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Privatization in Mongolia

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INTRODUCTION[1]

In 1990 the public sector in Mongolia, as in other post-communist countries, accounted for about 90 percent of the gross domestic product (GDP). With a view to reducing this share, the government adopted a sweeping privatization program in mid-1991. The State Privatization Commission (SPC) was created to oversee the privatization program and placed under the responsibility of the Deputy Prime Minister. Parliament then passed a wide range of laws and regulations to improve the legal basis for capital ownership. The Privatization and Companies Law was passed in June 1991. A stock exchange was created a few months later, in 1992, although a secondary market in equities did not emerge until 1995. The Foreign Investment Law was enacted in July 1993 to provide liberal provisions for profit remittance, tax holidays, and exemptions from customs duties and sales taxes. The Securities Law was passed in June 1994 as a basis for a secondary market trading of shares; and legislation to clarify land ownership and other rights was enacted in November 1994. The privatization of the state owned enterprises was regarded as "the center of the reform program," and many senior government officials regarded this as the most important achievement of the reform process. The same priority was given to price liberalization.

The first phase of privatization concentrated on Voucher Privatization which was launched in May 1991. In the framework of this program some 44 percent of the state's assets, which corresponds to property evaluated at more than 22 billion TUG (the exchange rate at the time was 1 USD = 7.1 Togrogs or TUG) were put on the block, and to date 90 percent of these assets have been handed over to the private sector. This first phase of privatization was practically completed by mid-1994.

Supporters of the program claim the results have been "impressive" and that Mongolia has experienced the most successful privatization program as compared to programs in effect in the republics of the former Soviet Union. We shall examine the privatization program in greater detail, but the statement that privatization was "at the center" of the reform process is undoubtedly true.

This report is divided into four parts. The first part discusses the first wave of privatization. The second part discusses the development of the capital market in Mongolia; the third part presents and discusses the second wave cash privatization program. And the fourth part offers some new options.

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I. THE FIRST WAVE OF PRIVATIZATION. THE VOUCHER PRIVATIZATION PROGRAM

1. Definition of the program

The first wave of privatization which focused mainly on the Voucher Privatization Program started in May 1991 and lasted until the end of 1994. This program was launched for four main reasons:

– because social justice could be served by the distribution of state-owned assets;

– because of the low level of domestic financial savings;

– because of the lack of a well developed capital market;

– because of the absence of adequate methods for valuing the state enterprises' assets.

Vouchers carried a nominal value of 10,000 TUG and consisted of a blue large privatization coupon with a face value of 7,000 TUG and three small privatization pink coupons each with a face value of 1,000 TUG. Small privatization coupons could be traded and exchanged, but the blue vouchers were not tradable. This coupon structure affected the structure of the privatized firms. Large privatization accounted for 70 percent of the total assets to be privatized and small privatization 30 percent. The vouchers were made available as of May 31, 1991 (the time of the Privatization Law's enactment), and distributed free of charge to each Mongolian citizen.

Distribution of the vouchers to the population through bank branches was concluded at October 1993, and more then 90 percent of the population (more than 1,97 million of the 2,2 million of population) had obtained their vouchers. This percent is high in comparison to other countries given the size of the country and its small population density.

The Voucher Privatization Program was divided into there subprograms:

1. The first program related to large-scale privatization (blue vouchers) involving large enterprises.

2. The second program related to small privatization (pink vouchers) involving small-scale enterprises.

3. The third program related to agricultural privatization (both pink and blue vouchers) involving the assets which were distributed to farmers and herdsmen without being offered for public sale.

Large-scale privatization covered mainly the industry, construction, transportation, and trading sectors. Investors used their blue voucher to bid for the shares of enterprises sold in batches through the Mongolian Stock Exchange (MSE). Firms first were corporatized with 10 percent of shares reserved for the employees at a preferential price before the auction, giving them the option of taking the shares or offering vouchers on the stock exchange in anticipation of a lower price. The remaining 90 percent were available for sale in exchange for blue vouchers at the stock Exchange. The State Privatization Commission valued the company's fixed assets, checked their balance sheets, and determined the number of shares to be issued. A potential investor would declare the price of shares and a time period for which the bid would remain valid. The brokers from different provinces collected the declarations and phoned bids to the Stock Exchange. The highest bidders won, and brokers registered the owners and provided ownership certificates.

Small-scale privatization comprised restaurants, small factories, shops, and retail outlets. The voucher holders used the pink vouchers they received or collected through the secondary market to bid for shares of the enterprises at auctions organized jointly by local authorities and the privatization commission. The pink vouchers were tradable. They were exchanged for shares either during the MSE sessions or during the 30 auctions spread around the country.

Agricultural privatization covered the agricultural assets which were distributed among farmers and herdsmen without being offered for public sale or state farms' privatization which involved the creation of joint-stock companies with state participation.

The agricultural privatization started in 1991 with the gradual transfer of assets — livestock, machinery, winter animal shelters — to the members. Each district economic organization called a *negdel* was given considerable latitude in deciding how to carry out this transfer with the result that many intermediate forms of organization and property ownership appeared. Initially most *negdels* became joint stock companies with some continued collective ownership of assets and some common economic planning at the district level. They very quickly divided further into limited liability companies (distinguished from shareholder companies by a smaller minimum asset value) or voluntary cooperatives (*horshoo*), or they dissolved completely leaving individual households as independent private operators. Usually such *horshoo* were created on the basis of existing informal groupings at the neighborhood level. There are now estimated to be about 40 *horshoo* in the livestock and fodder sector and about 300 companies.

State farm privatization involved the division of farm plots. The livestock held by cooperatives were subdivided among the herdsmen. Until 1991 the crop sub-sector was dominated by state farms and cooperatives whose principal activity was wheat production. After privatization, the government retained a 51 percent majority ownership in most of these entities. Workers on the state farms are now shareholders in new agricultural enterprises. Each farmer or herdsmen could use both blue and pink vouchers to acquire his part of the property. The privatization was accomplished by local privatization committees.[2]

[2] The remaining unused pink vouchers are eligible for use in the privatization of the housing stock. this process, however, did not start, as yet, because of the President's decision to not sign the Law passed by the Parliament.

2. Scope of the first wave of privatization

Until 1991 all enterprises in Mongolia were regarded as budgetary units with no corporate status. They were managed and regulated by branch ministries, municipalities, or provincial authorities.

During the first wave, some 4,483 enterprises were sold with a total fixed assets value of TUG 21,628.5 million. The structure of privatized companies by usage of blue and pink vouchers is presented in Table 1.

Of all these privatized firms, 19,796 TUG million (92%) were sold for vouchers and 1,832 TUG million (8%) were sold for cash or for credit.

Under the large privatization program, 681 enterprises were sold (from the 804 planned) with the total value of TUG 8,921 million absorbing the majority of blue vouchers issued (8,818 thousand). The privatization advanced the most in trade, next in construction with approximately 60 of the value added placed in private hands. Privatization in industry and transport (where the larger businesses predominate) advanced at a slower pace with an estimated 45 and 35 percent of the value added produced by the private sector. A majority or minority state stake was retained in about one-third of the firms. Ten percent of the assets, as mentioned above, were reserved for employees, and the balance was sold at the newly-founded Mongolia Stock Exchange.

Small-scale privatization of shops and other small service units proceeded without difficulty. There 3,300 small enterprises (from all the 3,750 enterprises designated for sale) were sold with a total assets value of TUG 5,304 billion. These units were small businesses and trading companies, small agricultural entities, restaurants, small factories, shops, and retail outlets. Approximately 90 percent of the blue and 60 percent of the pink vouchers were used.

Agricultural entities, including state farms, fodder and diary farms, and herding cooperatives were divided among existing workers or herders. The agricultural privatization absorbed TUG 5,937 thousand vouchers, from which 4,045 were blue vouchers and 1,892 pink vouchers. These vouchers acquired 790 agricultural entities and state farms with a total value of TUG 7,299 million.

The privatization of small enterprises appears largely successful, and the devolution of operational and strategic decisions appears to have resulted in effective management. Privatization of large enterprises, however, has been more problematic. Some enterprises include over 20,000 shareholders scattered throughout the country. As a result, governance remains ineffective and shareholder authority nominal. The shareholders do not obtain information about enterprises' performance, and dividends are not paid. The diffused ownership structure also prevents outsiders from exercising effective control.

The state's involvement remains significant even for majority privately owned enterprises. The diffusion of ownership enables government to control the enterprises effectively even as a minority shareholder. For many large enterprises, the government influences board decisions through the enterprise's own board members. These members represent not only the interests of government as owner but also as regulator. This situation results in conflicts of interest with adverse consequences for enterprise performance.

Small privatization as shown in Table 2, was dominated by trade, agriculture entities, and transportation, but was practically non-existent in the case of telecommunication, state farms and industry.

As a result of these reforms, there are now four basic categories of enterprises in Mongolia based on ownership:

1) 1012 firms which are fully state-owned;

2) 181 majority state owned enterprises in which the state retains at least 51% of the shareholdings;

3) 61 majority private companies in which the state retains up to 49% of the shareholdings;

4) 4241 fully private firms including newly established private enterprises as well as former state-owned firms.

The structure of ownership to the end of December 1994 is shown in Table 3.

As a result of privatization, there are about 4,483 totally or partially privatized economic entities of which 451 are joint-stock companies; 1,890 are limited liabilities companies; and 850 are sole proprietorship business. Some of the largest public enterprises are joint ventures, particularly in the mining, transport, and textile sectors. Indeed, the largest public enterprise in Mongolia, Erdenet Copper Corporation, is a joint venture with Russia.

Since 1991 private participation in the economy has increased significantly as shown in Table 4. By 1994 nearly two-thirds of the GDP was produced by private entities. Private participation has increased mostly in trade, wholesale, and retail activities which were the biggest growth sectors in 1994-1995. Private enterprise output has also been high in the livestock (agriculture sector) and, to a lesser extent, in the construction sector. The value added of large privatized manufacturing firms remained relatively low.

3. Summary

The success of the transition depends on three things: (i) creating an environment in which the market mechanism can operate efficiently, (ii) maintaining and preferably accelerating the rate of growth so that reform is accompanied by a rise in the average standard of living, (iii) constructing an effective social safety net so that those who are harmed by restructuring the economy are not thrown into poverty. A privatization program should be judged by whether it contributes to these three objectives.

First of all, privatization in Mongolia was purely a transfer scheme: the government distributed state assets to private citizens. This presumably resulted initially in a highly equitable distribution of wealth, but it did little to increase economic efficiency or improve the allocative function of the markets for goods and services. Ownership is now diffuse, shareholders exercise little control over management (they are usually the same persons who managed the stated enterprise before privatization), financial accountability is poor, and many of the large "privatized" enterprises continue to have majority or minority state ownership. In practice, shareholders control only in theory because it seems that privatization was done for its own political reasons. Former SOEs were privatized only in name. The management remained unchanged, and the old style of management continues.

Second, privatization has not paved the road to greater competition, lower costs, and allocative efficiency. Because of the very small domestic market in Mongolia, privatized enterprises are able to exercise monopoly power as sellers, and for companies purchasing products from the rural areas, there is almost a monopolistic buying arrangement.

Third, because state enterprise and collective assets were given away rather than sold, would-be owners experienced no initiative to save in order to accumulate assets. Private wealth increased without the necessity of private effort.

Fourth, privatization provides no role in constructing a social safety net or in preventing the emergence of serious poverty.

Fifth, the first wave of privatization has not created any real owners of businesses. Thousands of nominal shareholders have come into existence without producing real owners. It is clear that the failure to create an owner with a substantial stake in the business is a mistake.

Sixth, different paces of privatization were observable: faster in some sectors and slower in others. The privatization of light and food industries progressed quickly. The privatization of power and energy, mining, road construction, transportation, telecommunication, international trade, supply, banking and finance, and housing went at a lower pace. These sectors had survived in the past mainly through government subsidies.

Seventh, until now privatization has shared ownership only with local people. Ownership should be widened to include foreign investors also.

Privatization thus is a partial administrative success, but it has created very little positive to assist Mongolia through its transition difficulties. Moreover, by creating private monopolies, undermining savings, and accentuating unemployment, it has initiated several negative effects. Along with the privatizing of existing assets, the government should also concentrate on creating conditions for new enterprises to emerge in the private sector. What is desperately needed is not only the redistribution of wealth but also the creation of new wealth by opening space in which a dynamic private sector can accumulate, innovate, and grow.

II. THE DEVELOPMENT OF THE SECURITIES MARKET

1. The securities market and its participants

The Mongolian privatization program, to a greater extent than in other countries, was connected with the development of the capital market. The vouchers were exchanged for shares of privatized companies on the stock exchanges, the brokerage firms played the role of investment funds, and a relatively high percent of shares was traded on the stock exchange.

Undoubtedly, the preconditions for developing a securities market in Mongolia have been created since the launch of the privatization process. The legislative basis for this market to function, however, is very weak. In practice, only two laws relate directly to the capital market: the Law on Securities in Mongolia and the Partnership and Company Law of Mongolia. There are no regulations concerning the activities of investment funds, financial companies, or audits. On April 1, 1993, the parliament approved the new Law on Accounting.[3] This law only generally describes the accounting profession. It deals with bookkeeping responsibilities, the role of the accounting, and the role of the Ministry of Finance, but it does not relate to accounting standards. In addition, this law is very far away from the international standards' requirements. The Arthur Andersen firm is currently working on modifications for this Law.

In June 1995 the Ministry of Finance prepared instructions on how to translate or how to restructure the old balance sheet and the income statement to new conditions. Some firms introduced this, and some did not.

The Law on Securities requires that in the case of a public offering, the registration documents shall contain documents verifying the financial position of the issuer. All companies on the Stock Exchange appeared on the capital market before the resolution was assumed and before the auditing firms were created. As a result, not one of them went through the normal audit. Only financial statements of all new listed companies must be approved by the auditing firms. But no one, as yet, has made an initial public offering.

Additionally, the joint-stock companies listed in the MSE must submit their brief financial statements for three, six, and twelve months; information on the status of their shares and materials from their general shareholders' and supervisory boards' meetings to the MSE and Securities and Exchange Commission (SEC). SEC is entitled to check the statements. The statements also have to be confirmed by the State Tax Inspection; however, of 456 companies, only 220 are submitting their statements at all. There seems to be no mechanism to force them to do so.

To create a new emission, the company has to publish its financial statements in the press. It submits 14-16 items of information in the emission prospectus including financial data for the recent three years. Only nine companies have issued new shares, and is doubtful if they provided required information.

Generally speaking, all firms can be divided into three groups.

The **first group** is firms which are fully private, and those firms must have financial statements approved by the independent auditing firms. The problem is that these auditing firms are very weak and inexperienced. There are no foreign auditing firms[4]. There are at the moment 15 domestic firms: nine in the Ulan Bator area, six outside the Ulan Bator region, and two branches of Ulan Bator firms. These firms in Mongolia can take the form of a joint stock company or a limited liability company. All requirements concerning charter capital and the size of shareholders in Mongolia are regulated by the existing law, the Partnership and Company Law. The additional

[3] This part of the report was prepared in the result of discussion with Mr. Larry Ruddell from Arthur Andersen and Mr. Sugor, the Chairman of the Accounting Department of the Ministry of Finance.

[4] The only exception is Arthur Andersen, which formally has in Ulaanbaatar the representative office, the main office is located in Hong Kong. Arthur Andersen audited Telecommunication Company before its sale to South Koreans and the Gobi Cashmere Joint Venture.

requirement is that all founders have a CPA which is currently given by the Mongolian Institute for Certificate Public Accountancy after the founder passes the required exams. The Institute was established in March 1996, and 160 certificates were handed to professionals. There are some doubts about the fairness of exams. The certificates are given for two years; work is in place to expand this period to life.

The **second group** comprises budget institutions and foreign direct investments which have to be audited by the Accounting and Analysis Department in the Ministry of Finance. This means that approximately 100 firms are audited by the Accounting and Analysis Department of the Ministry of Finance. The staff of the Department is eight persons, not enough for providing auditing services for 100 firms. The audit conducted by the Department is very formal. The employees check only some general data without going into the depth.

The **third group** contains firms with state participation which must also audited by the Ministry of Finance. This group contains more than 200 entities located outside the Ulan Bator. These firms are audited by the local branches of the Ministry of Finance that are even more understaffed and less experienced than the staff in the Ministry of Finance.

The tax inspection is a big problem since it is not prepared according to the new rules; moreover, it requires the preparation of financial statements in the old forms.

Record keeping in Mongolia is in very good shape with very detailed rules on how to record the different information in which account. This system and its accounts are left from the old system. There is no managerial accounting or financial accounting which would allow a basis for managerial financial decisions.

Arthur Andersen helped four companies adapt to International Rules. They are MIAT (Mongolian Airlines) which should be purchased by the domestic investors for USD 36 million without a tender process. Another company is Telecommunication Company with 40 percent of its shares bought by South Korean Telecom, Erdenet, Ore Processing Company, and Vrice, the liquor industry.

In May 1996 the Arthur Andersen company prepared the first draft of the Law on Auditing. This law should be accepted in October 1996 by the government and approved by the Parliament. The new elections and changes in the government practically delayed all works. The Ministry of Finance promises to pursue this Law, but essentially nothing happens. The Department of Accounting and Analysis of the Ministry of Finance is more concerned with practical auditing questions than progress in the law: this law will indirectly take some powers from them. The works on auditing were also slowed by the President of the Association of Auditors, who is a lawyer, and believes that all works on auditing should be made by legal firms, not accountants. He has prepared his own draft of the Law on Auditing which has created additional confusion and delayed all work. Realistically, firms are not currently audited, and their financial statements do not reflect their real economic situation.

The Ministry of Finance expects that by the year 2000, all companies will adopt international accounting standards.

Arthur Andersen also led some work on the amendment for the Law on Accounting, especially new provisions concerning code of ethics and professional conduct. A draft of the new law is also being developed in the Ministry of Finance. Nobody knows when it will be approved by the government and go to the Parliament.

The Instruction on Auditing is still based on old communist principles. The data are collected on a cash (not on accrual) basis, straight line depreciation is in use, the average for FIFO and LIFO is applied. The valuation is made on a straight cost basis. The more sophisticated methods of discounted cash flow method or the P/E method for business valuations are not in use.

Generally speaking the Mongolian accounting standards are outdated, and they do not allow for comparison or for financial analysis.

There are a few reasons why no one foreign auditing firm is present in Mongolia. First of all, the domestic firms cannot afford the fees required by the foreign firms. Secondly, the demand for these services (as mentioned by Dr. D. Serjamts from the Securities and Exchange Commission) is limited. Third, the firms still do not see the reason to hire foreign auditors when more complicated analysis are conducted by the Accounting Department from the Ministry of Finance.

One of the solutions proposed by the Arthur Andersen company is to invite foreign auditing firms to establish offices in Ulan Bator. The state would give these firms some kind of support in the form of subsidies for a period of eight years. These subsidies would then decrease substantially. During this time these foreign auditing firms would train the local accountants so that the price of the service would decrease and match the local abilities.

There are some attempts undertaken by the Maastricht School of Management to evaluate the equity of the existing companies. These attempts, however (according to Mr. Ruddell from Arthur Andersen) are not serious enough. The firms' financial statements would first be converted according to international standards, and later some form of evaluation would be undertaken.

2. The Mongolian Stock Exchange and its role in privatization

The Mongolian Stock Exchange (MSE) was created in 1991. In the first phase from February 1992 to August 1995, the MSE operated as a mechanism of voucher distribution (blue coupon — privatization of big enterprises). During the second phase beginning in August 1995, the MSE assumed the role of the regular stock exchange.

In the first phase the government distributed nearly 20 million vouchers to the citizens. These citizens had to buy shares of companies with vouchers through the brokerage firms and the MSE. Competitive sales mechanisms were used. The nominal value of all shares was assigned as TUG 100. Buyers could offer any prices for the shares of companies they wanted (within the nominal limit of their blue coupon — TUG 7,000), and those with the highest bid could buy. Nominally each coupon could acquire 70 shares, but it happened that some investors could by 7 thousand shares and some only seven shares. Prices of shares varied between 1 TUG and 1000 TUG.

During this period until the first half of 1995, the MSE sold shares of 470 companies worth 19,400 TUG million, served about 1,1 million people, and traded 1,540,500 blue vouchers and 1,377,200 pink vouchers received from over 460,000 people.

The second period of the MSE functioning started in the fall of 1995. In September 1995 the State Great Hural (the Parliament) adopted the Law on Securities and set up the Securities Committee. In 1995 the government issued Decree No. 106

on some measures in the secondary securities market and on trading in cash which solved many issues related to the reorganization of the MSE as a non-profit entity; privatization of brokerage firms in 1995, financial resources needed to conduct a secondary securities market, creation of conditions for effective participation of individuals in trading securities with cash, preparation of regulations on distribution of dividends, and prices of shares traded in cash.

Now the MSE performs duties such as registration of companies' shares under privatization, deposit, trade, settlement, public information, registration of securities, intermediation in shareholding companies to distribute dividends, and assistance to shareholding companies in organizing its meetings, etc.

During the period of 1991-1996, most of the organizations selected for the stock exchange though the voucher privatization scheme underwent mergers, splits or divisions, and reorganizations. The present number of joint stock companies (corporations) listed in the stock exchange is 434. The total number of traded shares amounts to 28,711,965. The total number of traded shares amounts to 28,711,965. The total value of traded shares amounts to 4,645,535,819 TUG (USD 6,831,670). The average daily value of traded stock on the exchange is 15,747,579 TUG (USD 23,158); the average daily volume traded is 97,329 shares. The average stock price is 163 TUG (USD 0.24). Shares exist in the dematerialized (electronic) form only. The commencement of MSE activities on August 28, 1995, brought to the list of traded companies such well known companies as Erdenet copper concern, the Mongol Petroleum Company, and the Gobi Cashmere Factory — all were quoted on the Mongolian Stock Exchange.

Discounted treasury bills are also traded at the MSE. The total traded number of bills amounts to 15,794 with a total value of 144,264,673 TUG (USD 212,153.93). The daily turnover is TUG 20 million average, on peak days, over TUG 100 million.

At the end of 1996, 45 per cent of the shares traded on the stock exchange remained in state ownership, 51,8 per cent were sold to the public, 1,9 per cent were bought by employees at their nominal value, and 0,4 per cent were bought by holding companies.

The number of shareholders grew very fast in 1993 and 1994 and slowed in 1995. The number of shares declined successfully from 1993. On the other side we saw a growing tendency of privatized firm to pay dividends. If in 1993 each shareholder on the average received 1141 TUG, then in 1995 this amount grew to 1622. Also, the process of concentrating shares has slowed down. If in 1994 one shareholder kept 32.5 shares, then in 1995 this amount was half. See Table 5.

MSE is computerized. There are 29 broker companies in the country registered in the MSE. Their firms are connected to working stations in the SE through telecommunications channels. The SE is open every business day (Monday through Friday) at 11:00-12:30. Since its opening, the SE has operated 289 market days.

Shares of 366 limited liability companies with a nominal capital of not more than TUG 5 million have been sold on the parallel free market (not through the stock exchange). The total value of the shares is about one billion TUG. Information on these companies was first published in newspapers, and orders from the public were received within 14 days. The stock exchange managed these transactions. This was an important step for privatization activities in Mongolia. This method differs from the sales of shares though the stock exchange as it creates the possibility of shares being concentrated in the hands of a few people.

The establishment of about 30 pink coupon markets (small privatization) in local areas also played an important role in the sale and purchase of coupons. Coupons worth about TUG 2,5 billion have been traded n these markets (40 percent of total amount).

As mentioned, the September 1995 Law on Securities also created the Mongolian Securities and Exchange Commission (SEC). The SEC is responsible for granting licenses to operate in the securities market and for monitoring the stock exchange activities. It employs 20 people who are responsible for checking (auditing) financial statements of JSCs whose shares are traded on the MSE. They are doing so however, in our understanding, only in cases of complaints (petitions, claims).

An investor who wants to purchase more than 20 percent of the shares of a JSC has to apply to the SEC which discloses information on its financial situation, history, background, etc. The tender is announced in the mass media, and the investor may purchase its stock during the 45 days after the announcement. In practice, the procedure never worked. Apparently, there were nine cases of intention and one attempt which failed. Price for stock of an announced enterprise usually goes up, and the investor is unable to buy it.

In cases when the Law on Securities is violated, the SEC can do one of four things:

– render the MSE transactions invalid;
– apply small fines;
– confiscate the value of an illegal transaction to the state budget;
– initiate court proceedings.

Also, investment funds exist in a very unclear situation. Formally there are no investment funds in Mongolia. Some of the brokerage firms have established their own investment funds, called joint funds in Mongolia, within the structure of the brokerage houses. Approximately 15 of the 29 brokerage firms have established such joint funds. These active brokerage firms are not in conformity with the official Law on Securities in Mongolia because the law distinguishes between brokerage and dealership activities. Formally, there are no dealers in Mongolia; therefore, the joint funds are formally illegal. There are a few private investment funds, but these are not registered. There is no law on investment funds in Mongolia; therefore, this type of activity is unregulated.

In summary, it can be said that investment funds are not developed because of a deficiency in the law, a lack in capital, and because there were no professionals who could risk starting such new businesses.

Surprisingly, brokerage firms are very well developed. These firms have to be registered in the Securities and Exchange Commission after fulfilling four conditions:

1. The brokerage firm must assume the legal form a limited liability company with a charter capital minimum of TUG 10 million.

2. Minimally, one person should have some form of Mongolian public accountancy certification.

3. The brokerage firm has to have an office.

4. The brokerage firm must have logistical technical support in the form of computers, modems, etc.

In only one case did the SEC suspend the license of one of the brokerage firms. It happened when this firm sold 5 thousand shares without the permit of the owners.

There are currently no underwriters registered in Mongolia. The reasons are first, the novelty of this business, and second, the large charter capital required — TUG 200 million (about USD 300 thousand). The role of underwriters could be played theoretically by 15 banks in the Republic of Mongolia. All of them, however, are plagued with bad loan portfolios, low capital adequacy ratios, etc. Only the Golomt Bank, Trade and Development Bank, and Exim Bank appear to be sound. There are problems in receiving money deposited. Wire transfers are delayed. As a solution, the Securities and Exchange Commission created its own clearing account in a reliable bank, and it now makes all settlements with sellers and buyers on its own behalf without delay. The present balance of the account is TUG 1 billion.

3. Summary

First, the legal basis of the capital market is very weak. New laws regulating the activity of auditing companies, introducing new accounting standards in conformity with international accounting standards, regulating the activity of investment funds and financial companies, etc. are needed.

Second, in Mongolia there exists a shallow capital market. The approximate demand for securities amounts to TUG 18-20 billion. Supplying a large number of shares in the framework of the floatation path of privatization will cause a strong fall in the prices of existing stock and further undermine the credibility of the Stock Exchange.

Third, auditing is underdeveloped and not enforced. This may result in foreign investors seeing a lack of reliability in these companies. . Too a large role is played by the Accounting Department of the Ministry of Finance. This Department should concentrate on the preparation of a new accounting law, not on auditing functions.

Fourth, the SEC is understaffed with only 20 persons employed. As a result, the SEC cannot effectively monitor unfair trading practices utilized by the brokers, nor can it audit the prospectuses or financial statements of firms already listed on the stock exchange or in the process of issuing new shares.

Fifth, the barriers to purchase of controlling share of stock are too strong.

Sixth, the state retained 51% of the companies. This is a serious negative factor for the securities market. The MSE rating shows that shares of fully private corporations are in greater demand and more expensive than those with a state majority (See Table 9). People are afraid of governmental interference, even though some companies with state interest are more reliable and profitable than the private ones;

Seventh, there is a complicated tender procedure for those who buy more than 20 percent of a company. There are already 280 companies where more than 5 percent of the stock is concentrated in one hand. Fifteen joint investment companies have been created in the expectation of a possible governmental sale of large blocks of stock. But the market is very shallow. According to the MSE General Director, some TUG 2-3 billion is waiting in the market for an offer to purchase controlling stock including domestic and foreign investors. Among the latter, Chinese, Russian, Japanese, and American investors were mentioned.

Eighth, three categories of stock: categories A, B, C or 1, 2, 3 floors with different risk should be created.

Ninth, the MSE needs technical assistance in a) introduction of a continuous listing; b) with creation of above-mentioned categories of stock; 3) training of SE specialists and brokers.

Tenth, the banking system is underdeveloped.

III. SECOND WAVE OF PRIVATIZATION

1. Definition of the second phase of privatization

The second phase of privatization was announced in June 1994 when the Cabinet approved guidelines for the cash privatization program. On October 15, 1994, the government adopted Resolution No. 179 which offered an “Accelerated Program for Privatization.” The resolution proposed that 102 enterprises were to be privatized either for vouchers or for cash, 215 partially state-owned enterprises would be fully privatized for cash, 88 businesses and vacant properties would be auctioned to the highest bidders for cash or disposed of by other means of privatization.

In summary, Resolution No. 179 identified more than 400 public enterprises to be sold on a cash basis while making provisions for the use of remaining vouchers held by Mongolian citizens.

What firms are selected for privatization? The authors had a chance to analyze the data of 713 firms distributed in three categories:

– firms which will be not privatized in the second wave,
– firms which will be privatized,
– firms which are already private.

The sample in not fully representative because there is lack of data in some parameters which distort the averages in various tables. The comparison, however, seems to be interesting.

Firms to be privatized in the framework of the second wave are significantly smaller (measured by the book value and fixed assets) than the firms which should stay in the state's possession. The completely privatized firms are the smallest. The average price per share is, in turn, the highest in privatized firms and the smallest in the state owned firms. Differences are very large: share prices in private firms are three times higher than in the state-owned firms. The share price is positively correlated with the return on equity and return on assets, and it is surprisingly adversely correlated with return on sales. It seems that state-owned firms are more profitable than those which are private, a typical situation in the post-communist countries where private firms have better opportunities to minimize their profits thus increasing their costs and where state-owned firms have easy access to state subsidies.

The next observation, especially visible in Table 6 and Figure 2, is that “small is the best.” The smallest firms have better ROS. The bigger firms, however, have higher ROA and ROE. ROA and ROE are unbelievable high and result probably from the fact that the figures concerning assets and charter capital are “a shot in the dark.”

This is especially visible when book value is compared to the share capital. In no one case does the book value equal the share capital. In about 8 percent of valid cases, share capital is bigger than book value. In 25 percent, valid cases' share capital is less than 10 percent of book value. Charter capital (“share capital” in the tables) seems to be extremely low, especially when comparing the assets and book value of the companies. This also seems to show that the share capital was deliberately kept at a low level to make purchases possible.

Table 7 and Figure 2 seems to show that bigger firms are in some ways stronger because they pay more dividends (although only about 7% of firms paid dividends at all). People also seem to place more trust in larger enterprises (higher prices of shares).

The analysis of the firms designated for privatization shows that the largest firms (measured by book value, fixed assets, and net sales) are those from the industrial sector and from transport and communications. These firms also pay the highest dividends. The smallest are firms from construction and agriculture. The largest firms are usually in the state's possession. In industry and in construction the state owns more that 75 percent of shares, in construction and agriculture 47.9 and 54.3 percent of the shares.

The financial indicators show that the firms from trade and services are the most financially sound (ROE 203.9; ROS 101.5; and ROA 11.) and industry (ROE 157.4; ROS 10.8; and ROA 13.1). The least profitable seem to be firms from transportation and construction. Surprisingly high results are achieved by firms in agriculture.

Another interesting observation can be made by the analysis of the relationships between prices of shares and the state interest in the firms. Table 8 and Figure 3 show that the larger the portion of shares in the state ownership, the lower are the share prices. The highest prices are in the group of already privatized firms, the lowest in the group of firms which will remain (partly) unprivatized. Prices also depend on the number of shares which belong to the state: prices are higher when the state possesses fewer shares (Cramer's V = 0.22348; see Table 9).

Similarly, the price of shares depends on the sector of economy. The best prices are observable in industry, the worst in agriculture (Cramer's V = 0.18957; see Table 10). Prices also depend on the financial results of the company, first of all on ROS and net profit (Cramer's V respectively 0,16036 and 0,16379; see Table 10).

The main feeling is that investors are not interested in how big the enterprise is (in terms of the number of employees or the value of equity etc.), but rather in what sector they are located.

Of all valid cases, in 34.2 percent of the firms, the state has 100 percent of the shares, and only in 16.7 percent does it hold less than 50 percent of shares. This means that in 83.3 percent of the valid cases, the state has a control package of shares.

2. The cash privatization program

The State Privatization Committee, the body which replaced the old State Privatization Commission, was instructed to utilize seven different methods of selling state-owned enterprises in the framework of the second wave:

– auction sale;
– sale by tender based on the merit of each offer;
– flotation, i.e. sale of shares though the stock exchange;
– establishment of joint ventures;
– liquidation;
– management buy-out (MBO) in the form of management contracts;

– golden share.

There are four mixed methods planned which will combine auction with management buy-out, tender with MBO, flotation with MBO, and tender with floatation.

The methods of the second privatization wave are shown in Table 12.

The most popular method of privatization is management buy-out in the form of management contracts. This method is used in more than half of all firms designated for privatization. In second place is flotation followed by tender and auctions. The golden share method should be used in nine cases and only in the banking sector. Joint venture and liquidation are planned to be used only in one case.

The opposite relation is visible between the average percent of shares designated for sale and the frequency of the method. The most popular method of MBO will relate to the lowest percent of shares (20%). The least frequent methods of liquidation relate to all 100 percent of shares and joint ventures to 51 percent of shares.

The most popular combination of methods is flotation and management buy out. This method is planned to be used in 138 cases (42%).

The analysis of methods used shows an overrepresentation of management buy-out. Apparently the management lobby exerts strong pressure to obtain access to the privatized firms. This solution, however, is the least promising for the progress of reforms. In this method, essentially the same managers will continue to govern enterprises using the same methods and the same personnel as in the past. The only positive effect of this combination is that some kind of strategic investor will be selected. The fact that it will be the same manager as before can have the opposite effects on the performance of the privatized firms.

It is interesting to analyze what methods are selected by firms going private. Insight into this problem gives us the data in Table 13.

First of all, the management contract (as unique method, not combined with others) is used in the largest firms measured by net sales, gross and net profit, net assets, book value, and number of employees. It seems that the management of these firms was in a position to force the privatization authorities to apply this method. These firms are also characterized by the highest ROE, and they pay the highest dividends. The tender method is applied in the case of the second largest firms designated for privatization. These firms have the highest ROS (90.5). In the third place is a combination of flotation and MBO. In the fourth place are firms designated exclusively for flotation: for sale through the stock exchange.

The sectoral distribution of methods shows that the industry, agriculture, construction, trade, and services prefer flotation combined with MBO (see Table 14). The law requires a three year period for management contracts. For the first three sectors, flotation holds the second place, and in case of trade and services, the auction holds second place. The banks will be sold exclusively by the golden share method in which the state will try to keep its control over the banking institutions. What flotation will look like is still unclear. The management of the SPC is of the opinion that currently traded stocks are undervalued. Two ideas are under consideration: either to completely revalue all the companies or to use the current price plus some markings. Some investors believe that the price should be twice as high as the stock market price. All these ideas seem to show a lack of understanding on the part of some privatization authorities of how the stock market works in Mongolia.

According to the SPC authorities, generally in agriculture and the food sector, the companies with a minority of state holdings will be floated. Those with the majority state holding will close management contracts for 20 percent of shares. Privatization of mines will use auctions for smaller companies, tenders for larger. The privatization of gold mines will go through tender and will entail certain environmental requirements, including cleanup of previous contamination.

The somewhat mixed results give us a comparison of the firm in which the state plans to keep some shares and the firm in which the state wants to sell all shares (see Table 15 and Figure 4). The state wants to keep some interest in the much larger firms as measured by the net sales, fixed assets, and book value. These firms have a higher net profit (although surprisingly their gross profit is lower than in other firms) and a higher ROS (155.8 vs. 17.8). They should be large, state owned mammoths, subsidized by the state for which the state still keeps a majority control (86.9% of the shares belong to state). The state plans to sell approximately 40 percent of these firms' shares.

The firms from which the state plans to sell all shares are usually more privatized than other firms. They have surprisingly more employees which shows that firms where the state retains some shares are more capitalized: in these firms the share capital is on the average three times larger than in other firms. And they also tend to pay higher dividends.

The state wants to keep some shares of the best enterprises: those with better figures on net sales, a better net profit, more assets, a higher book value, unbelievable high ROS (155,8%). It is very interesting, that those firms have a lower average share capital (e. g. are cheaper from the market point of view). Undoubtedly the state plans to keep control of firms which are larger and more capitalized than other firms.

The next principle introduced in the second wave of cash privatization assumes that privatization will be done case by case during the next four years. The government is more focused on revenues than on speed of privatization. The expected revenues from the sale of the state-owned property is shown in Table 16.

As we see from the Table 16, the main privatization efforts will be made in the first two years, in 1997 and 1998, when practically two-thirds of the assets should be sold. The largest revenues are expected from privatization in geology and mining, industry, food and agriculture, and transport and communication. Astonishingly small revenues are expected from the privatization of the state banks. This indirectly shows the low capital standing of Mongolian banks.

3. Summary

First of all, the new program is not developed in detail (much of the staff of the State Privatization Committee has been in office only a few weeks). The new program exists only in the form of a list of enterprises which should be privatized during the next four years. This list also details when these firms should go private and what method of privatization should be applied. There is no description of procedures, no clear description of methods, no goal on privatization, no philosophy to back such a program..

Second, in our opinion the whole program is unfeasible. The most popular method of privatization is flotation combined with an MBO. This means that the sale of enterprises will proceed mostly through "stock market offerings" with 20 percent allocated to the management contract. There is no doubt that such a combination is very slow and very politically sensitive. The sale for managers should go first followed by flotation. The slowness is a result of the unavailability of capital, the impossibility of valuation, the political unacceptability of the outcome, and the complicated procedure of closing management contracts. The first reason is an effect of the lack of domestic savings and the lack of foreign investment interest.

Third, it is practically impossible to evaluate firms designated for auction or tender of a MBO. The historical costs and depreciation estimates used in mechanical calculations of book value are irrelevant. Extrapolation of cash flow is unreliable for assets likely to undergo significant restructuring. There is no doubt that the value of firms cannot be determined by accountants. It can only be determined by the market.

Fourth, the impossibility of measuring the value of privatized companies will have a very negative impact on the political atmosphere around the privatization. If the price is set too high, nobody will be interested in acquiring such enterprises. In this situation the state will still be an owner, and the enterprises will continue to form inefficient managements. If the price of assets is set too low and some lucky investor acquires an enterprise, the public will soon become aware that this buyer seemed to have receive a special deal. As a result an outcry of corruption erupts, and the newspapers and opposition parties demand that the deal be canceled. The government will be held responsible for "selling the country for free." Subsequently the government and the SPC become more cautious, and privatization comes to the halt. This problem may be particularly acute in the case of foreign involvement.

Fifth, implementing privatization though management contracts will face similar problems. The first problem will be determining the performance conditions for the management to meet, and later verifying whether they were actually met. Given the lack of a reliable measure from financial markets as well as poor accounting standards and practices, performance will be very hard to measure. When managers do not meet the standards, the SPC will exercise the only option of re-nationalizing the part of the company which was under control of the management group. This will be a step in the wrong direction.

Sixth, there is no assurance that the management groups will be motivated enough to take action to increase the net worth of the enterprises. Foreign experiences, for example from Kazakstan, seem to show that many management groups are more interested in draining financial resources from managing enterprises than in increasing their value.

Seventh, there is an obvious lack of clarity as to the power of various governmental bodies to approve or influence privatization decisions. And from the other side, the SPC alone has a dual responsibility for both privatization and managing state assets.

The clearly visible tendency is a shift in the direction of the management at the cost of privatization. Another question is whether the SPC is under the jurisdiction of the Prime Minister, Parliament, or the Ministry of Finance. The existing ambiguity distorts the whole process.

IV. RECOMMENDATIONS

In our opinion the following recommendations can be addressed to the government of Mongolia concerning the improvement of the privatization process and any capital market activities.

In the privatization area the government should consider implementation of some kind of second wave of mass privatization program. Five options are theoretically possible.

1. A new mass privatization program performed as the first wave

The government will publish new vouchers which will be given for free to the public. The public next will exchange these vouchers through the brokers at the MSE for shares of privatized firms.

This approach has the following advantages:

– this method was already practiced in Mongolia and is very well known;

– there is an infrastructure which would help in implementing of this method.

This method has also some disadvantages:

– there is some social resistance against mass privatization. The pubic sees few benefits from using this method;

– this method does not solve the problem of the strategic investor in privatized companies;

– there is no revenue to the state budget.

2. Privatization though national investment funds: the Polish solution

The government will create national investment funds and invite a foreign firm to assume the management of these funds. The funds will take over the remaining shares still at the disposal of the state. Some of these funds will assume the role of the strategic investor, some the role of minority investors. The public will purchase certificates which will give them shares in all investment funds. Certificates will be tradable on the secondary market. After some period (for example ten years in Poland), the closed investment funds will re-open.

This method has the following advantages:

– a strategic investor is assumed from the start of the program;

– the national investment fund is oriented toward the maximization of net worth;

– no business valuation is necessary;

– limited revenues to the budget from the sale of certificates is possible.

There are some disadvantages:

– the program is complicated and requires a long procedure for selecting a management group;

– the program creates strong political opposition because of the involvement of foreign management groups.

3. The creation of pensions funds to take over the remaining state owned share

These funds will operate as regular investment funds. This solution is similar to the Polish solution with the exception that instead of the National Investment Funds, National Pension Funds will be created. The employees will receive certificates in all these funds proportional to their time of employment and salary according to the rule: the longer the employment and the higher the salary, the larger the number of participation points.

There are the following advantages of this method:

– this option solves the problem of a social safety net;

– a strategic investor is assumed from the start of the program;

– the national investment fund is oriented toward the maximization of net worth;

– no business valuation is necessary.

However, this method has some disadvantages:

– the program is complicated and requires a long procedure for selecting of management group;

– no revenues to the state budget are assumed.

4. The auction of blocks of shares

Although traditional auctions typically sell single physical assets, it might be possible to organize a massive sale of blocks of shares for cash.

There are advantages of this method:

– a strategic investor will be selected at the moment of sale;

– the sale would result in a higher ownership concentration.

There are also the following disadvantages:

– introduction of the program will take a few years;

– a business valuation will be necessary;

– the program will not be transparent;

– the program will create political resistance.

All of the proposed methods (with the exception of the last one) allow for fast and transparent privatization, allow for avoiding costly and time consuming business valuations and a difficult auctioning process. In the authors' opinion the fourth method of expensive vouchers is most feasible for introduction in Mongolia.

5. The introduction of expensive vouchers

An expensive voucher program would be similar to a conventional voucher program, but the number of shares would be limited by setting a high price to restrict entry.

The State Property Committee will issue participation certificates (PC) in a limited amount with a high nominal value. For example, the number of all PCs could be 200 thousand, and the nominal value of a PC could be Tug 100 thousand. The sale price of a PC, however, would be much below its nominal price (for example 20% to 50% of the nominal price).

The PCs should be issued in eight tranches (offerings) with a half a year interval. The first tranch of 25 thousand PCs could be issued on July 1, 1997, the second on January 1, 1998, etc.

The secondary market for the trading of PCs should be permitted. The sale price of the PCs in the first tranch should be set at a level which will be calculated taking into account population's existing savings, the number of shares channeled to the Stock Exchange, and the state budget expectations, etc. The sale price for the next tranches should be set at a level between 75-90% value of the PCs on the secondary market.

The PCs should be sold in each emission only to domestic investors. Foreign investors should be allowed to acquire certificates only on the secondary market.

The remaining shares, being in the state property, should be (after exclusion of those firms which will remain in state ownership as well as these which will be sold in the framework of tenders) channeled to the stock exchange. The shares could be transferred to the stock exchange in eight portions every half a year. The existing time schedule prepared by the SPC for the following four years could be applied.

These shares next will be traded during stock exchange sessions for real cash and for certificates. The fact that the sale price of certificates is below their nominal price should create an additional demand for certificates and increase their sale price.

The shares of particular companies should be divided into three tranches: a tranch of 30 percent block of shares, a tranch of two blocks of five percent of shares, and a third tranch of remaining shares for small investors. The blocking of shares should allow for creation of strategic investors who will assume an active role in company governance. The fact that investment funds or private investors will purchase a block of 30 percent of shares will encourage them to make additional recapitalization by issuing new shares to increase the controlling interest to more than 50 percent.

The price of particular blocks of shares will be set on the stock exchange as a result of the play of demand and supply forces.

The participation certificates can be invested either directly through the brokers on the stock exchange, or they can be invested by the exiting or newly established investment funds.

The investment funds, thanks the ability of concentrating the PCs, should have the possibility of assuming a strategic role in corporate governance. They should be allowed, for a limited time like five years, to control more than the legally accepted portion of 10 percent of the shares. They should, in extreme cases, be allowed to control even 51 percent of the shares. After the five year period, they should sell their majority interests and assume the role of passive investors, a role typical of mutual funds.

In the proposed program a very important role is played by the stock exchange. Actually, the shares of 433 Mongolian joint-stock companies are listed on the MSE. The authors, after talks with the representatives of the Stock Exchange as well as the

Securities Exchange Commission, are of the opinion that the Stock Exchange can absorb an additional number of approximately 160 million shares.

There are, however, two dangers:

– the rapid influx of a large number of shares by the exiting shallow capital market will lead to a fall in prices and will lower the credibility of the MSE;

– the influx of many new shares of non-audited companies will lower the credibility of the Mongolian Stock Exchange. The SEC with its 20 specialists is not in a position to check the financial statements of firms coming to the market. Three existing auditing firms also are not in a position to guarantee the trustworthiness of the provided financial statement. We can also to add these facts that international accounting standards are in most cases not observed.

Therefore, we believe that the following recommendations can circumvent the exiting barriers:

– the PCs with higher than the selling price nominal value will create an additional demand which will provide for keeping the price of the shares at the previous level;

– the Mongolian Stock Exchange should be divided into three floors: the first, second, and the third one with different hours of trading. In the framework of the first floor, only corporations audited by international accounting firms should be listed. On the second floor should be those corporations which provide financial statements, but these statements are either revised by the Ministry of Finance or by the SEC. In the framework of the third floor should be listed those firms which provide no financial statements (currently 120 firms). This division of the stock exchange into three floors will allow for risk assessment, and it will also create an incentive for the firms from the second or third floor to be promoted to the first floor.

The proposed scheme of privatization, in our opinion, meets the most (if not all) assumed aims:

– allows for fast privatization;
– is clear and transparent;
– provides a strategic investor and improves corporate governance;
– provides revenues to the state budget;
– encourages additional recapitalization of privatized joint-stock companies;
– gives privileges (at the first stage) for domestic investors;
– allows for saving the main points in the program proposed by the SPC.

The last provision is very important:

– it provides for utilization of the time table proposed by the SPC. Enterprises can be designated for privatization according to the schedule proposed by the SPC;

– it also provides for the utilization of all paths proposed by the SPC. Auctions and tenders can be applied in the case of firms designated for tender. Management contracts can be used by investment funds. Joint-ventures can be established by foreign firms by acquiring of shares or participation certificates on the secondary markets. The golden share can be used in case of firms in which the state will wish to keep control.

The introduction of the project will, however, require some changes in the existing legislation. For example, Provision 2 in Article 9 in the Securities Law of Mongolia must be changed: “Any person who intends to own directly or indirectly

20% and more of total shares of any company must make a tender offer in accordance with Article 8 of this Law". The law should also allow for the purchase of more than 20 percent of the shares in the case of an initial public offering.

Tables and figures

Table 1
The structure of privatized assets (in TUG million as of July 1, 1995).

Type of privatization	Large privatization (Blue Vouchers)		Small privatization (Pink Vouchers)		Cash privati-zation	Credit privati-zation	Total	Per cent
	TUG	Per cent	TUG	Per cent				
Non-agriculture sector	8,818.0	63	2,603.0	44	1,617.0	215.0	13,254.1	62
Agriculture sector	4,045.0	29	1,892.0	32				27
Remaining to be sold	1,066.4	8	1,370.0	23			2,436.7	11
Total	13,929.4	100	5,865.0	100	1,617.0	215.0	21,628.4	100
Per cent	64		27		7	1	100	

Table 2
Assets privatized by voucher at the end of December 1994 (number of enterprises and TUG million).

Sector	Large privatization		Small privatization		All entities		Average	Share of small pri-vatization
	Number	TUG	Number	TUG	Number	TUG	Number	TUG
Industry	199	5,487	164	195	363	5,682	15.65	0.04
Construction	157	781	185	156	342	937	2.74	0.20
Transportation	88	542	131	243	219	785	3.58	0.45
Telecommunications	2	12	1	0	3	12	4.00	0.00
Trade	138	899	1,194	947	1,332	1,846	1.39	1.05
Housing	0	0		20		20		
Other services	16	193	1,050	407	1,066	600	0.56	2.11
Agriculture	325	4,045	232	1,892	557	5,937	10.66	0.47
State Farms	194	1,340	39	15	233	1,355	5.82	0.01
Other	81	1,007	287	1,429	368	2,436	6.62	1.42
Total	1200	14306	3283	5304	4483	19610	4.37	0.37

Source: calculations based on data provided by the SPC.

Table 3
Number of companies state-owned and privatized by voucher by the end of December 1994

Sector	Large privatization*				Small privatiza-tion**	All entities privatized
	Majority state-owned	Part state-owned	Private-owned	Total		
Industry	50	8	141	199	164	363
Construction	19	5	133	157	185	342
Transportation	23	10	55	88	131	219
Telecommunications	0	1	1	2	1	3
Trade	38	5	95	138	1,194	1332
Housing	0	0	0	0	0	0
Other services	1	1	14	16	1,050	1066
Agriculture	0	0	325	325	232	557
State farms	31	27	136	194	39	233
Other	19	4	58	81	287	368
Total	181	61	958	1200	3283	4483

* By blue vouchers.
** By pink vouchers.
Source: data provided by the SPC.

Table 4
Sectoral composition of the GDP by ownership in 1994 (in per cent)

Sector	Per cent share of GDP	Private enterprises	Public enterprises
Private enterprise dominated:			
1. Agriculture	33.8	87.8	12.2
2. Construction	2.1	62.0	38.0
3. Trade and Wholesale	14.0	90.0	10.0
Pubic enterprises dominated:			
5. Industry (including mining)	32.0	36.0	64.0
6. Housing, other services	0.0	30.0	70.0
7. Transport	3.1	35.0	65.0
8. Other	15.0	20.0	80.0
Total	100	63.7	36.3

Source: calculations based on data provided by the SPC.

Table 5
Shareholders and dividends in the Mongolian Stock Exchange (1993-1995)

	1993	1994	1995	Total
Shareholders	308932	409349	112732	831003
Dividends (TUG)	352547173	606648024	182884055	1142079252
Average (TUG)	1141	1481	1622	1374
Number of shares	24428987	18671759	12609436	55710182
Average (TUG)	14,4	32,5	14,5	20,5

Source: calculations based on data provided by the MSE.

Table 6
The size of firms measured by the number of employees

	Average N=465	1-100 N=141	101-200 N=150	201 and more N=174
Book value (thous. TUG)	442829.2	153167.2	141803.0	821401.6
Average price per 1 share (TUG)	103.0	80.5	66.2	153.9
Per cent of shares owned by the state	49.7	51.7	48.5	48.7
Per cent of shares sold to employees	7.0	3.9	6.8	9.1
Per cent of shares sold through the Stock Exchange	49.2	49.9	50.1	47.6
Net sales (thous. TUG)	631677.1	55237.3	180730.1	1273326.0
Gross profit (thous. TUG)	161273.0	9737.7	44313.8	325583.3
Net profit (thous. TUG)	108230.7	4130.1	27819.4	212797.5
Fixed assets (thous. TUG)	374283.6	146215.4	82960.4	711487.2
Current assets (thous. TUG)	549910.0	47621.2	216469.1	1067294.3
Current liabilities (thous. TUG)	469449.5	40578.1	164727.6	928177.2
Share Capital (thous. TUG)	31563.5	17721.8	27362.0	45937.0
No. of employees	238.9	62.2	144.2	463.7
No. of shareholders	2648.2	1025.4	1672.8	4731.9
Return on assets (per cent)	12.1	7.8	11.9	14.2
Return on equity (per cent)	143.6	36.4	77.8	240.7
Return on sales (per cent)	10.0	12.3	8.5	9.9
Long term liabilities (thous. TUG)	52766.8	2821.7	9409.5	110665.8
Distributed dividends (TUG)*	38.1	13.9	20.23	51.6

* Only in cases where this event took place.

Source: calculations based on data provided by the MSE, the Statistical Office of Mongolia, and Tax Inspection in Mongolia.

Figure 1
The size of firms measured by the number of employees

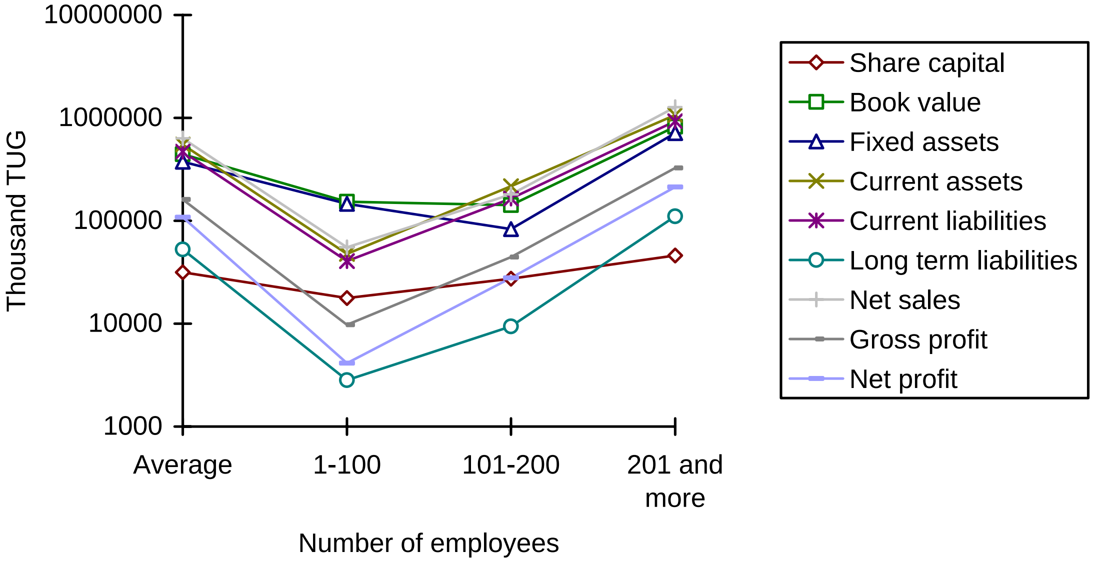

Table 7
Financial situation of firms designated for privatization, state-owned and private

	Average N=713	Not to be privatized N=173	To be privatized N=329	Private N=211
Book value (thous. TUG)	1390439.0	916310.0	2716965.9	195062.8
Average price per 1 share (TUG)	102.7	48.8	67.7	145.0
Per cent of shares owned by the state	65.5	72.0	62.3	–
Per cent of shares sold to employees	7.2	7.8	7.0	–
Per cent of shares sold through the Stock Exchange	49.2	49.8	48.9	–
Net sales (thous. TUG)	692127.3	580624.1	1075944.4	336635.6
Gross profit (thous. TUG)	136168.2	100656.6	244303.3	45102.1
Net profit (thous. TUG)	121320.8	112122.0	210789.2	27982.2
Fixed assets (thous. TUG)	1309270.4	988674.4	2549331.9	123644.2
Current assets (thous. TUG)	626062.4	551731.2	1039628.8	183061.2
Current liabilities (thous. TUG)	494942.2	372352.0	891994.0	106847.4
Share Capital (thous. TUG)	31466.9	26879.8	44025.6	23645.1
No. of employees	238.9	207.0	219.3	267.3
No. of shareholders	2648.2	1466.8	3531.2	2411.2
Return on assets (per cent)	11.2	9.1	14.4	9.9
Return on equity (per cent)	143.6	113.3	167.3	131.5
Return on sales (per cent)	40.8	74.7	34.0	8.7
Long term liabilities (thous. TUG)	30268.1	13219.8	52475.0	21574.2
Distributed dividends (TUG)*	38.1	35.7	43.9	–

* Only in cases where this event took place.

Source: calculations based on data provided by the MSE, the Statistical Office of Mongolia, and Tax Inspection in Mongolia.

Figure 2
Financial situation of firms designated for privatization, state-owned and private

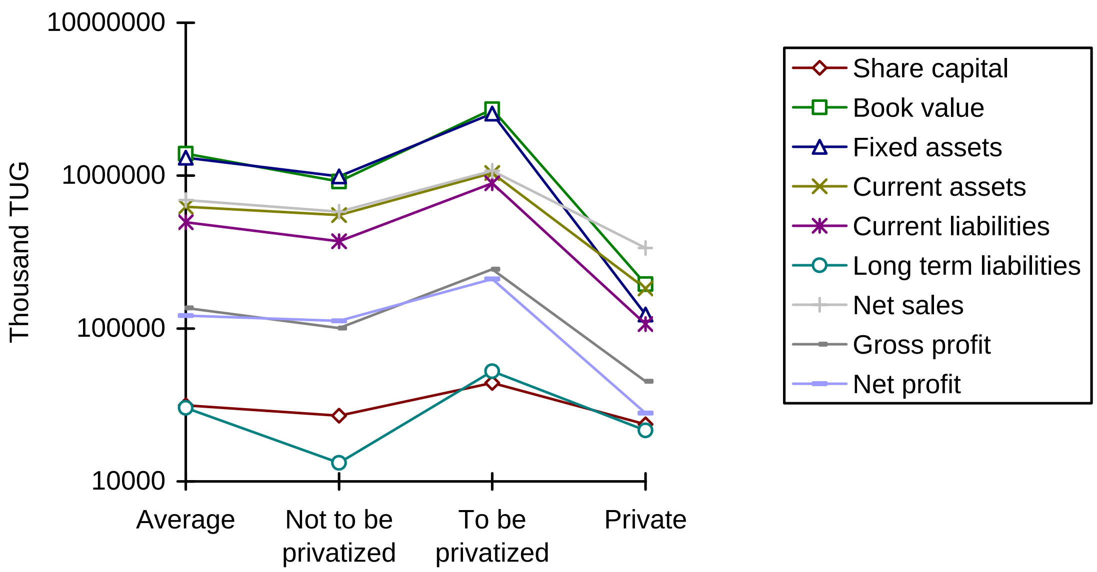

Table 8
Distribution of firms to be privatized by each sector of the economy

	Average N=329	Industry N=126	Agriculture N=77	Construction N=40	Transport & communications N=51	Trade & services N=57	Banking N=8
Book value (thous. TUG)	1390439.9	2351589.0	227195.0	85136.1	1442634.0	774924.2	–
Average price per 1 share (TUG)	102.8	1133.9	52.3	61.0	75.6	200.8	–
Per cent of shares owned by the state	65.6	75.2	47.9	54.3	75.8	72.9	51.2
Per cent of shares sold to employees	7.3	5.4	10.7	10.5	8.3	4.2	–
Per cent of shares sold through the Stock Exchange	49.1	44.5	52.9	50.2	50.4	46.5	–
Net sales (thous. TUG)	692127.3	955953.4	212811.2	194503.8	1063487.8	451601.1	–
Gross profit (thous. TUG)	136168.2	155866.8	42896.6	22416.2	168788.8	175713.9	–
Net profit (thous. TUG)	121320.8	143348.5	94443.2	12018.6	162418.3	134193.0	–
Fixed assets (thous. TUG)	1309270.4	2296349.4	113576.8	55344.9	1581141.8	552313.7	–
Current assets (thous. TUG)	626062.4	671514.4	313523.0	82025.1	951074.0	710824.5	–
Current liabilities (thous. TUG)	494942.2	652738.5	191975.9	42684.7	629267.5	466878.3	–
Share Capital (thous. TUG)	31513.0	53801.0	17218.4	17908.2	13493.2	28914.7	–
No. of employees	238.9	316.5	207.2	246.8	184.5	122.8	–
No. of shareholders	2652.9	4690.0	1075.0	1254.5	850.8	3025.7	–
Return on assets (per cent)	11.2	13.1	11.9	10.5	7.9	11.0	–
Return on equity (per cent)	143.6	157.4	96.3	102.8	47.8	203.9	–
Return on sales (per cent)	40.8	10.8	90.4	5.3	8.2	101.5	–
Long term liabilities (thous. TUG)	30268.1	31909.4	17575.3	754.5	233.7	66458.3	–
Distributed dividends (TUG)*	38.1	38.9	13.7	29.0	17.4	47.8	–

* Only in cases where this event took place.
Source: calculations based on data provided by the MSE, the Statistical Office of Mongolia, and Tax Inspection in Mongolia.

Figure 3
Distribution of firms to be privatized by each sector of the economy

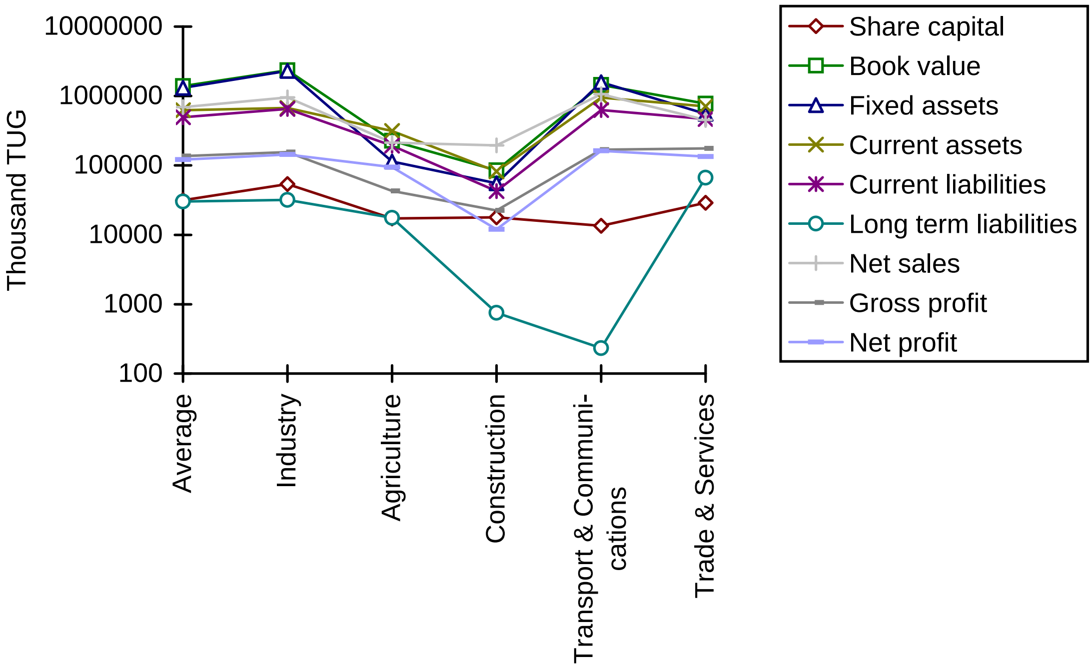

Table 9
Prices of shares and number of shares owned by the state (in per cent)

Price per 1 share	State package of shares	
	Up to 50%	More than 50%
1. Up to TUG 30	25.5	50.9
2. TUG 31-100	46.8	35.3
3. More than TUG 100	27.7	13.8

Source: calculations based on data provided by the MSE, the Statistical Office of Mongolia, and Tax Inspection in Mongolia.

Table 10
Prices of shares and sector of the economy (in per cent)

Price per 1 share	Sector				
	Industry	Agriculture	Construction	Transport and communications	Trade and services
1. Up to TUG 30	27.8	50.5	41.5	39.0	27.5
2. TUG 31-100	35.1	37.4	44.7	36.6	42.0
3. More than TUG 100	37.1	12.1	13.8	24.4	30.5

Source: calculations based on data provided by the MSE, the Statistical Office of Mongolia, and Tax Inspection in Mongolia.

Table 11
Prices of shares and net profit (in per cent)

Price per 1 share	Net profit, TUG		
	Up to 2,000	2,000-15,000	More than 15,000
1. Up to 30 tug.	26.3	24.1	8.2
2. 31-100 tug.	47.4	40.7	44.9
3. More than 100 tug.	26.3	35.2	46.9

Source: calculations based on data provided by the MSE, the Statistical Office of Mongolia, and Tax Inspection in Mongolia.

Table 12
The proposed methods of privatization

Method	Number	Per cent	Average per cent of shares per 1 firm to be sold
1. Auction	24	7.3	75.6
2. Tender	62	18.8	55.0
3. Flotation	65	19.8	37.0
4. Joint venture	1	0.3	51.0
5. Liquidation	1	0.3	100.0
6. Management buy-out (MBO)	167	50.8	20.7
7. Golden share	9	2.7	48.7
Total	***329***	***100.0***	***53.9***
Included in the total are these planned mixed methods:			
1. Auction + MBO	3	0.9	
2. Tender + MBO	1	0.3	
3. Flotation + MBO	138	42.0	
4. Tender + flotation	7	2.1	
Subtotal	*149*	*45.3*	

Note: in this group of firms, the state owns 62.4% of shares.

Source: calculations based on data provided by the MSE, the Statistical Office of Mongolia, and Tax Inspection in Mongolia.

Table 13

Methods of privatization for the group of to-be-privatized enterprises and average data on these enterprises*

Data	Average N=318	Auction N=21	Tender N=54	Flotation N=58	MBO N=25	Auction + MBO N=3	Flotation + MBO N=138	Tender + flotation N=7
Per cent of shares owned by the state	61.2	84.0	67.8	44.0	89.4	60.3	55.6	100.0
Per cent of shares to be sold	52.9	80.7	55.5	37.9	40.2	60.3	53.6	100.0
Net sales (thous. TUG)	1032182.4	119028.0	1030484.0	498211.2	2504180.6	725571.4	868582.8	565393.4
Gross profit (thous. TUG)	244364.4	11955.2	125275.9	104747.4	529957.8	398376.3	275725.5	230665.7
Net profit (thous. TUG)	211043.8	20830.8	86725.4	72253.6	1599274.6	230835.0	180392.3	279819.8
Fixed assets (thous. TUG)	2653186.3	92644.5	827844.5	1766734.0	13704732.8	277832.7	346123.0	2950876.7
Current assets (thous. TUG)	997986.4	278381.8	587778.7	703745.3	2087312.6	788912.3	1118259.31	226391.4
Current liabilities (thous. TUG)	881796.2	23707.7	522080.1	519781.8	2877745.9	263431.6	654277.9	440341.4
Book value (thous. TUG)	2818188.8	122259.7	893272.3	1903809.3	12914299.4	803313.4	699476.9	2736926.6
Share Capital (thous. TUG)	50905.9	38142.5	38549.7	19204.9	287140.6	132577.2	55078.1	–
No. of employees	208.3	98.0	193.9	204.1	394.5	232.0	211.5	66.5
Return on assets (per cent)	13.7	12.0	7.1	14.0	12.0	21.6	16.1	28.5
Return on equity (per cent)	172.4	59.4	108.3	269.3	794.5	181.4	164.2	–
Return on sales (per cent)	29.9	-2.0	90.5	11.0	22.1	31.8	15.3	31.8
Long term liabilities (thous. TUG)**	529329.5	–	6230.0	250070.1	–	–	699439.3	–
Distributed dividends (TUG)**	38.3	13.4	36.6	45.7	101.1	27.1	38.2	–

Source: Calculations based on data provided by the MSE, the Statistical Office of Mongolia, and Tax Inspection in Mongolia.

* The data on the main methods of privatization are in a “pure” form and do not contain the data on mixed forms. No mention of some methods means there is no data on them.

**Only in cases where this event took place.

Table 14
Methods of privatization for the group of to-be-privatized enterprises and sectors of the economy*

Sector	Auction N=21	Tender N=54	Flotation N=58	Joint venture N=1	Liquida-tion N=1	MBO N=25	Golden share N=9	Auction + MBO N=3	Tender + MBO N=1	Flotation + MBO N=138	Tender + flotation N=7	Total
1. Industry	10.1	16.2	12.1			21.2		1.0		35.4	4.0	100.0
2. Agriculture		5.9	39.6			1.0				53.5		100.0
3. Construction			15.4	7.7						76.9		100.0
4. Transport & communications	14.3	65.3	6.1			4.1			2.0	2.0	6.1	100.0
5. Trade & services	8.5		2.1		2.1	2.1		4.3		80.9		100.0
6. Banking							100.0					100.0
Total	6.6	17.0	18.2	0.3	0.3	7.9	2.8	0.9	0.3	43.4	2.2	100.0

* The data on the main methods of privatization are in a "pure" form and do not contain the data on mixed forms. The absence of some methods means there is no data on them.

Source: Calculations based on data provided by the MSE, the Statistical Office of Mongolia, and Tax Inspection in Mongolia.

Table 15
Some data on firms: firms in which the state wants to keep some shares after privatization and from which the state wants to sell all the shares

	Average N=324	To keep some shares N=57	To sell all shares N=267
Per cent of shares owned by the state	62.0	86.9	56.7
Per cent of shares to be sold	53.7	39.8	56.7
Net sales (thous. TUG)	1080637.0	1534708.9	934325.0
Gross profit (thous. TUG)	245629.2	59970.0	303247.6
Net profit (thous. TUG)	212621.6	351540.6	193848.8
Fixed assets (thous. TUG)	2569937.0	9506741.5	458735.7
Current assets (thous. TUG)	1040561.5	1264882.4	969074.6
Current liabilities (thous. TUG)	892285.0	2075976.6	524025.4
Book value (thous. TUG)	2762002.2	9043349.5	834770.6
Share capital (thous. TUG)	76966.8	25669.5	81383.1
No. of employees	219.3	216.9	219.5
Return on assets (per cent)	14.6	11.2	15.1
Return on equity (per cent)	164.3	–	164.3
Return on sales (per cent)	34.2	155.8	17.8
Long term liabilities (thous. TUG)*	492458.0	–	492458.0
Distributed dividends (TUG)*	35.7	10.3	36.7

* Only in cases where this event took place.

Source: calculations based on data provided by the MSE, the Statistical Office of Mongolia, and Tax Inspection in Mongolia.

Figure 4
Some data on firms: firms in which the state wants to keep some shares after privatization and from which the state wants to sell all the shares

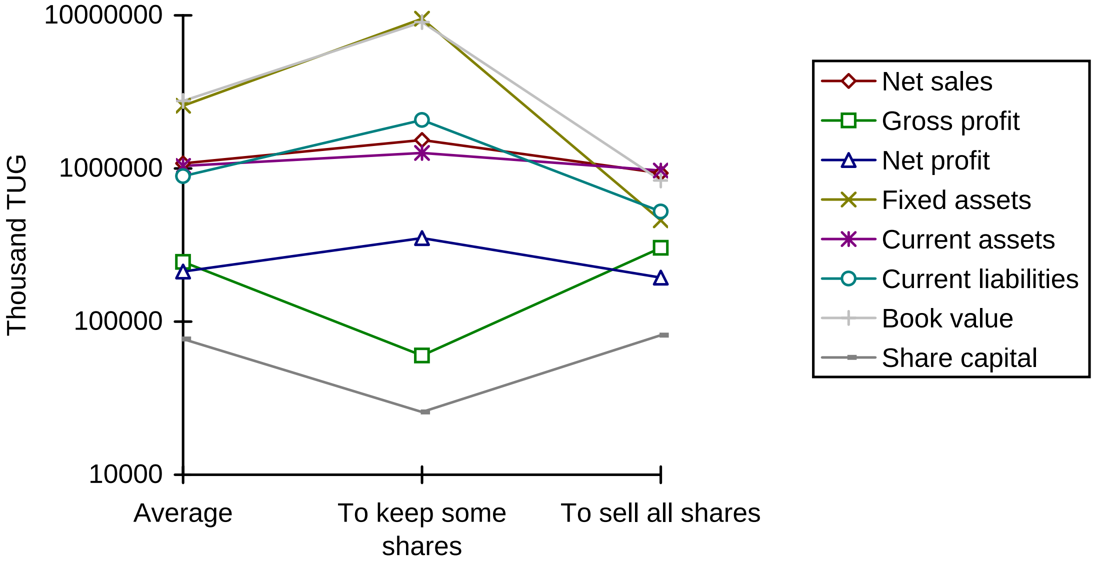

Table 16
The expected revenues from cash privatization (in TUG thousand)

Sector	Total revenues	1997	1998	1999	2000
1. Food and Agriculture	11800000.0	3500000.0	3500000.0	3500000.0	1300000.0
2. Industry	13106300.0	5600000.0	7106300.0	400000.0	
Geology and Mining	25382000.0	2600000.0	3500700.0	9421400.0	9859900.0
3. Transport and Communication	10358459.5	5758459.5	4600000.0		
4. Procurement or supply and environment	2534522.3	1191071.9	563415.5	379709.9	400325.0
5. Construction and utilities	1622643.4	1000301.6	261873.7	360468.1	
6. Banking	1500000.0	500000.0	1000000.0		
Total	66303925.2	20149833.0	20532289.2	14061578.0	11560225.0

Source: calculations based on data provided by the MSE, the Statistical Office of Mongolia, and Tax Inspection in Mongolia.

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