MAURITIUS

Finding the Right Foreign Investors remains the challenge

No one seems to have a realistic answer to one of world economy's most urgent problem: how to improve access to finance for millions of Small and Medium Enterprises (SMEs)? Secretary General of IOSCO, David Wright, gave us some insight on the problem before focusing on the issue of long term financing

- HERRSHA LUTCHMAN-BOODHUN

Mistrust of institutions towards SME funding

Lately, local papers have provided statistics as to the number of Small and Medium Enterprises (SMEs) facing difficulties and having to shut down. This problem is not unique to Mauritius, said David Wright, Secretary General of the International Organisation of Securities Commission (IOSCO), during a press meet at Maritim Hotel. The Financial Services Commission hosted the Annual Meeting and Conference of the IOSCO Growth & Emerging Markets (IOSCO-GEM) Committee from the 23rd to 25th of April. In its aftermath, a report will be sent to the G20 to address important issues for emerging markets.

On the last day of the Annual Meeting, participants attended a public conference on 'Long-term Financing through Capital Markets Programme'. In his opening remarks, Ranjit Ajit Singh, the Chairman of the IOSCO-GEM, stated that SMEs represent a major engine for growth, and therefore access to finance, and particularly long-term financing (LTF), becomes important. *"SMEs and LTF are two imperatives the GEM is focusing on against the backdrop of tighter regulations on banks. We want to ensure these two pillars move as smoothly as possible,"* he said.

However, it is a fact that many institutions refuse to lend big amounts to Small & Medium Enterprises. Why? They doubt their growth potentials. But, points out David Wright, SMEs are the backbone of every economy, and not just in Mauritius. For instance, in the European Union, there are 20 million such companies, and they are the ones which create employment. So, he added, the financing of these companies is absolutely critical.

"What's happening is that credit to small companies in the Western world has squeezed because of the banking regulations and systems. So, we come back to the problem. How can the capital market help small companies?" he asked.

Different types of financing are required for SMEs – a start-up finance, venture capital, medium term financing – and traditionally, they are finally listed on the stock market. *"Things get worse here because stock markets find it difficult to create investor interest in the equity of small companies,"* states David Wright.

According to the Secretary General, first of all, it is expensive, and secondly, there is an issue of transparency. Thirdly, investors prefer to buy the main index (for example FTSE 100) in the form of equity. *"Hence, this financing chain has got some holes in it. I don't think anybody has quite worked out how to fill the holes. We are all in the same situation. The European Central Bank thinks it's better to stack up the SME credit and securitize it. Job to be done! It's unfinished work..."* claimed David Wright.

The shift from Banking to Capital Markets

IOSCO Secretary General, David Wright, pointed out that long-term financing has become a complex subject. What regulators have to do is to see how they can match the demand for long term financing – which is huge - with the supply. It means that those who need capital can get access to it; and those who offer the capital can get the expected returns. Moreover, there are different forces at work. In general, he explained, there has been a shift to short term. People, in general, hold equities for a much shorter time than they did before. They trade much more. Trading has also become much easier today and people take their profits quickly and churn over their portfolios more often. That makes LTF more difficult. Another factor is that the accounting rules tend to push towards the shorter end of the market. For example, there are quarterly reports for big companies and the shares move around. There is this societal move towards the short term.

In the process, the share of capital market is increasing day by day. There is a global shift from banking system to capital market, which *"represents an important datum in history."*

The capital markets are composed of different elements: equity markets, bond markets, securitization markets, asset management... There are also different types of funds – investment funds, pension funds among others.

However, the first challenge is the size of the needs. To match up the demand and supply side across the globe is very challenging. That's why different parts of the financial market – equity markets, the corporate bond markets – will have different roles to play. Banks are indeed facing more capital requirements. That means they have less credit available for others. *"Some people think they need to hold more capital in the future, which will mean even less credit available. Particularly if they cannot leverage their balance sheets as they did in the past. So, this means there is a shift in the capital market,"* points out David Wright.

The challenge for Mauritius is exactly the same. We will need to find the right type of capital to invest in the necessary infrastructure needs of the economy. *"For some of these needs, you are probably going to need to find some outside investors. So, the conditions for these investors are going to be very important. If you think about an investor, he or she can invest in millions of different products over the world,"* he said.

But they will invest in good projects, which are well managed, deliver good returns, and in a market where there is proper regulation, strong security, and an international valuation of the local regulatory system.

For Clairette Ah-Hen, Chief Executive Officer of the FSC, well-functioning capital markets are vital for everyone. They support businesses and growth across the world. They also provide important services for investors - from large pension funds to the smallest individual investors. *"Capital markets help in the effective allocation of resources from savers to entrepreneurs and hence towards economic development,"* she said.

Raising of finance, either through equity, with a long term perspective, or through less risky securities such as bonds, can create the dynamism and long term perspective that all of us are awaiting.

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A SECONDARY BOND MARKET?

In one of the recent issues of *Capital Publications*, a local economic actor complained about the lack of a secondary bond market. David Wright, however, says that Mauritius is not the only country which does not have a secondary bond market. If you takes a look at the "so called trading and liquidity of corporate bonds", there are not many countries in the world that have a liquid secondary market.

"A secondary bond market is important because some people who would have bought a particular bond might want to sell. If there is no market, it's impossible to sell. They effectively lock in capital for a long period of time."

And this isn't what people always want. They want to sell and the problem gets more difficult when there are smaller markets: "So, what people do – what has been done in the past – is, instead of having a small issue of say USD 500 million, you stack up and have different issuance (USD 500M for the Water Authority, USD 500M for roads, USD 500M for education or a new airport). You add them up and create a securitised product and try and sell a much bigger security composed of all these issuances."

What is interesting to note, according to him, is that the securitization business was damaged by what happened in the United States with the Subprimes. Now however, there seems to be a revival of interest in securitisation. IOSCO and the Basel Committee have just set up a new working group to work out how to make these markets function better. "In the future, maybe the securitisation markets can help develop the secondary bond market," concludes David Wright.