JAPAN'S INVESTMENT AND DEVELOPMENT OF ASEAN FINANCIAL MARKETS: Thai and Malaysian cases

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JAPAN'S INVESTMENT AND DEVELOPMENT OF ASEAN FINANCIAL MARKETS : Thai and Malaysian cases

SHOJIRO TOKUNAGA

The rush by various countries including Japan to invest in ASEAN is continuing. However, beyond what would be expected, the expanding enterprises are procuring funds in local money markets certainly for working capital but also a considerable sum for equipment investment. The money markets of the ASEAN countries are showing signs of changes with this "localizing of raising capital ("financial self-reliance of the subsidiaries)." Medium-and long-term money markets have taken root and a new international money market connection has developed between ASEAN, Singapore and Tokyo. It seems as though the new age for Asian money markets has followed the development of a borderless economy.

1. *ASEAN Investments and Fund Procurement in Local Money Markets*

(1) The Opening of the ASEAN Economies

In the latter half of the 80's, Thailand and Malaysia have aggressively introduced foreign capital directed toward exports to foster their industrialization. From January to may of 1988, the Board of Investment of Thailand (BOI) authorized 1,965 investments plans for a recorded total capital investment amount (payment) of 83.1 billion bahts of which half was foreign investment. In Malaysia as well, for January of 1988 to August of 1989, 63% of the authorized investments totaling 17.3 billion ringgeh was foreign investment.

A majority of the foreign capital investments since 1986 has been directed towards export and the percentage of the GNP for export goods and services in 1988 was 73% for Malaysia and 35% for Thailand. Along with foreign investment projects, Thailand will accelerate its exports in hopes of eliminating its trade deficit within a few years.

The economies of Thailand and Malaysia are free but it is unusual that the foreign corporation have brought in only a portion of the investment capital. The large amounts of equipment funds, which exceed the equity investment (and loans from parent companies to subsidiaries), are loans on deeds (short-term); and the working capital is a combination of loans on bills and overdrafts which have been raised in the local money markets.

(2) Procurement of Investments and Working Capital in Local Money Markets.

For foreign corporations such as Japan which are making new investments in Thailand, one-third of the investment amount is financed with equity investment and the remainder is financed locally with loans in baht ("Commerce Report"-October 25, 1988 : A local survey by the author shows a case where 20% of the total investment amount was equity investment from Japan and the remainder was raised locally. Also, according to "9th Study of the Conditions at Japanese Corporations in Bangkok" by the 1984 Bangkok Japanese Chamber of Commerce and Industry.) The Bank of Thailand (central bank) has packaged investments connected to the production and distribution of export productions and provids low interest financing.

Malaysia, whose income and expense balance is basically in the black, is more thorough. The "window guidance" of the central bank makes the infusion of foreign capital difficult simply by making it obligatory for foreign-affiliated corporations (Non-Resident Controlled Companies : NRCC), where more than half of the investment is made by non-residents or the final decisions are made by non-residents, to borrow 60% of the loans in the local money market. This is the so-called "60 : 40 Regulation". This regulation is included in the export rediscount system, namely the Export Credit Refinancing (ECR) scheme which is low interest export financing.

Let us examine the conditions of the local money markets of Thailand and Malaysia which provide not just working capital to foreign-affiliated corporations but also equipment funds.

2. Local Money Markets and Local Procurement of Capital Funds

(1) The Thai Money Market and Procurement of Capital Funds

The money market of Thailand consists of the Central Bank, 15 commercial banks (2,078 domestic branches), 14 foreign banks (2 Japanese banks), 4 government-affiliated special banks and 94 finance companies (at the end of 1988), Actually, four major commercial banks control the money market here. Of the financial institutions, including the Central Bank and the finance companies, the commercial banks have a 62.8% share of the total assets but the four major commercial banks control 62% of those amounts (Refer to Table 1).

Figure 1 is from a manuscript of Bank of Thailand where the credit market divided into capital and money markets. It gives the relationship between these markets and the actual Thai

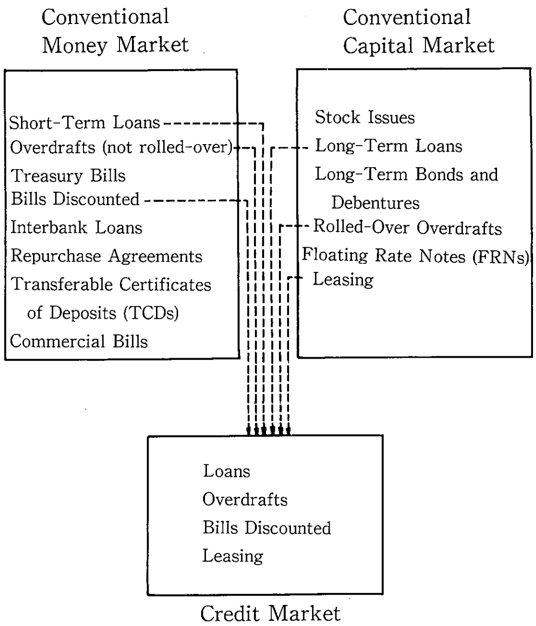

Fig. 1 Classification of the Credit Market in Thailand.

procurement market of the companies. When corporations raise funds within Thailand, the most common procedures include loans, overdrafts, discount bills as well as leases.

The corporations can be financed through overdrafts and discount bills for not only short-term funds but also for long-term funds involving investment in equipment. When a company wishes to obtain long-term funds, either a long-term loan exceeding one year is used or overdrafts are renewed for long-term borrowing. However, there is no actual difference between the two. Even long-term loans are none other than "renewals" with varying interest rates according to the length of commitment. In other words, long-term funds are conversions of short-term funds and Thailand only has a short-term money market where interest rates are exorbitant and the fluctuations are drastic.

Discount bills are connected to the rediscount bill system (packing loans) involving exports which the Central Bank finances at low interest rates. This system is authorized by the central bank and is institutionalized financing which advances the purchasing funds of the exporter at a low interest with the loaded freight as security.

Leasing (finance leasing) do not has tax and amortization systems in place and are currently not often used as financing procedures.

Table 1　Thai Financial Markets
(On assets basis ; as of end of Dec. 1988 ; million baht)

Bank of Thailand	328,331 (16.8%)
Commercial Banks	1,258,170 (62.8%)
4 Governmental banks	271,879 (10.9%)
Finance Companies	199,664 (9.9%)
	2,004,044 (100.0%)

Source : Bank of Thailand (Manuscript, 1989)

Table 2　Malaysian Financial Markets
(On assets basis ; as of end of 1988 ; million Ringgehs)

Central Bank	265 (11.7%)
Commercial Banks	945 (41.6%)
Finance Companies	243 (10.7%)
Merchant Banks	70 (3.1%)
Discount Houses	22 (1.0%)
Development Financial Institutes	55 (2.4%)
Savings Institutions	88 (3.9%)
Provident, Pension and Insurance Funds, etc.	579 (36.5%)
	2,267 (100.0%)

Source : Bank Negara Malaysia, *Annual Report*, 1989.

(2)　The Malaysian Money Market and Fund Procurement

The Malaysia money market consists of commercial banks (at the end of 1988, 22 domestic banks with 765 branches, 16 foreign banks with 146 branches), finance companies (47 with 486 branches including 16 subsidiaries of banks), merchant banks (12) and discount houses (which accept short-term deposits, government bond investment, discount bills) which are centered around the central bank. These are accompanied by various types of financial institutions such as development banks (medium-and long-term financing), government savings banks (small-scale deposits which are invested in government bonds) and various types of funds such as pension funds.

Table 2 gives the shares (total assets amounts comparison) of the money market. However, when corporations are raising, funds the financial institutions that play an important role are the commercial banks, the finance companies as well as the merchant banks. The finance companies are mindful of consumer loans (41%) and often evolve as supplementary businesses to the commercial banks. The proportion of financing for manufacturers is only 4.5% (April 1989). The financing for manufacturers by commercial banks (20.4%) together with the merchant banks is high at 26% (September 1988) and most function as subsidiaries of the domestic and foreign

Table 3　Declining Shares of Foreign Banks in All Malaysian Commercial Banks

	Foreign Banks (Branches)	Malaysian Banks	Totals
1970	2,769 (62.1%)	1,691 (37.9%)	4,460 (100.0%)
1980	12,234 (38.0%)	19,962 (62.0%)	32,186 (100.0%)
1985	20,776 (28.0%)	53,457 (72.0%)	74,233 (100.0%)
1989 (April)	24,994 (24.5%)	77,066 (75.5%)	102,060 (100.0%)

Source : Bank Negara Malaysia, *Quarterly Bulletin*, 1989, No. 1.

commercial banks.

The Malaysia money market differs form Thailand in the strong influence of government regulations and foreign banks. As shown in Table 3, the 62% share of foreign banks in 1970 has changed sharply by lowering to the present rate of one-fourth. The government policy for intensive nurturing of domestic banks was behind this. As it has already been pointed out, "60 : 40 regulation" the 60% of funds that are raised in the local market by NRCC and the regulation of the amount lent by non-residents (including parent loans to subsidiaries and off-shore loans that exceed 1 million ringgehs require approval) are part of this current.

When short-term funds are raised by corporations it is generally by overdrafts from the commercial banks or by revolving credits through merchant banks (250,000 ringgehs per single name bill borrowed for a set period and renewable funds). Long-term funds are raised as short-term funds rolled over or a loan on deeds. Loans on deeds carry the stipulation that the interest to the one making the long-term commitment be reconsidered at regular short intervals. As in Thailand, the fixed interest rate medium and long-term money market is not well developed. It is possible to get medium and long-term funds through leasing and institutional financing.

Low-interest institutional funds also exist for short-term funds. This is the export rediscount system (ECR in Malaysia). Until now the funds were available after export. The range of application has extended to include those who provide parts and raw materials to the final exporter and has become an important source of funds to the export businesses.

Let us consider the reasons why foreign enterprises raise medium-and long-term funds, including capital for equipment, on local money markets which only function as short-term markets.

(3) Why Are Funds Raised On The Local Market ?

In an immature market which has not yet developed its medium and long-term money markets, the interest rates are relatively high and it is vulnerable to fluctuation. However, there are positive reasons why Japanese corporations and others try to raise funds on the local short-term money markets.

(1) To avoid the losses caused from exchange fluctuations due to yen appreciation.

(2) The loans are made to highly trustworthy corporations on the interbank rate base and Japanese corporations (subsidiaries) are able to obtain low cost funds themselves or based on the guarantee of the parent company in Japan.

(3) Low-interest institutional financing exists such as the export rediscount system.

(4) Borrowing of off-shore funds is regulated (particularly in Malaysia).

(5) The parent companies are limiting lending to themselves to avoid disrupting the balance sheet with expanded overseas capital.

(6) The expansion of local lending has also been stimulated by corporations which aim to limit capital expenses as much as possible and wish to collect on their investment within the period during which the investment incentive is in effect.

3. *Singapore As An International Money Market.*

(1) Growth of the Asian Dollar Market.

At the same time that the Tokyo international money market (Japan Offshore Market: JOM) was being established at the end of 1986, the Singapore off-shore market, called the Asia Dollar Market (ADM), seemed as if it would face shrinkage. Actually, the opposite was true. Hong Kong and Singapore which respectively had only 10.5% and 12.3% of the world off-shore market at the end of December 1980 expanded to have 25% and 21.8% respectively by the end of June 1987. (Figure 2)

The scale of the market (on the basis of total assets) currently held, as of the end of March 1989, by the ADM is 1.85 times that at the end of 1986 (155.1 billion U. S. dollars) which means it has inflated to 288 billion U. S. dollars. The foreign exchange markets which was 366 million U.

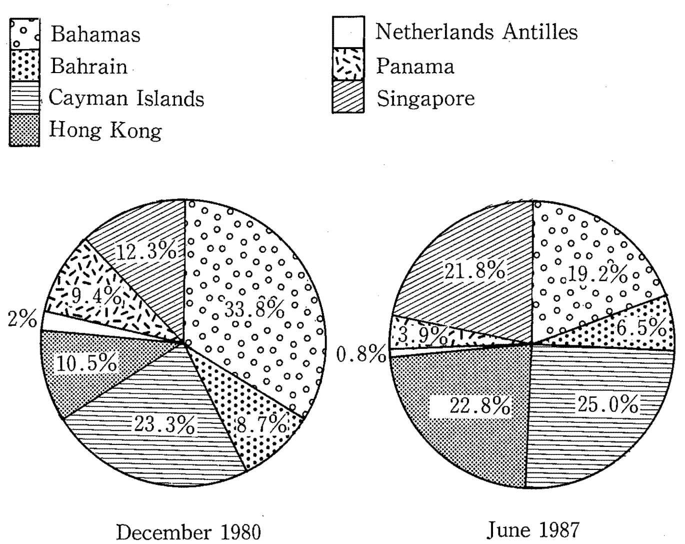

Fig. 2 Off-shore lending: market shares

Source: Bank of England, *Bulletin*, May 1988.

S. dollars in 1974 grew rapidly to 13 billion U. S. dollars in 1985 and reached 43 billion U. S. dollars in 1988.

Fixed and working capitals for foreign corporations in Thailand and Malaysia are raised locally. Why then has Singapore also grown as an international money market? There must be some financial connection between the two. The secret is in the "ASEAN countries' financial markets."

(2) International Distribution, Exchange Settlement and Financial Center.

Singapore is on a segment of the global financial market which connects North America, Europe, Japan and other Asia. Singapore's role is increasing in importance particularly as an ASEAN countries' financial and exchange markets.

The key to the position and role of Singapore in the ASEAN financial markets is the Asianization (borderless trends) of production and Foreign companies' control of the exchange transactions of various ASEAN countries.

The Asianization of production and its process, mutual supplimentation of materials, parts, semi-manufactured goods and products by Japan, Asia NIEs and ASEAN is advancing at a fast tempo in conjunction with the trend toward borderlessness of the economy.

With the progress in the Asianization of production and the production systems, Singapore is beginning to take on the following new functions mainly for the foreign corporations in ASEAN.

(1) It is an international physical distribution center, as with the CDC (Central Distribution Center) and IPO (International Procurement Office), which collects and piles parts and products made in the Asian region including Japan as well as separation and delivery of products to all the areas of the world.

(2) It is a centralized international settlement center including foreign exchanges (mainly in U. S. dollars): the settlements accompany the trade between ASEAN countries and the various countries of the world. In the ASEAN, the exchange transactions are strictly controlled such as settlement with foreign currencies (prohibition on settlement with the domestic currency) and the trade based completely on actual demand (occured from real foreign trade). Therefore, the foreign corporations avoid exchange risks by conducting their currency trading with Singapore. Thus, these countries are centralizing their finances.

(3) It is the financial control center for foreign corporations, including Japanese companies, which are expanding their operations in ASEAN. By giving the functions of a subsidiary for financing to other Japanese subsidiaries in Asia, the finances of ASEAN and other company

entities in Asia (factories, etc.) are managed.

Operational Headquarters (OHQ), as a rule, have these three functions and have received priveleges under the tax system of the Singapore government. At present, Japanese companies that have received this status including *Sony*, *Fujikura Densen*, *Tateishi Denki* and *Matsushita Electric*, but in actuality large number of the Japanese subidiaries in Singapore are progressively taking on the function of OHQ.

Also, the Singapore ADM and exchange market are focal points for the regional offices of foreign corporations which raise funds in the ASEAN countries and for the foreign bank regional offices which support these companies. When the corporations located in ASEAN countries raise funds from the local banks, they receive stand-by credit (bank guarantee) from Japanese banks in Singapore with the guarantee of the parent company in Japan. This is one of the reasons why municipal banks and major provincial banks which have not been authorized to establish branches have branches here in the form of off-shore banks.

When the corporations and banks which are extending their operations into the ASEAN countries are involved in a large scale project or are not able to raise low cost funds in the local money market, the Singapore ADM will take an active role as a base for the money supply.

For the above reasons, Singapore is a buffer zone for a not yet mature money market in the ASEAN countries and a base for international integration of the money markets in the ASEAN countries.

4. The Asianization of Economies and Japan's Reaction.

(1) Changes in the ASEAN Local Money Markets.

Singapore is a base for goods distribution, exchange settlements and financing as well as a general buffer zone for the money markets of the ASEAN countries. On the other hand, the local money markets of the ASEAN countries are also beginning to show change.

The monetary authorities of Thailand and Malaysia are fostering the modernization of bank management and growth of medium and long-term money markets. It is interesting that the Japanese corporations which are raising funds in the local money markets for capital and working capital are the major impetus behind the advancement at local financial market, the so-called "local financial self-reliance (Japanese subsidiaries raising their own funds)."

The investment rush with foreign capital mainly from Japanese corporations is changing the money market of Thailand. The commercial banks of Thailand, which have had a strong policy for circulating capital for financing, are shifting their loans from commercial to manufacturing

Table 4 External debt/Liabilities, Manufacturer Credits/Total Credits

	External debt/Liabilities	Manufacturer Credits /Total Credits	Retail & Wholesale /Total Credits
1981 (Dec.)	9.3	22.6	22.8
1985 (Dec.)	6.4	23.1	23.1
1988 (Dec.)	5.4	25.8	18.9
1989 (June)	5.5	—	—

Source: Bank of Thailand, *Monthly Bulletin*, October 1989.

business loans while lowering the percentage of foreign debt which comprises the total debt. (Table 4.) The emphasis in financing through the rediscounting system (packing loans) for export promissory notes is moving form the four major agricultural goods to export.

On the other hand, there is a strong trend toward trying to develop a stock market involving both medium and long-term funds. The governments are actively moving towards the privatization of government run businesses with the intention of placing the stock on the stock market. In addition, venture-capital-type investments which such as the ASEAN Fund, Nomuras' Thai Fund and Japan ASEAN Investment Company (JAIC) were intended to be listed on the stock exchange are also observed. A group of Japanese companies are beginning to list stock. The trend in the future will be toward having the stock exchange be a criteria by the Board of Investment of Thailand.

At this moment the privatization and venture capital trends are considered part of the program to introduce funds from overseas required as local capital. However, coupled with this, the movement to change the lease funds to medium and long-term funds by reconsidering the tax and amortization systems will certainly have an impact on the growth of the medium and long-term markets. As a part of this process, the form of the commercial banks which prefer short-term loans must inevitably change.

The same kinds of changes can be seen in Malaysia as in Thailand. The growth of medium and long-term money markets, which followed the movement from a short-term fund supply market to a stock market, has become the new issue of "financial self-reliance."

(2) "Financial Self-Reliance" and Japan's Response.

Another movement in the ASEAN financial markets that should be given attention has a different characteristic ; "financial self-reliance" and the local control of foreign financial institutions. As it can be seen with the new Malaysian banking laws of 1989, government control is obvious through reconsideration of authorization and local control over foreign banks (in Indonesia, as well, commercial banks are authorized as joint ventures). On the other hand, the policy in Malaysia seems to partially or completely eliminates the barriers between commercial banks and non-commercial banks such as industrial banks, finance companies and merchant banks. In connection with the modernization and reorganization of the financial markets institutions, all are being opened up the extent that their operations is being extended. Further, there is a liberating aspect to this policy which allows the banks and stock to expand business in the form of joint ventures. The policy is trying to advance the internationalization of the money market.

The more the Japanese economy become borderless, the stronger the dependence of Japan on East Asian and ASEAN. It may seem paradoxical but if the Japanese economy tries to develop a completely mutual relationship with the economies of the ASEAN countries, the hope would be for the economies of the ASEAN countries to mature and be substantively independent. This includes the money markets.

In order for the ASEAN economies to develop, it is necessary to have a smooth development of the medium-and long-term markets including the stock stock market. It is expected that the Japanese corporations will put shares on the local stock market and make efforts toward development. In the long run, the fund raising base for Japanese companies will become more firm.

The financial institutions in Japan should strengthen the international financial ties between Japan, Singapore and ASEAN ; and it is also necessary to aggressively advance "financial self-reliance", including joint ventures. If the local money markets of the ASEAN countries mature, this will supply the industrialization process and the borderless trend (an organic structure of co-existence for both production and cnsumption) and the economies of the Asian region will continue to grow. In this borderless economy, the international responsibilities of the Japanese financial institutions will increase.

Along with the increased independence of the ASEAN money markets and their maturation, these countries will have a better chance for internationalization. With the maturation process of the local money markets, the ASEAN countries will probably internationalize their money markets domestically. In this way the internationalization of the money markets is appropriate to the Asianization of the economies and an age of Asian co-existence.