<u>XXIII REGIONAL PROGRAMME OF MONETARY STUDIES CONFERENCE</u>

THE NATIONAL INVESTMENT COMPANY: THE INSTITUTION, IT'S OBJECTIVES AND LIKELY CONSEQUENCES

Rawle Mitchell

Paper Presented At the Annual Conference
of the Regional Programme of Monetary Studies

Unit Trust Corporation
Trinidad and Tobago

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I. INTRODUCTION

Mr. Chairman, Distinguished Guests, Ladies and Gentlemen. Permit me, firstly, to express my thanks and appreciation for allowing me the privilege to speak at this seminar and secondly, to make it clear that the views expressed are my own and not necessarily those of my employer, the Trinidad & Tobago Unit Trust Corporation.

The Trinidad & Tobago Minister of Finance, in his 1991 budget presentation announced that the government was **"committed to begin the restoration of benefits to all employees in the Central Government and its Statutory Agencies."**

Consequently, in May 1991, the government published a White Paper entitled **"Proposals for Settlement of Pay Arrears to Public Sector Employees and Workers of Caroni (1975) Limited in the Context of Government's Policy of the Widest Possible Public Participation in Business Enterprise."** Central to the document, is its proposal to establish a National Investment Company (NIC), the capital of which will comprise shares of thirteen (13) companies deemed to be the most profitable state enterprises operating in Trinidad & Tobago.

Revised proposals entitled **"A Presentation to the Representative Unions on Progress to Date on Government's Proposal for the Setlement of Public Sector Pay Arrears"** dated November 8, 1991 have indicated that the number of companies has been reduced to eleven (11).

The first part of this paper examines the objectives and characteristics of NIC as a precursor to placing it in its category as a financial intermediary. The second part addresses the likely impact of the NIC on the local economy, while the final part analyses alternatives to the NIC.

II. OBJECTIVES, CHARACTERISTICS AND MECHANISMS OF NIC

II.1 Objectives of the NIC

Mr. Chairman, it should be iterated that privatisation is an international trend and not merely a lonely path treaded by the Trinidad & Tobago government; this government is merely joining the queue.

If one were to trace the re-emergence of the privatisation issue during the decade of the eighties, almost always the following objectives would be found to assume paramount importance:

1. overcoming the operational inefficiencies and resource waste widespread in state enterprises;

2. reducing government budget deficits through (a) proceeds from sales and (b) reducing public sector borrowing requirements;

3. increasing the shareholding democracy;

4. contributing to output or industrial growth by facilitating investment that was previously constrained by lack of funds;

5. the need to attract foreign capital -- particularly since one of the conditionalities prescribed by the multi-lateral lending agencies relates to the disposal of governments' interest in certain enterprises.

In the case of Trinidad & Tobago, however, the claim is that the divestment programme through the establishment of the NIC will achieve three (3) principal objectives:

i) the payment of arrears to public sector and Caroni workers, estimated at $2.3 billion at December 31, 1991;

ii) the continued divestment of state enterprises; and

iii) increasing the participation of citizens in the ownership of the wealth of the country.

This linkage of debt to public servants and the divestment process, by its very nature, has made the NIC the topic of serious and, at times, heated public discussions. In spite of this, the NIC's role as an addition to the financial community can be most rewarding, since when the NIC becomes fully operational, it will have assets approximating the total capitalisation of the domestic stock market and almost equivalent to the largest commercial bank in Trinidad & Tobago.

Mr. Chairman, I would now outline the NIC proposal.

II.2 NIC: Its Characteristics and Mechanisms

One needs to emphasize that the scheme must be seen in the context of the dilemma government faces with respect to its commitment to repay public servants their arrears and its cash situation.

As outlined in the White Paper and its update, the main characteristics of the NIC can be summarised as follows:

i) The assets of NIC will comprise mainly of contributions from the Corporation Sole by way of a transfer of government's shares in State Owned Enterprises (SOE's). The final NIC portfolio will also, in addition, include government's holding in quoted companies, cash and bonds;

ii) NIC will use its shareholdings of the various SOE's as the basis for the issue of units;

iii) Units will be issued in five series, each of which will be redeemable on one pre-determined date as follows:

SERIES	REDEMPTION DATE	PAYMENT BY
A	31.03.93	31.05.93
B	31.03.94	31.05.94
C	31.03.95	31.05.95
D	31.03.96	31.05.96
E	31.03.97	31.05.97

iv) The unit valuation procedure will be in accordance with the bid price (in the case of quoted shares), the net present value of redeemable shares (in the case of TCL), and the Directors' valuation (in the case of unquoted shares). The Directors valuation is subject to:

a) Independent Reporting Accountants;

b) Review of (a) by co-ordinating Accountants;

c) Review of (a) and (b) by the Governments' financial advisors and stockbrokers; and

d) Investment bankers operating under the capacity of underwriters.

v) All state enterprises, not listed on the Stock Exchange, but included in the NIC's investment portfolio are scheduled for listing before 1993.

vi) In attempting to make the units transferrable and marketable, the framers have stated their intent to establish a secondary market for the NIC's units. This is envisaged to be completed during the first year of NIC and, as such, the B, C, D, and E unit series will be listed on the Stock Exchange in 1992.

vii) NIC will preserve the nominal value of the units. Additional features of the NIC worthy of mention here are as follows:

- NIC will have a finite life of five years. The framers have indicated that **"a suitable mechanism to allow for such continuing long-term investment by unitholders"** will be put in place to supercede the NIC.

- the NIC will be able to borrow against its assets.

- through the sale of units to individuals and institutional investors, the NIC is expected to generate the sum of $300 million -- this will be used to make an initial cash payment of the proposed settlement.

- the amount of the liability to be settled will be overfunded so as to make the state the largest holder of units in the NIC. These "overfunded units" valued at $800 million (representing over 30 percent of the total units in issue) will be used to:

  1) meet the operating expenses of the NIC

  2) pay bonus incentives

  3) fund the NIC's unit guarantee schemes

  4) provide residual investments by the state in the NIC after all units have been redeemed in full in 1997.

- the NIC will be exempt from the payment of taxes on dividends income and capital gains;

- the initial cost of setting up and launching the NIC, will be borne by the state.

The White Paper further stated that incentives would be provided to encourage long-term savings and investment. These include:

1) **Bonus**

- individual unitholders will receive incentive bonuses of up to 5 percent of the redemption value, but this bonus will be recovered if the investment is sold or redeemed inside the three-year period according to the following scale:

YEARS HELD	BONUS RECEIVED
>1	1%
>2	3%
>3	5%

2) **Preferential Rights**

- all unitholders will have a preferential right (or passport) to allocations of shares in flotations of the underlying investments of the NIC.

3) **Income Tax Benefits**

- a concessionary rate of income tax will be applied to the total settlement.

viii) The framers of the NIC have indicated that the draft legislation will provide provisions and regulations for the following:

- the issue of special shares to the government
- disclosure rights
- limited shareholdings
- nominee names
- concert parties
- penalties

III. IS THE NIC ANOTHER UNIT TRUST?

Careful examination of the White Paper indicates that the framers intent is, to have the NIC seen in the context of a debt equity conversion program -- to speed privatisation in a politically acceptable way and also as an opportunity to strengthen the domestic equity market.

Early discussions concerning the realisation of public servants and Caroni workers debt indicated the establishment of a "State Unit Trust", with features similar to those of the NIC. The title (State Unit Trust) in combination with the instrument being classified as a "unit" certainly does not add skepticism to the belief that the NIC is a unit trust.

The evidence however refutes this claim, since the proposed institution does not fulfil several fundamental tenets of a unit trust, for example:

(i) traditional units do not have fixed redemption dates and in fact investments held in a unit trust must be easily realisable;

(ii) units in equity based 'unit trusts' are required (by law) to be valued on a daily basis;

(iii) equity based unit trusts' are required to quote both the bid and offer prices; and

(iv) unit trusts' are the only market makers in units. A unit trust may appoint an agent to sell units on its behalf, but a unit trust cannot appoint agents to repurchase units on its behalf.

As further information on the NIC is released, the greater would be one's appreciation on the fact that the institution is a hybrid of a unit trust, a mutual fund and an investment trust.

IV. ANALYSIS AND IMPLICATIONS OF THE NIC FOR THE LOCAL ECONOMY

Over the past few years, activities influenced in part, by the impact of the economic decline and efforts by individuals, firms and the central government to deal with the financial distress that ensued, culminated in a number of financial activities which indicated the existence of an emerging securities market. This market has brought the Merchant Bank and the Trinidad and

Tobago Unit Trust Corporation into prominence, and as a consequence, these institutions are playing a more dynamic role in the financial market place, thereby providing a fillip to the further development of the domestic financial sector.

At the outset it must be recognised that the launch of the NIC will mean an addition to the domestic financial environment of Trinidad and Tobago. Its introduction however will undoubtedly be facilitated by the broadening and deepening of the money and capital markets alluded to earlier.

If the Stock Exchange is to achieve its originally conceived dynamic role as the mechanism for mobilising and allocating long-term investment resources, then companies must continue to be attracted to the list of quoted stocks. Thus arguably, the most significant institutional impact of NIC will be its use as a vehicle for the conversion of some perceived "non-tradeable" assets to "tradeable instruments", since the NIC will serve to release approximately $2.5 billion worth of equities from state enterprises onto the market place.

The attractiveness of the state enterprises to be included in the NIC, in terms of both quality and quantity, will therefore result in an immediate enhancement in the options available to the investor. In fact, even though adequate financial statements on the proposed companies are not widely available, on the surface, the list of companies appear to be an impressive one, since they represent entities believed to be the most profitable state enterprises in the country.

Latest documentation on the NIC contains considerable modifications to the institution as originally conceived. For example, the most recent document reveals that of the original thirteen (13) companies cited for divestment, no fewer than five (5) have been removed from the list. These developments have given rise to tremendous speculation, yet relief. The fact that Government has accepted the reviews by the Reporting Accountants on the proposed companies, suggests that legitimate concerns are being actively addressed by the Divestment Committee.

Another issue deals with the dividend implication of the NIC. Dividend receipts from the companies presented in the portfolio of the NIC are expected to play a critical role in meeting the institution's liquidity needs, particularly in respect of meeting unitholders' promised dividend income. Although the major proposed companies do not have a dividend history, one would expect that the reorganisation which would precede and in some instances follow their divestment would enable them to pay dividends.

Another issue which needs addressing is the fact that consumers would have a higher price exacted upon them in terms of higher charges for the "efficient service" of these new private companies. Government would no doubt implement mechanisms te ensure that the products are not unduly priced.

NIC has the potential to achieve widening shareownership structure in Trinidad and Tobago. It has been estimated that over 100,000 persons will immediately become beneficiaries of the Plan by being issued with units. To the extent that the units are backed by the portfolio of equity investments held by NIC, the unitholders from the outset become indirect owners of the equities.

However, since it is the intention of NIC to dispose of its holdings of shares in the open market through offers for sale, this means that over time, the basket of shares held by NIC will shrink and so too will be the indirect owners of the equity. Hence continued share-ownership will be secured through the following:

(i) individuals acquiring shares directly at the time when they are put on sale;

(ii) existing unitholders continuing to hold units beyond the redemption dates thereby maintaining their status as indirect owners of the equities remaining in the basket; and

(iii) indirect ownership through membership in institutions such as pension funds, credit unions, insurance plans and Unit Trust which may have acquired the shares at the time of offer.

Mr. Chairman, this last and most important issue has been deliberately held back since (i) I want us to assume that the framers of NIC fully recognised and addressed the issues raised above, thereby appropriately creating the groundwork to introduce the NIC as conceived and (ii) it would lead us directly into the final segment of my presentation.

A divestment programme along the lines suggested will provide a continuous flow of securities on the market thereby expanding and deepening the character of the stockmarket. Of critical significance to both the administrators and investors, must be the absorptive capacity of the domestic capital market to accommodate the share issues approximating $2.0 billion over the stated five (5) year period. Put simply, this would average $400 million for each of the five years that the entity is supposed to last for.

These aspects of the NIC could lead to a broader securities market, thereby auguring well for investors who need to strengthen their portfolios by diversifying their holdings across sectors. Yet, there's the need for great caution, since the sums being talked about have never before been traded on the local exchange.

A more detailed examination of the primary and secondary market operations of the Stock Exchange provides a better indication of its absorptive capacity. The data presented in Table I illustrates the value of transactions conducted on the floor of the Exchange for the period 1986 to 1991.

TABLE I

TRINIDAD & TOBAGO STOCK EXCHANGE
PRIMARY AND SECONDARY MARKET ACTIVITY
1986 - 1991

	SECONDARY MARKET			PRIMARY MARKET
Year	No. of Shares Sold ($m)	Market Value of shares traded (TT $M)	Average Daily Value of Shares Traded (TT$)	Value of Shares
1986	42.7	93.3	645,972	--
1987	34.4	45.3	308,262	26.2
1988	31.1	57.3	392,506	3.4
1989	71.3	146.7	971,445	12.0
1990	66.4	235.3	1,657,140	21.0
1991	53.4	156.7	1,682,192	7.5

Source: i) Trinidad & Tobago Stock Exchange

ii) Central Bank of Trinidad & Tobago Quarterly Statistical Digest, Vol IX, No. II, June 1991

TABLE II

RESERVES AND INVESTMENTS IN LOCAL FINANCIAL INSTITUTIONS

$ Million

1.	Commercial Banks			2642.7
	Other Liquid Assets	633.7		
	Investments	928.8		
	Other Assets	1080.2		
2.	Finance Houses and Merchant Banks		313.5	
	Net External Assets	78.9		
	Private Investments	78.1		
	Public Investments	17.6		
	Due from Banks	138.9		
3.	Trust and Mortgage Finance Companies			335.5
	Due from Banks	37.2		
	Public Investments	140.2		
	Private Investments	141.9		
	Interest Receivable	16.2		
4.	Thrift Institutions			19.3
	Due from Banks	8.5		
	External Assets	7.6		
	Investments	3.6		
5.	Development Banks		85.5	
	Due from Banks	0.9		
	Investments	84.6		
6.	Life Insurance Companies			1148.6
	Foreign Assets	129.4		
	Other Investments	105.8		
	Company Securities	461.2		
	Government Securities	452.2		
TOTAL				4545.1

Source: Central Bank Quarterly Statistical Digest

The sum of $400 million of divestment per year over a five-year period is a significant amount of money for the market to absorb. The market value of transactions in 1989 and 1990 was $146.7 million and $235.3 million respectively. Therefore, one would require a different approach by institutional investors such as pension funds and insurance companies. The magnitude of current investments and reserve capital of the local financial institutions estimated at $4.6 billion (see Table II), lends credence to the fact that the domestic capital market could truly accommodate over time, the stated offers for sale. However, the market covers a wide spectrum of instruments and as such, the success of the floating of the shares will depend on their relative attractiveness compared with the other available instruments.

NIC's related activity in the domestic capital market will place an additional claim on available liquid resources to the effect that there is

(i) increasingly tight liquidity in the financial system; and

(ii) a dramatic rise in interest rates.

A further dilemma could arise if the units fixed redemption rates coincide with very unfavourable market conditions. For example, unfavourable market price or demand for petro-chemicals, energy and energy-based products. Our experiences with these sectors instruct us that luck plays a key role in their out-turn.

V ALTERNATIVES

In its present form the NIC can satisfy the problem of debt servicing, however,the full benefits of divestment will be lost if the NIC's preoccupation is with this debt. Simple modifications to the proposal would undoubtedly result in it accomplishing the desired results. These and alternative mechanisms will now be identified.

Mr. Chairman, for NIC units to be fully acceptable they must be tradeable. To this end, the formal secondary market for the units should be built-in from the start. Caricom and extra-regional investors should be allowed to participate in Government's divestment because of the strain the size of the divestment, in addition to Government's borrowing requirements, would place on the local financial market. The Caribbean Stock Exchange would be a facilitator to this realisation.

Following the above, another suggestion is to allow individuals and corporate investors, both local (Caricom nationals) and foreign, to participate in raising the sums required for the initial cash payment.

Inflexibility of redemption dates can prove problematic for the NIC since, these dates may not be conducive for share floations on the Stock Exchange. If this proves to be correct, then the likely result would be that the price these shares obtain may be below their market value intrinsic worth.

I am suggesting that the NIC should be a holding company in the true sense, that is, a company whose defined function is to hold shares of other companies with the intention of controlling and co-ordinating their policies. As such, the NIC's mandate would be to enhance the profitability of the enterprises it owned and prepare them for full or partial privatisation.

In this pure form, public employees (and those who purchase) will hold a financial instrument which would have features normally obtained on Government debt securities, such as bonds. Here though the possessors of the instrument will know what the return will be from the time he/she gains possession. In exchange for this known return the individual will give up claims to dividends and capital appreciation to Government. These potential benefits given up can then be utilised by Government via the NIC to meet costs of either redeeming the instrument or in financing new state investments. Of course, when conditions are right, divestment of enterprises can take place.

Another option open to Government would be to sell the SOE's either totally or in part to Caribbean nationals and international concerns. In instances where the industry is deemed "too sensitive" certain instruments can be put in place to ensure that ownership by any one group is constrained. National interest can be maintained through the concept of an instrument like a 'golden share' which would ensure Government voting control. Additionally, the companies articles will be adjusted to ensure certain changes cannot be made.

In the final analysis Government needs to devise a mechanism that will encourage foreign investment, increasing the share ownership democracy, divestment of their shareholdings while still retaining corporate control of stretegic companies, in addition to, meeting the debt obligations to public servants. The revised NIC meets with these socio-economic demands.