Savenaca Narube: Development of the capital market in Fiji

Opening address by Mr Savenaca Narube, Governor of the Reserve Bank of Fiji, at the official opening of the CMDA Provincial and Tikina Investment Companies Workshop, Suva, 28 November 2007.

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Mr. Daryl Tarte, Chairman of the Board of CMDA
Mrs. Mereia Volavola, Chief Executive Officer of CMDA
Workshop Participants
Ladies and Gentlemen

Introductory remarks

Good Morning

It is my pleasure to be here with you this morning at the opening of Capital Markets Development Authority Workshop for Provincial and Tikina Investment Companies. Let me say that I am extremely delighted that the CMDA has decided to reach out to this very important segment of the market in its endeavour to develop the capital market. I therefore congratulate CMDA for organising this workshop. The timing is appropriate, the market is ready for you, the institutional arrangements are in place and all we need are viable projects and your decision to use the market place for your financial needs.

The workshop's theme – **"Capital Markets – Growing Your Company"** – is very relevant at this point in time as we all work together to grow the Fiji economy.

Economic growth

We at the Reserve Bank talk a lot about economic growth or in fact lifting the rate that we grow. I have said many times before and I will say that again today that if we continue to grow at our current average rate of less than 3 percent we will double our economy in about 50 years and that is a lifetime. Other countries are doing it at half that period or even less. We must therefore collectively aim at raising our growth rate to over 5 percent per year. At that rate we will double the economy in less than twenty years and what a difference that makes.

One should then pose the question: What do we need to do to raise this growth rate to over 5 percent per year? Obviously a lot of things! And more ironically we know what those things are! On the macro level, one of the key things we need to do is to lift the level of investment from its current level of about 15 percent of GDP to over 25 percent. This translates to about $600 million investment per year. Can we do it? Of course we can! We had done it in the past and we can do it again. The average investment level of all developing countries in the world is about 25 percent of GDP. So, this level is well within our reach.

The next question therefore becomes: How can we lift investment to 25 percent of GDP? There are many factors to this such as political stability, the quality of our infrastructure, the efficiency of the approval process and the cost of doing business. These are very important issues and we need to do all we can now to deliver them to the investors.

However, I would like to focus on one important issue and that is the role of the capital market in raising this investment and thereby promoting economic growth. This, I believe, is the central theme of this workshop.

Definition of capital market

Before I go and identify this role of the capital market, I would like to ensure that we are all at the same level of understanding of what the capital market mean. Capital is of course money – most of us know that. The market is just like the Suva market. But unlike selling and buying of cassava and dalo that happens in the Suva market, we buy and sell money in the capital market. Money or capital becomes a commodity just like cassava and dalo.

There are different levels of market where money is traded. They are differentiated from one another basically by the maturity of the products that are sold and bought in the market. For instance, the money market refers to the short end of the market where products of the shortest maturity are traded. These products include treasury bills and promissory notes up to say one year in maturity. You will find commercial banks as investors in this segment of the market. This is the fastest growing market in Fiji and is now the largest.

Then there is the capital market which includes longer term products. There are two components of this capital market – there are bonds and there are, what we call, equity or shares. The largest component of this market in Fiji is, of course, government bonds. The bonds are termed as fixed income securities because the interest rate that they pay is fixed. The equity share of this market has also grown with 4 companies listed in 1996 to now over 15. Unlike the fixed income from bonds, the return you get from equities varies according to the performance of the company. You will normally find the long term players like insurance companies and pension funds in this segment of the market. I would like to think that most of you in this workshop may find that this where you can be sourcing most of your funds.

Finally, there is the wider financial market where almost everything to do with money is included. I will only focus on the capital market.

Role of the capital market

Now what does the capital market offers to investors like you? I would like to think a lot more than you may have thought of. Let us examine this in detail.

Like all things in life there are two sides to the market – you have a seller and a buyer. On one side, we have a buyer and in this case one who has a project and is looking for money. We normally call this person or company the issuer. On the other side, we have the seller who is selling money. We call this person the investor. What the capital market does is to bring the two sides together.

Compare this with depositing your money with commercial banks which is the traditional way to save money for many of us. We deposit our money with them and they in turn pay us interest. The banks then invest our monies by lending it out to borrowers. In this case, rather than the capital market, it is the commercial bank that brings the two sides together. But note three subtle differences here:

- The owners of the money that is the depositors do not have any say in where their money go to and what projects that are funded from their deposits;
- The depositors do not have any say in the interest rate that they get from their deposits; and
- The depositors do not have any say in the interest rate that their money is lent out for.

Depositing your money may the best way to save for some of us. It has its advantages. The major one would be that the saver does not bear the risk of lending out his money. The risk is collectively shared with all other depositors.

The capital market however gives you an alternative source of saving. What are the differences in using the capital market for savers?

1. Diversify your savings options;
2. Secondly, the value of your money may appreciate over time unlike deposits where the principal remains the same;
3. Thirdly, you have a longer choice of maturity than the normal 3 year maximum maturity in fixed deposits;
4. Fourthly, it may give you a better return on your money;
5. Fifthly, you decide on what project or company that you want you money to go to; and
6. Lastly, if you need the money, you can break the investment perhaps at a lower cost than breaking a term deposit.

If you are a borrower, the capital market can:

1. Diversify your sources of funds;
2. May get you a lower cost of funds;
3. May avoid fees and charges; and
4. Equity funding does not fetch interest costs;

Mind you there are also risks to using the capital market and I am sure that you will cover these issues in detail in your sessions today.

I hope that I have given you a flavour of what the capital market can do for you.

Let us get back to the question: How does all these support investment and economic growth?

There are basically two ways:

1. One, it may encourage more savings. Fiji savings rate is very low. If we remove the mandatory savings through FNPF, our saving rate is even lower. For investment to happen, we need to generate more savings. Successful countries are normally associated with higher savings rate; and
2. Two, it directly promotes more investment by giving the one borrowing the money alternative sources of funds. With diversified sources of funds, more investors can emerge or more investments are made thus taking us towards the target of 25 percent of GDP.

Development of the capital market

It is therefore extremely important that we develop the capital market in Fiji. I must say that we have come a long way since the establishment of the CMDA. I was very much involved in the establishment of the Authority as the groundwork was done at the Reserve Bank. I can remember some of the ground breaking decisions that were taken then. They have begun to bear fruit.

Of course, one of the key roles of the Authority is to regulate the market to ensure that everyone plays by the rule. The underlying aim is to protect the investors' interest. This is very important. Confidence in the operation of the market is critical to people like you using the market. A lot has been achieved over the years in this regulatory area.

I recall that one of the other major roles that we identified the Authority to have was to develop the market. That was why the word "Development" was specifically included in the name of the Authority. How can one supervise a market that was not there in the first place? This meant that the CMDA had to strike the right balance between regulation and development.

I said that the market has developed in the last fifteen years. But I still have a sense that we still have some way to go. The challenge therefore is to take stock and re-examine our route. Are there constraints that we still need to overcome? If so how can we do that and who should do it?

I recall some years ago when the Minister for Finance asked a group of us to actually do this stock take and advise him on how we can take the capital market further. We identified several issues and I would to share these with you this morning.

1. The capital market was in need of deepening on both products and participation;
2. The investors were dominated by FNPF both in fixed income and equity. The proposed deregulation of FNPF could diffuse this dominance;
3. Individual participation in the market was negligible. To promote a wider participation, we recommended that the share investment scheme of the FNPF should be extended to government and government guaranteed bonds;
4. There was a need to increase awareness on all aspects of the capital market;
5. The preparation of prospectus was costly. Avenues where this cost can be reduced should be examined. The possibility of government assistance in this area should be considered;
6. Government should consider issuing bonds only earmarked for small investors;
7. We should establish what we call market makers;
8. Government to use brokers to float its bonds and treasury bills; and
9. The CMDA Act should be reviewed to strengthen the role of CMDA and to incorporate the lessons learnt from the last ten years of development. I agree with Mrs. Mereia Volavola that it was about time that changes were made to the Capital Market Act, Companies Act, Foreign Investment and other legislations to further enhance Fiji's economic growth.

The Minister in his Budget Speech last Friday mentioned that CMDA would study the impact of real time settlement on market trading activities in 2008. I support such a modernisation and I wish the CMDA all the best with this project. We at the Reserve Bank of Fiji recently launched a real time gross settlement system or FIJICLEAR.

Provincial companies

I said at the beginning that I was very glad that CMDA has brought this group together to talk about you using the capital market more. As I look across our provinces, I note the increasing venture into businesses and investment. I fully support this move. It is inevitable.

At the same time, I am impressed with the amount of savings that we can generate at provincial and district levels. We had our Nadroga Day earlier this month and the opening contribution alone was over $100,000. We do have the ability to generate these high levels of savings.

I wonder how much of such savings are being generated at our provincial, district and village level each year? I think that it can be a substantial sum.

What kind of return are we getting from these savings? What we perhaps need to strengthen is our investment side of those savings. And this is in my view where the capital market can help out. It can bring us closer to other forms of investment.

I also note that most of the provincial companies are engaged in the building and rental of office complexes. Funding is mainly through bank long term loans. Loan repayments are made from rental income and contributions. Again, the capital market can provide a viable option to funding these projects.

Financial performance

Let me end with three related issues on investment:

- The first is the concept of the real cost of capital. Provincial companies fund a lot of investment through "soli" which is given free of interest. If we had borrowed these funds what would be our total cost of capital?
- Second, records from the Registrar of Company's Office revealed very little information on the financial records of provincial companies. Is governance an issue? We all know that financial management and accountability are extremely important to business and I see that you will be addressing these issues during the workshop.
- Third, what is the shareholder's return on these investments?
- Lastly, can we learn from the past? I think we can and we should. The recent offering of the Yatu Lau Company Limited is very interesting. I will follow the current public float of $1.5 million with interest and wish the company every success. I note that the company has put in place sound governance structures to ensure that the business of the company is separated from the business of the provincial council

Concluding remarks

Finally, I would like to sincerely thank Mrs. Mereia Volavola for her kind invitation. I also wish to thank all the presenters who have given up their valuable time from their busy schedules to share their knowledge with the participants today.

Official opening

I now have much pleasure in declaring this workshop for provincial and investment companies "Capital Markets – Growing Your Company" open.

Thank you.