Stock Exchange As a Channel of Foreign Investment

LESSONS FOR CAMBODIA

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Up to now, there is only a primary market in Cambodia and no secondary one. This means that potential investors have no place to invest their money. So the establishment of a stock exchange in Cambodia as a channel of foreign investment becomes a must in the coming years. Lessons from foreign countries are very useful to this effort.

1. Foreign experience of developing the stock exchange

a. China:

China restored the stock exchange in 1980 by issuing T-bills. From 1982 on, many companies started to issue bonds and in September 1984, Tiangiao Department Store became the first privatized concern. In 1986, the Bank of China recognized operation of the first over-the-counter market in Shanghai and many state-owned companies were privatized in the same year. The stock market started to develop actually in 1988 when trading in T-bills and shares was legalized. In the years 1990-91, two stock exchanges came into being in Shanghai and Shenquin. From then on, more and more state-owned companies were privatized and new strong ones were established according to the 1994 Companies Law. In this period, the State stopped intervening in the business management.

In China, many financial institutions engaged in issuing bonds and controlling the market. The Bank of China inspected and accepted bonds issued by financial institutions and mutual funds. The Ministry of Finance and Planning Committee were responsible for issuing T-bills and controlling bonds issued by state-owned investment companies. In 1991 the Ministry of Finance adopted the underwriting contracts. And as a result, 58 financial institutions and agents could sell all T-bills at a commission of 0.15%. From then on, the underwriting became the main method of issuing T-bills.

As for limited companies that wanted to go public, they should meet requirements posed by the stock exchange (financial disclosure, annual financial statement, etc.) The stock exchange helped attract foreign investment, which reached some US$5 billion a month in the past few years.

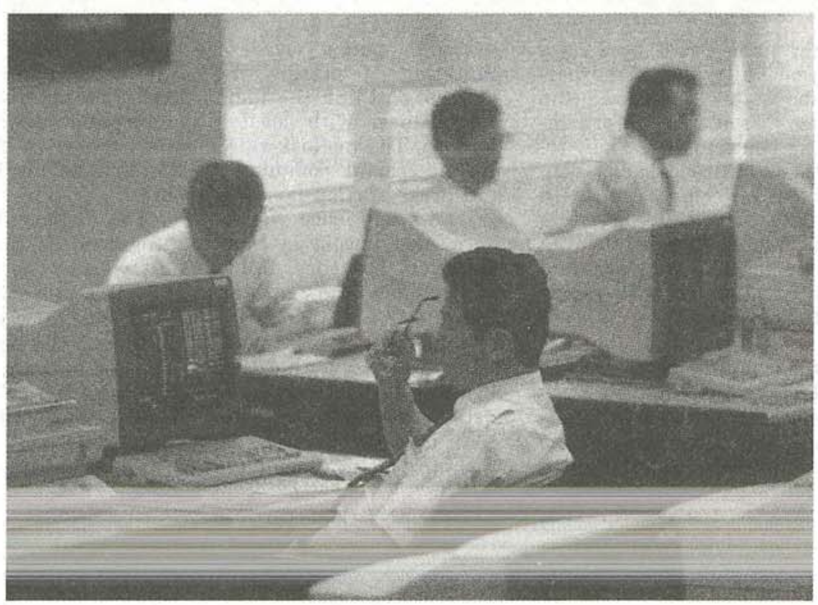
b. Malaysia, South Korea, Bolivia and Russia:

Four basic methods were adopted by these countries to privatize state-owned companies:

(1) Granting certificate: Russian government granted certificate to all citizens with a fee of 25 ruble. The face value of a certificate was 10,000 ruble and they are negotiable. Some 180 million certificates were issued. Over 10,000 companies engaged in bidding for them. Mutual funds purchased them and then used them to bid for companies' shares. Some 51% of certificates were purchased by these funds and 65% of it was invested in public companies.

(2) Collective investment: Various kinds of mutual funds were established in Sri Lanka, Zambia, and Malaysia. In 1971, the Malaysian government launched the NEP with a view to increasing the volume of capital held by Bumiputera, the dominant ethnic group in Malaysia. All members above the age of 18 of this group were allowed to buy shares from state-owned companies, and as a result, this group controlled some 20% of the national assets in 1988.

(3) Public offering: Shares in South Korea were offered for sale at a discount with a view to redistributing more wealth among low-income earners. This method is suitable to countries with relatively developed asset and finance markets. From 1988 to 1992, 95% of shares from seven chaebols were distributed this way (20% sold to workers of issuers and 75% to low-income earners) and 5% went to the public. Various incentives were given to encourage participation in this program. All workers of chaebols could buy shares at a 30% discount and pay in a 5-year and



interest-free installment plan. Low-income earners also enjoyed some preferential treatment when buying shares.

Up to 1988, some 34% of assets from these groups have been sold to some 3.2 million South Koreans. Shareholders could sell their shares at a 100% profit.

(4) Privatization: Bolivian government started this program in 1993 and sold the six biggest state-owned companies in telecommunications, aviation, mining, rairoad, oil and power. This program attracted a lot of foreign direct and indirect investment.

c. Hong Kong:

With the market economy free from the need for loans from the government, Hong Kong is a good example of how governmental bodies facilitated the development of the capital market. Bonds and exchange bills are used as instruments for developing the market by maintaining a standard rate of interest. Prices of bonds are determined through regular auctions with a view to maintaining public interest and attention. To encourage the secondary market, an exchange fund was established to do business with dealers.

2. Lessons for Cambodia

Studying realities in some countries, we could see that the stock exchange requires a long time to come into stable operation. Most leading countries in Southeast Asia are export-oriented economies and their present stock exchanges have developed for some decades although they have been supported by foreign companies. This means that the development of the stock exchange is a long and complicated process. The following are some valuable lessons for Cambodia.

a. Chinese experience: Chinese stock exchange experiences three stages of development:

- 1981-85: It is a stage of unruly development in which companies issued shares and bonds when both issuers and buyers had only limited knowledge of the stock exchange.

- 1986-91: The government realized the need for a well-organized stock market but they haven't worked out right directions and management techniques.

- From 1992 on: The managing machinery is perfected and the stock exchange started to integrate into the world finance market.

Chinese stock exchange has developed with some difficulties and defects but its speed is rather high. Its experience gives Cambodia the following lessons:

+ The government should work out the track for establishment and development of the stock exchange and introduce policies suitable to each stage of development. Foreign investors could be encouraged to take part in the stock exchange from its first stage.

+ The stock exchange must be totally under management of the central government instead of local ones.

+ The official market is only for shares and stocks of quality. Trading system must be appropriate to each stage of development because stocks couldn't be traded as ordinary commodities.

b. Lessons from Russia, Malaysia, South Korea and Bolivia:

+ There must be a well-devised program to turn state-owned companies into joint stock ones in order to encourage the public to buy shares. The face value of shares must be suitable to the personal income. Investment institutions are needed to attract idle money and take part in the privatization program.

+ When privatizing state-owned companies, full attention must be given to small savers and investors. Appropriate policies must be made in order to help them buy shares from well-run companies.

c. From Bolivian and Hong Kong experience of the state control over the stock exchange, Cambodia should review its restructuring of major state-owned companies. The Government can use open market operations to control the finance market. Bonds and shares could be issued constantly and in large quantity with a view to making them available to everybody, thereby attracting all possible sources of money. Systems of financial institutions and banks, and auditing standards must be perfected in order to provide the public with necessary instruments.

In short, to secure sources of finance when facing the shortage of capital, studies on the establishment and development of the stock exchange as a channel of investment, especially the foreign investment, is of great importance to Cambodia.■