Fordham International Law Journal

Volume 17, *Issue* 5 1993 *Article* 16

The Role of Multilateral Financial Institutions in Bringing Developing Companies to U.S. Markets

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THE ROLE OF MULTILATERAL FINANCIAL INSTITUTIONS IN BRINGING DEVELOPING COMPANIES TO U.S. MARKETS

*Alain Soulard**

INTRODUCTION

Ladies and gentlemen, I appreciate having the opportunity to speak at Fordham Law School today. On behalf of International Finance Corporation ("IFC"), I would like to thank the sponsors of this Conference for inviting us to participate.

I. *THE INTERNATIONAL FINANCE CORPORATION*

Many of you know of IFC. For those who are not familiar with us, I would like to tell you briefly about ourselves. IFC is part of the World Bank Group. Although we are not a subsidiary of the World Bank, we share the same board of directors and a substantially common, though not identical, shareholding structure. IFC was founded thirty-seven years ago, in 1956, and currently has more than 140 countries as shareholders. Our mandate is to assist the growth of the private sector in developing countries, an objective that complements the role played by the World Bank in the public sector. Unlike the World Bank, which only provides loans guaranteed by governments, IFC makes loans and equity investments. Our role is developmental, but we accept no government guarantees, nor do we provide subsidized financing. We are required to operate purely on a market basis, taking the same risks as any other private investor. As of the end of June 1993, IFC had total assets of U.S.$8.9 billion, including U.S.$4.5 billion in loans and U.S.$0.9 billion in equity.

II. *A HISTORICAL PERSPECTIVE*

Now, I would like to give you a historical perspective of IFC's involvement in emerging markets. Until the mid-1980s, IFC was essentially what most multilateral financial institutions still are today; that is, a source of project finance for developing countries. IFC made mostly loans and equity investments for its

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own accounts. It had no activities that could be considered as investment banking. It was only in the mid-1980s that IFC's Capital Markets Department became involved in what could be considered as investment banking.

In practice, IFC has had a specialized capital markets department for the past twenty years. That department mostly advised member governments and private sector entities on financial sector development, and more particularly on securities market development. It helped create an acceptable legal and regulatory framework for securities markets. It assisted with the establishment of the necessary infrastructure, including clearance and settlement systems and depositaries. It also invested for IFC's own account in various financial institutions, such as banks, leasing companies, investment houses, etc. We currently have investments in 110 financial intermediaries in developing countries.

Starting in the 1980s, IFC has put more emphasis on the mobilization of external capital in addition to its own for the promotion of private investment in member countries. Increasing the flow of foreign investment into emerging markets became a major objective of IFC. This objective has been carried out through a two-pronged approach: first, through loan syndications, and second, through international securities issues.

On the commercial bank debt side, IFC has developed its co-financing of investment projects through a very active syndication program. Foreign banks involved in IFC-led syndications contribute more than U.S.$1 billion annually to this resource mobilization effort.

With respect to external resource mobilization through securities issues, the Capital Markets Department has been the driving force. It has been successful in convincing portfolio investors that emerging markets offer attractive investment opportunities, and it has now become the focus of IFC's investment banking activities.

III. *THE EMERGING MARKET CONCEPT*

Now, perhaps I need to talk to you about the concept of emerging markets. At first, like other parts of IFC, the Capital Markets Department promoted and invested for IFC's own account in a variety of financial institutions. IFC, through these

operations, sees itself as having a catalyst's impact. For example, it has supported some of the first Indian leasing companies and helped the Government of India set up the regulatory framework for leasing activities. There are now approximately 400 leasing companies in that country.

The same catalytic impact eventually has been observed with respect to emerging market equity investments, but emerging market investments have not always been as popular as they have now become. IFC sponsored one of the first successful emerging market country funds, the Korea Fund, which had an initial capitalization of U.S.$60 million and was set up in 1984. It was difficult at first to convince Scudder, Stevens & Clark, the fund manager of the Japan Fund, that the same model could be applied to an emerging market country and that Korea was going to be the next Japan. The term "emerging market," itself, was coined by IFC at approximately that same time.

The launch of the Korea Fund was actually preceded by an unsuccessful attempt by IFC to promote the Third World Investment Trust ("TWIT"). The TWIT was designed as a global emerging market fund. It was not successful. Some felt that its acronym, TWIT, did not help and came up with the "emerging markets" term. The TWIT was eventually reborn in 1986 as The Emerging Markets Growth Fund. Managed by Capital International, its capitalization has increased from the original U.S.$50 million to approximately U.S.$3.5 billion now.

Since then, IFC has helped establish about thirty single, multi-country, regional, and worldwide emerging market funds. In aggregate, these funds have mobilized over U.S.$2 billion. IFC has also promoted six debt-to-equity conversion funds involving approximately U.S.$1.6 billion in commercial bank debt.

We are still playing an innovative role in that field. For example, this year we launched a corporate bond fund for Latin America, an Africa Fund, and a fund designed to invest in gold-producing companies in developing countries.

What we have tried to do through these activities was to increase the demand for emerging market securities. As information and quality of research on the emerging markets improved, sophisticated investors became increasingly interested in country funds. The very positive performance of some of the early funds sponsored by IFC — such as the Korea Fund, the Thailand

Fund, the Emerging Markets Growth Fund, the Malaysia Growth Fund, etc. — contributed to the increasing popularity of investing in emerging markets.

IFC was also instrumental in improving the quality and the timeliness of information on the performance of the securities markets in emerging markets and on the quality of individual companies. In the early 1980s, the Capital Markets Department sponsored the creation of a database on developing country stock markets. This has now become the Emerging Markets Database, which covers twenty countries and more than 1,000 companies. The total market capitalization of these countries increased from U.S.$66 billion in 1982 to U.S.$770 billion by the end of 1992, and has doubled in relative terms from three percent of world market capitalization in 1982 to seven percent now.

The Emerging Markets Database publishes weekly market indices for the countries it covers and has recently created an investable index in addition to its global index. The investable index reflects the limited access by foreign investors to some emerging markets. These indices provide benchmarks to assess performance by fund managers. They also provide the basic tools for management of some of the index funds that IFC is in the process of launching.

There are now more than 200 emerging market country funds. We estimate that, in aggregate, U.S.$12 billion is currently invested in emerging markets through country funds out of a total of U.S.$17 billion invested in emerging market securities. Some other estimates put the total foreign investment in emerging markets at U.S.$50 billion. What is clear is that the annual flow into emerging markets is quite large, possibly as high as U.S.$1 billion.

The total assets of institutional investors from developed countries are estimated at about U.S.$7.5 trillion and are growing at fifteen percent annually. Of these holdings, about ten percent, U.S.$750 billion, is held in foreign assets, but less than one percent are held in emerging markets.

A small increase in asset allocation to emerging markets could increase the flow of foreign capital quite substantially. Such an increase in asset allocation would be possible considering that the share of developing countries in the world GDP is

about twenty percent and their share in global equity market capitalization is approximately five percent.

What we think we achieved through the developing country fund phenomenon was to alert foreign portfolio investors and managers to the pretty good returns that could be achieved in the emerging markets. Effectively, this brought foreign institutional investors to the local markets, thus increasing demand for quality securities. More important than the billions of dollars eventually raised in the process, the emerging markets were recognized by institutional investors as a new asset class. As such, the emerging markets could be allocated a specific portion of their portfolios.

A similar approach is being followed now by IFC with respect to corporate debt issues and emerging market indexes. Specifically, we are trying to convince institutional investors, as opposed to banks recycling flight capital, that emerging market bonds deserve to be treated as an asset class in their own right. The rationale is that yields are comparable to junk bonds because of country circumstances, but that the issuers are blue-chip quality companies with first-rate balance sheets.

The rationale for considering index funds as a separate asset category is similar, but is addressed to passive index investors. Index investors typically have no or very little exposure to emerging markets. The argument is that with emerging market exposure, returns are increased while risks are reduced due to the low or negative correlation between the performance of developed and emerging markets.

IV. *INCREASING THE SUPPLY OF SECURITIES*

Now, looking to increase the supply of securities from emerging markets and to increase demand by international investors coincided with new trends in emerging markets in the 1990s. These market trends effectively increased the supply of securities both in the local and in the international markets.

First, privatizations in central and eastern Europe and elsewhere increased the supply of securities as well as the size and the liquidity of many local markets. Second, more and more closely held companies have moved from traditional family sources of finance to raise capital in their domestic markets. This also increased local market capitalization and liquidity.

Third, the government agencies regulating the securities markets of developing countries have taken serious steps to improve company disclosure, streamline the clearing and settlement procedures, and to facilitate access to the local market for foreign investors. IFC has supported these initiatives through its technical assistance activities.

Finally, the capital requirements of some of the larger blue-chip companies — for example, the newly privatized utilities — in the emerging markets have simply become too large for the domestic capital markets. Companies needed to rely increasingly on the equity markets as banks globally were trying to meet BIS guidelines and were booking fewer assets.

The search for new sources of equity capital has led these companies to market shares directly to investors in the major developed markets. This effectively has widened the range of investors that these issuers could approach. As some of the more sophisticated institutional investors became familiar with the emerging market concept, they also became more interested in individual companies in those markets. Once emerging markets were recognized as a new asset class, staff resources were allocated to the research and management of these assets and portfolio investors saw less of a need for delegating to a fund manager the task of selecting individual stocks. The shift from country funds to international issues by selected companies was also encouraged by the fee structures involved. Institutional investors able to bypass investment fund managers could save on the typical annual management fees of 1% to 1/2% charged by fund managers.

Consistent with this growing demand from international portfolio investors, IFC focused on helping companies from developing countries gain access to international markets directly through international offerings of their securities. Over the past three years, IFC has helped twelve emerging market corporate issuers tap the international securities markets to raise both debt and equity funding. This was in addition to the fund promotional activities that I mentioned earlier.

The 1990 New York listing of shares of the Compania de Telefonos de Chile (CTC), an issue supported by IFC, marked the first time that a Latin American company had ever been listed on the New York Stock Exchange. Other New York listings

promoted by IFC in the past three years included: an ADR issue by Vitro of Mexico; three country funds from Mexico, the Philippines, and Turkey; two convertible bond issues from an Indonesian and a Mexican company involved a U.S. tranche placed privately and a European tranche with a Luxembourg listing; and, several straight equity issues for companies in Mexico, Venezuela, and Colombia. These straight equity issues were structured as global offerings with either a local market or a Luxembourg listing, and with a 144A tranche for the U.S. market.

In practice, IFC's own portfolio of client companies has been the primary source of its securities activities. These companies have often been clients of IFC for more than a decade. Sometimes IFC was a founding shareholder and has nurtured the growth of the companies to the point where they can consider accessing the international market. This is seen both as a means of increasing name recognition in those markets and as a means of diversifying sources of funds.

These activities are consistent with IFC's developmental role *vis-á-vis* its clients and *vis-á-vis* the local securities markets. In this process we help increase the exposure of these emerging market clients to the financial reporting standards and the investor relationship requirements of the more developed markets. Finally, by bringing more foreign investment into local markets, and through dual listings on the local and on an international market, we feel that we are able to increase the integration of these markets into the global marketplace.

CONCLUSION

In conclusion, we believe that we can be proud of our record in securities market activities for emerging market countries. On the one hand, we have contributed to the emerging market phenomenon by bringing foreign portfolio investors to the local markets; and, on the other hand, we have now become increasingly active in bringing the companies from emerging markets to those international markets.