Capital Market Development: Internationalization

by Maj Gen. M A Matin (Retd)

A market friendly approach, in which the Government allows the markets to function well and concentrates interventions on areas where markets prove inadequate, can show success in promoting economic growth and poverty reduction. Strategies in which governments support rather than supplant competitive markets offer the best hope for meeting the challenge of development, opines the World Development Report-1991.

In a market friendly approach, which seems to offer most promise, the respective roles for the market and the state must be well understood. In areas where markets work or can be made to work and reasonably well, state interventions should not be there. In many countries of the world, the trend of privatization of state-owned enterprises has substantially increased. At the same time, governments' activities in the areas, where market alone can do little, have also increased, and these sectors are: education, health, nutrition, family planning, etc. etc.

In two fold strategy for reducing poverty, generation of income-earning opportunities for the poor is the first necessity. And it is possible only through rapid industrialisation. A sound and effective capital market is an absolute necessity for rapid industrialisation and more so for private sector enterprises. Efficiency of the private sector and its management proficiency is now a well recognised notion. A vigorous private sector is the antidote to cure years of malaise in our social and economic facet. Impediments to the orderly development of the capital market are many: Lack of the political and social stability, lack of free market ideology, hostile economic policy to free market mechanisms, inappropriate tax/regulatory incentives, insufficient supply of securities, absence of financial intermediaries, lack of savings. Political and social upheaval contributes to the decline of the capital market, and free market ideology and economic policy help it to grow. Private sector's growing role in the economy has a positive effect. The capital market will be threatened if policies hostile to free market mechanisms dominate the economy. Tax incentives influence the development of capital market. Investors are aware of after-tax returns of various financial investments, and hence tax implications play an important role in the way they allocate savings between debt, equity or non-financial assets. A functioning capital market depends on a continuous supply/availability of securities.

Demand and supply of securities is the key to capital market development. In the country, the supply of securities could be tremendously increased by (1) Unloading of securities from the government portfolio, (2) More industrialisation, and (3) Privatisation. According to knowledgeable sources, Government of Bangladesh owns shares in 17 multinational companies : Listed with Stock Exchange-7, not listed-10 (public limited-4, private limited-6). Private limited multinational companies should be persuaded by the government to convert themselves into public limited companies to pave the way for public shareholding. In the country the numbers of state owned enterprises under various sector corporations are: Bangladesh Chemical Industries Corporation-23, Bangladesh Steel & Engineering Corporation-21, Bangladesh Forest Industries Development Corporation-14, Bangladesh Textile Mills Corporation-42, Bangladesh Sugar & Food Industries Corporation-21, Bangladesh Jute Mills Corporation-37, Bangladesh Oil, Gas & Mineral Corporation-13, Bangladesh Petroleum Corporation-8, Bangladesh Railway, Bangladesh Road Transport Corporation, Power Development Board, Telephone & Telegraph Corporation and many more are there in the list of state owned enterprises. Through privatisation activities, the supply of securities to the country's capital market would be ensured.

Privatisation enhances supply of securities and to make the Government's privatisation programme a success, enough investments would be required. The growing investor awareness (as demonstrated through ICB's array of instruments), and Life Insurance, Pension Funds, Provident Funds have tremendous potentialities for investment in the securities market. To expand demand and increase the level of activity in our capital market, the prohibitions on foreign investors must also be considered objectively for its withdrawal/cancellation.

Internationalization encompasses: (1) International investing in the country's security market, and (2) Interest of international securities to our investors. For the country's securities market to have its greatest positive effects on our national economy, it is necessary that there be a gradual opening of the country's securities market to the international community. For internationalisation, four major questions need to be analysed: (1) Is there a large enough pool of international investable funds to make foreign portfolio investment a viable source of funds for the country ? (2) Would the country securities be of interest to international investors? (3) Would international securities be of interest to our investor? and (4) What are the implications to investors and the Government on opening of local and international markets to investment? Positive responses to all these questions would, of course, help to take positive decisions.

According to some sources, USA has already invested a big chunk of their unit trust, mutual fund and pension fund in foreign equities. Japanese are also investing in offshore equity. UK and many European countries are also showing interest. Oil rich Middle East is a big source of fund for foreign portfolio investment. It appears that foreign fortfolio investment may be a viable source of funds for the country.

There are over 35 securities markets in the developing countries with a total market capitalization of over US$ 250 billion, and over 8000 listings. There is much room for growth in these markets.In recent years, equity and bond markets mobilised more funds for development through primary issues than World Bank loan disbursements. In Korea and India alone, primary issues amounted to over US$5- billion in 1985. In India, over 5,000 companies are listed which is larger than markets in the UK and Japan, although most of the companies are much smaller. International investors are showing an increasing interest in these emerging capital markets. Over US$1-billion has been invested by international investors in Brazil, Korea (S), Taiwan, Malaysia, Mexico and India, and it is likely to increase many times once the remaining barriers to foreign portfolio investment are removed.

There are investment restrictions in most of the developing countries, but the trend is clearly toward gradual liberalisation and internationalisation of the capital markets. Among the top markets, Chile, Thailand and the Philippines are relatively open. Brazil, India, Taiwan, Korea(S) and Mexico are accessible through a variety of funds. And in many other countries there are signs that some may be opening up to international investors.

There are reasons why developing countries do not fully open their markets to international investors, and they are: (1) Concern about firms being taken over by foreign investors, (2) Not wanting their currencies traded outside their domestic markets, and (3) Concern over money flows into and out of the country. To minimise the perceived impact of those concerns, intermediary steps (before total liberalisation of protfolio investment) have been found very successful in mobilising additional funds for development in many developing countries. And the intermediary steps include: (1) investment by international investors in multinational companies operating in the country, (2) Allowing non-resident citizens to invest in local securities, foreign depository receipts, country funds, convertible bonds and restricted international investment.

Once the country has the experience to evaluate and understand the implication of opening the market to foreign investment, and also allowing domestic investors to invest internationally, the final step would be to open the market to foreign investors.

The most successful intermediary step to liberalisation has been the issuance of country funds. Many developing countries have allowed foreign portfolio investors to invest in country funds. Most of the offerings have been closed-end funds with their capital base fixed, and some country funds at a glance, as obtained from 'South' June, 1987:

Name of fund	Value in million US Dollar	Year Launched	Manager/Broker
* Brazil fund	98.0	1975	Banco Lar Investimento
* Mexico fund	42.5	1981	Impulsora de Fondo Mexico
* Korea fund	89.0	1984	Scudder-Steveus
* Korean Europe fund	30.0	1987	Schroeder Investment Management
* Taiwan fund	30.0	1986	Merrill Lynch
* Thailand fund		30.0	1986Vickers decosta /Morgan Stanley
* Bangkok fund		25.0	1986 Merrill Lynch
* Malaysia fund	65.0	1987	Morgan Stanley
*India fund	120.0	1986	Merrill Lynch
* Philippine Long Term Equity fund	20.0	1987	Thornton Unit Trust Management

Many of these funds have done very well, with shares trading at a premium over net asset value. In addition to country funds, some developing countries, such as Korea, have allowed limited direct investment in stocks through several mutual funds set up for foreign investors, as a step towards liberalisation and final internationalisation of the market. Problems sometimes would arise, but solutions are also there. Some countries, such as Brazil, also allow, if in collaboration with a domestic investment firm, the possibilities of international investors being advisors to a locally established fund. With this process, the foreign investors make the major investment decisions, while the local investment bank is essentially the operations arm of the company.

Malaysia, Singapore and Hong Kong allow international investors to invest fully in their capital markets without any restrictions. There are no distinctions between local and international investors, and many firms are listed on more than one exchange. These markets have been very successful in mobilising billions of dollars of both domestic and international funds to aid in individual company expansion and overall country economic development.

In 1989 Investment Corporation of Bangladesh (ICB), one of the major institutions in the country dealing in capital market, proposed to float: (1) Wage Earners Unit Fund, and (2) Bangladesh Fund (both closed). Wage Earners Unit fund envisaged to mobilise the savings of Bangladesh wage earners/non-resident citizens working abroad, and Bangladesh fund was for both international and domestic investors. But they were not blessed with presidential approval.

For overall economic development a shift has been taking place in many developing countries of the world, and they are now looking outward. The world is becoming much more integrated, and a country could hardly exist all by itself. Interdependence for something or other is there. Security markets are no more considered as "gambling for the rich," as once thought by the academics and politicials.

Benefits could be reaped by establishing a sound and functioning securities market. In many developing countries government attempts to develop capital markets without private sector dialogue have been unsuccessful.

For poverty stricken and resource-poor Bangladesh, *CAPITAL MARKET is THE SOLUTION* for economic betterment of the people. Rapid industrialisation is absolutely necessary to create income-earning opportunities, and rapid industrialisation is not possible without a sound and functioning capital market.

And for development of the capital market, the institutional activities of ICB and DSE must be strengthened, and Govt's privatization programme must be launched without any delay.

A complete blue print for industrialisation, showing commodity-wise need (for a period of ten years) for domestic market as well as potential international markets, must be prepared and published by the Government for information and guidance of the potential investors/entrepreneurs.

Training of potential investors/entrepreneurs and managers must be organised year-wise.

Gradual opening of the capital market to international protfolio investors, through floatation of country funds like Bangladesh fund and Wage Earners Unit Fund (both closed end), must be thought of for early implementation.

Country's available know-how and expertise must be fully utilised. Let our conscience guide us to work hard sincerely, honestly and with patriotic zeal for economic development of the country and to lift millions out of poverty.

Bangladesh Jute Industry-1

by Kazi Zahedur Rahman

ALTHOUGH the jute plant is claimed to have been identified in this subcontinent nearly 3000 years ago, the age of the jute industry, in the global context, is about 160 years only. Jute had to travel from the Indian subcontinent to the United Kingdom and go through a series of spinning experiments for about 37 years beginning 1795 in order to prove its worth as a textile fibre of great commercial importance. These persevering exercises led to the establishment of the first jute spinning mill in Dundee in 1832. But in the homeland of jute, the first jute mill was established in 1855 in the suburbs of Calcutta. Japan is known to be the only other Asian country to have ventured in the jute industry in 1889. By 1947, 108 jute mills were set up in India.

Consequent upon the partition of India, 70% of the jute growing areas of the subcontinent fell in the then East Pakistan, while all the 108 jute mills fell in India. Thus the then Pakistan had ample supplies of jute with no jute mill while India came to own more jute mills than she had fibre for. So India needed to expand her jute acreage and Pakistan employed her resources to establish jute mills. For Pakistan unavoidable choice of location for her jute mills was the then East Pakistan. Adamjee Jute Mills Ltd. was the first composite jute mill to have come up. The drive, speed and efficiency with which the Adamjee Jute Mill, the biggest mill, was set up deserve to be emulated by any entrepreneur at any time.

The mill site, comprising an area of 227 acres, was a lowlying area which had to be raised to 9 ft. on an average. Simultaneously steps were taken to ensure that the imported machineries and equipments, the required infrastructure, the production staff, the management personnel and the necessary logistics were in place in time and the Mill No. 1 with 1000 looms was commissioned in December, 1951 in about 7 months' time. Thus the jute industry had its birth on the soil of Bangladesh, 119 years after Dundee and 96 years after Calcutta.

A few high lights of the Pakistan jute industry might be in order to compare the performance of the post-independence jute industry. The most striking feature of the then Pakistan jute industry was its phenomenal growth. India took 92 years to set up 108 mills but Pakistan established 73 mills in a span of 20 years. What is more, 52 of these mills came up in course of 7 years from 1964 through 1971. The growth, too rapid, was at times unplanned. The ills of planlessness became evident when the mills were constrained by the imbalance between the loomage capacity and the spinning capacity. Again decline in the productivity began to show up within about 15 years of the installation of the units. In late 60s the mills were reported to have lost their economic viability. Yet the industry expanded and survived as a commercially viable sector through a high rate of subsidy the industry enjoyed in the form of export bonus which ensured profit for an inefficient enterprise also. Further the price of raw jute was kept depressed at the cost of the farmers and to the benefit of the mill owners by subjecting the raw jute export to heavy taxation.

The story that the performance of the jute industry in the then Pakistan was excellent was, close scrutiny showed, a tale rather overtold. The occasional flashes of good performance were no doubt there. The best performance year was 1969-70 when in 63 mills with about 2,25,000 looms in operation, production peaked to 6,31,000 tons, export to 5,30,000 tons and domestic consumption reached 84,000 tons. Independence handed in a grown-up jute industry to Bangladesh. 73 mills were operational and 4 more which were in the process of establishment came up by '74-75. But for this, Bangladesh, a newly born country with an war-torn economy and depicted resources, would have had to strive long and hard to establish and feed into growth a huge jute industry, so vital to its economy.

What came in a platter was not, however, without serious problems and constraints. The impact of the war of liberation was massive. The whole industry was in a complete disarray, if not in ruins. Non-Bangladeshi owners, top brasses in the management, supervisory staff and a large number of skilled workers had fled the country. Even the Bangladeshi owners were at a stand-off. The industry lay virtually abandoned. Machineries suffered damage, spare parts, stores and inventories were looted rather freely. In the given situation, Govt. could not but have taken over the industry. Not that maleficence stopped soon after the Govt. had taken over. The administrators then appointed even did not care to prepare any inventory of the available assets.

The first 4 years after independence was perhaps the worst period. Malpractices were allegedly rampant. Policy shifts also had had their effects. Bonus voucher was withdrawn. Due to frozen liquidity, working capital was short. Out of 25,000 looms, about 18,000 were in operation. Average annual production was 4,50,000 tons and export 3,60,000 tons — about two-thirds of what it was in 1969-70. Easy capital flight during the war of liberation coupled with continuing loss in the subsequent years led to liquidity gap and decapitalisation.

The home problems were exacerbated by certain international factors. In early 1970 polypropyleue made heavy in roads in all the major markets of jute leading to a substantial demand shift from the jute manufactures to the synthetic substitutes. Foreign enquiries dropped. Lifting was short of the sales. During 1972-75, 1.75 lakh tons of sold stocks were not lifted by the foreign buyers. The years 1974-75 ended with a heavy carry over of 1.27 lakh tons- highest-ever.

As on June 30, 1973 liquidity gap stood at Tk. 106 crore, according to a study. Export of jute goods to developed countries declined due to world recession. The adverse effect of the above factors was further heightened by a steady rise of price of raw jute in the internal market on the one hand and a downswing of the price of jute products in the external market on the other.

Bangladesh currency was devalued twice and to the extent of 160% by 1975. The objective was, among others to boost up the jute industry, as well as to keep the price of jute products competitive in the world market.

Unfortunately the industry could not reap the benefit of such a large devaluation. The windfall profits which the devaluation fetched should have largely offset the liquidity gap and the losses. There was no development programme and no heavy import bill for the jute industry either. Yet during the period, 1971-72 to 1974-75, total financial loss was Tk. 114 crore.

Inescapable conclusion was that the management failed to exercise an effective check on the alleged malpractices and malfeasance. Things seemed to have been allowed to go their way with studied non-chalance, as it were. Loss could perhaps be less with a more vigilant and efficient management.

The planners and policy framers also appeared to have been otherwise too pre-occupied to give the jute sector the attention it merited. Special measures were necessary to correct the ills in the jute industry. In India jute sector accounted for about 5% of their total foreign exchange earning.

Like India jute was dovetailed in the Commerce Ministry, though our jute sector in the initial years of independence earned about 85% of the total foreign exchange. In October, 1973, a Jute Division was created only to trail another Ministry. An independent Jute Ministry was created as late as 1976. Bangladesh Jute Association (BJA) had, of course, kept up a pressure for the creation of the Jute Ministry. Those who are associated with our jute industry have to bear in mind that it is their privilege to convert the 'golden fiber' into the value-added and their responsibility of loss minimization and profit maximization of the industry.

Postal goods unloaded from a train at Kamalapur station. Star Photo.

Kiwis Fret Over Foreign Ownership of NZ Farmlands

WELLINGTON: Most farmers here have called for continued controls on the sale of land to foreigners as the government moves to introduce new rules for foreign investment in the next few months.

Officially, New Zealand's National Party government wants to attract foreign investment, particularly from Japan.

But some New Zealanders are uneasy about overseas investors buying property here. And there was some opposition when it was announced last year that Japanese interests were buying the Wairakei golf course at one of the country's most popular tourist resorts.

The Japanese application to buy Wairakei was at first turned down but the decision was later reversed.

The question of foreign ownership was recently debated at the national conference of Federated Farmers which represents most New Zealand farmers.

Some delegates argued that farmland should be treated no differently from other areas of investment, but a majority of farmers came out strongly for continued control over foreign ownership of farms.

They opposed sales to foreign nationals and overseas-owned companies unless individual buyers were permanent residents of New Zealand. If they were not, sales should be approved only if the lands minister was happy there would be substantial benefit to New Zealand.

There were demands that New Zealanders should have reciprocal rights of purchase in the buyer's home country and that free trading arrangements should exist between New Zealand and the buyer's country.

Farmer Graeme Weld told the conference: "The fact we have to face is that we have the land under our care for a reasonably short period and with that goes certain responsibilities. One of those is to make sure the land is kept for future generations of New Zealanders to own."

Lands Minister Rob Storey, who is campaigning to keep controls over foreign ownership of farmland, is at present responsible for approving sales to foreign individuals.

The laws for which he is responsible include restrictions to:

** Stop undesirable speculation in New Zealand land by foreigners;

** Stop or restrict absentee ownership of land;

** Ensure that land required for a recreational reserve remains in New Zealand ownership;

** Ensure islands remained New Zealand-owned.

Applications by foreign companies to buy land go not to the lands minister but to the Overseas Investment Commission which follows a liberal policy on foreign investment here.

The Commission is required to consider only the "net economic benefit" and a very general "national interest" requirement.

Lands Minister Storey recently criticised approvals given to land sales by the Overseas Investment Commission which he said rarely contained conditions and offered no guarantee any undertakings given would be fulfilled.

New legislation was required, he said, and the ultimate responsibility of approving sales considered to be sensitive should rest with him. "My view is really based more on questions of social concern and national identity than pure economic grounds," he says.

"As a politician I have to feel comfortable when people say 'you've flogged off New Zealand, why did you do it? I like to able to quantify the benefits."

— Depthnews Asia

Oil Companies Making Beeline for Vietnam

Vietnam may have oil potentials up to 3 billion barrels that, if fully developed, would place it in the class of oil producers Malaysia and Australia. by Manolo Jara

OIL companies are making a beeline for Vietnam, lured by the country's liberalised foreign investment policy and generous production sharing contracts.

Latest government figures indicate that oil companies from at least 14 countries are engaged in offshore oil exploration in Vietnam.

These include oil giants like Shell of the Netherlands, Total of France and BHP of Australia as well as Partamina of Indonesia, ONGC of India and Petronas of Malaysia.

The US is not represented due to a trade embargo imposed by Washington since 1975 following the end of the Vietnam war. "The embargo has given non-US oil companies a rare opportunity to obtain production sharing contracts (PSCs) without competition from giant American consortiums," says minerals economist Charles Johnson.

And as the Soviet empire crumbles, neither is Moscow expected to figure actively now in Vietnam's oil exploration.

The two trading and ideological partners earlier set up VietSovpetro, a joint venture company, to participate in the endeavour.

Mr Johnson, who is connected with the East-West Centre in Honolulu, estimates that Vietnam may have oil potentials totalling 1.5 to 3 billion barrels.

If such potentials are fully developed, that would place Vietnam in the category of a "middle ranking " oil producer like Malaysia and Australia.

"Natural gas is also likely to be plentiful," adds Mr Johnson. "I expect that a number of gas fields will be discovered with reserves of one to four trillion cubic feet each or a total of perhaps 10 trillion cubic feet or more."

Mr Johnson predicts that in the next three years, several oil and gas discoveries will be made in "quick succession." He bases this on the level of exploration activity, the size and location of the basins in Vietnam and the number of discoveries already made both within and outside Vietnam.

"Another boost to exploration and commercial development will come when the major US oil and service companies move into Vietnam after the trade embargo is lifted," he says.

Estimates are that Vietnam today produces about 55,000 barrels per day (b/d). The output is projected to rise to 100,000 b/d by the end of 1991.

For the year 2000 to 2005, Mr Johnson predicts that production could be in the 300,000 to 500,000 b/d range, "with an optimistic high of 600,000 b/d or a pessimistic low of 200,000 b/d."

Offshore oil exploration began in the 1960s in what was then South Vietnam. In 1974, they struck oil in what is now known as the Rong (Dragon) oilfield. A year later, the Bach Ho (White Tiger) oilfield was discovered. A third oilfield was later named Dai Hung (Great Bear).

Dai Hung is the largest of the three with possible reserves of between 300 and 600 million barrels. Bach Ho appears to have 175-300 million barrels, and Rong may have 100-150 million.

At present, Vietnam's refining capacity is very limited — about 800 to 2,000 b/d. There were plans to build a larger refinery at Tuy Va to refine most of its offshore oil but the Soviets dropped out of the picture.

However, companies like Shell and Total are reportedly interested in building a new refinery with a capacity of 120,000 b/d to come on line by the mid-1990s.

As oil firms intensify their exploration activity, Vietnam is also trying to resolve its boundary disputes with neighbouring countries.

Mr Johnson says that Vietnam's claimed boundaries overlap with China in the Gulf of Tonkin, with Indonesia north of the Natuna Islands, and with Thailand and Cambodia in the Gulf of Thailand.

The Spratly Islands, where Vietnam may offer 30 deepwater areas for exploration and drilling, are also an area of contention disputed by China, Taiwan, Malaysia and the Philippines.

But during the past year, Vietnam has been discussing with Thailand the possibility of joint exploration and development of the gas-rich 6,000 square kilometres being disputed by the two countries in the Gulf of Thailand.

Vietnam, according to Mr Johnson, has also approached Indonesia to resolve their seaboundary disputes. However, he says that Hanoi may have a more difficult time in settling its boundary disputes with China. — Depthnews