the foreign exchange markets are carried out by SWIFT (Society for Worldwide Interbank Financial Telecommunications). Needs of banks to settle the growing number of cross-border payments and settlement and an increase in information cost in the 1960s have lead commercial banks and non-banking organizations to accelerate the introduction of new technology for external transactions and transferring informations. However, the establishment of different data processing system by various institutions caused the impediment for exchanging information. Furthermore, demand of transferring information in short period of time has been noticeably increased. The most appropriate way of solving such constraints is to standardize foreign exchange transactions of commercial banks and to secure promptness and accurate information of the foreign exchange transactions.

A number of commercial banks in Europe and North America took an initiative to develop an integrated dealing system. Originally, SWIFT was created in 1973 in Belgium. Around 293 commercial banks from 15 different countries including: Austria,

Belgium, Canada, Denmark, Germany, Finland, France, Italy, Luxembourg, Holland, Norway, Sweden, Switzerland, England and USA supported SWIFT system.

At present, nearly 7000 financial institutions and commercial banks in 197 countries have a SWIFT account and more than 2 million volume of trade in transaction is being processed per day. The SWIFT is a cooperative society of Belgium and is owned and controlled by its members. Any commercial bank can become membership and as a shareholder. While non-banking financial institutions will be only participants. SWIFT two main headquarters are in Holland and the USA, which is responsible for coordinating regional centers. Regional centers of SWIFT, which are responsible for clearing the transfers required in foreign exchange transactions, are located in London, Hong Kong, New York, and Rio de Janeiro.

In all commercial banks in Mongolia have a SWIFT system and 2 of them have a limited authorization of operation while others have full rights for transactions. SWIFT system operations in Mongolian commercial banks are mainly as follows:

1. Transferring financial data through system: Transfer financial data from one customer to another. Processing and communications services of the highest security and reliability.
2. Information format: Message is formatted according to SWIFT message standards. Message formats have to be updated. This one of requirements of SWIFT to attract more financial services.
3. Conducting trainings and workshops: Depending on customers' capability and type, various trainings on SWIFT operation are being conducted. In addition, SWIFT conducts seminars on SIBOS activities. As result of annual seminar for customers, SWIFT proposes an expectation

forward international finances and future approaches. Based on the perceptions, they carry out their planning activities.

4. Rendering value added services: Value added processing includes promotion of the most reliable customers and exchange inter-bank data and information.
5. Seasonal services:

**TEN MESSAGE CATEGORIES ARE LISTED BELOW.**

Table 3: The Message Categories

| No | Type of message   | Code Record |
|----|---|-------------|
| 1. | Customer's transaction  | MT100       |
| 2. | Financial institution's transaction   | MT 200      |
| 3. | Foreign currency exchange <ul style="list-style-type: none"> <li>• Foreign currency option</li> <li>• Loan and Savings</li> <li>• Forward commitment</li> <li>• SWAP</li> </ul> | MT 300      |
| 4. | Cash in process of collection   | MT400       |
| 5. | Securities  | MT500       |
| 6. | Precious metal syndicate  | MT 600      |
| 7. | Letter of Credit  | MT 700      |
| 8. | Traveler's checks   | MT 800      |
| 9. | Bank statement <ul style="list-style-type: none"> <li>• Interest change</li> <li>• Nostro account</li> </ul>  | MT900       |
| 10 | Miscellaneous   | MT 90       |

The abbreviation for “Message Type” is “MT.” MT’s are numbered (e.g., MT 111, MT 112, etc.) depending on the information type and contents. The SWIFT market is related to the information contents and sphere that are transferred through SWIFT (see Table 3). In other words, SWIFT covers a wide range of markets, which are handled by financial institutions. For example, the foreign currency exchanges, the monetary market, trade finance, and the securities market.

### **The Significance of SWIFT**

Member organizations have the following advantages when using SWIFT:

1. SWIFT transfers the information and messages in a short period of time to the customers. If the sender and recipient are connected to the electronic network simultaneously, the message can be transferred within 10 seconds.
2. The information and messages have high level of precision. In this way, the receiver can understand the message
3. The security, confidentiality, and completeness of the message are guaranteed. All messages are encoded and have a code protection so it is impossible to alter, delete, or transfer without permission during the transmission process.
4. The cost of the message transmission is lower compared to the other methods available. The cost per product decreases as the products’ quantity increases. As the number of messages transferred increases, the cost of the message transmission decreases. In the recent cost estimates, it is expected to be 0.17 USD

5. The recipient always confirms whether they have received the message. Thus, the system prevents the loss or damage to messages. SWIFT retains all the messages and information in its secure memory.
6. SWIFT does not only offer a quick transfer of funds; it also offers a variety of training courses and seminars.

The commercial banks that are connected to SWIFT place the orders through the telephone by using MT 300 and can also make the payments through the network. In order to conduct inter-bank transactions by using SWIFT, commercial banks are required to be connected to the network. A total of 12 commercial banks in Mongolia are connected to the SWIFT network in order to conduct foreign settlement activities. The Mongolian banks are able to conduct FX transactions as well. If the bank maintain a sufficient currency reserve, it is possible to make transactions and settlements directly. Currency trade via SWIFT is a method by which the Mongolian foreign currency trade can attend international standards. Therefore, SWIFT is the most efficient and reliable way to manage interbank FX market.

### **Stage II – Evaluation of the Five Alternatives.**

In order to evaluate the five alternatives in the first stage, I have developed the following criteria:

1. Delivery time - 20 score
2. Costs - 20 score
3. Implementation possibility - 20 score
4. Bank participation - 20 score
5. Risks - 20 score

Evaluation of the five versions analyzed by the above-mentioned criteria:

Table 4: Evaluation of alternatives

|                            | 1 <sup>st</sup>                       | 2 <sup>nd</sup>                             | 3 <sup>rd</sup>                              | 4 <sup>th</sup>                              | 5 <sup>th</sup>                     |
|----------------------------|---------------------------------------|---|--|--|-------------------------------------|
| Delivery time              | Short period of time<br>/20scores/    | Short period of time<br>/20 scores/         | Time required<br>/10 scores/                 | Time required<br>/10 scores/                 | Short period of time<br>/20 scores/ |
| Costs                      | High<br>/5 score/                     | High<br>/5 score/                           | High<br>/5 score/                            | Mid-range<br>/10 score/                      | Low<br>/20 score/                   |
| Implementation Possibility | Seldom<br>/0 score/                   | Mid-range<br>/10 score/                     | Low<br>/5 score/                             | High<br>/15 score/                           | Very high<br>/20 score/             |
| Bank participation         | Banks cannot participate<br>/5 score/ | It is possible<br>/15 score/                | It is possible<br>/15 score/                 | It is possible fully<br>/20 score/           | It is possible fully<br>/20 score/  |
| Risks                      | Only commercial risks<br>/15 score/   | Commercial and Internet Risks<br>/10 score/ | Commercial and liquidity Risks<br>/10 score/ | Commercial and liquidity Risks<br>/10 score/ | Only commercial risks<br>/15 score/ |
| Total score                | 45 scores                             | 60 scores                                   | 45 scores                                    | 65 scores                                    | 95 scores                           |

Each alternative was evaluated by 100 of scoring. Each alternative was assessed five criteria, which are 20 scores each.

Table 5: Score of Criteria

|                            |  |
|----------------------------|--|
| Delivery time              | <ul style="list-style-type: none"> <li>• Possibility of making payment and transferring it in short period: 20 score</li> <li>• Able to make payment in a short period of time while transfer require time: 10 score</li> <li>• Requires time for transfer: 5 score</li> </ul> |
| Costs                      | <ul style="list-style-type: none"> <li>• High cost            5 score</li> <li>• Normal cost        10 score</li> <li>• Low cost            20 score</li> </ul>  |
| Implementation Possibility | <ul style="list-style-type: none"> <li>• Very little           0 score</li> <li>• Little                5 score</li> <li>• Middle               10 score</li> <li>• High                 15 score</li> <li>• Very high            20 score</li> </ul>                          |
| Bank participation         | <ul style="list-style-type: none"> <li>• Little                5 score</li> <li>• Available            15 score</li> <li>• Full                  20 score</li> </ul>   |
| Risk                       | <ul style="list-style-type: none"> <li>• High                 5 score</li> <li>• Not high            10 score</li> <li>• Little                15 score</li> <li>• No risk              20 score</li> </ul>  |

**Stage III – Conclusion from the Above Mentioned Table.**

**Alternative 1: 45 score.** It is possible to conduct inter-bank FX transactions in a relatively short period of time if banks are

connected to the Reuters network. However, the connection cost is very expensive. Furthermore, it is not possible to implement this method in a short period of time. The implementation process is lengthy. It is not possible for each bank to connect to the Reuters Network so the sphere of inter-bank FX transaction is very limited. Banks connected to the Reuters Network will face FX transaction risks. It is potential to decrease the foreign currency risks with the development of the currency market.

**Alternative 2: 60 score.** The use of Internet Explorer will be quicker because the two parties communicate online. In order for Mongolian banks to make, inter-bank transactions, or remittances, will require installation of a new software program. In order to participate, the dealing banks will have to allocate the funds in advance. The implementation possibility is ranked at mid-range because the banks consider that it has a very high network risk and are not interested in participating in the trading. In this case, banks have the possibility of being connected directly to the Internet network. There is a high risk of being affected by the Internet Explorer network.

**Alternative 3: 45 score.** It is impracticable to make the transactions or remittances any faster by establishing the foreign exchange unit at the Stock Exchange. Currently, the activities of the Mongolian Stock Exchange are not profitable. There is often a delay in payments and transactions. The establishment of a foreign exchange unit at the Stock Exchange cannot eliminate these problems. Regarding the cost, it is considered to be relatively high, as all banks have to be connected to the Mongolian Stock Exchange by internal network. All banks may be involved to organize this issue in a unified manner. In addition to

the foreign exchange risks, there are also the liquidity risks to be considered.

**Alternative 4: 65 score.** It is possible to make togrog transactions and settlements quicker without any delay by establishing a Clearing House. Regarding the other foreign currencies, it will require 2 working days. The Clearing House will be built in the under the Financial Project so it will be eliminated from the establishing costs or expenses. However, all banks have to install the new software program to deal with the foreign exchange. The implementation possibility is mid-range. If the banks will install the necessary programs, they will be able to participate. A Clearing House is available only for the togrog. Other countries' currencies have to be concentrated at their own Clearing Houses. In addition to the foreign exchange risks, there are also the liquidity risks to be considered.

**Alternative 5: 95 score.** SWIFT is the quickest way to carry out foreign exchange. SWIFT combines security and reliability of via its messaging platforms. Risks are reduced, costs lowered, and improved delivery to the customers is ensured. Since almost of banks are connected to the SWIFT network, there are no additional costs required. The costs of SWIFT decrease the more often it is used. Settlements can be conducted on time and the participating banks will only cover the foreign exchange risks. In order to decrease the foreign exchange risks, it is possible to use the financial derivatives such as Forward, Futures, Options, and SWAP. From all the alternatives listed above, the 5<sup>th</sup> is the most effective, economical, and has the highest implementation possibility.

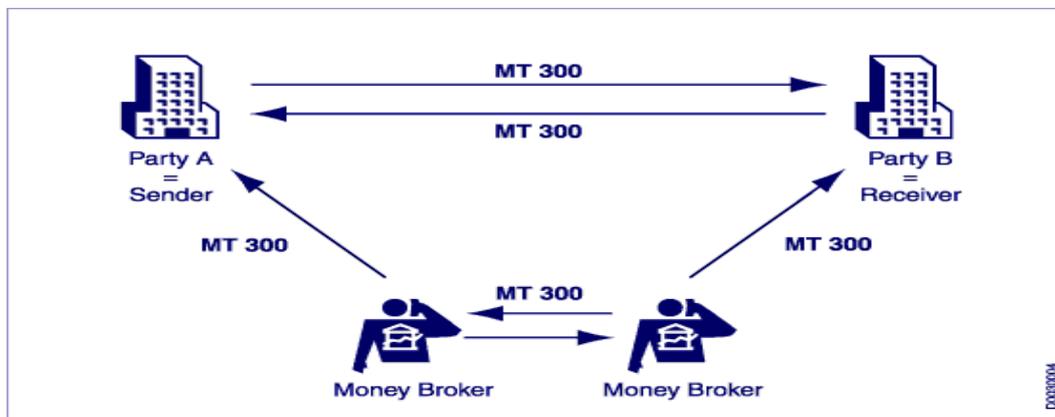
**Stage V – The Creation of the Inter-bank Foreign Exchange by using SWIFT.**

The assessment of the alternatives is as follows by descending:

1. Alternative 5 – 95 score
2. Alternative 4 – 65 score
3. Alternative 2 – 60 score
4. Alternative 1 and 3 – 45 score

*As per result of assessment, I have chosen Alternative 5:  
Application of SWIFT system for the foreign exchange transactions as most appropriate options.*

The interbank FX transactions through SWIFT network:



Source: [www.swift.com](http://www.swift.com)

Figure 3. Scheme 1: SWIFT FX transactions

1. Bank brokers trade the transactions on the phone. In order to trade on the phone, a dealer must be professional.
2. Based on the settled transactions, trading information is sent to exchange currency centers respectively by using SWIFT MT-300.
3. Correspondent banks of the exchange currency center.

## CONCLUSION

The interbank foreign exchange market is a wholesale market for both spot and forward foreign currency transactions (either outright or swaps). Both banks and non-bank financial institutions may participate in FX market. However, the market is usually organized around authorized dealers, and sometimes assisted by brokers, with some dealers behaving as market-makers to maintain liquid and continuous markets. An interbank FX market represents a form of market structure where market participants determine a decentralized allocation of FX. Ensuring that participants are free to establish buying and selling exchange rates for transactions with their customers and among themselves by providing for efficient dissemination of information on bids and asks fosters competition in the market.

It is essential to develop a spot market in Mongolia in particular as trading is being conducted in cash hand to hand. In other words, the most effective way of developing a FX market is to give people a better understanding of FX market incrementally since Forward and Futures transactions cannot be conducted directly.

Within the framework of the research work "Development of the Inter bank FX market in Mongolia", commercial banks will be able to conduct transactions and transfer reliable information in

short time and using SWIFT network. Once, all commercial banks are connected to SWIFT network, not only spot market also forward, option and futures markets will be developed accordingly.

Application of SWIFT network for FX transaction has more advantages in many senses. Particularly, transactions can be settled promptly and accurately. It can be concluded that an alternative is the most effective options. In addition, except spot transactions, other financial derivatives can be settled thorough SWIFT network.

Outcomes of using Alternative 5 are as follows:

1. All commercial banks will be connected to the SWIFT network and operation of foreign settlements expands;
2. Volume of FX transactions will be increased and fully protected from any risks; and
3. It will be a root of the FX market development in Mongolia

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