

Banking — Finance

Merchant Banking with International Participation

Sri Lanka's first Merchant Bank, with foreign participation was inaugurated in Colombo on March 24th this year. The new Merchant Bank is a joint venture of the People's Bank and Guinness Mahon & Co., Ltd. a leading firm of merchant bankers in the United Kingdom. Established under the name People's Merchant Bank Ltd. it is expected to help in meeting the pressing need to expand the activities and services of banking and other financial institutions of the country. Such expansion becomes urgent today with the increasing demands for both domestic and foreign finance.

The increased demand for funds in Sri Lanka has arisen as a result of the massive development programme undertaken by both public and private sectors over the last few years. Earlier measures undertaken, over the last five years, in this direction have included an increased scope of operations and coverage of the State Commercial Banks; the establishment of a National Development Bank; the inviting of foreign banks to open branches in Sri Lanka; encouraging the establishment of Commercial Banking units as forerunners of a fully fledged off-shore Banking system; and steps towards developing of a Stock Exchange to assist in the mobilisation of capital for the numerous development projects that have been launched. These steps have also been taken with a view to expanding and revitalising the entire banking and financial infrastructure of the country. It is therefore in the context of mobilising greater resources for the country's development, as well as the

promotion of Colombo as a international financial centre, that this new Merchant Bank was established. This venture is also intended to help in extending Sri Lanka's banking services to new fields of finance such as overall financial packaging, syndication of loans, placement of funds, assistance to companies for mergers and acquisitions, and in the management of complex industrial ventures.

Two other areas to which the new Merchant Bank is expected to direct its activity are contractor's support finance; which includes advice on materials and equipment procurement, arranging and managing export credits and syndicated loans and issuing guarantees and performance bonds; and Corporate Finance which covers business management advice, mergers and acquisitions and consultancy services. A British export guarantee line of credit is also being made available through the People's Bank to Sri Lanka's importers as a result the Guinness Mahon partnership.

The experience of recent years has shown that without the massive flows of foreign resources that have taken place very little of the development activities undertaken by the government would have been possible. A relatively small and poor country like Sri Lanka could not mobilise domestically more than a small part of the resources it needs for the development projects it has undertaken. Many of the oil importing developing countries have been compelled to resort to private capital markets to raise some of the finances for their development needs. Sri Lanka has not escaped this trend. The government (for its balance of payments needs) and state corporations (for their capital deve-

lopment needs) have in recent years raised syndicated commercial loans in the international capital market through the Western merchant banks. This new merchant bank, with its international connections, should now give Sri Lanka the opportunity of securing foreign commercial loans on more favourable terms when the need arises.

For instance, the international bond market is noted for its volatile interest rates. In attempting a foreign syndication a local merchant bank with its foreign collaboration will be in the best position to do so, since it will also be in constant touch with the international money market.

In the five year period ahead (1983-1987) it is anticipated that Sri Lanka would need to continue raising funds in the private international markets; possibly over US\$ 150 million a year during this period. Government would need to borrow US \$ 79 million (net) per annum on the average on commercial terms; these include items such as US Aid Housing Guarantee loan and bridging finance for Kotmale. The net medium and long term borrowings by the private sector and corporations are expected to be about US \$ 78 million per annum, according to estimates of the Government's Public Investment Programme 1983-1987. Furthermore, direct foreign investments which are estimated to reach a level of US \$ 50 million in 1982 are expected to increase over the period; therefore at least a further US \$ 50 million will also have to come in annually on foreign investments, according to these estimates.

Until recently Sri Lanka's banking and financial system was structured in such a way as to meet mainly the short term credit needs of the country. But today the problems of finance are far more complex and banking has both become an instrument of socio-economic change, and evolved into a technology for delivering a wide range of financial services. No country can afford to be cut off from developments on the international monetary scene with the growing inter-dependence in international trade and finance. This applies particularly to small countries like Sri Lanka which have been traditionally import-export based economies and have in recent years moved strongly towards a liberalised trade and exchange system. In this context the exposure of such a country to international competition, in the financial sphere, is significant.

The open economy policy of recent years has produced an enormous expansion in investment, commerce and trade; and particularly promoting export activities, in banking and in a general business environment in which there are now attractive prospects for financial investments. Furthermore, there is also the promise of political stability which can induce strong investor confidence. The importance of the establishment of a Merchant Banking sector in Sri Lanka may be seen more clearly in this context.

areas. The competition will always be there.

Do you think that under this situation Sri Lanka will be able to compete in the American market.

At this moment of time, Yes, As long as we can give them the kind of quality and price they want, there is no doubt we can sell.

How competitive are we price-wise? Are we able to compete with other Asian suppliers?

At the moment, Yes.

Do we have problems of contact (eg. transport) due to distance of the markets?

Yes, especially with regard to shipping charges. The costs are high. There has been an improvement, but when considered in terms of mileage with other suppliers we are still paying more. For instance, more than Hong Kong for South Korea.

Are you not resorting to air freight for export of your apparel products? Do you have problems of air freighting your goods?

Yes, but it is not exactly a big issue. The problem is handling at air ports. I don't think Air Lanka's air cargo service is doing a good job. May-be, because their volume of business or the volume of cargoes they handle is increasing. But for some reason, although they have bought new equipment etc. the services are not adequate. Similarly space is also a problem; because shortage of space results in mishandling.

How satisfactory is the handling of cargo at the Colombo Port?

It has improved a lot. The increased use of containers have helped a lot.

Have any new manufacturers of garments come into the Export Processing Zone?

No, I don't think. There is not much scope for newcomers to manufacture garments because the quotas are utilized I think. The attention is now on attracting new lines of investment other than garments. For instance, electronics, electrical goods etc.

Do you think the possibilities of producing garments has reached a maximum limit now?

No. If anyone comes in and manufactures a new item where there is no quota there is scope.

Stephen Tong, Chairman of the Katunayake Industrial Promotion Zone Manufacturer's Association in a discussion with T. B. Karunaratne of the People's Bank, Research Division.

When we last met you nine months ago to discuss the international market situation relating to apparel products you mentioned at that time that markets were very tight and competitive and that under the existing quota arrangements market prospects were not bright. What would you say is the position today?

There has been an improvement in recent times. Over the past few months things have been picking up; especially for the ready-made garment trade. I think things would get even better. The American markets are recovering. Whether you like it or not you have to depend on American market, it is a prime mover; even Japan has to depend on the American market to a great extent.

How would you consider the European Community as a market for garments; is this market also improving?

The economic recession in the EEC appears to be coming to an end; the situation continues to improve. The question is how fast they can improve and how long the improvement will last. With interest rates and oil prices coming down things should pick up here. People are buying again. They are getting confident again and improvement should grow stronger, if not now, in six months time.

Aren't we trying to face competition from other countries that have established Free Trade Zones and the growing number of suppliers of apparel products?

Almost every country is going into the Zone business. Even America is effectively considering establishing Free Trade Zones in the cities. They have already made a start in some of their industrial

At our last discussion you mentioned that there is risk in producing new items that are not under quota. You said there was a risk of marketing. Has the position regarding such items changed?

The position now is that I am producing one non-quota item, but I don't know when quotas will be introduced it may be any moment. For example, when we started earlier quotas came, then we were asked to diversify. But this time America imposed quotas on four more items.

Are there any factories that were in production in the Zone but have now closed down? If so what are the reasons?

I don't think that garment factories are faced with such a situation, but there are some factories producing rubber and related products having problems. They were faced with marketing problems and nothing more.

Have quotas not caused marketing problems for garment exporters. For instance, quotas are given by importing countries to the Government authorities; in obtaining your share of the quota did you face any problem?

These quotas have been in existence for the last three years and are distributed according to past performances. New firms which have been established after quotas came are getting allocations from the quotas. These factories should also record substantial production.

Have quotas affected the expansion programme of the established factories?

Of course yes. Infact, we are producing at 80 to 90 percent of our capacity. We cannot expand since quotas have limited us. We have been operating for four years and employees have increased their skills. Their levels of efficiency are much higher now. Two years ago we did not have this problem; they were not so skilled then. But now we are unable to make maximum use of their skills.

Do you still import raw materials for the manufacture of garments? There are several textile factories in production within the country; why are you still reluctant to use their products for the manufacture of garments?

The materials most garment factories require in the Zone are not available here. Local factories produce materials like sarees, and for the local market. I think they are still not geared to produce

for international markets and at a competitive price. I think quality can be achieved; but the design is the problem. The local manufacturers are not aware of recent trends in designs. If they could produce the materials we require it is good for us as well, because there will not be such costs as transport involved. They therefore can have a margin which can give them a competitive position. But the essential thing is to have the right product.

What is the position regarding costs of manufacture in the Zone.

Our present concern is only with the electricity charges; the fuel adjustment charges of the Electricity Board.

What about the cost of labour?

It has been increasing here every year, as in the case of other producer countries. But in countries like Singapore and South Korea labour costs are very high. Labour cost by itself, is much less here; but, there are lots of unproductive pay days, where nothing is produced.

When we last met you were of the view that the business climate and investment climate here were not very good. What would you say is the position now?

One year ago or even half a year ago we did not know when this recession would end. Now we know and we have better signs that the end of recession is in sight, so the investment climate should be better. Now investors can finance their ventures without any fear.

INVESTMENT PROGRAMME'S PERSPECTIVE OF GARMENTS EXPORT SECTOR

The Government's Public Investment Programme 1983-1987 has recorded as a disturbing feature, the inability of Sri Lanka's garment exporters to meet their entire quota requirements. Another feature commented on, in this document, is the heavy dependence of the garments industry on imported inputs. The hope is expressed that indigenous textile and handloom industries will gear their production to the requirements of the garments export sector. The Programme states:

"Garments and textiles have emerged as the second most important item of exports from Sri Lanka. With a modest beginning in mid-1960s, the exports in 1982 amounted to SDRs 146 million, with the 16 percent share in total exports. come down from 85 percent in 1978 to 61 percent in 1981.

Sri Lanka's export of garments, however, depends heavily on a narrow base of 4 or 5 items of clothing - namely, shirts, blouses, trousers and jackets, all of which have evoked restrictions from the importing countries in the form of quotas which permit only marginal expansion per annum. Any higher earnings from quota items could only be generated through production of higher value items. Recently, a disturbing feature in the export of garments has been the inability of the exporters to fulfill the entire quota requirements, mainly due to the rigid conditions imposed by the new Multi-Fibre Agreements. It is however, encouraging that the process of diversification has already started and, as a result, the share of the above items in the total export of garments industry. Another major factor which is adversely affecting efforts for reducing costs and improving competitive efficiency of the garments industry is its heavy dependence on the imported inputs which account for nearly 70 percent of the total value of exports. The local exporters have no control over such large import components for their exports. The rapid expansion of industry during a relatively short period has also exerted tremendous pressure on the availability of skilled and experienced workers. However, in view of the steps being taken to ensure full utilization of capacity and additional exports of about 18 million pieces of non-quota items from 1983 onwards from the GCEC, the garment sector is expected to maintain its momentum. It would be in the interest of both the indigenous textile and handlooms industries if they are geared to produce the variety of cloth required by the garments industry."