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AGENCY FOR INTERNATIONAL DEVELOPMENT

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PROJECT PAPER
ANNEXES

PHILIPPINES: Financial Resources
Mobilization (492-0377)

September 11, 1987

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ANNEX L1

PRIVATIZATION PLAN

A. The Problem

The movement of the Philippines from a generally private sector oriented economy towards a mixed economy with a growing and inefficient public corporate sector gained impetus as long as fifteen years ago. During the 1970s neither the donors nor the international financial community gave due attention to the trend towards ever greater public sector domination of industry and large scale service sector businesses such as airlines and banking. However, the subsequent emergence of "crony-capitalism"--private monopolies leveraged with public funds--caught the attention and interest of the world financial community and signalled how much structural change had taken place in the business sector of the Philippines. As the complex architecture of crony capitalism was gradually revealed during the waning years of the Marcos administration, the full extent of the government's ownership and involvement in industry and business became increasingly clear.

The government owned the only airline, banks, steel mills, cement corporations, mining corporations, shipping lines, oil corporations, refineries, urban bus companies and trucking firms. On top of this mass of chartered public business, the government's domination of financial and capital markets, and the liberal use of sovereign guarantees to shore up private credits, had given the Philippine government enormous exposure to the nominally private businesses operated by the cronies. When the weaknesses in the financial structure of the Philippines were dramatically exposed during the crisis of confidence which followed the assassination of Benigno Aquino in 1983, the reality of this massive government exposure to private firms became clear. Over the next three years an increasing number of crony and other firms failed to meet their debt obligations. Many owners walked away from their companies with little regret--having made their profits in the mobilization and procurement phases of projects, leveraged with public funds. others skillfully stripped their assets undetected by the inexperienced, and often unconcerned, public sector bankers who held their paper.

As the defaults to the government banks cascaded, with single company defaults triggering the collapse of holding companies and corporate shells to which many of the government loans had been extended, the size of the public sector portfolio grew apace. Today, the public sector, chartered and acquired, eats a quarter of the national budget. President Aquino and her economic cabinet officers have given high priority to divestiture and privatization. This priority has been underscored by the donors. The IBRD has required divestiture and restructuring plans for public financial corporations and for non-financial (industrial and service) companies as a condition for program loans. USAID has tied food aid to privatization conditions in the agricultural and food processing area. These efforts have been relatively well-received by the economic technocrats of the GOP who share the donor's sense of urgency in staunching the budgetary bleeding into the public corporate accounts and in restoring leadership to the private sector in most industrial and corporate activity.

Before examining the specifics of privatization in the Philippines it is useful to consider the overall financial magnitudes of the issue. The GOP's budget deficit for 1986 was an estimated $1.4 billion, or around 4.7 percent of GNP, caused in large part by government expenditures in the form of subsidies, net lending and equity contributions to chartered public corporations, and debt servicing for the three largest government financial institutions. In 1986, GOP equity contributions and net lending to public enterprises amounted to 27.7 billion pesos, or 26 percent of total budgetary expenditures. Outlays to the government financial institutions absorbed 58 percent of this assistance. To reduce this burden and to reverse the statist policies of the previous administration, the present administration must divest itself of three classes of assets:

1. Chartered Public Corporations (Non-Financial) - The previous Administration pursued interventionist policies which led to the establishment of inefficient and heavily subsidized parastatals, most in direct competition with the private sector. The formation of public sector companies expanded rapidly in the 1970s and early 1980s, quadrupling from 65 in 1970 to 264 in 1986. A core of 14 very large chartered corporations constitute about half of total public corporation assets, and 74 smaller corporations and 174 wholly owned subsidiaries make up the remainder. These entities range from the Philippine National Oil Company (PNOC) and Philippine Airlines to a variety of corporate subsidiaries in transport, trade and manufacturing. In terms of gross value added (GVA), this sector grew faster than the economy between 1975 and 1984, growing by 24.6 percent per annum compared to 14.1 percent for Gross Domestic Product (GDP). However, the contribution of this sector to total employment has been very insignificant. In 1984, employment in public enterprises accounted for less than one percent of total employment.

2. Chartered Public Corporations (Financial) - Policies of the previous government perpetuated an over-reliance in the economy on bank borrowing to finance medium-to-long-term capital requirements. The volatility of the Philippine economy over the past five years caused many companies to default on their loans to the government financial institutions, which then acquired assets through the conversion of loans to equity. In most instances

the financial obligation to the banks exceeds the value of the assets. To avoid decapitalizing the government financial institutions the government has had to provide them with massive financial support from the budget. There is an urgent need for the government to relieve itself of this financial burden, and to eventually divest itself of financial institutions such as DBP, PNB, the Land Bank (LB), the Philippine Export and Foreign Loan Guarantee Corp. (PEFLGC), and numerous insurance and special purpose financial firms because of their drain on the budget.

Both DBP and PNB have undergone financial restructuring as part of the conditionality attached by the IBRD to its Economic Recovery Program Loan (see Section C.1). On an obligation basis, net lending to DBP is expected to decrease from 7.6 billion pesos ($371 M) in 1986 to a projected 5.7 billion pesos ($278 M) in 1987. Net lending and equity investments for PNB are projected to drop from 11.0 billion pesos ($537 M) in 1986 to 2.8 billion pesos ($137 M) in 1987.

3. <u>Acquired Assets</u> - Government financial institutions acquired hundreds of assets in the form of private companies that defaulted on their loans. The case for divesting these assets has been evident to the domestic and international financial community for many years. The previous IMF Stand-by Agreement with the GOP sought to force a measure of financial discipline on DBP and PNB. The key economic team members in the new Administration's cabinet know that privatization is imperative and have arrived at a mechanism to undertake this task, as discussed in paragraph B below.

B. GOP Approach to Privatization - After several ad hoc attempts to privatize individual entities, the Aquino administration issued Proclamations 50 and 50-A in December 1986, formally launching a program for the expeditious disposition and privatization of certain government corporations and/or assets thereof. Proclamation No. 50 created the Committee on Privatization (COP) and the Asset Privatization Trust (APT) and 50-A, issued shortly thereafter, refined the requirements of the original Proclamation (to the satisfaction of the IBRD). The COP is a Cabinet-level committee tasked with identifying for the President those non-performing assets and government corporations to be privatized, determining which assets will be transferred to the APT, establishing guidelines for privatization, and approving the sale and disposition of assets. The APT was created to serve as the disposal unit in the process, with five full-time trustees from the private sector. The APT will focus primarily on the acquired assets of PNB and DBP, and the government-owned corporations or parastatals. Operating guidelines for the APT have been finalized and issued. These guidelines address: the transfer of non-performing assets to the Trust; priorities for asset disposal; policies on conservation, rehabilitation, restructuring, mergers and other reorganizations; the choice of markets for disposition; valuation; sales methods; sale to previous owners; and operations and administration. The guidelines for the disposal of government corporations have not yet been issued.

C. Other Donor Plans

1. The World Bank (IBRD) - The IBRD has been a vital force in promoting privatization in the Philippines. It conditioned its $310 million economic recovery loan on reforms in the government financial institutions, including the establishment of a mechanism for the privatization of acquired assets and the restructuring of the DBP and PNB. In addition, the IBRD has developed a $150 million Public Corporate Sector Rationalization loan, to privatize selected non-financial government corporations and increase the operating efficiency of the remaining public corporations. The IBRD is requiring Philippine government agreement on the structure and implementation of the rationalization effort as a precondition to both the public corporate sector loan and the second tranche of the economic recovery loan. The GOP is now finalizing comprehensive guidelines on the privatization and disposition of 125 public sector corporations as it hopes to begin negotiating for the $150 million loan in April.

2. International Finance Corporation (IFC) has committed $12.5 million to the First Philippine Capital Fund for the purpose of converting part of the Philippines' foreign debt into equity investments. This "Fund" will likely be a contributor to the privatization process through the purchase of investment in the acquired and distressed assets of the GFIs. The IFC might also provide general technical assistance to the APT as required by the GOP. In the GOP execution of specific privatization deals, IFC may provide specialized technical assistance to potential buyers.

3. Asian Development Bank (ADB) - The ADB has no plans for significant near-term involvement in privatization, but is providing grant technical assistance for privatization-related studies. However, the ADB has made a $500,000 equity infusion to Planters Development Bank and is

negotiating opening a $10 million window for direct lending to private corporations without requiring a government guarantee.

D. The Mission Approach to Privatization - The Mission envisions its major contribution to the privatization process to be assisting the GOP develop its privatization strategy and implementation framework. The Mission's approach adheres to the principle that the process of privatization generally and divestiture specifically is a market process which must be implemented by private sector entities qualified to do so, i.e. private investment/merchant banks, accounting and consulting engineering firms, lawyers, etc. This approach sets us apart from the multilateral development banks (MDBs) who have indicated a willingness to provide financial and technical resources to review, classify and selectively rehabilitate assets before their disposal or leverage the sale itself.

E. Specific Actions - The initial thrust of the Mission's privatization plan has been to act as a catalyst to focus the GOP's policy makers on the need to divest the government of non-performing and public corporate assets in an expeditious but orderly manner. The Mission has identified short and long term targets of opportunity for assisting the privatization process in the Philippines, as presented below.

1. Short-Term

a. Accomplishments to Date

1) Studies - Initially, the Mission funded several studies on the public corporate sector in the Philippines which were used by the IBRD in its appraisals for the economic recovery and public corporate sector loans. Subsequently, the Mission used the PRE Bureau contract with the Center for Privatization for a key study performed by the First Boston Corporation. Entitled "Recommendations on the Privatization Program for the Republic of the

Philippines", this study provided significant input to the GOP's decision not to undertake a massive physical and financial rehabilitation of assets prior to their sale because costs incurred would probably not be recovered. The study furthermore stressed the importance of centralization, simplicity, flexibility and speed for the GOP to succeed in privatization.

2) Privatization Conference - An international conference called "Philippine Opportunities for Entrepreneurs and Investors (PHOENIX) focusing on the divestiture of government corporations was held in December, 1986. The Conference was hosted by the Presidential Commission on Government Reorganization (PCGR) and involved key GOP officials in a presentation of investment policies and opportunities. This conference represented the launching of the GOP's privatization program and the first in a series of marketing activities to generate interest in the assets being privatized by the GOP. The Mission deemed this an excellent opportunity for AID to be publicly associated with GOP privatization efforts and received the assistance of the PRE Bureau to financially support this conference. AA/PRE Neal Peden attended the conference and was featured as a speaker, and PRE recruited and financed several individuals skilled in asset evaluation techniques who led and participated in a panel discussion on this topic.

3) National Food Authority (NFA) - Since the Mission's development thrust is agriculture and rural development, special emphasis is being given by the Mission to the privatization of government agribusiness and agri-marketing firms such as the National Food Authority (NFA) and the commodity marketing firms such as the Philippine Cotton, Dairy and Tobacco Corporations. The former Minister of Agriculture formally requested advisory services to establish a framework for the divestiture of NFA. A review of the NFA non-grain business operations was made, their commercial viability

assessed, net worth and fair prices ranges were established and an action plan for divestment developed and recommended. The study's recommendations have been well received by the new Secretary of Agriculture.

b. Planned Advisory Services

The Secretary of Agriculture has requested that the Mission fund assessments similar to the NFA study for the Philippine Cotton (PCC) and Dairy (PDC) Corporations. The Mission plans to respond favorably to this request.

2. Long-Term

a. The Financial Resources Mobilization Project (492-0377)

The purpose of this planned FY 1987 project is to create the environment necessary to mobilize private term financial resources for investment in productive private enterprises. The Project's approach will be to: 1) assist the government to divest itself of state-owned corporations and acquired assets; 2) facilitate the creation of a privately owned mechanism to channel investment to firms slated for privatization or distressed private firms; and 3) improve the capacity of the capital markets to mobilize equity investment.

Specifically, with regard to privatization, the newly-created Asset Privatization Trust and other governmental disposal units will require assistance in evaluation, finance packaging, identification of foreign investors and marketing. The project will provide technical assistance in the form of investment banking, legal, accounting, marketing, and technical service for the following activities: a) evaluation; b) financial packaging; c) presentation of formal opinions on the "fairness" of the terms of the sale; d) preparation of prospectus; e) identification of potential direct and portfolio investors, particularly direct foreign investors for the larger entities to be privatized; f) assistance in negotiations with prospective investors; and g) issuing shares of state owned companies in the public securities exchanges.

In addition to the need for an effective government privatization unit, there is also the problem of finding purchasers for ailing businesses. Currently, there is no entity in the Philippines adequately equipped to "turn around" troubled businesses, and provide valuation, purchaser proposal preparation, and management services on behalf of investors. The Mission has received a proposal for such a "turn-around company", which could serve as a mechanism to channel investment into firms slated for privatization or distressed privately-held firms. It is expected that project funds will provide technical services and seed capital needed to establish such a company.

While privatization addresses the short-term problem of non-performing or inefficiently performing enterprises that consume an inordinate portion of the government budget, there is plainly need as well for a longer term solution which would create an environment in which the mobilization of private, term financial resources for investment into productive enterprises is encouraged. Effective capital markets would be an essential feature in such an environment. The project therefore will also provide technical assistance to develop recommendations for specific interventions to address the policy, legal, regulatory and organizational constraints to capital market development, and to develop action plans for their implementation.

b. The Accelerated Agricultural Production (AAP) Project

The Mission plans to assist the GOP to undertake privatization activities related to agriculture through the Market Development

Component of the AAP project, signed in August 1986. Follow-on privatization activities for NFA, PCC and PDC further to those described above may be financed, once the project's Conditions Precedent have been met. In addition, the Mission plans to furnish assistance in setting-up an asset disposal unit for the Department of Agriculture.

c. Venture Capital

In the area of venture capital, PRE has agreed to work with the Mission in identifying an appropriate USAID intervention. We realize that the U.S. approach to venture capital cannot be applied here at this time because of structural economic weaknesses, i.e. a weak capital market. Therefore, we will be identifying innovative approaches to venture capital development and usage that will probably be tied to a transfer of technology. We will also use our work on venture capital to strengthen the capital markets.

ANNEX L2

MALACAÑANG
Manila

PROCLAMATION NO. 50

PROCLAIMING AND LAUNCHING A PROGRAM FOR THE EXPEDITIOUS DISPOSITION AND PRIVATIZATION OF CERTAIN GOVERNMENT CORPORATIONS AND/OR THE ASSETS THEREOF, AND CREATING THE COMMITTEE ON PRIVATIZATION AND THE ASSET PRIVATIZATION TRUST

RECALLING that the reorganization of the government is mandated expressly in Article II, Section 1(a), and Article III of the Freedom Constitution;

HAVING IN MIND that, pursuant to Executive Order No. 5 (1986), there is a need to effect the necessary and proper changes in the organizational and functional structures of the government, its agencies and instrumentalities, in order to promote efficiency and effectiveness in the delivery of public services;

TAKING INTO ACCOUNT that the government considers imperative the formal launching of a program for the rationalization of the government corporate sector calculated to create and sustain a legal, socio-political and economic environment conducive to the cultivation of a high degree of dynamism and performance motivation among government-owned or controlled corporations under a regime of relative autonomy, flexibility, viability and continuing accountability to the people in their operations;

CONSIDERING that the government has decided to adopt, as the twin cornerstones of the program, the following parallel imperatives for the attainment of national policy:

(a) The judicious use of the corporate form of organization in the creation of government bodies for the production and distribution of economic goods and services to the public, and the need to rationalize and monitor the operations of government corporations to help bring about improved performance, assure more efficient use of resources and in general to re-orient their activities and priorities in a manner consistent with national objectives, to the end that the private sector is given primacy and the government assumes a supplemental role, in entrepreneurial endeavors under a climate of fair competition; and

(b) Reducing the number of government corporations which has proliferated to unmanageable proportions; circumscribing the areas of economic activities within which government corporations may operate; and aiming to achieve these goals through the privatization of a good number of government corporations, and the disposition and liquidation of the non-relevant and non-performing assets of retained corporations as the logical first step to their rehabilitation.

TAKING NOTE that there has already been created, in pursuit of the first imperative, an inter-ministerial body called the Government Corporate Monitoring Committee under Executive Order No. 936 issued on February 29, 1984, and reconstituted into the Government Corporate Monitoring and Coordinating Committee under Memorandum Circular No. 10 dated May 19, 1986;

REALIZING that it is now necessary to constitute the inter-ministerial body to pursue the second imperative, the latter to function as the counterpart of the above-mentioned Government Corporate Monitoring and Coordinating Committee in the implementation of the remedial aspect of the program for the rationalization of the government corporate sector under the integrative control and direction of the President of the Philippines;

CONVINCED that it is necessary, expedient and advantageous to centralize the disposition and privatization process in a public trust entity which shall on its own and, where necessary, by engaging the services of qualified professionals, institutions, syndicates, and consortia of institutions in the private sector, whether domestic or foreign undertake the dispositive aspect of the program for the Rationalization of the Public Corporate Sector;

COGNIZANT that the transfer and prompt disposition of the large non-performing assets of certain government financial institutions are central to the rehabilitation of these institutions and the economic recovery program, and that in the execution of this task it is essential to devolve such responsibility upon a specialized entity external to the government financial institutions themselves so that the latter will not be distracted and their energies diverted from the vital concerns of inherent and substantive financial operations;

NOW, THEREFORE, I, CORAZON C. AQUINO, President of the Philippines, do hereby order:

ARTICLE I. STATEMENT OF POLICY AND DEFINITION OF TERMS

SECTION 1. Statement of Policy. It shall be the policy of the State to promote privatization through an orderly, coordinated and efficient program for the prompt disposition of the large number of non-performing assets of the government financial institutions, and certain government-owned or controlled corporations which have been found unnecessary or inappropriate for the government sector to maintain.

SEC. 2. Definition of Terms. As used in this Proclamation and unless the context otherwise requires, the term:

(1) Assets shall include (i) receivables and other obligations due to government institutions under credit, lease, indemnity and other agreements together with all collateral security and other rights (including but not limited to rights in relation to shares of stock in corporations such as voting rights as well as rights to appoint directors of corporations or otherwise engage in the management thereof) granted to such institutions by contract or operation of law to secure or enforce the right of payment of such obligations; (ii) real and personal property of any kind owned or held by government institutions, including shares of stock in corporations, obtained by such government institutions, whether directly or indirectly, through foreclosure or other means, in settlement of such obligations; (iii) shares of stock and other investments held by government institutions; and (iv) the government institutions themselves, whether as parent or subsidiary corporations.

(2) Government Institutions shall refer to government-owned or controlled corporations, financial or otherwise, whether organized by special charter as in the case of a parent corporation, or under general law as in the case of a subsidiary corporation.

(3) Committee shall refer to the Committee on Privatization constituted under this Proclamation.

(4) Asset disposition entity shall refer to any government agency, including government banks, specifically designated or contracted by the Committee to perform the disposition of assets.

(5) President shall mean the President of the Republic of the Philippines.

(6) Trust shall mean the Asset Privatization Trust created under Sec. 9 herein.

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ARTICLE II. COMMITTEE ON PRIVATIZATION

SEC. 3. Committee on Privatization. There is hereby constituted a Committee on Privatization to be composed of the Minister of Finance as Chairman, with the Minister of Trade and Industry, the Director General of the National Economic and Development Authority, the Minister of Budget and Management, and the Minister in charge of the Presidential Commission on Government Reorganization, as members. Whenever any member of the Committee is unable to attend a particular meeting, he may designate any of his immediate subordinates with the rank of Deputy Minister or its equivalent to attend in his stead.

The Committee shall exist for a term of five years counted from the effectivity date of this Proclamation unless sooner terminated or superseded by another body by the President.

SEC. 4. Responsibilities and Objectives. It shall be the duty and responsibility of the Committee to use the powers granted to it under this Proclamation to achieve the objectives of (a) divesting to the private sector in the soonest possible time through the appropriate disposition entities, those assets with viable and productive potential as going concerns, taking into account where appropriate the implications of such transfers on sectoral productive capacities and market limitations, and (b) disposing of such other assets as may be transferred to it, generating the maximum cash recovery for the National Government in the process. These objectives are to be pursued within the context of furthering the national economic recovery through a strengthened and revitalized private enterprise system.

SEC. 5. Powers and functions. The Committee shall have the following powers and functions:

(1) To identify to the President of the Philippines, and arrange for transfer to the National Government and/or to the Trust and the subsequent divestment to the private sector of (a) such non-performing assets as may be identified by the Committee, and approved by the President, for transfer from the government banks for disposal by the Trust or the government banks, and (b) such government corporations, whether parent or subsidiary, and/or such of their asets, as may have been recommended by the Committee for disposition, and approved by the President; Provided, that no such identification, recommendation or approval shall be necessary where a parent corporation decides on its own to divest of, in whole or in part, or liquidate a subsidiary corporation organized under the Corporation Code; Provided, further, that any such independent disposition shall be undertaken with the prior approval of the Committee and in accordance with the general disposition guidelines as the Committee may provide; Provided, finally, that in every case the sale or disposition shall be approved by the Committee with respect to the buyer and price only;

(2) To determine which of such assets shall be transferred to the Trust or referred to other government institutions, whether financial or otherwise, for disposition and, pending disposition, for conservation and management;

(3) To establish mandatory as well as indicative guidelines for the conservation, rehabilitation and disposition of such assets, whether by the Trust or any other government institution;

(4) To approve or disapprove, on behalf of the National Government and without need of any further approval or other action from any other government institution or agency, the sale or disposition of such assets, in each case on terms and to purchasers recommended by the Trust or the government institution, as the case may be, to whom the disposition of such assets may have been delegated; Provided that, the Committee shall not itself undertake the marketing of any such assets, or participate in the negotiation of their sale;

(5) In its discretion, to approve or disapprove, subject to the availability of funds for such purpose, the rehabilitation of assets pending disposition by the Trust or any other government agency authorized by the Committee, or the Trust with the approval of the Committee; Provided that, the budget for each rehabilitation project shall be likewise subject to prior approval by the Committee;

(6) To exercise on behalf of the National Government rights of ownership with respect to such assets, including the right to vote, whether directly or through duly authorized nominees, shares of stock held in the name of the National Government, and which have not been transferred to the Trust;

(7) To issue necessary guidelines to all government agencies to govern ongoing negotiations on the disposal of government corporate assets;

(8) To approve the organization and financial requirements of the Trust, including its annual budgets for operations, conservation, and the administration of assets entrusted under its care;

(9) To monitor and review as necessary from time to time the entire privatization and divestment program, including those which are being undertaken by parent government corporations, and the status of its implementation; and

(10) To appoint, transfer, remove, and fix the remuneration of personnel of the Committee; providing that the Committee shall hire its own personnel only if deemed absolutely necessary for the discharge of its responsibilities and, as far as practicable, it shall avail itself of the services of the personnel seconded or detailed from other government offices.

SEC. 6. Meetings. The Committee shall meet as frequently as is necessary to discharge its responsibilities, Provided, that it shall meet at least once every month. The presence of a majority of the members of the Committee shall constitute a quorum, and the concurrence of a majority of the members present at a meeting at which a quorum exists shall be adequate for any decision by the Committee; Provided that, where the matter involves the approval of any disposition or rehabilitation proposal, the unanimity of the entire Committee shall be necessary.

The Committee shall act on any recommendation for disposition submitted to it not later than thirty (30) days from date of receipt thereof, failing which such recommendation shall be deemed approved.

SEC. 7. Funding. The amount of Ten Million Pesos to cover expenses of the Committee in connection with the discharge of its responsibilities under this Proclamation, is hereby authorized, said amount to be charged against the One Hundred Million Pesos (P100,000,000) appropriation intended for the capitalization for the Asset Disposition Trust under Presidential Decree No. 2030.

SEC. 8. Legal Counsel. The Minister of Justice shall be the ex oficio legal adviser to the Committee.

ARTICLE III. ASSET PRIVATIZATION TRUST

SEC. 9. Creation. There is hereby created a public trust to be known as the Asset Privatization Trust, hereinafter referred to as the Trust, which shall, for the benefit of the National Government, take title to and possession of, conserve, provisionally manage and dispose of assets as defined in Section 2 herein which have been identified for privatization or disposition and transferred to the Trust for the purpose, pursuant to Section 23 of this Proclamation. .

SEC. 10. Purposes and Objectives, Domicile, Term of Existence. The principal purpose of the Trust shall be to affect or cause to be effected, directly or through other external agencies, the disposition within the shortest possible period of assets transferred to the Trust for the purpose.

The Trust in its divestment program should seek in the soonest time possible, to restore existing physical facilities involved into viable and productive operations under private sector management and ownership, and thus to contribute towards national economic recovery within the context of a private enterprise system. Within the context of this major purpose, the Trust is expected to generate maximum cash recovery for the National Government.

The Trust shall have its principal place of business in Metropolitan Manila.

The Trust shall exist for a period of five years from the date of this Proclamation, and all assets held by it, all moneys and other property belonging to it, and all its liabilities outstanding upon the expiration of such period shall revert to and be assumed by the National Government.

SEC. 11. *Sourcing and Application of Funds by the Trust.* The capital and working funds of the Trust shall consist of:

(1) The amount of Ninety Million Pesos (P90,000,000) chargeable against the One Hundred Million Pesos (P100,000,000) appropriation intended for the Asset Disposition Trust under Presidential Decree No. 2030, which shall be used for capital acquisitions approved by the Committee, and to cover administrative expenses, including those for the hiring of appraisers, as may be necessary for its effective and efficient operations; as well as to advance for expenses of securing, conserving, and maintaining assets, and where necessary, operating the asset prior to its disposal;

(2) Amounts authorized under Section 34 of this Proclamation to be excised from the proceeds of disposition and retained by the Trust, as agreed upon with the Committee;

(3) Subsequent annual appropriations under the General Appropriations Act, as well as funds which may be authorized by the President in accordance with law from unused or available balances in the General Appropriations Act;

(4) External funding assistance, whether in the form of loans, grants or otherwise; which the Trust with the approval of the Committee may source or obtain from appropriate institutions, domestic or foreign, bilateral or multilateral, government or private, such as the International Bank for Reconstruction and Development, Asian Development Bank, United Nations Development Program, and commercial banks and investment houses; and

(5) Where necessary and subject to the prior approval of the Committee, service fees levied on the trusteed assets in such amounts as may be appropriate and reasonable.

SEC. 12. *Powers.* The Trust shall, in the discharge of its responsibilities, have the following powers:

(1) To formulate and, after approval by the Committee, implement a program for the disposition of assets transferred to it under this Proclamation, such program to be completed within a period of five years from the date of the issuance of this Proclamation;

(2) Subject to its having received the prior written approval of the Committee to sell such asset at a price and on terms of payment and to a party disclosed to the Committee, to sell each asset referred to it by the Committee to such party and on such terms as in its discretion are in the best interest of the National Government, and for such purpose to execute and deliver, on behalf and in the name of the National Government, such deeds of sale, contracts and other instruments as may be necessary or appropriate to convey title to such assets;

(3) To take title to and possession of and to take such steps as may be necessary to conserve assets transferred to it by the Committee, including, without limitation, to oversee the management and operation of corporations or other businesses constituting such assets, and to file suits and institute proceedings on behalf of and in the name of National Government for the recovery and protection of such assets;

(4) Subject to the prior approval of the Committee, to undertake the rehabilitation of such assets in instances where such rehabilitation is necessary to conserve the value of such assets or permit their sale.

(5) To engage such external expertise as may be necessary for it to fulfill its task;

(6) To lease or own real and personal property to the extent required or entailed by its functions; to borrow money and incur such liabilities as may be reasonably necessary to permit it to carry out the responsibilities imposed upon it under this Proclamation; to receive and collect interest, rent and other income from the corporations and assets held by it and to exercise in behalf of the National Government and to the extent authorized by the Committee, in respect of such corporations and assets, all rights, powers and privileges of ownership including the ability to compromise and release claims or settle liabilities, and otherwise to do and perform any and all acts that may be necessary or proper to carry out the purposes of this Proclamation: Provided, however, that any borrowing by the Trust shall be subject to the prior approval by the majority vote of the members of the Committee;

(7) To adopt its internal rules and regulations, to adopt, alter and use a seal which shall be judicially noticed; to enter into contracts; to sue and be sued; and

(8) To submit periodic reports to the Committee on the status of the disposition program under its responsibility, and such other reports as may be required by the Committee.

SEC. 13. *Essentiality of Trust Functions.* The rationalization of the government corporate sector is deemed to be a critical concern of government; and the Trust in undertaking the tasks of divestment and privatization must give due and pragmatic regard to the preferences and motivations of the market for investible private capital both in the Philippines and overseas, act with dispatch on all problems and opportunities which may come before it to the end that the objectives of the Trust are completed within the five-year period mandated in Section 10 hereof. Accordingly, the Trust shall be and is hereby accorded the widest latitude of flexibility and autonomy in its operations, particularly in the areas of accounting, auditing, procurement, contracting, asset management and disposition, and personnel, subject however to the provisions of this Proclamation.

SEC. 14. *Trustees.* The powers and functions of the Trust shall be exercised collegially by a group of Trustees which shall be composed of a Chief Executive Trustee and four other Associate Executive Trustees;

All of the Trustees shall be appointed by the President, upon recommendation of the Committee. The Trustees shall serve on a full-time basis for a term of up to five years, but in no case longer than the term of existence of the Trust, or unless sooner relieved by the President.

SEC. 15. *Qualifications.* No person shall be appointed a Trustee unless he is of good moral character, of unquestionable integrity and responsibility and of recognized business competence. No director, officer, consultant or stockholder of corporations constituting or having an interest in assets held by the Trust may be appointed Trustee. Except as may be considered necessary to achieve the objectives of this Proclamation, the Chief Executive Trustee and the Associate Executive Trustees shall not sit on the board of directors or otherwise participate in the direct management of corporations constituting assets transferred to the Trust.

SEC. 16. *Removal.* The President of the Philippines may remove any Trustee for acts that are fraudulent, unlawful or manifestly opposed to the purpose of this Proclamation or if the member ceases to be qualified to become a Trustee under Section 14 of this Proclamation.

SEC. 17. *Vacancies.* Any vacancy created by the death, resignation or removal of any Trustee shall be filled by the appointment by the President of the Philippines of a new member, who shall serve for the unexpired portion of the term of the previous member.

SEC. 18. *Meetings, Quorum.* The Trustees shall meet as frequently as is necessary to discharge its responsibilities, but shall meet at least every two weeks. The presence of a majority of the Trustees shall constitute a quorum, and the concurrence of a majority of the Trustees present at a meeting at which a quorum exists shall be adequate for any decision by the Trust; Provided that, where the matter involves a proposal for disposition or rehabilitation of any asset, the unanimity of all the Trustees shall be necessary.

SEC. 19. *Compensation.* The basic compensation and other emoluments of the Chief Executive Trustee and his other benefits shall be negotiated between himself and the Committee. The emoluments of the Associate Executive Trustee shall be fixed by the Chief Executive Trustee with the approval of the Committee. In both instances, it shall have the approval of the President.

In view of the limited life of the Trust and the nature of its functions, the pay scales of the Trustees and other officers and employees of the Trust shall be exempt from the standardized salary scale and position classification prescribed by the Office of Compensation and Position Classification and the eligibility and other requirements of the Civil Service Commission.

All directors' fees and other income accruing to a Trustee, officer, or employee of the Trust, resulting from his membership on the board of any of the corporations under the administration or control of the

Trust shall accrue to the Trust, without prejudice to the Trust providing supplemental remuneration to other than Trustees for such additional responsibilities entailed by such membership.

SEC. 20. *Exercise of Authority.* In the exercise of the authority granted to it under this Proclamation, the Trustees shall:

(1) Issue such internal rules and regulations as the Trustees may deem necessary or convenient for the proper discharge of the functions of the Trust;

(2) Enter into management and such other contracts as may be appropriate; and

(3) Develop its own staffing requirements, and for this purpose, appoint, remove and fix the renumeration of personnel of the Trust; provided that as far as practicable it should rely largely on secondment from government entities undertaking related functions, and on qualified external expertise in an advisory capacity and on a contractual basis.

SEC. 21. *Legal Counsel.* The Minister of Justice shall be the ex-oficio legal adviser to the Trust.

ARTICLE IV. OPERATIONAL PROVISIONS

SEC. 22. *Transfer of Assets.* The Committee shall:

(1) Arrange for the transfer to, and eventual disposition by, the National Government of certain non-performing assets of government financial institutions, as may be determined under terms mutually acceptable to all the parties concerned, and

(2) Arrange for the disposition of certain government-owned or controlled corporations which have been approved for divestment by the President of the Philippines; Provided, that the matter of appropriate valuation procedures for such transfers of assets shall be determined by the Committee.

The terms of transfer of assets may include appropriate arrangements for the consideration thereof, including but not limited to the assumption by the National Government of such liabilities of the government financial institutions and/or other government corporations, whether real or contingent.

The National Government, through the President, is hereby authorized to assume the obligations of government institutions including those due to the National Government on terms and to the extent determined by the President, on the recommendation of the Minister of Finance, to be warranted by the transfer of assets from such institutions pursuant to this Proclamation.

The President is likewise authorized, in the implementation of the program of privatization of certain government corporations created under special law, whether parent or subsidiary, to amend the corporate charters thereof so as to terminate their corporate existence; Provided, that such specially chartered corporations shall be specifically identified and approved for divestment, dissolution, consolidation, merger or regularization into a regular line agency within six months from date of issuance of this Proclamation, and Provided, further, that this authority to terminate the corporate existence of such corporations created under special law shall be exercised within five years from date of this Proclamation and in no case beyond the lifetime of the Committee or the Trust.

SEC. 23. *Mechanics of Transfer of Assets.* As soon as practicable, but not later than six months from the date of the issuance of this Proclamation, the President, acting through the Committee on Privatization, shall identify such assets of government institutions as appropriate for privatization and divestment in an appropriate instrument describing such assets or identifying the loan or other transactions giving rise to the receivables, obligations and other property constituting assets to be transferred.

The Committee shall, from the list of assets deemed appropriate for divestment, identify assets to be transferred to the Trust or to be referred to the government institutions in an appropriate instrument, which upon execution by the Committee shall constitute as the operative act of transfer or referral of the assets described therein, and the Trust or the government institution may thereupon proceed with the divestment in accordance with the provisions of this Proclamation and the guidelines issued by the Committee.

Nothing in this Proclamation shall:

(1) Affect the right of the National Government to pursue the enforcement of any claim of a government institutions in respect of or in relation to any asset transferred hereunder;

(2) In relation to any debt hereby assigned and transferred to the National Government of which a government institution is the *original creditor*, give rise to any novation or requirement to obtain the consent of the debtor; and

(3) *In relation to any share of stock* or any interest therein, give rise to any claim by any other stockholder for enforcement of rights of pre-emption or of first refusal or other similar rights, the provision of any law to the contrary notwithstanding.

Where the contractual rights of creditors of any of the government institutions involved may be affected by the exercise of the Committee or the Trust of the powers granted herein, the Committee or the Trust shall see to it that such rights are not impaired.

SEC. 24. *Deeds of Assignment.* Each government institution from which assets are to be transferred pursuant to this Proclamation shall and is hereby directed to execute, promptly and in no event later than thirty days after the issuance by the President of the relevant instrument referred to in Section 23 hereof, a deed of assignment in favor of the National Government, which shall, in annexes thereto, describe, account by account, the nature and extent of such assets and to deliver to the Committee such agreements, instruments, records and other papers in respect of such assets as may be deemed by the Committee to be reasonably necessary or appropriate. Each such deed of assignment shall constitute the Minister of Finance in representation of the National Government as attorney-in-fact of the government institution empowered to take such action and do such things as may be necessary or desirable to consolidate and perfect the title of the National Government to such assets, exercising for the purpose, any and all such rights and privileges, appertaining to the transferor-government institution, pursuant to the provisions of applicable law or contract.

A copy of such deed of assignment, together with excerpts from its annexes describing particular property to be transferred, duly certified to be true by the appropriate official before a notary public or other official authorized by law to administer ~~oaths~~, shall provide sufficient basis to registers of deeds, transfer agents of corporations and other persons authorized to issue certificates of titles, shares of stock and other evidence of title to issue new certificates, shares of stock or other instruments evidencing title to the assets so described to and in the name of the National Government or its duly authorized agent.

The transfer of any asset of government institutions directly to the national government as mandated herein shall be for the purpose of disposition, liquidation and/or privatization only, any import in the covering deed of assignment to the contrary notwithstanding. Such transfer, therefore, shall not operate to revert such assets automatically to the general fund or the national patrimony, and shall not require specific enabling legislation to authorize their subsequent disposition, but shall remain as duly appropriated public properties earmarked for assignment, transfer or conveyance under the signature of the Minister of Finance or his duly authorized representative, who is hereby authorized for this purpose, to any disposition entity approved by the Committee pursuant to the provisions of this Proclamation.

SEC. 25. *Reorganization of Trusteed Corporations.* In order to align the organizational and manning structures of parent government-owned or controlled corporations as well as corporations established through the Corporation Code which are transferred to the Trust, with the centralization of the exercise by the government of its ownership role over such corporations through the Trust, this Proclamation proclaim and mandates that:

(1) As of the effective transfer of title over such corporations to the Trust, non-stock parent government-owned or controlled corporations transferred to the Trust may, if affirmed by the Committee, be converted into stock corporations and their various charters are hereby expressly amended for this purpose: each such corporations to have their respective networths, after due adjustment pursuant to Section 13 hereof, divided into common shares of stock at par values as determined by the Trust;

(2) Except as may be otherwise determined by the Trust, the number and composition of the different boards of directors, or trustees of trusteed corporation shall be fixed at five (5), the provisions of their respective charters or articles of incorporations to the contrary notwithstanding; Provided, that this subsection shall not apply to government corporations with minority private shareholders; and Provided, further, that the board membership seats and officership positions, as well as the incumbents thereof, may continue until such time as the Trust shall have decided on each of the trusteed corporations.

(3) The chairman and members of the board of directors or Trustees and the presidents or chief executive officers of the trusteed corporations shall be appointed: (a) in the case of parent corporations, by the Committee; and (b) in the case of subsidiary or affiliate corporations, by the Trust. In both instances, it shall have the approval of the President.

(4) The Trust may require any one or more of the trusted corporations to adopt and implement cost-reduction measures to enhance the viability, and therefore the disposability of such corporations, to potential buyers; and such measures may include personnel retrenchment plans;

(5) The Trust may direct any one or all of its trusteed corporations to submit to it within realistically fixed time-tables, such reports and other information as the Trust may require in the exercise of its ownership and dispositive roles over such corporations; and

(6) The Trust may cause trusteed corporations organized through the Corporation Code to undergo reorganizations, mergers, consolidations, spin-offs and other corporate acts of similar nature as the Trust may deem necessary or desirable to hasten disposition or privatization, provided that such major corporate acts shall conform with the provisions of the Corporation Code where applicable, and shall in any case have the prior approval of the Committee.

SEC. 26. Committee to Determine Transfer Value. The Committee is hereby vested with full and complete powers and prerogatives to determine the values, other terms and conditions, at which government corporate assets and liabilities shall be transferred and conveyed to the Trust pursuant to the mandate of this Proclamation: Provided, that, any valuation approved by the Committee for purposes of the transfer to the Trust shall not be deemed as a condonation of any obligation by any third party involved.

SEC. 27. Automatic Termination of Employer-Employee Relations. Upon the sale or other disposition of the ownership and/or controlling interest of the government in a corporation held by the Trust, or all or substantially all of the assets of such corporation, the employer-employee relations between the government and the officers and other personnel of such corporations shall terminate by operation of law. None of such officers or employees shall retain any vested right to future employment in the privatized or disposed corporation, and the new owners or controlling interest holders thereof shall have full and absolute discretion to retain or dismiss said officers and employees and to hire the replacement or replacements of any one or all of them as the pleasure and confidence of such owners or controlling interest holders may dictate.

Nothing in this section shall, however, be construed to deprive said officers and employees of their vested entitlements in accrued or due compensation and other benefits incident to their employment or attaching to termination under applicable employment contracts, collective bargaining agreements, and applicable legislation.

SEC. 28. Trust Succession to Powers and Functions of Attaching Ministries. The powers and functions of the relevant ministries over corporations respectively attached to them under the Integrated Reorganization Plan insofar as these powers and functions pertain to corporations transferred to the Trust, shall devolve upon and shall be exercised by the Trust over such transferred corporations. The unexpended balance of appropriations if any, earmarked for the support of the operations of the transferred corporations remaining in the control of the aforesaid ministries, shall also be transferred to the Trust to form part of its Operating Funds as specified in Section 11 of this Proclamation. From the date of the transfer of a government corporation to the Trust, all the requests for budgetary outlays from the General Fund by such corporation shall be subject to the prior approval by the Trust.

SEC. 29. Interim Responsibility for Transferred Assets. During the period prior to receipt by a government institution of notice from the National Government through the Committee that arrangements for the management of assets transferred from such government institution under this Proclamation have become effective, such government institutions shall be responsible for administering such assets for and on behalf of the National Government under such terms and conditions as may be agreed upon by the National Government and the government institution.

SEC. 30. Incontestability. The determination by and decision of the Committee that the terms on which an asset is to be sold or otherwise disposed of are consistent with the objectives in this Proclamation and in the best interest of the National Government shall be conclusive. The validity of any sale or disposition concluded by the National Government acting through the Trust its authorized agent or entity under this Proclamation shall, except for fraud, breach or material misrepresentation on the part of the purchaser, be incontestable and be binding and enforceable against the National Government and all third parties.

SEC. 31. Immunity and Indemnity Provision for Committee Members and Trustees.

(1) No civil action shall lie against the Committee and/or the Trust and no civil or criminal action shall prosper against a member of the Committee or a Trustee in its or his discharge of the tasks and functions contemplated by this Proclamation, unless: (a) the act or omission complained of clearly relates to a mandatory provision of this Proclamation the performance of which is expressly devolved or delegated to the concerned defendant as a ministerial duty rather than a discretionary or judgmental function, and (b) the act or omission is attended by fraud, bad faith; gross negligence; or violations of the provisions of the Anti-Graft Law;

(2) In the event that any member of the Committee, or a Trustee, or any member of their respective staffs during or after his incumbency, is called upon to defend his actions, related to the performance or non-performance of an act, or the execution of a transaction contemplated by this Proclamation, before any administrative, judicial or legislative proceeding, the government shall provide him with counsel without cost, or shoulder and pay the cost of a counsel of his choice, as well as other costs of litigation for which he may be held liable: Provided, that where the civil or criminal action is based on (a) and (b) of the preceding paragraph, and the member of the Committee or Trustee or of their respective staffs is found guilty of the acts complained of, such member shall be fully liable to and reimburse the Government for all sums advanced by the Government in accordance with the provisions of this Section to cover cost of counsel and other costs of litigation.

SEC. 32. Receiverships. Without prejudice to any other remedy or course of action available to the Trust, the Securities and Exchange Commission shall, in addition to the jurisdiction and powers conferred on it by Presidential Decree No. 902-A, upon petition filed ex-parte by the Trust, appoint a receiver nominated by the Trust to take over the management and custody of the properties of a corporation referred to the Trust or whose obligations have been referred to the Trust under this Proclamation, or which holds assets subject to liens in favor of the Trust, in cases where such equity, obligations or liens have been referred by the Trust to external agencies for conservation and disposition and there is imminent danger of dissipation, loss, wastage, or destruction of assets or other properties or paralization of the business operations of such corporations which may be prejudicial to the interest of its stockholders, creditors, the general public or the National Government or where the appointment of a receiver has been stipulated by the parties to be a real or chattel mortgage or other agreement as an aid to foreclosure thereof. Such receiver shall have all powers of a regular receiver under the provisions of the Rules of Court and of a management board or body under Section 6 (d) of Presidential Decree No. 902-A.

SEC. 33. *Proceeds from Sales of Assets.* All proceeds from the sale or other disposition of assets net of fees, commissions and other reimbursable expenses of the Trust shall form part of the General Fund of the National Government and be remitted to the National Treasury immediately upon receipt of such proceeds: *Provided, however,* that the Trust shall be entitled to retain, upon approval by the Committee, such portion of the proceeds as may be necessary to maintain a revolving fund to be utilized for the payment of fees and reimbursable expenses and meeting the costs and expenses incurred by the Trust in the conservation and disposition of the assets held by it, or otherwise in the performance of its responsibilities under this Proclamation, including such amounts as may be required to service borrowings incurred by the Trust pursuant to the authority and for the purposes provided in this Proclamation.

In respect of the proceeds from the sale or other disposition of corporate subsidiaries of parent government corporations, such proceeds shall accrue to the parent corporation. The proceeds shall be net of fees, commissions and other reimbursable expenses of the Trust as approved by the Committee, where the disposition was undertaken by or through the Trust.

SEC. 34. *Exemption from Taxes, Fees, and Other Charges.* The provisions of any law to the contrary notwithstanding, the Trust as well as the corporations and assets held by it, shall be exempt from all taxes, fees, charges, imposts, and assessments arising from or occasioned by the passing of title over such corporations or assets from the government institutions to the Trust and/or from the Trust to a private acquisitor or buyer imposed by the National Government or any subdivision thereof including but not limited to stock transfer taxes, capital gains taxes, documentary stamps, registration fees and the like: *Provided,* that in case the said government institutions acquired the said assets by foreclosure, the non-payment of similar taxes, fees, charges, imposts, and assessments shall not be a bar to the consolidation of title in the foreclosing institutions and the subsequent passing of title to the Trust or the corporations held by the Trust.

The sale or transfer of such corporations or assets shall not be enjoined or hindered by the existence of any liens by way of taxes, charges or other assessments in favor of the government at the time of sale or transfer: *Provided,* that the proceeds from such sale or transfer shall be subject to a tax lien and first be applied to satisfy such obligations secured by said liens.

SEC. 35. *Audit.* Generally accepted accounting principles shall be observed in the recording of the transactions of the Committee and the Trust, of the corporations trusted to the National Government or to the Trust, or of transactions related to assets similarly trusteed. For the purpose of insuring the regularity and integrity of financial transactions of aforementioned entities, and of transactions related to the assets with which they officially deal, and to facilitate the disposition of assets to private entities, such entities and assets may be audited as follows:

(1) The Committee and the Trust shall be subject to audit by the Commission on Audit; *Provided, however,* that consonant with the flexibility criterion mandated on its operations under the provisions of Section 13 of this Proclamation, the Trust at its discretion and option may utilize the [illegible]s of reputable private auditors if authorized by the Commission on Audit.

(2) The non-performing assets of government financial institutions trusteed to the National Government directly or through the Trust for disposition or privatization may continue to be subject to audit by private auditors; and

(3) Government-owned or controlled corporations approved for disposition and transferred to the National Government directly or through the Trust shall continue to be audited by the Commission on Audit for as long as they have not yet been disposed of; and, if considered necessary by the Trust for facilitating the divestment thereof to prospective private sector buyers, may also be audited by private auditors.

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SEC. 36. Such sum or sums as may be necessary for the transfer of assets and liabilities, including liabilities of government financial institutions due the National Government, to the National Government as well as servicing thereof are hereby appropriated subject to the availability of funds in the National Treasury.

SEC. 37. *Reporting Requirements.* The Committee shall at least on a semi-annual basis submit to the President of the Philippines and to the legislative body a report on the status of its asset disposition program, which report shall include a description of the individual assets disposed of, the purchasers thereof, the consideration received therefor and the agreed terms of payment.

The Trust shall report on a quarterly basis its performance and financial condition to the Committee; and within three (3) months from the closure of books at the end of each fiscal year, submit a comprehensive annual report through the Committee, to the President and to the legislative body on the status of the privatization efforts and its asset disposition program, which report shall include a description of the individual corporations privatized and assets disposed of, the purchasers thereof, the consideration received therefor and the agreed terms of payment.

ARTICLE V. MISCELLANEOUS PROVISIONS

SEC. 38. *Separability Clause.* Any portion or provision of this Proclamation may be declared unconstitutional shall not have the effect of nullifying the other provisions thereof: provided, however, that such remaining portions can still stand and be given effect in their entirety to accomplish the objectives of this Proclamation.

SEC. 39. *Repealing Clause.* This Proclamation supersedes Presidential Decrees Nos. 2012 and 2030. All laws and decrees and all other executive orders, rules and regulations, or parts thereof, inconsistent with any of the provisions of this Proclamation are hereby repealed or modified accordingly.

SEC. 40. *Effectivity.* This Proclamation shall take effect immediately.

Manila, December 8, 1986.

Corazon C. Aquino

CORAZON C. AQUINO
President of the Philippines

By the President:

JOKER P. ARROYO
Executive Secretary

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MALACAÑANG
MANILA

BY THE PRESIDENT OF THE PHILIPPINES

PROCLAMATION NO. 50-A

MODIFYING PROCLAMATION NO. 50

The following sections in Proclamation No. 50 are hereby modified to read as follows:

Section 18 shall hereafter read as follows:

"SEC. 18. Meetings, Quorum. The Trustees shall meet as frequently as is necessary to discharge its responsibilities, but shall meet at least every two weeks. The presence of a majority of the Trustees shall constitute a quorum, and the concurrence of a majority of the Trustees present at a meeting at which a quorum exists shall be adequate for any decision by the Trust; Provided that, where the matter involves a proposal for disposition or rehabilitation of any asset, the concurrence of at least four (4) Trustees shall be necessary."

Section 25(3) thereof shall hereafter read as follows:

SEC. 25(3). The Chairman and members of the board of directors or Trustees and the presidents or chief executive officers of the trusteed corporations shall be appointed: (a) in the case of the parent corporations, by the Committee; and (b) in the case of subsidiary or affiliate corporations, by the Trust. In both instances, any such appointments shall be subject to the confirmation of, or change by, the President. However, pending such confirmation or change, the appointees of the COP or the Trust may assume office and discharge the responsibilities thereof until such time as the President disapproves or recalls the appointment and appoints a replacement."

Section 31 is restored but shall read as follows:

"SEC. 31. No Injunctions. No court or administrative agency shall issue any restraining order or injunction against the Trust in connection with the acquisition, sale or disposition of assets transferred to it

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pursuant to this Proclamation. Nor shall such order or injunction be issued against any purchaser of assets sold by the Trust to prevent such purchaser from taking possession of any asset purchased by him."

Done in the City of Manila, this 15th day of December in the year of Our Lord, nineteen hundred and eighty-six.

Corazon C. Aquino

By the President:

JOKER P. ARROYO
Acting Executive Secretary

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DEPARTMENT OF AGRICULTURE PRIVATIZATION PROGRAM
SCOPE OF WORK FOR TECHNICAL SERVICES

BACKGROUND

The Department of Agriculture (DA) has requested USAID assistance in developing privatizaton strategies for several of its attached agencies and their subsidiary operations. The DA has recently established an Asset Disposal Unit (ADU) which would be responsible for divestiture of those corporations or subsidiary operations which can more effectively be undertaken by the private sector. USAID will initially provide financing to the DA for technical assistance in three areas: (1) development of divestiture strategies for the Philippine Dairy Corporation (PDC) and Philippine Cotton Corporation (PCC) and conduct preliminary asset valuations of both corporations, (2) development and refinement of operating guidelines for the DA's ADU, and (3) development of a detailed operational divestiture plan for NFA as follow-up to the divestiture study of the National Food Authority (NFA). The consulting team will work directly with the Office of the Undersecretary for Attached Agencies and the newly created Asset Disposal Unit of the DA. The specific scope of work follows:

A. Divestiture Strategies for PDC and PCC

1. Review of key aspects of existing business operations of PDC and PCC including status of current staffing and management operations, validity of business plan, relevance of marketing strategy, details of financial situation including P and L, cash flow, debt/equity ratios, regulatory tax and licensing matters. Key issues include the organic structure, organization and management and contribution of each component to the overall corporate objectives. Above information together with additional material will be utilized in making determination of overall commercial viability of the corporation, how it relates to other government entities, e.g. subsidies, debts with government banks, etc.

2. Estimates and calculations will be made of net worth, based upon realistic assessment of market factors rather than historical acquisitions costs, both tangible and intangible assets will be incorporated in these estimates, as well as the relevant factors affecting their profitability levels as indicated above.

3. Based upon the foregoing, a "fair price" range will be established for each of the firms, based upon a reasonable assessment of what a going market price would be for the enterprise. This would serve as a general guide and expectation of what the DA could expect from placement of the the enterprise on the market, given assumptions about prospective buyers, various formulations and "packaging" of the transactions, etc. also competitive factors and conditions in each of the relevant affected sectors. Following the sale, events such as elimination of government subsidies needs to be factored in to the calculations.

4. An asset valuation would be conducted to ascertain the break-up value of each enterprise including those cases where continuing or prospective commercial viability of the enterprise would be questionable. That valuation would utilize commonly accepted valuation techniques and approaches, customary accounting practices, realistic appraisals of existing market conditions, possibly including consideration of liquidation in certain cases.

5. Drawing upon all of the above listed activities as well as the particular knowledge and expertise of the consultants will be the design and formulation of a do-able action plan for divestiture of PDC and PCC, that would provide to DA decision makers relevant information and available courses of action to decide upon and carry out a successful divestiture program. The action plan should explicitly consider the viability of proposals put forward by the PDC and PCC.

6. In addition to the forementioned tasks, the consultants will carry out an analysis of the competitiveness of the Philippine cotton industry. The purpose of this exercise is to (1) assess the impact of current trade, regulatory and subsidy policies on the cotton industry and on the overall Philippine economy; and (2) determine which, if any aspects of the cotton industry enjoy an international comparative advantage. This will require a quantitative analysis of the cost and benefits of current protection levels as well as an assessment of future viability of various segments of the cotton industry given projected world price trends (1987-1997) and current GOP policies of trade liberalization and rural income growth.

B. Operating Guidelines for the DA's Asset Disposal Unit (ADU)

1. Develop recommendations for operation and administration of the ADU including scope of activities, relationship to Asset Privatization Trust (APT) and Committee on Privatization (COP), and Department of Finance.

2. Assist ADU in developing operating guidelines for transfer of assets to ADU and for disposition/transfer of liabilities associated with corporate assets to the National Government.

3. Assist ADU in developing operating guidelines for management and disposal of assets to be divested including; establishing criteria for prioritizing assets for sale, procedures for conservation of assets, desirability of the financial restructuring of assets prior to disposition, and evaluation of restructuring, mergers and other forms of reorganization of functions.

Identify alternative modes for the ADU to access and utilize technical and administrative support services in carrying out its functions, including:

- performing sectoral/industry analyses, as necessary;

- reviewing existing business operation to determine overall commercial viability of concern and its components;
- performing project-specific studies as necessary (e.g., rehabilitation vs. liquidation);
- estimating net worth of concern and its components, based on realistic assessment of market factors;
- conducting asset valuation of each component of the concern to determine break-up value;
- establishing a fair price for the concern and its components;
- assisting with turnover of accounting information, files, documents to ADU, including information on physical assets, employment data and third-party creditor information;
- recommending appropriate information and data management systems, including both hardware and software;
- preparing sales materials, including prospectus, photos, maps, surveys, financial information, to be made available to prospective buyers; develop advertising and brochures;
- aggresive marketing of the concern, including preparation of a potential buyers list;
- preparation of sales memoranda;
- bid development;
- legal services;
- business statements in reference to offers received;
- investment banking services when necessary in case of world-wide sale of concern;
- development of clear action plan for disposal, including time frame for completion of process, action priorities and responsible persons/agencies;
- conduct training sessions as necessary for ADU support staff controllers, internal auditors, security/custodian services, labor relations.

C. <u>Follow-on Work for NFA/FTI Divestiture Program</u>

In the context of (B) above, evaluate alternative courses of action on outstanding issues in the transfer and divestiture of the NFA subsidiary operations. This assessment will build on divestiture studies conducted by AYC and NFA last year.

Personnel Requirements

Full-time Consultants	6 p.m.
AgriBusiness/Business Management Analyst	2 p.m.
Privatization (General)	2 p.m.
Asset Valuation Specialist	2 p.m.
Part-time Consultants	3.5 p.m.
RP Privatization Consultant	1 p.m.
NFA/FTI Specialist	1 p.m.
Cotton Industry Specialist/ International Economist	1 p.m.
Local Dairy Industry Specialist	0.5 p.m.
TOTAL	9.5 p.m.

COMMITTEE ON PRIVATIZATION

Proposed Operating Guidelines for Asset Privatization Trust

1. As provided under Proclamation No. 50 creating the Committee on Privatization and the Asset Privatization Trust, hereinafter referred to as the Committee and the Trust, the principal purpose of the Trust shall be to effect or cause to be effected, directly or through other external agencies, the disposition within the shortest possible period of assets transferred to the Trust. The Trust in its divestment program should seek, in the soonest time possible, to restore the existing physical facilities involved into viable and productive operations, under private sector management and ownership, and thus to contribute towards national economic recovery within the context of a private enterprise system. Within the context of this major purpose, the Trust is expected to generate maximum cash recovery for the National Government.

The Trust shall discharge its responsibility and perform its functions in accordance with the following guidelines which are hereby being established by the Committee pursuant to its authority under Sec. 5 (3) of the Proclamation.

2. For purposes of these guidelines, assets shall include (i) receivables and other obligations due to government institutions under credit, lease, indemnity and other agreements together with all collateral security and other rights (including but not limited to rights in relation to shares of stock in corporations such as voting rights as well as rights to appoint directors of corporations or otherwise engage in the management thereof) granted to such institutions by contract or operation of law to secure or enforce the right of payment of such obligations; (ii) real and personal property of any kind owned or held by government institutions, including shares of stock in corporations, obtained by such government institutions, whether directly or indirectly, through foreclosure or other means, in settlement of such obligations; (iii) shares of stock and other investments held by government institutions; (iv) the government institutions themselves, whether as parent or subsidiary corporations; and (v) such other items as may subsequently be identified by the Committee.

I. GENERAL PROCEDURES OF THE COMMITTEE

3. The Committee, initially, will be receiving assets for disposition from three major sources. These sources of assets are as follows:

(1) Development Bank of the Philippines:

(2) Philippine National Bank including those of its own and those from NIDC, its wholly-owned subsidiary; and

(3) Parent government-owned or controlled corporations, that is, those created by special charter or of their subsidiaries, as may be determined and recommended by the Committee and approved by the President.

Assets from DBP and PNB shall consist of those non-performing assets, including loan accounts identified and recommended by the Committee and approved by the President for transfer from these banks to the National Government.

4. As soon as feasible, the Committee shall identify, by itself or with the assistance of the Trust and/or other disposition entities, preferrably even on a prospective basis, the most appropriate entity to undertake the ultimate disposition of any asset transferred to it, as well as the interim conservation and in extreme cases the rehabilitation, as may be necessary, of the asset. These entities to undertake disposition may include the following:

(1) The Trust, in those cases where the Committee has considered that the asset can be disposed of on a productive entity basis, whether actual or potential, or where the disposition of a parent government corporation is involved;

(2) The government financial institution from which the non-performing assets were transferred, namely, Development Bank of the Philippines and Philippine National Bank, for those assets which the Committee has determined as not suitable for disposition as a productive facility, and which therefore should be disposed of as physical assets and in much the same manner as other acquired assets of the bank; or

(3) The parent government corporation concerned, in those cases where it has itself decided on the divestment of its own corporate subsidiary, where it would wish to undertaken the disposition itself, and where the selection of the parent corporation as the disposition entity has been decided upon by the Committee.

5. Where the Committee has decided on a disposition entity other than the Trust, the Committee may nevertheless assign to the Trust the task of monitoring and coordinating the disposition activities of those other entities. In any case, the Trust shall at all times be kept informed by all other disposition entities of their respective disposition activities.

B. GUIDELINES ON THE TRANSFER PROCESS

Under these overall principles, objectives, and purposes, the following initial guidelines will be observed by the Asset Privatization Trust, hereinafter referred to as the Trust, in the conduct of its disposition and divestment activities:

6. Transfer of Non-Performing Assets to the Trust

Assets may include (a) those evidenced by ownership of shares, whether all, or a majority of, or even a minority of the shares outstanding, or (b) the physical assets themselves, such as real estate, improvements, physical facilities, or equipment. Assets may be further classified into (a) those over which the transferor government financial institution has acquired ownership, and (b) those which are being held by the government financial institution as security for loans, whether past due or current.

The Committee shall refer these non-performing assets to the Trust, which shall examine and evaluate these assets to determine which of these non-peforming assets can be disposed of directly by the Trust, or by other disposition entities which may or may not be under the direction and responsibility of the Trust.

The Trust shall submit to the Committee the results of its findings, including a recommendation on which of the assets the Trust feels (a) should be entrusted to the Trust, and (b) can be best disposed of, the government financial institutions themselves as gauged by the Trust, because among other reasons they are not enterprises with a viability potential, or negotiations for their disposition are in an advanced stage. Furthermore, the Trust may entrust the custodianship of assets assigned to it by the Committee to the government financial institutions who shall in such cases, be, in effect, custodian-trustees of the Trust.

7. Determination by the Trust of the Priorities for Disposal

Within the overall context of rendering productive once more idle or underutilized assets, the Trust, as a general rule, shall give priority to situations that would yield the maximum cash recovery in the shortest possible time; however, priority attention may also be considered under certain existing circumstances, such as where (1) the cost of conservation and/or maintenance of an asset is great, (2) the rate of deterioration of plant and equipment is rapid, (3) rehabilitation by new owners could immediately generate employment or have strong linkages with other industries, or (4) locational considerations apply, as in certain projects which may be the sole employment sources in their respective locales.

C. GUIDELINES ON THE MANAGEMENT OF TRUSTEED ASSETS

8. Policies on Conservation.

The Trust may continue or initiate, as the case may be appropriate steps to conserve the physical assets entrusted to its care.

In the cases of productive facilities which are not being operated, such steps shall be limited to preserving the assets from further deterioriation or loss, providing the necessary security and maintenance services in the process.

In those cases where the facilities are being operated, the Trust shall ensure that the net cash operations resulting therefrom shall be adequate to cover its requirements; where such operations will result in a negative net cash position, the prior permission of the Committee shall be obtained.

9. Policies on Rehabilitation

As a general rule, the rehabilitation of assets prior to disposition should be avoided. In exceptional cases, however, physical rehabilitation, including financial restructuring, could be considered if an asset or company is judged to be marketable but rehabilitation is required for (1) sheer physical conservation of assets where shutdown or mothball costs may approximate costs of operation; or (2) preservation of factor inputs such as technical skills or maintaining necessary-to-the-enterprise contractual relations such as franchises, supply contracts. Again, in general, assets entrusted to the Trust should not incur additional government exposure for rehabilitation.

10. Policies on Restructuring, Mergers and Other Reorganizations.

As an additional option, the Trust could undertake business reorganizations such as spin-offs, mergers, and the like, if judged to be useful, and deemed essential to enhance marketability.

D. GUIDELINES ON THE DISPOSITION OF ASSETS

11. Choice of Markets for Disposition

Where the realizable price is equal, preference should be given to: (a) buyers who intend to rehabilitate an asset for productive utilization within the country, (b) buyers who are nationals or, in the case of corporations, the majority shareholdings of which are owned by nationals.

In developing the disposition strategy for each asset, due consideration will be given to the availment of public securities markets, employee stock ownership plans, debt/equity swap plans and other possible sources of capital.

Foreign equity participation in enterprises which will continue to be operated domestically shall be in accordance with existing rules and regulations governing foreign investments, the specific policies for which may vary, depending upon the particular sector.

12. Valuation.

Standard formulae shall be used in order to establish a range of values, including appraised value, replication cost, capitalized earnings approach, and other accepted methods; in any case, the valuation methodology should be suited to the characteristics of the particular asset being sold. Serious efforts shall be made to establish the realistic economic value of assets, especially those which appear to be overpriced acquisitions or overdesigned plant investments. The valuation processes are critical for the establishment of realistic floor prices, since the rule would be to sell via bidding procedures. Where the bidding procedure does not provide the basis for determining a fair floor bid price, a mechanism to determine a fair floor bid price or a fair target bid price shall be worked out by the Trust and approved by the Committee.

13. Sales Methods

(1) Bidding. The use of sealed bids should be followed, with negotiated offers being resorted to if bidding should prove unsatisfactory, impractical, or inappropriate under the individual circumstances. Cash bids would be given preference, and all bids must have a posted bond from an acceptable financial institution. In any case, the bidding rules and procedures to be followed for the disposition of any particular asset should be publicized and made known well in advance for the guidance of prospective bidders.

(2) No Portfolio Position. As a rule, the Trust should not take a new portfolio position by selling on installment basis since this would impose the burden of multi-year account monitoring, lead to the possibility of subsequent foreclosure, or extend beyond the life of the Trust.

For sales on an installment or deferred payment basis, the Trust should require a covering guarantee from acceptable financial institutions.. Such a guarantee would further and establish the bankability of the transaction, and would allow the Trust to discount the receivable paper without recourse.

(3) Use of Brokers. Whenever appropriate, brokers may be used, provided that terms and conditions of their engagement are clearly set forth in advance by the Trust.

(4) Where deemed appropriate to protect continuing operations and financial well being of assets to be sold, the Trust may require potential investors in or buyers of any particular asset/corporation to provide reasonable information concerning their financial, managerial, industrial and/or other credentials. The Trust will consider such information in qualifying bidders.

14. Sale to Old Owners

Sales of acquired assets to previous owners is discouraged, but not prohibited. Where there are at least three bidders for an asset, previous owners should not be qualified for bidding. Where previous owners are qualified because of the lack of sufficient (i.e., three) bidders, or due to some compelling justification which APT should make known to the Committee, they should be so identified and information provided on any outstanding unsettled claim of the bank against such previous owner. The recommendation for the approval of sales report submitted by the Trust to the Committee should state whether the asset being disposed of is a physical asset or a financial asset and in either case, the Trust shall inform the Committee of the implication of the proposed disposition to an old owner on the outstanding unsettled claim of the bank of such owner, more particularly, if the sale price will not cover the entire unsettled claim, as well as its recommendation on the concommitant action to be taken under the circumstances.

E. GUIDELINES ON OPERATIONS AND ADMINISTRATION

15. As provided for in the Proclamation, the Trust shall be provided the greatest flexibility in its operations. The necessity for prior Committee approval and review would be initially limited to the following:

(1) General programs, priorities, and criteria.

(a) The general program of disposition, inclusive of assets to be disposed of by the Trust, the sectoral or other basis of priorities of attention, and tentative timetable for disposition. A preliminary program should be submitted on or before March 31, 1987 and the detailed program on or before May 31, 1987, without prejudice to the submission of subsequent adjustments as may be warranted.

(b) The organizational, financial and operational requirements of the Trust, including its budgetary proposals, for its administration, its operations, its disposition programs, and its conservation and rehabilitation requirements. A preliminary draft should be submitted on or before March 31, 1987 and the detailed program on or before May 31, 1987, without prejudice to the submission of subsequent adjustments as may be warranted.

(c) Guidelines subsequent proposed by the Trust for its internal use which may deviate from the general principles embodied herein.

(d) Borrowing funds or contracting loans from whatever source, or availing of assistance from official bilateral or multilateral sources.

(e) The retention of any proceeds arising from the sale, or where necessary the lease or management of assets earmarked for disposition.

(2) Individual disposition of assets.

(a) A recommendation/position on any specific asset approved for disposition, as to whether the disposition is to be undertaken by the Trust or by other entities, and if by the Trust itself, whether directly or through the utilization of other disposition entities.

(b) Any recommendation for the rehabilitation of an asset, or the continuation of operations of an asset on a negative cash flow basis, which will in either case entail a guarantee by, or commitment or exposure of, additional National Government resources.

(c) Any recommendation to sell or transfer an asset submitted by the Trust to the Committee shall include information on (1) the buyer, (2) the price and other terms of the sale and (3) where the selection procedure had deviated from that previously approved by the Committee, the modifications in the procedure employed. Prior approval of the sale by the Committee as to buyer and price is required before the sale can be consumated, provided that in the absence of advice to the Trust by the Committee after the lapse of 30 days from the date a sales recommendation is received by the Committee of the disapproval by the latter of a recommended sale, the Trust is authorized to proceed with the recommended sale.

(3) For proposed actions of the Trust other than those covered in Section 15 (1) (c) above, for which prior approval of the Committee is required and where no other government agencies or entities are involved, Committee action on the request should be undertaken not later than 30 days after receipt of the Trust proposal, and the results forwarded by the Committee to the Trust within another 10 days. In the absence of notification from the Committee to the Trust after the expiration of the above period, the Trust can assume that the proposal has been appproved.

16. It is expected that, in the process of keeping permanent staff levels at a minimum, the Trust will have to rely to some extent on external advisors, consultants, and other expertise to fulfill its mandate. While the Trust has the discretion to determine the scope and nature of required external expertise, the Committee shall be notified of all such engagements, without the need for Committee approval or in any way impairing the right or authority of the Trust to undertake such engagements pursuant to existing law.

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ANNEX L5

As of August 6, 1987

LIST OF 121 GOVERNMENT-OWNED OR CONTROLLED CORPORATIONS REVIEWED FOR PRIVATIZATION

Corporation	Area of Activity
OK for Immediate Privatization	
1. Batangas Land Co., Inc.	Land ownership
2. First Chicago Leasing & Equipment Credit Corp.	Lease financing
3. GY Real Estate, Inc.	Land ownership
4. Inter-Island Gas Service, Inc.	LPG marketing
5. International Corporate Bank, Inc.	Commercial banking
6. Kamayan Realty	Land ownership
7. Manila Gas Corporation	Production/distribution of piped gas
8. Mindanao Textile Corp.	Garment manufacturing
9. Nadeco Realty Corp.	Land ownership
10. National Precision Cutting Tools, Inc.	Production of high-quality industrial tools
11. National Shipping Corp. of the Philippines	Cargo shipping
12. Negros Occidental Copperfield Mines, Inc.	Copper mining
13. Pandacan Gas Storage Corp.	Gas transportation
14. Pinaglabanan Realty Corp.	Land ownership
15. Usiena, Inc.	Machinery/equipment distribution and servicing
16. Beta Electric Corp.	Electrical products and Equip't manufacturing
17. NDC-Nacida Raw Materials Corp.	Procurement of raw materials for Nacida-registered enterprises
18. National Chemical Carriers, Inc.	Shipping agent, manning and crewing services
19. National Marine Corp.	Overseas cargo shipping
20. National Shipways Corp.	Ship repair and maintenance work
21. National Stevedoring & Lighterage Corp.	Stevedoring, lighterage and port management optns
22. National Trucking & Forwarding Corp.	Trucking, freight forwarding and warehousing
23. Phil. Phosphate & Fertilizer Corp.	Fertilizer production
24. Phil. Pyrite Corp.	production of pyrite concentrates
25. Semirara Coal Corp.	Coal mining
26. Tacoma Bay Shipping Co.	Ship-owning and leasing optns
27. The Energy Corp.	Management of stock investments
28. Phil. Plate Mills Co., Inc.	Manufacture of steel plates
29. Bislig Coal Corp.	Coal mining
30. Filoil Industrial Estates	Land ownership
31. Filoil Refinery Corp.	Oil refining
32. Malangas Coal Corp	Coal mining
33. PNOC Coal Corp.	Coal mining
34. Energy Supply Base, Inc.	Supply base optns
35. PNOC Marine Corp.	Shipbuilding and repair
36. Commercial Bank of Manila	Commercial banking
37. Meat Packing Corp. of the Philippines	Meat processing/canning
38. Hotel Enterprises of the Philippines, Inc.	Hotel ownership/management
39. [illegible] Dredging and Development Corp.	Dredging and reclamation
40. Eastern Visayas Agricultural Projects, Inc.	Swine/poultry/farming
41. The Manila Hotel Corp.	Hotel operation and management
42. Maunlad Savings and Loan Assn., Inc.	Savings and loan association
43. Shoe Technology Corp.	Footwear manufacturing
44. Integrated Feed Mills Corp.	Feed production
45. Marawi Resort Hotel	Hotel operation
46. Monte Maria Poultry Farms, Inc.	Poultry farm operation
47. Agro-Livestock Commercial Development Corp.	Swine and goat breeding, manufacture of dairy products
48. Builder's Brick, Inc.	Brick production
49. Carmona Woodworking Industries, Inc.	Sawmilling services
50. Davao Agri-Business Development Co., Inc.	Tree farming
51. Davao Equipment Mfg. Corp.	Metal casting, foundry and fabrication
52. Food Terminal, Inc.	Food trading, processing, storage, real estate mgt.
53. Furniture Mfg. Corp.	Wood furnishing, interior decoration
54. INCA Coffee Estate Corp.	Coffee plantation
55. Kauswagan Food Corp.	Diversified fruit processing and marketing
56. Mountain Springs Development Corp.	Swine raising
57. Northern Foods, Inc.	Tomato paste production
58. Phil. Fruit & Vegetable Industries, Inc.	Tomato paste production
59. Phil. Genetics, Inc.	Cattle breed upgrading and dispersal
60. Ridge Resort & Convention Center, Inc.	Resort and convention facility management
61. San Carlos Fruit Corp.	Fruit puree production
62. Woodcoal, Inc.	Fuel briquette production
63. Woodwaste Utilization & Development Corp.	Construction materials production from logging wastes
64. ZNAC Rubber Estate Corp.	Rubber tree plantation
65. Mindeva Coco-Coir Industries, Inc.	Production of coco-coir fiber products
66. Mindeva Refrigeration Industries Inc.	Ice production/cold storage
67. Panaon Prawn Development Corp.	Prawn fry and larvae raising
68. Primary Foods, Inc.	Manufacture and sale of food products
69. Prime Center Trade International System, Inc.	Trading activities
70. Princess Panay Agro-Industrial Corp.	Plantation farming/fertilizer production and trading
71. National Sugar Refinery	Sugar refinery management
72. Republic Transport & Shipyard Corp.	Sugar terminal and shipyard operations
73. Ana Goodwill Fishing Corp.	Deep sea fishing
74. Gasifier Equipment Manufacturing Corp.	Gasifier equipment and farm machinery, fabrication
75. Phil. Dairy Corp.	Development of dairy industry and milk/dairy products production
76. Leyte Park Hotels, Inc.	Hotel operation
77. Metro-Manila Transit Corp.	Passenger bus operations and leasing
Already Submitted to APT for Privatization	
1. Asia Industries, Inc.	Machinery/equip't distribution
2. Marina Properties Corp.	Land Development (reclamation area)
3. Bicolandia Sugar Development Corp.	Sugar milling
4. Phil. Shipyard & Engineering Corp.	Ship repair and fabrication of steel products
5. Pilipinas Bank	Commercial banking serve
6. APO Production Unit, Inc.	Printing serve
7. Phil. Cotton Corp.	Cotton farming
8. Phil. American Bank	Commercial banking
9. Associated Bank	Commercial banking serve.
For Privatization Subject to Certain Terms and Conditions	
1. Phil. Airlines, Inc.	Commercial air transport
2. Century Holding Corp.	Bank holding company
3. Century Bank	Commercial banking
4. PNB Venture Capital Corp.	Venture capital company
5. Coco-Chemical Philippines, Inc.	Coconut oil milling
6. NIDC Oil Mills, Inc.	Coconut oil milling
7. Bancom Insurance Brokers, Inc.	Insurance brokerage
8. Union Bank	Commercial banking serve
9. Sarcelon, Roxas Securities, Inc.	Stock brokerage
10. Quedan Guarantee Fund Board	Grains guarantee services
For Further Study Before a Decision Could be Made	
1. Luzon Integrated Services	Security services
2. NDC-Guthrie Estates, Inc.	Palm oil plantation
3. NDC-Guthrie Plantations, Inc.	Palm oil plantation/processing
4. Phil. Associated Smelting & Refining Corp	Copper smelting and refining
5. NDC Plantations, Inc.	Agro-Forestry plantation
6. National Steel Corp.	Steel production
7. Refractories Corp. of the Philippines	Production of basic refractories
Deferred	
1. PNB International Finance Ltd.	Deposit taking company
2. National Realty Development Corp.	Real Estate management
3. National Warehousing Corp	Warehousing
4. National Service Corp.	Manpower services
5. Phil. Exchange Co., Inc.	Insurance agency
6. Phil. National Lines	Shipping
7. Bataan Refinery Corp.	Oil refining
8. Petro TBA Corp.	Marketing of automotive accessories
9. Petron Tankers Corp.	International oil tanker optns
10. Petrophil Corp	Marketing of petroleum products
11. Petrophil Tankers Corp.	International oil tanker optns
12. PNOC Crude Oil Tankers, Inc.	International oil tanker optns
13. Energy Development Corp	Geothermal energy exploration and development
14. Energy Drilling, Inc.	Geothermal/oil drilling serve
15. PNOC Oil Carriers, Inc.	International oil tanker optns
16. PNOC Shipping & Transport Corp.	Domestic oil tankering
17. PNOC Tankers Corp	International oil tanker optns
18. National Coal Authority	Blending/stockpiling of coal (imported)

ANNEX 16

International
Executive
Service Corps Doña Narcisa Building: Room 412, 8751 Paseo de Roxas, Makati, Metro Manila

A Proposal

for

A PRIVATIZATION PLANNING AND TECHNICAL ASSISTANCE PROGRAM

to

Philippine Government Organizations

by

The International Executive Service Corps

The International Executive Service Corps is a private, not-for-profit organization established in 1965. Its objective is to transfer technology from the United States to private companies and government entities in countries with developing economies. And this is accomplished by recently retired American business men and women on assignments of approximately three months. There is now a well developed system operating which includes 10,000 experienced Advisors available who represent virtually all areas of business and industry in the United States.

October 1986

Central P. O. Box 165, Makati, Metro Manila 3117 • Telephone: 816 34 29, 816 20 86 • Telex: 22274 IES P.

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SUMMARY

The International Executive Service Corps has on its roster of experts over 10,000 recently retired American business men and women who represent virtually all fields of business and industry in the United States. These Advisors volunteer their services.

In the Philippines today it is estimated that there are from 150 to 300 government owned or operated enterprises which the Presidential Commission for Government Reorganization has designated for abolishment, retention, merger, conversion as well as sale to the private sector either in the country or abroad.

The process of privatization or divestment of state enterprises to private owners is a complex one involving a number of stages and phases before, during and after sale. And the process is full of risks to the government as well as to the buyer.

This proposal presents a source of assistance to managers of government organizations with divestment responsibilities by which they can successfully transfer assets of high value to new owners and then insure the new entities growth and development which will then contribute to the national economy.

IESC is uniquely capable of assisting the Philippine government in the divestment process because of its pool of managerial and technical skills as well as network of contacts with all industries in the USA. And the cost is minimal because the Advisors volunteer their services.

INTRODUCTION

Privatization can be perceived very simply as the divestiture of government assets to the private sector. But actually privatization is a process which involves a wide range of techniques to transfer functions, in whole or in part, from government supported enterprises to the private sector under conditions where marketing forces can govern the operating policies and results of the enterprise. Indeed privatization is not one thing but many things requiring many different managerial and technical specialties.

The new Philippine government recently decided to privatize (divest itself of state-controlled enterprises) and open up restrictive policies in one step. And there are now estimated to be approximately 150 enterprises to be privatized by the Development Bank of the Philippines-Philippine National Bank, the National Development Company and the Ministry of Human Settlements as well as other entities.

IESC proposes to assist the Government of the Philippines by offering managerial and technical assistance in the process of privatization which involves many and different technical specialties.

This proposal is presented in three parts:

1. A description of the Typical Problems and Pitfalls of privatization indicating some of the many risks involved
2. The Basic Program in terms of stages and objectives
3. The IESC Role of potential assistance in the various stages of the process.

TYPICAL PROBLEMS AND PITFALLS

An effective divestiture of a government enterprise's assets is a complex business activity and difficult for both the government and the purchasing organization because the process presents a wide range of obstacles to planning which delays risk taking decisions. Any purchase presents problems of planning, organizing, analyzing, evaluating and negotiating for both parties. And the perception of risks to both parties should be minimized.

Vendor. The sellor will be interested in getting a fair amount for assets of the enterprise, transferring these assets in a smooth way, then seeing that the enterprise becomes a contributor to the national economy and the people. Even after a smooth divestment, the government should be concerned about the ability of the private sector to effectively manage the acquired resources. So provision for economical, part time, technical assistance in areas such as accounting, marketing, management, financial reporting could ensure the economic viability of the acquired organization.

Buyer. The buyer perceives risks in at least the following areas before, during and after a sale:

1. Lack of well functioning local markets and stable long term demand
2. Inadequacies of physical infrastructure to support industry growth and operation
3. Availability of debt or equity resources
4. Insufficiency of managerial and entrepreneural skills
5. Inability to develop and utilize effective business information
6. Qualities and capabilities of the labor force
7. Ability to manage technology changes and improvement on an ongoing basis.

Indeed the orientation of the private sector may well be different from the practices of the government enterprise. So the acquirer of a state enterprise faces not only a difficult external environment but the problem of trying to purchase, reorganize and operate assets that could well be presently structured and staffed differently than it should as a private enterprise.

In brief, the many potential risks to both the sellor and the buyer of a government enterprise are many and varied but these should be minimized by the availability of knowledgeable, objective and credible experts during the whole process.

BASIC PROGRAM

There is a basic program for the divestment of any government enterprise which will generally go through four stages each of which will have a particular focus of attention and its own general objectives.

Initiation - is the first stage which focuses on the preparation of a Basic Plan for divestment. And its main objectives are to establish organizational linkages, study and gather pertinent data, and prepare a basic business plan including the scheduling of technical visits by needed experts. This should take approximately three months.

Divestment Cycle - is the second stage which consists of contacting, evaluating and negotiating with clients. The focus of attention is the client (s). The main objectives are to prepare offering materials, make a detailed business plan, analyze opportunities/needs, negotiate, etc. While relations with any client may take 2 to 3 or more months the whole process of talking to a number of potential buyers could take two or more years.

Interim - stage that is between talks to different buyers is focused on data gathering and evaluation as well as the preparation for new negotiations. In effect the whole divestment process is a cyclical one. With each potential client new factors and critical issues will be identified, lead to modifications and adaptations to individual offerers. The key to succesful negotiation should be the ability to bring together the selling and purchasing organizations in a constructive and cooperative negotiating process.

Installation - is the fourth stage. And this will focus on the development of the new enterprise. Phases might include re-organization and take over, operation and evaluation with modifications. The main objective here is to provide technical assistance to the new management.

The entire process for an individual enterprise could take from 2 to 5 years.

IESC ASSISTANCE ROLE

An essential need of the entire privatization process is managerial and technical assistance which should be well organized and functionally specific for maximum effectiveness.

Organization. At IESC-USA there will be both an Executive Group and Working Group for implementing each divestment program. The Executive Group will consist of a Manager for planning and a Supervisor for coordinating Volunteer Executives in the field and Recruiters. In the Philippines there will be a Planning Team and two or three Technical Teams of the industry and firm, finance, production, marketing, etc. experts.

Specific Functions - of IESC personnel in the field would vary according to the development stages and be either in the (USA) or the Philippines:

	Stage	IESC Executives	Functions
A.	Initiation	Planning Team	Evaluate existing enterprise Prepare offering documents Develop basic business plan
B.	Divestment Cycle	Technical Team	Research on potential clients Short list clients Evaluate clients Adapt client plans Facilitate negotiations
C.	Interim	(Coordinator)	Develop transfer of assets plan Provide industry specific data Recruit technical assistants
D.	Installation	(Project Director)	Provide new technicians as needed Develop reorganization plan, new markets, training programs, etc.

IESC would assist the government divestment team, then source appropriate Advisors in any and all fields needed for the divestment of an individual enterprise.

CONCLUSION

Privatization is a multi-faceted and complex process, now of great financial significance to the economic rehabilitation of the Philippines, which requires many and varied talents to make each divestmen a success.

While foreign managerial and technical experience will not be needed for each and all Philippine government divestments it is strongly felt that such expertise would be advantageous and cost beneficial in most cases.

The advantages of IESC assistance are many: a vast pool of American expertise in virtually every field of business and industry; the ready acceptability of the Advisors; their objectivity and hence credibility to both the seller and the buyer; and, the cost beneficial nature.

M1

REPORT AND RECOMMENDATIONS
ON
DEVELOPING THE CAPITAL MARKETS
OF
THE PHILIPPINES

(SUMMARY OF RECOMMENDATIONS
AND ACTION PROGRAM, pages 1-15)

(Draft of March 14, 1987)

Terrence Reilly
Curtis, Mallet-Prevost,
Colt & Mosle

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Appendices

Appendix B. OBJECTIVES OF FINANCIAL MARKET DEVELOPMENT

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REPORT AND RECOMMENDATIONS ON
DEVELOPING THE CAPITAL MARKETS
OF THE PHILIPPINES

(Draft of March 14, 1987)

ONE: INTRODUCTION, AND DETAILED SUMMARY OF RECOMMENDATIONS AND ACTION PROGRAM

This report discusses actions that could be taken to foster development of the capital market in the Philippines. The report is provided in response to a request from the Ministry of Finance and the Ministry of Trade and Industry. Because changes are occurring in the Philippine markets, and the government is currently taking measures to improve these markets, the report is provided in draft form for discussion and revision.

A. Underdeveloped Capital Market

The capital market in the Philippines is underdeveloped. Few companies raise finance through the securities markets, and investors lack confidence in such markets. Companies are overburdened with debt, mostly short term, and have far too little equity capital. Until very recently there has been no government policy of encouraging long term finance through the securities markets.

1. Original 1985-86 Review

The USAID examination of the capital market in the Philippines was originally undertaken in 1985 and early 1986 to expand on an evaluation prepared in 1984 by consultants for the Asian Development Bank. The 1984 report focused largely on banks and bank lending. It was felt that USAID might assist by focusing on the securities markets for long term finance, and by participating in an expected implementation of recommendations in the report.

However, at the beginning of the evaluation in the summer of 1985, it became evident that the government was not contemplating any specific actions to develop the capital market. Discussions with the Central Bank indicated that "capital market development was not high" among its priorities at that time.

With no government request for assistance, USAID concluded that it should nevertheless attempt to gain an overview of the securities markets to see if development efforts were warranted.

Accordingly, discussions were held in 1985 with many people in the private sector, and the picture that emerged demonstrated that the long term securities markets were dramatically underdeveloped. (A more detailed discussion of the underdeveloped state of the Philippine capital markets is provided in Appendix A.)

Five types of problems emerged from the survey of market conditions.

(1) Market Difficulties. Few companies in the Philippines raised finance through securities issues. Only 4% of the top 1000 companies were listed on the exchanges. The proportion of shares of such companies available for trading was very small, probably around 10% and in some cases 30% of outstanding shares. Trading is concentrated in a limited number of companies.

The limited supply of securities led to excessive price swings in the exchanges; the absence of adequate disclosure of material information meant trading often was based on rumor or misinformation. Investors questioned the professionalism of the securities markets and lacked confidence in them. They believed they were not adequately regulated. Some "paper" companies (with no real business) had been floated, and investors had been harmed. In addition, in the early 1980s there was a major scandal in the short term note (commercial paper) market outside the exchanges, and investors suffered serious losses.

(2) Excessive Availability of Loans. Company finance was usually limited to loans from banks, and many companies obtained finance at concessional, below market rates. Companies incurred debts well beyond prudent ratios of debt to equity. In the main, the only companies that went to the securities markets

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to raise finance were the truly speculative ones, and the stock market was viewed as a gambling den.

(3) Distortion of Economy. Commentators argued that a third factor made it almost impossible to deal successfully with the first two difficulties: they alleged that the Philippine economy and business environment had been brought under the control of the head of state and powerful interests aligned with him. They asserted that these interests had control of or deep participation in all major lines of business, and businessmen did not want to expand their business for fear of being taken over by them. Institutional investors asserted that in fact there were no domestic businesses for them to invest in, because all had been "taken over, raped and pillaged" by these powerful interests. Therefore they invested abroad. Commentators asserted that no actions could be taken to improve the securities markets until this alleged distortion was dealt with, and this would require a major redirection of policy.

(4) Recession. Recession in the world economy and the Philippines led businessmen to doubt their future prospects. The downturn in business left many companies overburdened with debt, often in dollars, which they were not able to pay as business declined and as the peso dropped making it more expensive to obtain the foreign currency to repay the loans. It was a classic case of overborrowing, and borrowing in a currency for which the firms had no, or only inadequate, income streams, thus subjecting them to exchange risk. The overborrowing was fuelled by the foreign loan funds made available in the Philippines.

(5) Political. The political environment continued to worsen during 1983-85, and this triggered an even greater loss of confidence in the future. This reduced willingness of businesses to invest in capital assets and made investors unwilling to place funds long term, or perhaps even to keep their funds in the Philippines at all. Everything turned extremely "short term".

In the 1985 review of the market, it became clear that as the Philippines came out of its economic downturn, it would need an improved securities market to provide long term finance, preferably equity, to business enterprises. It was felt that possibly the

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drop in international loan funds and the painful consequences of having relied on excessive borrowing would now lead the government to adopt a positive approach to developing the long term securities markets.

This hope was somewhat encouraged in discussions with government officials in 1985. The officials were not necessarily uninterested in capital market development, but (a) in the past, they had not had the time to focus on the matter and to formulate a policy to use financial market development as a technique for economic growth, and (b) in the midst of needs to deal with urgent matters in 1985 (such as foreign debt rescheduling, economic adjustment demands, and bank failures), they did not then have the time or manpower to initiate a concerted evaluation. Certain government officials indicated that if USAID wished to initiate an effort to evaluate market development, the government would be willing to participate.

2. Revitalized Approach of New Government

A "sea change" came with the new government. In December 1986 the Ministry of Finance and the Ministry of Trade and Industry requested discussions on steps that could be taken to encourage development of the capital market. The objectives would be to provide long term finance to industry through the securities markets, which can mobilize savings and allocate those savings to productive enterprises in which the country enjoys a comparative advantage. (A detailed discussion of the development objectives and benefits of capital market growth is provided in Appendix B.)

The government has already established programs to reorganize and rehabilitate certain financial institutions, to sell off non-performing assets, to privatize certain government owned companies, and to allow for conversion of debt to equity in Philippine enterprises. These efforts are a clear signal that the private sector is to be encouraged.

During 1986 the value of transactions in the two stock exchanges increased dramatically, to P 11.4 billion as compared to P 4.04 billion in 1985, outstripping the previous high of P 6.79 billion in 1976. This reflected increased demand in light of changed political circumstances, substantial interest by

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foreign buyers (estimated by some as providing up to 40% of total buying) and substantial rise in prices of the limited shares available. Trading was concentrated in a limited number of companies. It is believed that a significant percentage of the reported transactions consisted of privately negotiated transactions in the shares of a limited number of companies, which were reported on the exchanges to obtain relief from capital gains tax. Recently the government has questioned whether the increased trading and share values represent not investment but use by various persons of securities trading to launder money retained in the country for political uses. In conclusion, therefore, while the total turnover value has increased, the supply of securities remains low as in the past, with few companies raising finance through the issuance of shares or other long term securities, and the problems in the market identified in the 1985 review continue to impede growth.

The government is dealing with the broader problems leading to the underdeveloped markets -- that is, the excessive availability of loans, government domination of business, recession and political problems. Thus, it becomes realistic now to address the more standard market difficulties. To begin a capital market development program, government officials requested assistance in focusing their efforts, for which they asked for this report.

B. Summary of Recommendations

This report discusses actions which could be taken to develop the securities markets. The major recommendations are summarized below. Following this, a proposed three-phase Action Program is discussed.

I. Need For Capital Market Development Policy, and Working Group

(1) Establish a clear policy for capital market development. [Recommendation 1, page 16]

(2) Create a Capital Market Development Working Group to conduct a detailed survey of the markets and to agree on specific market development steps to be taken. [Recommendation 2, page 17]

(3) The development work should be a joint effort between government and private sector businessmen, bringing together all available capital market expertise. [Recommendation 3, page 17]

(4) Consider whether it would be advisable to hold a capital market development conference, for which there are pros and cons. [Recommendations 4 through 6, page 18]

II. Increasing Securities Supply

The limited use by companies of the securities markets to raise long term finance through equity or debt securities is the principal constraint to market development. The following actions are recommended.

(1) Encourage improvement in the climate for business and expansion of business, which will need to raise long term equity finance through the securities markets. Conduct an evaluation of the business environment through the Capital Market Development Working Group or a separate Business Development Working Group. [Recommendations 7 through 10, pages 21 and 22]

(2). Eliminate or severely limit credit provided at below market rates, the availability of which overloads companies with debt finance and discourages them from raising long term finance through the securities markets. [Recommendation 11, page 22]

(3) Take steps to reduce high interest rates paid on short term securities in the money market, which discourage investment in long term securities. [Recommendation 12, page 22]

(4) Develop and adopt requirements for "securitization" of finance, to reduce reliance on bank borrowing, and encourage (or in some cases require) companies to raise finance through issues of securities. Steps to be considered include: (a) requiring companies that seek loan funds over a certain amount to raise a portion of that finance through a "parallel" public offering of securities; (b) requiring companies raising finance over a specified amount to offer merchant banks opportunities to raise such finance; and (c) requiring companies that obtain benefits under

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government investment schemes to raise finance through public offerings of securities. [Recommendations 13 through 16, pages 22 and 23]

(5) Increase the range of securities that companies can issue. [Recommendations 17 and 18, page 23]

(6) Remove tax disincentives to companies issuing securities (eg. tax deductibility of interest payments on debt, as compared to non-deductibility of dividends on shares), and provide positive incentives to the issuance of securities (eg. lower income tax and improved investment tax credits and depreciation for companies that have public offerings). [Recommendations 19 through 31, pages 23 through 25]

(7) If incentives to public offerings do not provide sufficient improvements, consider more direct inducements to companies to raise finance through public offerings, similar to those used in certain other countries. [Recommendation 32, page 25]

(8) Allow companies and their underwriters to determine underwriting fees and commissions. [Recommendation 33, page 25]

(9) Reduce regulatory disparities between open and closed companies of equal size, to reduce the advantages of remaining a closed company. [Recommendation 34, page 26]

(10) Sell public issues of shares at market value, and not at "par value", which discourages companies from raising finance through share issues. [Recommendation 35, page 26]

(11) Remove pre-emptive rights for new issues of shares, because these rights restrict financing by equity issues and encourage short term debt financing. [Recommendation 36, page 27]

(12) Eliminate the alleged past practice of unfair allocation of new share issues to privileged persons. [Recommendation 37, page 27]

(13) Consider requiring that certain share issues which are sold as private placements to individuals and institutions, instead be conducted as public

offerings. [Recommendation 38, page 27]

(14) Carefully consider the governmental program for privatization of government owned companies and non- performing assets in the light of the capital market development effort, and where practicable conduct privatization through public issues of shares to encourage development of the securities markets. [Recommendations 39 through 42, pages 27 and 28]

III. Increasing Securities Demand

Improvements are needed in the demand for securities, by both institutional investors and individuals. The following actions are recommended.

(1) Remove unfair disparities favoring investment in government securities or deposit in banks, as compared to investment in company securities. [Recommendation 43, page 30]

(2) Encourage institutional investors to invest in securities, and review and as appropriate relax any limitations that they can invest only in "admitted assets", which may preclude investment in certain securities. [Recommendation 44, page 30]

(3) Remove tax disincentives to savers investing in securities, and consider providing positive incentives of various kinds, including removal of double tax on share dividends. [Recommendations 45 through 50, page 30]

(4) Consider establishment of "personal equity plans" or "individual retirement accounts" with tax benefits, to encourage investment in securities. [Recommendation 51, page 31]

(5) Consider establishing specialized investment companies or mutual funds with tax advantages, similar to those provided in Brazilian "157 Funds" and French "SICAV Funds", in order to encourage broad investment in securities. [Recommendation 52, page 31]

(6) Encourage employee stock purchase plans. [Recommendation 53, page 31]

(7) Encourage broader advertising of

brokerage and securities investment to encourage savers to participate in the market. [Recommendation 54, page 31]

(8) Make finance more easily accessible for brokers to engage in securities dealing and for customers to purchase securities. [Recommendation 55, page 32]

(9) Allow brokers to act as underwriters, to provide the broadest distribution of securities. [Recommendation 56, page 32]

(10) Improve auditing, accounting and financial reporting, through adopting generally accepted auditing standards and accounting principles, establishing uniform requirements for financial statements, and adopting requirements to issue consolidated financial statements where appropriate. [Recommendations 57 through 61, page 33]

(11) Improve disclosure of material information from companies, and market information as to events occurring in the market. [Recommendations 62 through 74, pages 34 through 36]

(12) Consider improvements in professionalism in the securities markets, including limitations on manipulative practices and improvements in self-regulation and the duties owed by brokers to their customers. [Recommendations 75 through 79, page 36]

(13) Determine the extent to which government wishes to allow or encourage foreign investment, and if appropriate take steps to facilitate this. Consider encouraging repatriation of funds taken out of the country, for investment in domestic securities. [Recommendations 80 through 85, pages 36 and 37]

IV. Encouraging Financial Intermediaries

Improvements are needed in financial intermediaries and securities exchanges to bring together and stimulate increased securities supply and demand. The following actions are recommended.

(1) Take steps to foster development of broader based, more active securities firms.

Securities firms, particularly merchant banks and investment banks, may be considered as "engines" that make the new issues securities markets work. As a first step, make detailed evaluation of steps necessary to encourage securities firms. [Recommendation 86, page 39]

(2) Provide incentives for merchant banking firms to act as underwriters to bring to market new issues or blocks of privately held shares. [Recommendation 87, page 39]

(3) Determine financing needs of securities firms, and consider lines of credit and discount window to facilitate such firms' securities activities. [Recommendation 88, page 40]

(4) Remove limitations on underwriting fees and commissions. [Recommendation 89, page 40] As indicated earlier, take steps to increase the "securitization" of finance, thus providing opportunities for merchant banks and securities firms. [Recommendation 90, page 40] In addition, provide the tax incentives to companies to raise finance through public issues discussed above. [Recommendation 91, page 40]

(5) Improve issue procedures, and remove any legal impediments to securities issues. [Recommendations 92 through 95, pages 40 and 41]

(6) Encourage development of new types of securities finance and a full product line of business for securities firms. [Recommendation 96, page 41]

(7) Educate firms and companies on techniques of corporation finance and underwriting. [Recommendation 97, page 41]

(8) Provide authority and, if needed, incentives to encourage investment banks to act as dealers in securities they underwrite. [Recommendation 98, page 41]

(9) Consider authorizing and encouraging joint ventures between local and foreign firms with skills in merchant banking who are willing to make a commitment to the Philippines. [Recommendations 99 and 100, page 41]

(10) Remove any legal impediments to investment banking and underwriting, such as inappropriate regulation of investment banking firms as commercial banks. [Recommendations 101 and 102, page 42]

(11) Take steps to improve securities brokerage activity, including: removal of any inappropriate taxes; provision of lines of finance; removal of inappropriate "unlimited liability" standards and replacement of them by "net capital" (liquidity) ratios; allowing brokers to act as underwriters; and training for brokers. [Recommendations 103 through 113, pages 42 through 44]

(12) Improve ability of securities exchanges to meet development duties aimed at encouraging growth in the securities markets; evaluate and possibly improve certain aspects of exchange trading methods; consider improvements in their ability to act as "self-regulatory organizations" to prevent abusive practices in the markets. [Recommendations 114 through 129, pages 44 through 47]

(13) Re-evaluate, with caution, potential for growth of venture capital. Attempts to improve the situation have been made in the past but have not been successful. [Recommendations 130 through 137, pages 48 and 49]

V. Legal and Regulatory Matters

The legal and regulatory environment should be improved to foster increased securities supply and demand. The following actions are recommended.

(1) Establish a government or private sector entity with duties to foster development of the capital market. [Recommendations 138 and 139, page 51]

(2) Review organization and capacity of Securities and Exchange Commission to provide investor protection. [Recommendations 140 through 155, pages 52 through 55]

(3) Improve the capacity of stock exchanges to take steps to encourage development of the market, and to act as self-regulatory organizations. [Recommendations 156 and 157, page 55]

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(4) Review, and revise as appropriate, laws and regulations to remove impediments to market growth, particularly the Securities Act, the Corporations Code, and business tax laws. [Recommendations 158 through 185, pages 56 through 61]

(5) Conduct full "legal audit" of all other laws, rules, procedures, etc., which could impede development of the capital market, and remove such impediments as appropriate. [Recommendation 186, page 61]

VI. <u>Training, Education</u>

To facilitate improvements in the supply of and demand for securities and market development, the following training and education actions are recommended.

(1) Establish a program to educate companies in improved methods of corporate finance and where various types of finance can be obtained. Consider courses in "entrepreneurship" and risk-taking, and in ways to develop business in the Philippine environment. [Recommendations 187 and 188, page 62]

(2) Arrange for senior officials and private sector representatives to visit selected countries (eg. Korea, Jordan, Brazil) to study their market development techniques. Carry out training for improved disclosure of material information, conduct of brokers, and self-regulation in the securities markets. [Recommendations 189 through 193, pages 62 and 63]

(3) Conduct public education program on securities markets functions and opportunities. [Recommendation 194, page 63]

C. <u>Action Program</u>

To implement the above recommendations, an Action Program in three phases should be established. [Recommendation 195, page 64]

<u>Phase I: Initial Actions</u>

This first phase could be conducted over an 8 to 10 month period of intensive work, to survey relevant issues and agree on specific recommendations. During Phase I actions that clearly should be taken quickly to encourage market growth could be implemented as a matter of priority.

1. General. Establish joint government and private sector Capital Market Development Working Group, to design a specific action program for capital market development, including the recommendations in this report. Survey capital market, and survey environment for business encouragement. Visit other developing markets.

2. Supply/Demand. Design specific recommendations for increasing the supply of and demand for securities. Examine tax disincentives/incentives to supply of and demand for securities. Design requirements for securitization of finance. Review privatization program and take steps as appropriate to encourage privatization through public offerings of securities. Review accounting and auditing practices and agree on steps for improvement.

3. Intermediaries. Design actions to foster growth of full service securities firms, such as merchant/investment banks, and re-evaluate universal banking. Review trading procedures and other related matters in the stock exchanges and determine whether changes may be needed. Examine prospects for venture capital, and tailor such activities to Philippine needs.

4. Legal/Regulatory. Determine which entity should take charge of securities market development role, and how it should carry out development activities. Review Securities Act and Corporations Code and rules and regulations thereunder. Begin legal audit to evaluate other laws and regulations which may inhibit capital market development. Evaluate any needed protections for investors, including minority shareholders.

5. Training. Consider carefully organized visits to selected countries (eg. Korea, Jordan, Brazil) to evaluate their capital market development techniques and experiences.

Phase II: Medium Term Actions

Phase II could be conducted over a 12 to 18 month period. During this phase specific recommendations made in Phase I would be implemented, with implementation first of the steps that are likely to bring the quickest results.

1. Supply/Demand. Adopt incentives to companies to raise finance through public offerings of securities, and to investors to purchase securities. Take recommended steps to encourage increased securitization. Improve disclosure of company information and market information. Adopt recommendations to improve accounting and auditing.

2. Intermediaries. Adopt incentives and other steps necessary to encourage growth of securities firms.

3. Legal/Regulatory. Adopt any needed amendments to Securities Act, Corporations Code and other laws. Adopt any needed revisions to Securities Exchange Commission, stock exchange, and other rules and regulations. Continue legal audit to evaluate other laws and regulations which may inhibit capital market development, and adopt appropriate changes.

4. Training, Education. Train appropriate persons in capital market development, regulation and self-regulation. Begin education of issuers concerning use of financial markets. Begin public education program.

Phase III: Longer Term Actions

The third phase could be conducted over 24 to 36 months, during which longer term actions would be taken.

1. General. Review success of actions already taken, and make changes as needed.

2. Supply/Demand. Consider whether incentives adopted to increase the supply of and the demand for securities have been adequate. If not, consider more vigorous or more direct approaches.

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3. <u>Intermediaries</u>. Continue to evaluate and adopt proposals to improve securities firms.

4. <u>Legal/Regulatory</u>. Monitor success of changes made in securities regulation. Evaluate market development activities of Commission or other body charged with encouraging this. Adopt further changes as determined by legal audit.

5. <u>Training</u>. Continue training corporate finance executives, securities professionals and others.

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TWO: ISSUES AND RECOMMENDATIONS

I. Need for Capital Market Development Policy, and Working Group

A. Concerns

There is an urgent need to establish a clear and comprehensive policy to encourage development of the long term securities markets. In earlier periods, securities markets were not considered important savings mobilizers. Most companies were able to obtain finance from control groups, through loans from commercial banks, and through loans at below market rates of interest from development finance institutions.

It is true that many financial intermediaries have been established and numerous steps have been taken over the years. Nevertheless, these steps have often been ad hoc responses to specific circumstances. In addition, they have not always been successful, because they did not adequately reflect circumstances in the Philippines, were based on assumptions which did not turn out to be true, were frustrated by government favoritism, or were overtaken by changes in the economy.

B. Recommendations

1. Need for Development Policy. The absence of a clear policy at a high government level in favor of capital market development is itself a constraint to development. It has led many to believe that the government does not have a sufficient interest in it. Therefore, as a matter of priority, the government should now undertake an organized and concerted effort to establish a comprehensive policy to develop the capital and securities markets as part of the economic development strategy for the Philippines. [Recommendation 1]

2. Development Working Group. The government should establish a Capital Market Development Working Group to evaluate and agree upon steps to be

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taken to develop the market. The Development Group should be given a wide mandate, (a) to examine problems in the market and government policies which impede market development, and (b) to recommend actions to resolve problems identified now and problems which emerge over time. The recommended actions in this report may serve as the basis for initial work of the Development Group, but its mandate should be broad enough to cover all areas of needed investigation and action. [Recommendation 2]

3. Joint Development Effort. The Development Group should be a joint effort between the government and the private sector, and should bring together all available capital market expertise. Therefore, brokers, stock exchange officials, merchant bankers, institutional investors, representatives of individual investors in the market, and all other interested parties should participate directly in the Development Group, to provide detailed knowledge of how the markets work and what companies, investors and securities professionals need in order for the markets to develop. [Recommendation 3]

4. Possible Development Conference. Brokers indicated in 1986 that they wish to hold a conference on capital market development. The Securities and Exchange Commission indicated that it favors such a conference to encourage dialogue among, and market development proposals from, all interested parties and to reach specific recommendations on actions that should be taken to develop the market. A draft conference outline indicates that the following topics would be discussed over a two-day period: (1) Historical and Economic Background of the Philippine Capital Market and its Importance to a Developing Country; (2) Critical Issues; (3) Effects of Government Policies; (4) Regulatory Environment; (5) Approaches Toward Development: Regulation, Stock Exchange, Government Role; and (6) Conclusions and Recommendations.

There is some reason to be skeptical about capital market development conferences. They often lead to higher expectations than can be fulfilled. The fact that they are going to be held can lead some people to delay engaging in detailed action analysis of market problems because they expect to get that from

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the conference. Conference speakers often do not have any specific actions to propose. Thus a conference can easily degenerate into generalities or a "complaint session", discouraging action rather than encouraging it.

However, if the sole expectation of a conference is to advertise and announce a clear decision by the government to encourage capital market development, then a conference may be worth holding. Certainly conferences should not be discouraged, but regardless of any such plans the main effort should be to establish specific actions for market development by the Development Group. [Recommendation 4]

If a conference is held, the subjects to be addressed should include all important issues, and not be limited to any one group's narrow views. Senior government officials should participate in the deliberations at any conference. The government should advise the conference sponsors that it will seriously consider the recommendations of the conference. [Recommendation 5]

Any conference should be assisted by a Working Group of knowledgeable persons from the capital market and government, who would be responsible for establishing specific recommendations from the conference and presenting the same to appropriate parties. [Recommendation 6]

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II. Increasing Securities Supply

A. Concerns

Companies in the Philippines do not often raise long term finance through the securities markets. The result is that companies are seriously undercapitalized, and have too much debt. Of the top 1000 companies, in 1985, only 48 were listed on the Manila and Makati Stock Exchanges. The total number of listed companies was 138. Public offerings of equity securities have been limited to a few offerings a year. Most new issues have been rights issues of additional shares to existing shareholders at par value, below market price.

Most listed companies have only a limited number of their shares available for trading in the hands of the public. Estimates are that perhaps only 30% of the shares of listed companies is available for trading in the market, and the majority is held by principal owners and institutions as permanent investment. Some of the lesser known companies may well have only 5 to 10% of their shares available for trading.

Those interviewed and commentators suggested that the limited supply of publicly held securities was attributable to a number of factors:

(1) Earlier wide-scale availability of loans, often at below market rates of interest reflecting government selective credit policies, from government sponsored financial institutions, such as the Development Bank of the Philippines.

(2) High but changing interest rates, encouraging short term investment and discouraging long term investment.

(3) Inability of companies to provide the high yields on a long term basis that investors were used to obtaining from short term money market instruments.

(4) Failure by government to consider the long term securities markets as important mobilizers and allocators of savings, and absence of government policy to develop the securities markets.

(5) Tradition of families and businessmen to retain control of companies.

(6) In earlier periods, extensive government ownership of companies, and control of many industries by persons alleged to have had special relationships with government officials.

(7) In earlier periods, inhibitions of businessmen to expand or start new businesses, because they feared being taken over by others with special relationships with government authorities.

(8) Tax advantages encouraging companies to borrow, because interest expense is deductible but dividend payments on shares are not.

(9) Limitations on securities underwriting commissions (fixed by government) and other regulations discourage underwriting.

(10) Administrative difficulties and cost of public offerings.

(11) Dislike by businessmen of disclosure and other requirements applied to publicly held companies.

(12) Lack of confidence in the securities markets.

(13) Belief by businesses that because the securities markets have traditionally supplied only a limited amount of finance, they will not be able to provide larger amounts.

(14) Passage of the economy from limited trading activities, requiring very little long term capital, to enterprises requiring significant capital (industrial, mining, oil), but failure of financial institutions to shift in mentality from working capital financing to longer term financing.

(15) Predominantly agricultural base of the economy, with relatively few companies requiring significant capital.

(16) During earlier periods, improper allocation of new issues of securities to favored persons; it is alleged that in some cases companies increased

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their equity by issuing a block of new shares to favored insiders, and in some cases to outsiders with special relationships with government.

B. Recommendations

1. Business Environment. The environment for business in the Philippines appears to suffer from a number of difficulties, many of which may be more related to overall economic and political considerations, but all of which need to be addressed to clarify the role of business and to encourage it. If growth of business is encouraged, it will need additional capital, which could be obtained in the securities markets. A number of steps should be considered.

(a) Evaluation. An evaluation should be conducted by government and private sector business representatives, entrepreneurs, and outside experts knowledgeable in business development, of the workings, operations, problems and prospects of business in the Philippines. A high level working group should conduct the evaluation and suggest specific steps to improve the environment for business development. This could be the Capital Market Development Working Group, a special committee of this, or a separate Business Development Working Group with a representative from the Capital Market Development Working Group. [Recommendation 7]

Existing businesses, both large and small, should be polled, through a questionnaire followed up by selected interviews, as to the problems and prospects they see for business in the Philippines and what steps they believe should be taken to improve business prospects. [Recommendation 8]

(b) Government Business Activities. If it has not already been done, an examination should be made as to the extent to which government is involved in business activities, directly and indirectly. From this, a determination should be made, and widely announced, as to which commercial activities are to be considered legitimately within the scope of government, and those which should and will be left to the private sector. Substantial work has been done in this regard in connection with the Privatization Program. This work should be continued, but here we are talking about the effect on the business environment, focusing not on selling assets, but on steps to improve the environment for business. [Recommendation 9]

(c) Business Expansion Scheme. To encourage new ventures, or expansion of existing ventures, government should consider establishing a business expansion scheme (such as exists in England), designed to foster development of certain types of business, such as small businesses, high tech or not (as appropriate to Philippine needs). Possibly investors in equities of such companies should be allowed to take a credit to their taxes if the investor holds the shares for a specified period. Information as to where those in need of finance, such as entrepreneurs, may obtain it should be made widely available. [Recommendation 10]

2. Excessive Concessional Lending. Eliminate widespread concessional credit, to the extent it still remains, and require finance to be obtained at market rates. One of the major causes of underdevelopment of the securities markets appears to have been excessive availability of loan finance during earlier times, leading companies to borrow in foreign currencies even though they did not have an income stream in foreign currency and they bore exchange risk. It is imperative to assure that lending is at market rates and that company debts are not excessive. [Recommendation 11]

3. Short Term Market Rates. Take measures as practicable to reduce high interest rates paid on short term securities in the money market, which companies are not able to equal in interest or dividends on long term securities. [Recommendation 12]

4. Securitization. The supply of securities could be increased by requiring commercial banks and other lenders to insist that companies seeking loans demonstrate that they have prudent ratios of debt to equity and short term to long term debt. This requirement could be implemented by instructions from the Central Bank to the commercial banks. [Recommendation 13]

Companies seeking finance over a specified amount from banks and others (through short or longer term debt) should be required to raise a portion of that finance in a "parallel" public offering of notes, bonds or shares. [<u>Recommendation 14</u>]

All companies seeking finance over a specified amount should be required to provide the opportunity to independent merchant banks to bid to raise the finance through issues of the company's securities. This "competitive bidding" could produce lower cost financing. [<u>Recommendation 15</u>]

All companies that obtain benefits under government investment or funding schemes (such as development bank finance) should be required to raise parallel finance in the securities markets. The government should enforce any existing requirements, or adopt more effective requirements, that companies receiving tax holidays and other incentives should offer a certain percentage of their shares to the public and continue to maintain such public ownership. [<u>Recommendation 16</u>]

5. <u>Range of Securities</u>. Assure that all types of securities can be issued, such as non-voting shares, warrants, debentures, convertible debentures, debentures with warrants, zero bonds, floating rate notes, participating income bonds, etc. An evaluation of what additional methods of finance could be developed should be made by merchant banks, banks, universal banks, brokers, companies, entrepreneurs and experts in establishing innovative types of finance. [<u>Recommendation 17</u>]

The range of securities could include non-voting preferred shares (which share equally with common shares in dividends but rank senior in liquidation), which could be redeemable, thus encouraging controlling families and groups to raise finance from the public without threat of loss of control. [<u>Recommendation 18</u>]

6. <u>Tax Improvements</u>. Consideration should be given to providing incentives for companies to raise needed finance through public offerings. [<u>Recommendation 19</u>]

At an earlier time companies which had public offerings paid less income tax than closed companies. This difference did not bring about any significant number of public offerings. According to commentators, the tax difference was not sufficient (the reduced tax rate was only 5% lower, and required only that the company had 20 shareholders), and companies found ways to fit within the public offering exemption without having a bona fide public offering, for example by "parking" securities with favored friends, suppliers, etc.

Consideration should be given to the following actions to increase raising of finance through securities issues:

(i) Significantly reduce the tax paid by companies that have public offerings. [Recommendation 20]

(ii) Require the public offering to be to a specified minimum number of shareholders, such as 300 to 500, each owning a small number of shares, in order to avoid concentration. [Recommendation 21]

(iii) As suggested by one knowledgeable commentator, to prevent large investors from seeking to gain concentrated power in companies, encourage investors to diversify their investment by allowing a tax exemption, or lower taxes, on dividends they receive from publicly traded companies only where the dividends received amount to a small percentage of the total dividends paid out by that company. [Recommendation 22]

(iv) Require that the company maintain such broad public distribution, or lose the tax reduction. [Recommendation 23]

(v) Provide annual detailed tax audits for companies of a specified size of assets, sales, revenues, book value, etc., which could have public offerings but do not. [Recommendation 24]

(vi) Allow companies which have public share ownership meeting the standards described above to deduct from taxable income the dividends they pay out. This would remove the tax disparity which encourages companies to incur debt, interest on which is deductible. [Recommendation 25]

(vii) For companies meeting the "public offering" standards described above, provide increased tax depreciation, investment credits. deductibility of research and development costs, tax loss carry forwards and the like. [Recommendation 26]

(viii) Make it clear that expenses (underwriting commissions, accounting, legal, etc.) of public offerings are deductible for tax purposes, as are costs for negotiating and incurring loans. [Recommendation 27]

(ix) Reduce or eliminate any issue tax or stamp tax on securities. [Recommendation 28]

(x) Eliminate share transfer taxes on public sales by large shareholders, to encourage them to sell shares to the public. [Recommendation 29]

(xi) For company bonds, provide a final withholding tax on interest (now taxed at marginal rates up to 35%) to equal the withholding tax on preferred share dividends (15%). [Recommendation 30]

(xii) The existing tax on retained earnings of more than 100% of existing capital should be evaluated to see if it limits business expansion and thus the need to raise finance. If so, the tax should be removed. [Recommendation 31]

7. More Direct Inducements. If incentives to public offerings are not seen to offer sufficient improvements, consider more direct approaches, such as: (a) making bank loan finance available to companies only if they have public issues or requiring certain companies to raise equity finance through public offerings (approaches followed with success in Korea), and (b) granting limited liability to companies over a minimum size only if they have public issues (an approach followed in Jordan). [Recommendation 32]

8. Underwriting. Remove government control of underwriting and selling commissions, and encourage underwriting activities. [Recommendation 33]

9. Advantage of Closed Companies. A major

concern in capital market programs is to encourage companies to sell securities to the public. However, many businessmen fear the additional disclosure requirements they must face if their companies are publicly owned. Therefore, they prefer to remain privately owned "closed" companies. Accordingly, it will be necessary to evaluate the regulatory disparities between closed and open companies of comparable size, and to reduce or eliminate any unjustified advantages of remaining a closed company, for example by reducing the differences in financial reporting requirements. [Recommendation 34]

10. Par Value. Share issues in the Philippines have traditionally been sold at par value, rather than the higher value in the market. This amounts to a discount from the real value of the shares, discouraging companies from raising finance through share issues. It also tends to drive the market price down, discouraging investment, and reduces the supply of securities by discouraging controlling shareholders from publicly offering their shares at the reduced market price. Therefore, shares should be sold at market value. [Recommendation 35]

11. Pre-emptive Rights. Make it clear that existing securities holders do not have preferential rights to purchase new public issues of securities, and thereby increase the supply of securities in public offerings. In the US the removal during the 1920s of pre-emptive rights was a major spur to securities market growth. Other countries have relaxed or removed pre-emptive rights, especially in the case of underwritten public offerings of securities. The London Stock Exchange has recently indicated that it too will relax this requirement in the light of the need to provide industry with improved access to long term finance and to encourage merchant banking.

Pre-emptive rights can deter capital market development and encourage debt finance. Securities firms are discouraged from suggesting equity methods of finance, because the company cannot issue equity to outsiders without first offering it to shareholders. Thus financial intermediaries are encouraged to recommend loan finance approaches. Because the principal source of loan finance may be the banks, and banks

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lend (and prefer to lend) short term, companies end up with short term loans which they hope to roll over. Equity capital is discouraged. Therefore, pre-emptive rights should be removed. [Recommendation 36]

12. Allocation. Eliminate and prevent re-occurrence of any favoritism that may have existed in earlier periods in the allocation of issues of securities. Require all issues be offered publicly except in specified circumstances. [Recommendation 37]

13. Private Sales. It appears that some companies make private sales to institutional investors of fixed return preferred stock and bonds. Thus securities which could otherwise have been offered to the public are offered only to a privileged "inner circle". Preferred stock and bond issues should be listed for trading on the stock exchanges and be partially offered to the public. [Recommendation 38]

14. Privatization. A program is being implemented for the government to divest itself of (a) ownership and involvement in businesses in which it is determined it should no longer be involved, and (b) "non-performing assets" which government financial institutions were forced to take over. Any divestiture program should be carefully established and monitored to bring about the most efficient and economically sound reorganization of the companies and assets divested. Particular care should be taken to assure that purchasers are not given an inappropriate windfall through distress sales, or allowed to create undue concentrations of business power, as happened in Chile in the late 1970s when the government sold off nationalized companies. [Recommendation 39]

Consider which companies are proper candidates for sale to the public, and which could be sold to publicly traded mutual funds and investment companies established for this purpose. [Recommendation 40]

In privatization programs there is usually a tension between the desire on the one hand to obtain the best price and get non-performing assets off the books of the government ("revenue goals"), and the desire on the other hand to broaden public ownership of securities ("wider share ownership goals"). In many programs, the balance shifts simply to getting the assets off the government's books. However, in the case of profitable government owned companies, serious attention should be given as to whether the securities could be sold in widely distributed public offerings, with the result of not only taking the company off government books but also using the opportunity to help develop the securities markets. England has followed this approach in privatizing a number of important companies, such as British Telecom, British Airways and British Gas. This experience should be evaluated in connection with how the privatization program in the Philippines could be used to assist the capital market development program. [Recommendation 41]

Where debt to equity conversion programs are used to foster or provide inducements in the sale of government companies or non-performing assets, consideration should be given to encouraging or requiring the beneficiaries to distribute securities in the securities markets, especially with a view to avoiding reconcentration of control in a different group. [Recommendation 42]

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III. Increasing Securities Demand

A. Concerns

During earlier interviews it was claimed that the low demand for securities during earlier periods derived from the following factors:

(1) Unwillingness of investors to commit funds long term.

(2) Availability of other more profitable investments with fixed returns, including government securities paying very high yields (tax free).

(3) Economic downturn.

(4) Low profitability of companies.

(5) Requirements that banks and institutional investors invest in government securities, and limitation that insurance companies can invest in shares only if the issuing companies meet specified earnings standards which are too rigid.

(6) Insufficient number or interest of individual investors.

(7) Perceptions by investors that if they try to purchase securities, they will not be able to obtain them because of inadequate supply.

(8) Speculative nature of many companies listed on the exchanges.

(9) Lack of confidence in the exchanges. Fear of being minority shareholders in family controlled companies. Uninformed small investors have purchased securities on the basis of rumor, and having been harmed, do not trust the market.

While demand increased during the past year, the demand is not widespread, is more speculative and is likely to recede. Thus, broader and more sustained investor demand should be fostered.

B. Recommendations

1. Deposits, Government Securities. An evaluation should be made of any disparities favoring mobilization of savings into banks or government securities as compared to corporate securities (eg. tax treatment of earnings as compared to earnings on long term corporate securities). Appropriate recommendations to redress imbalances should be developed. [Recommendation 43]

2. Institutional Investors. Encourage institutions, such as insurance companies and trust departments of banks, to invest in securities. Insurance companies and other institutional investors are limited in their investments to companies which meet certain earnings tests over the preceding two or three years, so-called "admitted assets". These requirements should be reviewed and greater freedom allowed. [Recommendation 44]

3. Tax. Provide incentives to investors in public issues of securities. The government has indicated its willingness to undertake the tax analysis. Incentives to be considered include the following:

(i) Credit for purchases of new issues of securities (directly or through collective investment schemes, such as mutual funds and investment companies). [Recommendation 45]

(ii) Exemption from tax for dividends, totally or up to a specified amount. [Recommendation 46]

(iii) Reduction of withholding tax on shares. [Recommendation 47]

(iv) Provision for a final tax of 15%, withheld at source, on corporate bonds (now taxed at individual marginal rates up to 35%). This tax would then equal the 15% withheld as final tax on preferred share dividends. [Recommendation 48]

(v) Removal of double tax on shares and dividends. [Recommendation 49]

(vi) Tax write-offs for capital losses and worthless securities. [Recommendation 50]

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4. Personal Investment Plans. The Philippines should encourage individuals to invest in securities by providing tax incentives for "personal investment programs" similar to such plans now being adopted in England, or "individual retirement accounts" similar to plans existing in the United States. These plans provide incentives for individuals building up a portfolio of investments. [Recommendation 51]

5. Specialized Investment Companies. The government should consider authorizing establishment of investment companies or mutual trusts with incentives for small savers to purchase shares in the company or trust which will then invest the pooled funds in securities.

Brazil adopted such investment companies, called "157 Funds", in the late 1960s, and they constituted a very important spur to individual investment and thus growth of the securities markets. France adopted a similar approach, referred to as "SICAV Funds", and these provided incentives for small investors, although the incentives have varied over successive periods of private sector encouragement and then discouragement in France during recent years. Problems experienced in earlier attempts to establish "closed end, front loaded" funds should be evaluated. It is likely that these problems could be overcome with proper techniques. [Recommendation 52]

6. Employee Share Plans. The Philippines should consider authorizing or encouraging companies to set up programs whereby their employees may purchase shares in the company. Company employees will have a view about the company's future and an interest in participating in its growth through share ownership. [Recommendation 53]

7. Advertising. Widespread advertising of securities investment activities should be considered. This is a growing trend in England (where brokers have set up share marketing shops in department stores), and a long established practice in the United States. [Recommendation 54]

8. Securities Finance. Finance should be made available (subject to proper controls) for securities transactions, to permit brokers' customers to purchase securities on margin. Brokers should be allowed access to a discount facility to finance their trading portfolios. [Recommendation 55]

9. Broker Underwriting. Securities brokers should be allowed to act as underwriters, for more active distribution of securities and solicitation of public customers. [Recommendation 56]

10. Accounting and Auditing. Knowledgeable bankers complained that financial statements of Philippine companies are not reliable. They said that the statements often do not disclose information according to any uniform standards. Furthermore, the accounting principles applied are not uniform or based on specified requirements. They also indicated that the statements are not trustworthy, because the audits upon which they are based may not be accurate and are not based on specified or uniform auditing requirements. Finally, they indicated that some companies simply refuse to provide adequate disclosure of financial information or to file required statements with the Securities and Exchange Commission.

While the above concerns may not apply to the most respected companies, accounting and auditing principles must be established and applied which reflect the real situation and results of operations (profit and loss) of the companies involved. This means there must be uniform financial reporting requirements, agreed-upon and fair generally accepted accounting principles and generally accepted auditing standards, and independent accountants.

The following actions are recommended:

(a) Evaluation. A joint evaluation should be undertaken by the government, the private sector and the accounting and auditing profession of the areas requiring improvement. An evaluation of financial statements of representative companies should be carried out to determine exactly what problems exist. A letter should be sent to all accountants requesting their evaluation of adequacy of accounting and auditing requirements, financial reporting forms, and financial disclosure requirements of securities law and company law. [Recommendation 57]

(b) Accounting Principles. The Philippine Accounting Standards Council ("ASC"), formed in 1981 by the Philippine Institute of Certified Public Accountants, should be encouraged to establish generally accepted accounting principles ("GAAP"). Pronouncements of the Council should be given binding legal force unless disapproved of by the Securities and Exchange Commission. [Recommendation 58]

(c) Auditing Standards. Efforts should be encouraged to establish the proposed Accounting Standards Board ("ASB") by the Association of Public Accountants in Public Practice. It should be encouraged to establish and regulate generally accepted auditing standards ("GAAS") in the Philippines. The ASB would be an independent body composed of representatives from the Securities and Exchange Commission, the Board of Accountancy, and auditing firms. [Recommendation 59]

(d) Financial Statements; Consolidation. Uniform formats for financial statements should be required. Where appropriate, financial statements should be required to be consolidated, to include all subsidiaries and affiliated companies. [Recommendation 60]

(e) Supply of Accountants. Assistance should be provided to the Board to expedite examination of an increased number of persons seeking to qualify as certified public accountants. [Recommendation 61]

11. Disclosure of Information. It was asserted by most persons interviewed that Philippine companies do not disclose adequate information about their businesses and prospects, and that investment is made on the basis of rumor and inside information.

It is alleged that some companies required to file reports with the Securities and Exchange Commission simply fail to do so. In addition, the disclosure process through the Commission appears to be based on the concept that information is simply "filed" at the Commission, where interested parties are expected to

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come and inspect it. There appears to be no requirement or practice that the companies publicly disseminate the disclosure documents, for example to securities holders, stock exchanges, brokers, etc.

There appear to be no specific requirements that companies make "continuing" disclosure of material information to the market. Companies are not required to prepare annual meeting proxy statements complying with specified disclosure standards.

Finally, there is no well-established entity compiling information and statistics which publishes its own summary reports on companies, such as Value Line in the United States and Extel in England.

A number of steps should be considered:

(a) Filings, Data Base. Require all companies supposed to file reports, to make such filings. [Recommendation 62]

Evaluate practicality of keeping company disclosure reports in a computer base available for broad public access. [Recommendation 63]

Improve the system for record-keeping of reports to the Securities and Exchange Commission, by using a microfilm or microfiche system or its modern equivalent, also capable of producing "hard copies", and consider a more advanced computerized information system along the lines of the "Edgar" system at the United States Securities and Exchange Commission. [Recommendation 64]

Establish a centralized computer data base of published information on companies (financial results, securities prices, etc.), markets, finance, etc. This data base would be used (i) to provide needed information for comparisons among companies, (ii) to provide information on public offerings, private placements, trading in the markets, and financial statements, and (iii) to assist in the continuing evaluation of what steps should be taken to improve financial markets. If an existing computer system is already established, improve that system to include needed information and regular up-dating. [Recommendation 65]

(b) Material Information. A definition

should be adopted of "material" information required to be disclosed by the Securities Act. The United States definition is information "a reasonably prudent person would wish to know in order to make informed investment decisions". [Recommendation 66]

(c) "Continuing" Disclosure. Require companies with over a specified number of shareholders (such as 300): (i) to file a basic registration statement with the Commission and to update such statements annually, (ii) to make reports on the occurrence of specified events (sale of assets, etc.), (iii) to issue quarterly financial information (consolidated), and (iv) to disclose all material information at the time it first becomes known. Require such companies to issue proxy statements for annual meetings of shareholders, disclosing specified information concerning management, candidates for election, and the business and financial statements of the company. The above approach is known as "continuing disclosure", as compared to disclosure only at the time of a public offering. [Recommendation 67]

In addition, exchanges should review and improve listing disclosure requirements. [Recommendation 68]

(d) Public cf. Private Companies. To reduce the advantages of remaining a closed company, lessen disparity between the information which public and closed (privately owned) companies of a specified size must disclose or file with the Securities and Exchange Commission. [Recommendation 69]

(e) Paper Companies. Require adequate disclosure, or restrict access to public markets, by "paper" companies (those with no real business activities). [Recommendation 70]

(f) Market Information. Improve disclosure of market information (prices, volume of trading, etc.). [Recommendation 71]

(g) Liabilities, Enforcement. Allow claims for civil liability against companies which fail to make adequate disclosures. Improve enforcement capability of the Securities and Exchange Commission to impose disclosure requirements. [Recommendation 72]

(h) Credit Information. Consider improving Credit Information Bureau's services by improving underlying company information upon which its decisions are made. Require all companies which must make public disclosures and issue public financial statements to also file copies with the Credit Information Bureau. [Recommendation 73]

Consider expanding the Bureau's services into research beyond credit rating, to include the profitability, etc. of companies, to produce basic research reports. [Recommendation 74]

12. Securities Professionalism. Improve professionalism in the securities markets, to encourage increased interest and confidence and to deal with the perception that the market is a "gambling den". Consider the following actions:

(i) Limiting manipulative practices [Recommendation 75];

(ii) Improving regulation by the Securities and Exchange Commission [Recommendation 76];

(iii) Improving self-regulation by the stock exchanges [Recommendation 77];

(iv) Imposing on brokers fiduciary duties to act in the best interest of the customer and make informed recommendations [Recommendation 78];

(v) Facilitating "self-policing" by brokers and other securities professionals, by imposing on them civil liabilities to those harmed by their violations of law and regulation [Recommendation 79].

13. Foreign Investment. The government and private sector should examine foreign investment. A number of actions could be considered:

(a) Evaluation. Determine the extent to which the government wishes to allow or encourage foreign investment. This is a delicate political question, and different countries come to different solutions. The Capital Market Development Working Group

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should begin this analysis and expand it with other appropriate persons. [Recommendation 80]

(b) Investment Procedures. Evaluate the procedures for allowed foreign portfolio and direct investment, and remove any unduly burdensome requirements, inappropriate delays in remittances, etc. [Recommendation 81]

(c) Expatriates. Consider establishment of an investment fund for Philippine expatriates to invest in the Philippines. If politically acceptable, possibly consider some form of "amnesty" (as did India in 1984) for return of money from abroad in cases where it may have been improperly taken out. [Recommendation 82]

(d) Fund. As the markets improve, consider establishing an investment fund through which foreigners can invest in the Philippines (similar to what Korea has done). [Recommendation 83]

(e) Tax. Consider tax incentives for foreign investment. Evaluate withholding tax. Evaluate tax treatment provided by other countries for foreign investment, to determine relative competitive position of the Philippines. Review double tax treaties with foreign countries, to determine tax treatment for foreigners who invest in the Philippines, and the relative competitive position of the Philippines in this regard as compared to other countries. [Recommendation 84]

(f) Information/Access. Improve access by foreign investors to securities firms in the Philippines. Evaluate how foreign securities firms could help increase investment in the Philippines. [Recommendation 85]

IV. Encouraging Financial Intermediaries

1. Fostering Broader Based, More Active Securities Firms

A. Concerns

There is insufficient merchant banking and investment banking activity in the Philippines. The principal financial institutions are the commercial banks. Commercial banks that have obtained "expanded commercial banking" licenses under the 1981 universal banking law amendments are authorized to act also as merchant banks and engage in underwriting. The objective of universal banking was to encourage term transformation, whereby banks would provide longer term finance to companies. In 1973 brokers were eliminated from acting as underwriters, when underwriting authority was given to investment companies, and were not reinstated in 1981 when power to engage in underwriting was given also to commercial banks which qualify as universal banks.

Investment banks and merchant banks may be considered as the "engines" that make the new-issue securities markets function. They make "new business calls" on potential client companies to persuade them to use their services to raise finance through public offerings of securities, as compared to direct loans from banks. They compete to create new types of financing approaches and instruments, and to get companies to use these to raise finance.

Universal banking has not brought any appreciable increase in merchant banking activities or term transformation. It certainly has not increased the number of underwritings and public offerings.

For merchant/investment banking to flourish, several elements are required:

(a) Relative ease by firms to engage in a full range of services, including underwriting, and freedom of activity.

(b) Ease of companies to issue securities of all types.

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(c) Clear legal framework.

Those interviewed expressed a variety of views as to why merchant banking had not developed:

(1) High and fluctuating interest rates removed the possibility of investors and companies taking a long term point of view.

(2) The 1981 scandal whereby Dewey Dee, an investment company manager, is alleged to have absconded with large sums, leaving investors with worthless commercial paper, damaging investor confidence. Government severely restricted the commercial paper markets (apparently only 7-10 companies now qualify to issue commercial paper), where investment company merchant banks were most active.

(3) Commercial banks do not appear to be widely interested in merchant banking activities. They are not active in underwriting public issues of securities.

B. Recommendations

1. Evaluation. Securities firms were developing in the early 1970s, and much experience and many perceptions were gained then. A complete evaluation by the government and the private sector, with outside experts if needed, should be made as to what steps are needed to encourage securities firms to engage in long term securities finance. [Recommendation 86]

2. Incentives. Provide incentives for merchant banking firms who act as underwriters to bring new issues or blocks of privately held shares to market, such as (i) tax holidays for such entities, (ii) deduction of costs of establishing operations, (iii) tax exemption for income from underwriting commissions, and (iv) accelerated depreciation and tax loss carry forwards. Conduct detailed evaluation of these matters. [Recommendation 87]

3. Financing. Determine what financing

arrangements merchant banks require, consider lines of credit and discount windows for these firms. [Recommendation 88]

4. Underwriting Commissions, Securitization, Tax. Remove government control over underwriting and selling commissions. Companies and investment banks structuring and arranging for placement of securities issues should be able to decide the correct commissions for such services. Limiting the commission to government approved amounts can discourage underwriting. [Recommendation 89]

As discussed earlier, encourage "securitization" of finance to increase the potential supply of securities for securities firms to promote services [Recommendation 90], and evaluate tax incentives to companies to raise finance through public offerings of securities. [Recommendation 91]

5. Improve Issue Procedures. Streamline the procedures for public issues of securities by, for example:

(i) Requiring all companies over a specified size of assets or revenue to file with the Securities and Exchange Commission a basic registration statement, which must be revised annually, and then allowing companies that have public offerings to use this already filed basic disclosure document, with relatively minor additions, as a prospectus for the public offering. [Recommendation 92]

(ii) Removing the concept that the Securities and Exchange Commission "approves" issuers in public offerings, but instead providing that the Commission only reviews the adequacy of prospectus disclosures. [Recommendation 93]

(iii) Reducing any unduly burdensome listing requirements and costs. [Recommendation 94]

(iv) Revising the Corporations Code and related laws to the extent needed to make issuance of securities easier. (See further discussion under "Legal and Regulatory Matters" subsequently in

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this report) [Recommendation 95]

6. Full Product Line. To provide firms sufficient scope to become self-sustaining and profitable, encourage development of a full product line, including new types of securities, asset management and advice, market-making, private placements, venture capital, leasing, etc. Request proposals on this from brokers, universal banks, investment companies, the Securities and Exchange Commission and other knowledgeable persons. Adopt any needed changes in law and regulation to facilitate this. [Recommendation 96]

7. Corporate Finance. Educate firms and issuers on the techniques of firm commitment underwriting, in which the underwriters purchase the issue from the issuing company or selling shareholders (thus guaranteeing a fixed amount of proceeds from the issue) and resell the securities to investors. [Recommendation 97]

8. Dealing. Provide authority and any needed incentives to encourage investment banks to act as dealers in the securities they underwrite, to provide market liquidity. [Recommendation 98]

9. Joint Ventures. Consider joint ventures with foreign firms skilled in merchant banking and willing to make a commitment to the Philippines. Facilitate any such proposals, such as through tax incentives, ease of remittance of earnings, etc. [Recommendation 99]

It may be the case that foreign firms are deterred, because only investment companies (required paid-in capital of Pesos 20 million, equivalent to $1.060 million) and universal banks can engage in underwriting, but banks must be 60% Philippine owned, and an expanded bank license requires Pesos 500 million in capital (equivalent to $26.511 million). These matters should be evaluated. [Recommendation 100]

10. Regulation, Etc. Review legal environment for investment banking and underwriting, to remove

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any impediments and to assure that equal regulation applies to all types of underwriting, whether conducted by commercial banks acting as merchant banks, by investment companies, or by brokers. [Recommendation 101]

In general, it is suggested that underwriters and investment/merchant banks which do not accept commercial deposits from the public should not be regulated as "banks" under general banking law. [Recommendation 102]

2. Brokers/Dealers

A. Concerns

Brokers are very interested in methods to improve the markets as well as their own activities. A number of possible actions related to improvement of brokerage may be considered.

B. Recommendations

1. Evaluation. The Capital Market Development Working Group, brokers, exchanges and any knowledgeable experts should evaluate the workings, operations, needs and developmental prospects of brokers and dealers, in both their stock exchange and over-the-counter market activities, and should design appropriate recommendations. [Recommendation 103]

2. Gross Receipts Tax. Exempt underwriting, brokerage and similar income from the business gross receipts tax, which of course is passed on to customers. [Recommendation 104]

3. Finance. Provide finance for brokerage and dealer activities and for customer purchases of securities, subject to appropriate controls. [Recommendation 105]

4. Net Capital. If not already done,

evaluate replacing "unlimited liability" requirement for brokers with "net capital" (liquidity) ratios, which can better serve to protect investors by requiring brokers to maintain a safe liquidity ratio. This can also allow for broadening of access into the securities business by firms with needed capital but which justifiably will not take on unlimited liability. [Recommendation 106]

5. Underwriting. Allow brokers to act as underwriters, which they are not permitted to do. [Recommendation 107]

6. Branch Offices. Encourage brokers to have branch offices to develop and serve customers in various parts of the country. [Recommendation 108]

7. Professionalism. Evaluate whether increased professionalism is needed in brokerage, that is whether brokers should be required to be actively engaged in the business of brokerage or whether they can be principally engaged in other lines of business and if so what professional standards they must meet. [Recommendation 109]

8. New Entrants/Joint Ventures. Consider whether new securities firms (and possibly joint ventures with foreign firms expert in securities business development) should be encouraged. [Recommendation 110]

9. Training. Provide training, if required, for brokers in such subjects as: (i) new business development, (ii) financial analysis, (iii) legal and regulatory requirements, (iv) fiduciary duties to customers (recommendations, disclosure, conflicts of interest, best execution), (v) self-regulatory obligations, and (vi) books and record-keeping to segregate customer accounts and securities. [Recommendation 111]

An evaluation should be made of how "buy" and "sell" recommendations are made to securities customers, and whether the broker has, and must give to the customer, disclosure reports published by the issuer of the securities. [Recommendation 112]

Securities salesmen who deal with customers should be subject to improved licensing, training and professional responsibility standards, as compared to current requirements simply to attend a seminar and pay a nominal registration fee. In countries with advanced securities markets, salesmen are required to take courses and pass examinations on the working of the securities markets and to meet industry-wide competence and character standards. [Recommendation 113]

3. Stock Exchanges

A. Concerns

The examination thus far has not focused in depth on the operation of the stock exchanges. As indicated earlier, the major problem is inadequate supply of securities. However, if action is taken to improve supply and demand, the stock exchanges will require evaluation to assure that they function properly. In addition, improvement in investor confidence in the markets could contribute directly to increase demand for securities. Thus, it is evident that improvements in the stock exchanges should be considered to foster development of the market.

B. Recommendations

1. Evaluation. An evaluation should be conducted by the Capital Market Development Working Group and the stock exchanges, brokers and qualified outside experts of the workings, operation, organization, and governance of the stock exchanges to determine whether any changes and improvements are needed. [Recommendation 114]

2. Development Duties. Enhance developmental capacities and actions of securities exchanges, including (i) requiring exchanges to provide suggestions as to ways to increase supply of and demand for securities, and (ii) broadening securities traded on the exchanges (shares, debentures, bonds, participating

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income bonds, commercial paper, and negotiable certificates of deposit). [Recommendation 115]

3. Education. The exchanges should consider conducting educational and other programs to promote investment, such as establishment of mutual funds or pooled investment funds whereby savers may invest by small periodic instalment payments in a diversified portfolio of securities. [Recommendation 116]

4. Market Information. Review methods whereby information about transactions occurring on the exchanges is collected and disseminated to the public, so that the information is made available as it happens. Consider some "composite" reporting system to include transactions on both exchanges. [Recommendation 117]

5. Self-Regulation. It is suggested that the concept of securities exchange self-regulation has not taken hold in the Philippine securities markets. The securities exchanges should be given clear duties to act as self-regulatory organizations to provide fair, orderly, open and free markets, and to enforce compliance by members with rules of the exchanges and the Securities and Exchange Commission. The Commission should provide general, but not day-to-day, oversight of the exchanges to see that they perform their self-regulatory duties. [Recommendation 118]

An evaluation should be made by the exchanges and recognized experts of whether exchange rules are adequate to foster properly functioning markets and meet self-regulatory requirements. The capacity of the exchanges to detect and eliminate improper trading activities should be evaluated, and enhanced if that is needed, such as through "stock watch" departments to monitor transactions as they occur. [Recommendation 119]

6. Trading Procedure. Consider reorganizing the method through which securities are traded on the floor of the exchanges. Possibly replace the present system in which brokers stand in line and buy and sell only on a "first-come first-served" basis,

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with a system in which brokers may compete in open auction. Other markets have a more open process through which all interested brokers can compete with one another, such as through "open outcry". [Recommendation 120]

7. Future Delivery. Examine whether future or delayed transactions are allowed (formally or informally), whereby the customer may delay completing the transaction for several weeks or more. If these are allowed, consider reducing or eliminating them, because they can lead to market speculation and sudden drops, such as happened in December 1985 in Singapore. If share issuing companies change in value before the date for required delivery, this can lead to inability of customers to obtain and deliver the securities and to possible bankruptcy of securities firms. [Recommendation 121]

8. "Own Account" Trading and Floor Trading. Clarify when brokers can trade on the exchanges for their own accounts, and under what circumstances (eg. when and how to give priority and precedence to customer orders). Evaluate floor trading, whereby brokers on the floor of the exchanges, who thus have privileged access to market information and trends, can trade for their own accounts to the disadvantage of public customers. [Recommendation 122]

9. Market Connections. Consider relationships and trading connections between the two exchanges, to assure that brokers get the "best execution" (best price available in all markets) for customer orders. [Recommendation 123]

10. Jobber/Market-Maker. Consider whether there should be dealers on the floor of the exchanges who have affirmative duties to make markets for listed securities. [Recommendation 124]

11. Qualifications. Evaluate and if needed improve the qualification and professional training of exchange members. [Recommendation 125]

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12. Access. Consider whether it is easy or difficult to become a member of the exchanges, and if appropriate make access by qualified persons more open. [Recommendation 126]

13. Closer Exchange Relationships. Some brokers have expressed the view that brokers will fail or drop out of business unless the two active stock exchanges (Manila and Makati) join forces and merge. This report takes no position on this, but an evaluation should be made by the exchanges, and outside experts if needed, on whether the exchanges should consider joining forces or merging. [Recommendation 127]

14. Governance, Management. Require board of directors of exchanges to include public representatives, and exchanges to have full time professional management. [Recommendation 128]

15. Over-the-Counter Market. Transactions in the over-the-counter market outside the stock exchanges should be evaluated to determine if they are conducted and regulated adequately. [Recommendation 129]

4. Venture Capital

A. Concerns

Venture capital has not developed in the Philippines. This appears to have occurred because: (a) earlier attempts to develop venture capital in the Philippines were through banks and government sponsorship, (b) high interest rates encouraged the venture capital companies to pursue short term financing opportunities (such as financing individual crops and harvests) to obtain quick returns equal to such interest rates, as compared to making regular equity investments, (c) United States style venture capital may be based on scientific innovations for which venture finance is needed, and (d) there are no easy "exit routes" through an active securities market or mergers or sales of assets.

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B. Recommendations

1. Evaluation. An evaluation should be made of the experience and problems of venture capital thus far, to determine what specific difficulties have been faced. With reduction of high interest rates, there may now be reason to expect that venture capital companies would be willing to make longer equity investment. In addition, an examination should be made of more "grass roots" venture capital aimed at agricultural and other lines of business where venture capital management assistance could be provided appropriate to Philippine opportunities. Specific recommendations should be developed as to steps to encourage venture capital or a variant appropriate to the Philippines. [Recommendation 130]

2. Bankers' Role. Venture capital is perhaps not appropriate for banks, because bankers are eager to preserve assets and may not be sufficiently willing to take risks in equity investment or to provide management services to new venture companies. It is true that the banks have widespread branch networks which could be used to reach businesses throughout the country that could use venture capital. However, the approach taken thus far has not shown that the banks are able to take advantage of these networks for venture capital activities. Thus, this matter requires thorough examination and the approach of the banks to venture capital needs to be revised. [Recommendation 131]

3. Capital. The amount of capital of each venture capital company in the Philippines is felt by many to be insufficient. Thus, increased capital is probably required. This should be evaluated. [Recommendation 132]

4. Incentives. Just as the investment laws provide incentives and tax holidays for specific investment projects, it would be appropriate to develop specific incentives for venture capital investments. [Recommendation 133]

5. Institutional Investors. Encourage institutional investors to create joint venture capital pools. [Recommendation 134]

6. Fund. Possibly it would be worthwhile to create a venture capital mutual fund or investment company. Tax incentives may be justified. [Recommendation 135]

7. Foreign Partners. Consider establishing or fostering relationships between Philippine venture capital companies and foreign firms with venture capital expertise. [Recommendation 136]

8. Venture Capital Markets. Hold "markets" in which those in need of finance and those with venture capital to invest are introduced to one another. This approach has been followed in Holland (under the sponsorship of the Dutch American Chamber of Commerce) and in England. [Recommendation 137]

V. Legal and Regulatory Matters

A. Concerns

A number of laws and regulations in the Philippines are based on laws of other countries, and it is not clear that they reflect policies appropriate to development of the Philippine capital market and private business sector. Sufficient attention has not been devoted over the years to re-evaluating the laws and rules affecting markets and business, and modernizing them to meet changing circumstances.

In the 1985 interviews complaints were made about ad hoc rules and regulations being built one on top of another, as inadequately thought through regulations were supplemented by regulations to fill "loopholes" in the original regulations. It was argued that government officials are not as skilled in formulation of policy as commentators believe they should be. In 1985, some alleged that favoritism was shown in enforcement of law and regulation, and that some persons and companies do not comply, while others are "harrassed".

B. Recommendations

1. Development Entity. There is no entity now that concerns itself with securities market development. Such an entity should be established, to take an active role in evaluating impediments to market development and stimulants for market growth. Thorough analysis of these matters should be a continuing duty of such an entity. If an entity had been charged to undertake this function all along, the attempt now to discern what the problems and possible actions are in developing the market might not have been needed, or would be easier to conduct. Countries that in fact do take an exclusively regulatory approach are not the correct model for a country such as the Philippines, which must take positive steps to develop the market.

We were informed recently that the Securities and Exchange Commission now intends to assume a developmental role. We understand that the government may prefer to upgrade the development capabilities of an

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existing organization rather than to establish a new cabinet-level development committee.

The question of whether development functions can be performed by the securities regulatory body must be carefully examined. It may be more effective to establish a separate Capital Market Development Committee. [Recommendation 138]

To the extent that it is felt that no government body could conduct market development activities, a private sector body should be established, charged by government to recommend steps for the development of the capital market. [Recommendation 139] Such a body would have to be assured continuing access to appropriate governmental authorities and ministers. This could be accomplished by a number of means, including having the appropriate ministers sponsor the private body.

There is no reason why a statute or other legal instrument could not charge a private body with development duties and give it by law access to the governmental authorities it requires. It could require appropriate governmental authorities to receive the development body's recommendations and act on them within a specified period, or report to specified ministers, the legislature or the President's office with their justification for not acting.

In the UK the government has through the recent Financial Services Act appointed a private corporation as the prime regulatory body and delegated to it power to carry out and enforce the law. The UK government did not wish to have a governmental securities regulatory body, fearing it might become too rigid and thus impede the markets. This matter should be carefully examined in the Philippine context where a development approach is sorely needed for capital market growth.

2. Securities and Exchange Commission. The Securities and Exchange Commission is charged with administering the Securities Act of 1936, revised in 1982, the Investment Company Act of 1960, the Corporations Code of 1980 and other related laws. The Commission acts as a securities market regulatory body, and also as the registrar of companies to enforce the companies law and keep public records of all company

filings. The Commission has over 600 employees, about one half of which are engaged in companies work and the other half in securities regulatory work.

To improve the capital market, the following Commission-related actions should be considered. The discussion that follows includes a number of topics mentioned earlier, in order to bring together in one place a discussion of the technical legal approaches through which a number of the recommended actions would be implemented.

(a) Evaluation of Dual Function. An evaluation should be conducted with outside experts as to how the Commission will be able to fulfill its duties both to be a securities market regulator, to administer the Securities Act, and at the same time act as a companies registrar, to administer the Corporations Code. [Recommendation 140]

These two functions are in many ways contradictory. The companies registrar function involves many narrower questions, requiring perhaps a narrower mentality; whereas the securities regulatory function is broader, and based on economics and dynamic markets.

Thus, an examination must be made of how best to blend the function of companies registrar with this broader function, and how to prevent the narrower subjects from limiting the broader focus. The government is reported to be contemplating transferring the Commission from the Ministry of Finance to the Ministry of Trade and Industry. It is now intended that the Commission's role in enforcing company law could be largely transferred to a new Arbitration Bureau and Business Court. This matter should be evaluated. [Recommendation 141]

(b) Policy Activities. The Commission should be brought more actively into policy formulation within the government. The Commission has felt that it is engaged not in policy, but only in narrow activities to implement laws and regulations based on earlier policies that it does not have the opportunity or authority to reconsider. [Recommendation 142]

Commission personnel should be trained in appropriate methods of policy formulation. They should visit securities market development and regulatory bodies in other countries to see how this is done. There should be a government education course on this subject, taught by government and private sector persons with knowledge of both government and private sector needs. [Recommendation 143]

(c) Evaluation of Existing Rules, Etc. The Commission should be required now to evaluate all its rules and regulations, and its enforcement and adjudicative activities, to determine whether they are appropriate to today's needs, whether they are practical, and whether they should be retained, changed or removed. So far as can be determined, such a total reevaluation has never been undertaken. [Recommendation 144]

In addition, the Commission should be required to propose implementing regulations that may not have been adopted, but need to be (eg. on disclosure, broker conduct, duties of stock exchanges, etc.). [Recommendation 145]

Finally, the Commission should issue a "Concept Release" discussing and inviting views on ways to develop the market and provide adequate regulation. [Recommendation 146]

(d) Public Comment/Review. All proposed rules, regulations and important initiatives by the Commission should be put out for public comment from all interested parties, and the comments should be required to be evaluated and responded to in a reasonable manner prior to final action. There should be an "Administrative Procedures Law" which mandates that this occur. [Recommendation 147]

In addition, all major decisions should be made in open meeting (so called "in the sunshine"), to assure that the Commission's reasoning is open to scrutiny. [Recommendation 148]

Finally, the law should require (or any such existing provision should be re-evaluated) that all Commission actions are subject to judicial review, to be tested against specified standards, such as that the Commission has not acted arbitrarily, capriciously or beyond its authority. There have been general complaints among those interviewed that government action is often short-sighted, building up regulation upon regulation. Therefore, appropriate guidelines should be established to assure that all interested parties have an opportunity to be heard and that policy formulation is conducted in a way that results in practicable, accepted and easily complied with norms. [Recommendation 149]

(e) Review of Organization. The organization of the Commission should be subject to review by experts familiar with other governmental agencies and securities regulatory and developmental bodies. An evaluation should be prepared of the strengths and weaknesses of the Commission. Other securities regulatory and developmental bodies in countries with advanced financial markets periodically go through such evaluations, and make appropriate changes. [Recommendation 150]

(f) Economists. The Commission should have on its staff economists and others who are expert in financial and macro and micro analysis and in how to develop data bases to support policy decisions and rule-making. Such staff should be placed in each department in the Commission. [Recommendation 151]

There should also be a separate department of economists, headed by a respected senior person, both to coordinate the deliberations in the separate departments and to conduct evaluations on important matters for the Commission itself. Finally, this department should focus on initiatives to develop the market. [Recommendation 152]

(g) Outside Advisers. The Commission should have available to it the services of highly knowledgeable persons from the private sector. This should be accomplished by: (a) allowing private sector persons to spend time working in the government Commission; and (b) the Commission having an advisory group of knowledgeable private sector representatives who can assist in evaluating important subjects that will affect the private sector, and who can work with the Commission to help it learn how to devise appropriate regulations that reflect both societal needs and needs of private sector participants in the market. In countries most successful in financial market development, the government bodies involved engage in active dialogue with the private sector. [Recommendation 153]

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(h) Inspections. The Commission should have an expanded staff of inspectors to conduct spot examinations of brokers and other securities professionals, to assure that they are in compliance with Commission and stock exchange requirements. Some brokers feel that such examinations are currently not done adequately. [Recommendation 154]

(i) Ombudsman. The Commission should be given an enhanced role in settling disputes, such as customer complaints. An evaluation should be made as to whether the judicial (court) proceedings on these matters are adequate, too expensive or time-consuming, etc., and if so whether the Commission, or some outside separate body with government and private sector participation should be established to act as a sort of "Ombudsman" to settle these matters quickly, fairly and cheaply. [Recommendation 155]

3. Stock Exchange Duties. The stock exchanges should be charged with duties to act to develop the markets, and be required to submit proposals to the Commission on how they believe the markets can be developed. As a first step, each stock exchange should be required within six months to submit to the market development body a report on what steps it believes the government, the market development body and each exchange should take to develop the markets, and then each exchange should implement those steps that it believes it can. In addition, every six months each stock exchange, and any brokers trade association, etc., should be required to provide an in-depth study of development proposals. These proposals should be reviewed by the market development body and other responsible government authorities and private sector groups, and government officials should be required to respond to the proposals and to implement those that will help develop the market. [Recommendation 156]

The laws the Commission administers should impose on the stock exchanges clearer duties to act as self-regulatory organizations. [Recommendation 157]

4. Securities Act of 1936. In 1934-35 the financial markets in the Philippines experienced first an increase and then a severe drop in values, equivalent to a "crash". In response, the government adopted

the Securities Act of 1936. This law was designed to require disclosure and to impose regulation on the securities markets.

The law is a copy of parts of the United States Federal Securities Act of 1933 and Securities and Exchange Act of 1934, which were based on disclosure. However, significant changes were added, to blend in the approach of securities laws (so-called "blue sky" laws) of certain states (particularly California), adopting from those states the paternalistic concept that public offerings of securities may not be made unless the government body administering the law finds that the issuing company and the securities are "sound" investments.

Thus, the Philippine Securities Act of 1936 embodied a paternalistic approach, and a "transplant" to the Philippines of concepts adopted in the United States. At that time, no other country had securities laws as extensive as the United States. The suspicion is that in 1936 the administration, without expertise in financial market development, adopted an amalgam of United States regulatory approaches. The Securities Act was amended in 1982, but again to expand the scope of regulation, using approaches from certain amendments to the United States securities laws.

The following possible actions should be considered in connection with the Securities Act.

(a) Review. The Securities Act should be reviewed completely. The review should focus on what is needed for adequate development and regulation of the markets from an economic and business point of view. It is not obvious that the existing law can meet the needs of the current economy or market. [Recommendation 158]

The law does not seem to have helped in recent years to instill greater confidence in the securities markets. It is suggested that the reason for this is twofold: (1) there has not been an adequate evaluation of the economic development needs to be served by the markets, from which evaluation a properly designed development and regulatory environment could be devised; and (2) the United States laws from which the Philippine law was copied were designed to cure specific abuses which arose in the United States after the market had developed, and were not designed to meet the needs of developing a market.

In 1985, the Commission itself indicated that the advice of outside experts would be welcomed to "tear the law apart" and demonstrate what would be better.

(b) Eliminate Approval Requirement. The Securities Act should not require that the Commission approve the "soundness" of public offerings. The Commission should evaluate only whether the disclosure appears on its face to be adequate. This approval concept derives from the United States blue sky laws, which take a paternalistic point of view. [Recommendation 159]

(c) Terms and Conditions. The Securities Act allows public offerings to be made after registration with the Commission, subject to such "terms and conditions" as the Commission may impose "in the public interest and for the protection of investors". Setting "terms and conditions" is an inappropriately broad power for the Commission and should be reconsidered and probably deleted. [Recommendation 160]

(d) Commissions. The Securities Act should not continue to allow the Commission to fix the underwriting and selling commissions in public offerings. These should be determined by negotiation between the issuing company and the underwriters. [Recommendation 161]

(e) Disclosure. The law should make clear what is meant by "material" information which companies are required to disclose. [Recommendation 162]

The law should provide that for annual meetings, companies must prepare proxy statements disclosing specified information, so as to inform the shareholders and the market of relevant material information about the company and its business, and the persons being elected, their experience and their relationships and transactions with the company. The law should also impose on companies a general duty to disclose, promptly, as it becomes known to them, all "material information". [Recommendation 163]

(f) Dissemination of Disclosure. Disclosure

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documents (prospectuses, reports, announcements of material information, etc.) should be distributed to shareholders, investors, stock exchanges, bankers, analytical services, etc. These documents should not simply be filed at the Commission, as appears to be the requirement of the Securities Act, but should be put out to the market. [Recommendation 164]

(g) Secondary Distribution/Rights Offerings. The Securities Act requires registration with the Commission of each "sale or distribution to the public" (Section 4). The meaning of this phrase is not clarified in the Act. It is not clear if public offerings of large blocks of shares by controlling shareholders are required to be registered, which they should be in order to provide adequate prospectus disclosure to the purchasers and to the market in general. In addition, sales by companies to existing shareholders are exempt from registration (Section 6(4)), which they should not be, again in order to provide prospectus disclosure of material information to purchasers and to the markets in general. [Recommendation 165]

(h) Automatic Action. The Securities Act should specify that in cases where permits are required from the Commission, if the Commission does not act within a specified time (such as 30 days), the permit is automatically deemed to have been granted. [Recommendation 166]

(i) Manipulation. The anti-manipulation sections in the Securities Act (eg. Section 26) should be reviewed to determine: (i) whether they provide appropriate standards for the Philippines; (ii) whether other activities not specified in the Act should be prohibited; and (iii) whether the standard required by the Act that the manipulative activity must have been "for the purpose" of manipulation is impossible to prove, thus making ineffective the prohibitions on manipulation. [Recommendation 167]

(j) Accounting and Auditing. The Securities Act does not contain express power for the Commission to require companies to follow generally accepted accounting principles and auditing standards. This should be provided. [Recommendation 168]

(k) Penalties, Sanctions. These should be reviewed, and revised upwards if needed (with automatic inflation adjustment), especially the fine for not filing required reports, which is only Pesos 50 to 200 a day after payment of a basic fine. [Recommendation 169]

5. Corporations Code. The Corporations Code of the Philippines, adopted in 1980, replaced the 1906 Corporation Law, which was based on the then California Corporations Code. The 1906 law apparently was intended to introduce the United States corporation as the prototype in the Philippines, and to replace the Spanish "sociedad anonima". The new 1980 Corporations Code repeats many of the provisions of the 1906 law. The 1980 law was intended to "establish a new concept of business corporations so that they are not merely entities established for private gain but effective partners of the National Government in spreading the benefits of capitalism for the social and economic development of the Nation". (Explanatory Note to Cabinet Bill No. 3, which became the new Corporations Code of the Philippines.)

The 1980 Corporations Code should be reviewed to determine how it affects business expansion and corporate finance, including, but not limited to, the matters set forth below.

(a) Impediments. Examine whether the law creates any impediments to corporate finance or investment. [Recommendation 170]

(b) Pre-emptive Rights. As explained earlier, for public offerings, eliminate reliance on pre-emptive rights of existing securities holders to purchase new issues, which can impede the supply of securities. [Recommendation 171]

(c) Retained Profits. Reconsider the prohibition on retention of profits in excess of 100% of paid in capital. [Recommendation 172]

(d) Par Value. Remove improper reliance on sale of shares at par value instead of market value, which can limit the supply of securities. [Recommendation 173]

(e) Founders Shares. Possibly eliminate founders shares, which can provide special benefits to founders. [Recommendation 174]

(f) Un-issued Shares. Clarify that "authorized but un-issued shares" are legal in all cases under the Corporations Code, to allow for greater availability of shares for public issues. [Recommendation 175]

(g) Capital Increases. Remove Commission power to determine whether or not to approve increase in company capital, which should be left to the company. [Recommendation 176]

(h) Partially Paid Shares. Limit use of partially paid shares, which are not needed if par value is low (which should be permitted), and which can provide opportunities for market manipulation. [Recommendation 177]

(i) Delayed Dividends, Certificates. Require that companies promptly pay out dividends declared and promptly deliver certificates for shares sold. [Recommendation 178]

(j) Accounting. Review adequacy of auditing and financial reporting requirements for all companies, not only those with shares held publicly. [Recommendation 179]

(k) Minority Holders. Evaluate adequacy of protections for minority shareholders, who are generally perceived to have no rights and to be at the mercy of controlling shareholders. [Recommendation 180]

(l) Mergers, Etc. Review, and possibly remove, requirements for Commission approval of merger and consolidation of companies. [Recommendation 181]

(m) Closed Companies. Evaluate possible inappropriate availability under the Corporations Code of "close corporations" (less than 20 shareholders, shares prohibited from transfer). Close corporations are not allowed to have public offerings, are subject to no restrictions as to size of assets, and are not subject to public disclosure requirements. This encourages businesses to operate as closed companies rather than public companies that can raise finance through the securities market. [Recommendation 182]

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(n) Enforcement. Evaluate adequacy of enforcement powers. [Recommendation 183]

(o) Sanctions. Review and revise sanctions, penalties and civil liabilities in case of violations of the law and rules and regulations. [Recommendation 184]

6. Taxation of Business. Government and private sector representatives, assisted by outside experts in private business development, should evaluate and make recommendations for improving the tax treatment of business, to foster business expansion. [Recommendation 185]

7. Legal Audit. A detailed examination (referred to as a "legal audit") should be conducted to determine if laws, regulations and procedures in addition to those discussed above adversely affect development of the financial markets and private sector business. This evaluation should include, but not be limited to: (i) banking law, (ii) universal banking law amendments, (iii) insurance law and law governing investments by insurance companies, (iv) laws affecting venture capital and leasing, (v) omnibus investment code and Board of Investment regulations, (vi) laws concerning foreign investors, (vii) any price control or stabilization laws, and (viii) judicial laws and procedures. To expedite the evaluation, a letter should be sent to knowledgeable businessmen, financial experts, accountants and lawyers requesting them to provide views on the adequacy of existing law and regulation for business and capital market development. [Recommendation 186]

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VI. Training, Education

A. Concerns

As indicated throughout this report, there appear to be opportunities for improvement in many capital market activities. Accordingly, education and training of appropriate candidates would be worthwhile.

B. Recommendations

1. Corporate Finance. A program should be established to educate companies as to advanced methods of corporate finance, and where various types of finance can be obtained. [Recommendation 187]

2. Entrepreneurship. Courses should be considered concerning "entrepreneurship". Approaches used in college and business school teaching should be evaluated to determine whether they have been biased (as is the case elsewhere) in favor of "management" positions and against "production and sales", "entrepreneurship" and risk taking. [Recommendation 188]

3. Market Development. Appropriate persons, such as from the Securities and Exchange Commission and stock exchanges, should be trained in market development approaches as utilized in other countries. [Recommendation 189]

A group of government officials, securities professionals and stock exchange and company executives should visit a number of other markets (such as in Korea, Taiwan, Jordan, Brazil) to become better informed on: (i) growth of those markets and development strategies being pursued, (ii) current trends toward a wider range of financial services and increased "securitization" of finance, and (iii) internationalization of securities markets. A special sub-group should become informed on action programs followed in other countries to foster development of their financial markets. [Recommendation 190]

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4. Disclosure. Training should be provided to appropriate Securities and Exchange Commission and stock exchange officials, company executives, brokers, lawyers and accountants on how companies provide "continuing disclosure", and what constitutes "material" information. [Recommendation 191]

5. Self-Regulation. Stock exchange officers and personnel should be trained in self-regulatory methods as utilized in other markets. Stock exchange personnel, and company officers in charge of disclosure, should be trained in "stock watch" operations, whereby possibly questionable transactions (timing, size, price, etc.) are brought to light as they happen and are examined for propriety. [Recommendation 192]

6. Brokers. Securities brokers should be trained in methods of financial analysis, and segregation of customer accounts from the broker's accounts. [Recommendation 193]

7. Public. A program should be established to educate the public on how securities markets operate, investor rights and protections, and how to make investments (safe, speculative, long term, appreciation versus dividends). Consideration should be given to conducting weekly programs on television concerning business and investment. Consider holding junior achievement programs concerning developing and running a business. [Recommendation 194]

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THREE: ACTION PROGRAM

To implement the above recommendations, an Action Program in three phases should be established. [Recommendation 195] Set forth below is a sample Action Program.

Phase I: Initial Actions

This first phase could be conducted over an 8 to 10 month period of intensive work, to survey relevant issues and agree on specific recommendations. During Phase I actions that clearly should be taken quickly to encourage market growth could be implemented as a matter of priority.

1. General. Establish joint government and private sector Capital Market Development Working Group, to design a specific action program for capital market development, including the recommendations in this report. Survey capital market, and survey environment for business encouragement. Visit other developing markets.

2. Supply/Demand. Design specific recommendations for increasing the supply of and demand for securities. Examine tax disincentives/incentives to supply of and demand for securities. Design requirements for securitization of finance. Review privatization program and take steps as appropriate to encourage privatization through public offerings of securities. Review accounting and auditing practices and agree on steps for improvement.

3. Intermediaries. Design actions to foster growth of full service securities firms, such as merchant/investment banks, and re-evaluate universal banking. Review trading procedures and other related matters in the stock exchanges and determine whether changes may be needed. Examine prospects for venture capital, and tailor such activities to Philippine needs.

4. Legal/Regulatory. Determine which entity should take charge of securities market development role, and how it should carry out development activities. Review Securities Act and

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Corporations Code and rules and regulations thereunder. Begin legal audit to evaluate other laws and regulations which may inhibit capital market development. Evaluate any needed protections for investors, including minority shareholders.

5. Training. Consider carefully organized visits to selected countries (eg. Korea, Jordan, Brazil) to evaluate their capital market development techniques and experiences.

Phase II: Medium Term Actions

Phase II could be conducted over a 12 to 18 month period. During this phase specific recommendations made in Phase I would be implemented, with implementation first of the steps that are likely to bring the quickest results.

1. Supply/Demand. Adopt incentives to companies to raise finance through public offerings of securities, and to investors to purchase securities. Take recommended steps to encourage increased securitization. Improve disclosure of company information and market information. Adopt recommendations to improve accounting and auditing.

2. Intermediaries. Adopt incentives and other steps necessary to encourage growth of securities firms.

3. Legal/Regulatory. Adopt any needed amendments to Securities Act, Corporations Code and other laws. Adopt any needed revisions to Securities Exchange Commission, stock exchange, and other rules and regulations. Continue legal audit to evaluate other laws and regulations which may inhibit capital market development and adopt appropriate changes.

4. Training, Education. Train appropriate persons in capital market development, regulation and self-regulation. Begin education of issuers concerning use of financial markets. Begin public education program.

Phase III: Longer Term Actions

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The third phase could be conducted over 24 to 36 months, during which longer term actions would be taken.

1. General. Review success of actions already taken, and make changes as needed.

2. Supply/Demand. Consider whether incentives adopted to increase the supply of and the demand for securities have been adequate. If not, consider more vigorous or more direct approaches.

3. Intermediaries. Continue to evaluate and adopt proposals to improve securities firms.

4. Legal/Regulatory. Monitor success of changes made in securities regulation. Evaluate market development activities of Commission or other body charged with encouraging this. Adopt further changes as determined by legal audit.

5. Training. Continue training corporate finance executives, securities professionals and others.

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UNDERDEVELOPED STATE OF PHILIPPINE CAPITAL MARKETS, AND VIEWS OF KNOWLEDGEABLE COMMENTATORS

The capital markets in the Philippines have not provided adequate long term finance to industry and are seriously in need of improvement. The approaches of earlier periods which impeded development of the capital markets set the stage for inactive markets which continue today.

The original draft report written in 1985 explained that USAID then had no particular constituency requesting that a capital market development effort be undertaken. USAID had decided to survey the markets to determine the parameters of the problem in order to be able to advocate to the government that action needed to be taken. The new government has clearly indicated its desire to improve the capital markets, recognizing that the markets do not function adequately.

The comments obtained in 1985 indicated a serious depth of concern and it is not believed that these concerns have been specifically addressed in the new environment. It is true that industry participants now have increased confidence and optimism, but this optimism is still guarded and industry participants must await improvements to determine whether the political and financial stability necessary for capital market growth will emerge. In addition, the comments obtained earlier indicate that very serious problems existed then which must be dealt with by specific action. Accordingly, the earlier comments are relevant to seeing the general and specific problems which existed then and to identifying the actions which must be taken.

A. Underdeveloped Market

Many companies are heavily overloaded with debt, mostly short term.

The securities markets have fluctuated significantly during the past year. It is believed that a substantial amount of the trading activity reflects potential foreign interest in dealing on the Manila exchanges.

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There is a strong tradition of family controlled and run companies. Few companies have raised long term finance in the public securities markets. In earlier periods companies obtained concessional below market cost loans from government sponsored or controlled financial institutions, pursuant to selective credit policies of the government. The country relied extensively on foreign debt.

Many companies are government owned, and others have been taken over by lending institutions as "non-performing" borrowers. Merchant banking seemed to become more active during the middle to late 1970s, but it is virtually inactive now.

During our survey in 1985 and 1986 many complained that most of the companies in the major lines of business had been taken over, legally or through coercion and favoritism, by persons with powerful relations with the government. Some complained that businessmen were hesitant to start new lines of business because they feared that any success would entice persons with special relationships with the government to take over their franchises. Much capital fled the country.

The stock exchanges were criticized as gambling dens, with speculation and manipulation. Government has not had a program to encourage development of all the segments of the financial markets, and focused on the banking and lending segment.

In 1985-86 approximately 138 companies were traded in the two active stock exchanges, the Manila and the Makati Stock Exchanges. Of the top 1,000 companies in the Philippines, only 48 had shares listed on the stock exchanges. The remaining companies listed on the stock exchanges were speculative companies, in mining and oil, a number of which were paper companies, with no business activities.

Most listed companies have only a limited number of their shares available for trading in the hands of the public. Estimates are that perhaps only 30% of the shares of listed companies is available for trading in the market, and the majority is held by principal owners and institutions as permanent investment. Some of the lesser known companies may well have only 5% to 10% of their shares available for trading.

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New issues of shares amounted to 21 in 1975, 5 in 1980, 5 in 1981, 12 in 1983, 1 in 1984 and none in 1985. Most of the new issues were not underwritten, and the majority were rights issues at par value, below market prices. Only one corporate bond issue has been publicly offered in the last 10 years.

A number of companies were floated in earlier "boom" periods that had no real businesses but were shell companies on paper. Earlier "hot issues" were vigorously sold, prices ran up and later declined dramatically in value.

In the early 1980s, many companies issued short term commercial paper, and many of these companies failed. In one famous example in 1981 (referred to as the "Dewey Dee" affair), the manager of an investment company which sponsored issues of commercial paper absconded with vast sums, causing a severe loss of confidence by investors.

Investors have looked for guaranteed return, equivalent to that offered by bank deposits, and money market and government securities, which companies cannot pay on long term securities.

Investors allegedly believe when they buy shares in a company that they are buying into "Mr. X's" or "Mr. Y's" family, and investing in that family's management, in which they will have no voice as minority holders. Important investors allegedly do not purchase shares unless they can obtain enough shares to acquire a seat or seats on the board of directors and thus management participation.

Disclosure of material information by companies is often not made, or is inadequate. Thus buying and selling securities is often based on rumor. Trading on insider information (that is, information about the issuer company which is not yet announced generally in the market) is said to be prevalent. Although legal sanctions may be available, enforcement against insider trading is said to be inadequate.

The annual turnover value of secondary market trading was P 4.21 billion in 1969, P 5.93 billion in 1973, P 3.10 billion in 1975, and peaked at P 6.71 billion in 1976. It was P 4.65 billion in 1980, P 1.29 billion in 1981, P 1.21 billion in 1982, P 5.36 billion

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in 1983, P 2.18 billion in 1984, and P 4.04 billion in 1985.

During 1986 the value of transactions in the two stock exchanges increased dramatically, to P 11.4 billion as compared to P 4.04 billion in 1985, outstripping the previous high of P 6.79 billion in 1976. This reflected increased demand in light of changed political circumstances, substantial interest by foreign buyers (estimated by some as providing up to 40% of total buying) and substantial rise in prices of the limited shares available. Trading was concentrated in a limited number of companies. It is believed that a significant percentage of the reported transactions consisted of privately negotiated transactions in the shares of a limited number of companies, which were reported on the exchanges to obtain relief from capital gains tax. Recently the government has questioned whether the increased trading and share values represent not investment but use by various persons of securities trading as a means to launder money retained in the country for political uses. In conclusion, therefore, the supply of securities remains low as in the past, with few companies raising finance through the issuance of shares or other long term securities, and the problems in the market identified in the 1985 review continue to impede growth.

An instructive comparison of the importance of securities markets in Far Eastern economies is provided on the following page. It shows that, with regard to stock exchange trading, the Philippines is substantially below other countries which have taken a more positive approach to capital market development.

B. Views of Persons Interviewed

Interviews during 1985 and 1986 brought out a number of concerns from different groups. These concerns may be slightly lessened in the new environment in the Philippines and various persons among the groups discussed below may be more optimistic about capital market activities and may be considering specific actions. However, the concerns expressed earlier still remain as important problems which must be dealt with in the new environment through a corrective action program.

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Comparison of Stock Market Size in Terms of GNP (1982)

(Billion US dollars, %)

	Trading Value (A)	GNP (B)	(A)/(B)
Hong Kong	6.18	25.9	23.9
Singapore	2.42	14.2	17.1
Japan	175.96	1,091.9	16.1
Taiwan	3.30	46.6	7.1
Malaysia	1.40	24.8	5.6
Korea	2.64	66.0	4.0
Thailand	0.26	36.3	0.7
The Philippines	0.13	39.0	0.3
Indonesia	0.012	90.0	0.01

Source. Nomura Research Institute

1. Companies. Companies and entrepreneurs indicated that they were not interested in raising funds through public issues, because they did not want to dilute their equity. They indicated that they generated finance internally or from controlling shareholders.

Companies that do have public shareholding indicated in 1985 that their business was down and they were worried about "whether we will be here next year" -- many individuals were selling their homes and leasing them back short term, reflecting severe loss of confidence.

2. Limited Growth. Commentators indicated

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that families owning companies often did not wish to invest more capital to expand their businesses, and thus companies did not grow beyond a certain size. This could be an important limiting factor.

3. Chambers of Commerce. Chamber of Commerce representatives indicated that business was down significantly in 1985, by as much as 50%, and companies were preoccupied with survival, so long term capital market activity was not paramount in their minds.

4. Business Consultants. During 1985 foreign resident business consultants in the Philippines expressed the view that too many businesses were owned by the government, that businessmen were discouraged, and that finance was obtained on a preferential basis from banks or among family and interlocking groups. They appeared to be skeptical whether capital market development would emerge without a significant change in attitude by the government.

Among domestic business consultants experienced in finance, a prominent commentator indicated in 1985 that there were a number of measures which deterred business development and investment, and that a number of changes could be made to encourage finance and business. He felt, however, that the government at that time did not seem to accept, or listen to, recommendations along these lines, and that it should take vigorous action to formulate and implement a comprehensive program to develop the capital markets.

5. Venture Capitalists. There are a number of venture capital companies in the Philippines, which were set up by the banks with government participation. However, they have not been very active, possibly because each has limited capital, and they have focused on tiny projects, such as individual crops.

In addition, entrepreneurs are reluctant to sell equity, and the normal avenue for venture capital (investment in the equity of start-up ventures) has not been employed, perhaps because the traditional sell off (or exit) routes for such investments, the stock market and mergers, are not highly developed. The general impression is that without significant changes to tailor it to Philippine needs and provide incentives, venture capital will continue to be a disappointing area.

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6. Securities Brokers. In 1985 brokers indicated that their ranks were slimming as business dwindled in the absence of securities to sell. They felt that the government had no cohesive policy to develop the securities markets.

One leading broker indicated that the securities markets suffered most from the following problems:

(a) The government absorbed tremendous amounts of available savings into government securities paying rates (tax free, equivalent at one point to a taxable return of 42%) far in excess of returns which companies could pay on their long term securities;

(b) Money market rates were far above what companies could pay on long term shares and bonds, a result, he asserted, of internal monetary policy, leading companies to raise short term funds in the money market which should have been raised in the long term securities market; and

(c) The government had been too much involved in allocation of credit.

The same broker focused on the following more detailed concerns:

(a) Desire of businessmen not to open up their companies to the public, but still enjoy advantages of remaining closed companies;

(b) Dependency of businesses on loans as their main source of funds;

(c) The limited number of companies listed for trading on the stock exchanges;

(d) For companies that were listed, the limited percentages ("float") of their shares available for trading in the market, which restricted liquidity and thus led to volatility in secondary trading, which lack of liquidity also dampened the prospects of primary issues;

(e) Biases of institutions to purchase government securities, to meet government reserve requirements;

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(f) Difficulty of attracting investors to long term securities as compared to other opportunities, such as government securities, money markets, bank deposits, foreign currency, real estate and even jewelry; and

(g) Uninformed individual investors purchased securities on impressions, rumor and hearsay, rather than information about the issuer, which in fact was not readily available, and once "burned" these individual investors left the stock market.

This broker stressed the fact that during 1985 particularly the government siphoned off over Pesos 55 billion of funds through the issuance of government securities at high tax free returns. This demonstrated to him that in fact funds were available for investment, which funds "should certainly be made available for tapping by the [long term] capital market". He also stressed that public and private corporations had unbridled access to vast short term money market finance, which they should have raised in the long term capital markets.

This broker concluded that "unless the monetary authorities take a hand in stabilizing money market rates, we cannot expect a more balanced and rationalized channeling of investments ensuing to the benefit of the [long term] capital market". He believed that: "The question should therefore be asked if there is a major deficiency in our financial infrastructure such that the allocation of financial resources are not efficiently, much less adequately, distributed through the various channels" of the financial markets, particularly the capital market. Thus, the broker saw serious "structural imbalances" in the way the financial markets had been used, with the long term capital market being seriously underused, a consequence, he asserted, of government policy.

7. <u>Institutional Investors</u>. Institutional investors (insurance companies, bank trust departments) indicated that during 1985 they were not actively engaged in investment in long term securities. One also indicated that most Philippine companies were in significant difficulties and were not good prospects for lending and investment. Another stated that prudence left him, reluctantly, only with the potential to invest in multinational companies.

One institutional investor official stated during 1985 that even if he wished to invest in companies in the Philippines, there were no real prospects because, he asserted, "All major enterprises in all lines of business (except insurance) are controlled by [persons with special relationships with government]". He alleged that many of these companies had been "raped and pillaged".

8. Former Merchant Bankers. Those who had previously been active in merchant banking felt that there were not sufficient opportunities available for long term securities business (underwriting, etc.). Investors were not willing to invest long term because of interest rate volatility. They asserted that difficulties in regulation of investment banking had caused them to focus on money market instruments as compared to long term debt instruments and equity. When the money market activities led to excesses, the government eliminated money market instruments for most companies, and merchant banking declined. They also emphasized that persons who control companies were not interested in selling equity.

9. Universal Banks. Banks authorized to engage in merchant banking (uni-banks) indicated during 1985 that there was little opportunity in the corporate securities area. A few felt that there might be opportunities in mergers and acquisitions and reorganizations of "sick" companies, but their major prospects were in trading government securities.

10. DFIs. Development finance institutions seemed to feel that there had been sufficient subsidized credit available so that only the most speculative companies had to go to the public markets. They indicated that most businesses they dealt with simply had not been willing to sell off parts of their equity.

11. Banks. Banks indicated that former prime borrowers were having significant difficulty in obtaining finance. There was a dearth of quality borrowers.

12. Project Appraisal. It was asserted by many commentators that appraisal of proposed projects had been inadequate. It was alleged that bankers and lenders accepted the appraisal from the sponsors of a project, looked only to the numbers presented in the

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"four corners" of the appraisal itself, and did not verify any such figures.

13. Accountants. Practicing accountants explained that accounting and auditing might be relatively highly developed in the Philippines as compared to other countries in the region, but that significant improvements were needed in establishing uniform auditing standards, accounting principles and financial reporting requirements.

14. General. Many interviewed in 1985 expressed dissatisfaction with what they viewed as widespread impropriety in business and favoritism in government during that time. They felt that this might cause companies to be not as profitable as they ought to be if they wished to gain the confidence of potential investors. They seemed to believe that traditional practices of "taking care of yourself" had expanded and been exaggerated to the point of taking undue advantage of all opportunities. They believed that "the rules of the game have simply broken down".

15. Government Officials. During 1985 those interviewed had varying views. Some indicated that capital market development was "not a high priority". Others felt that capital markets had not been given adequate attention, but in light of other more pressing problems, their departments did not have the staff to conduct a comprehensive evaluation of what steps should be taken to improve the capital markets.

Still others felt that a concerted effort was needed to devise a clear and comprehensive policy concerning the contribution capital markets could make to the development of the country. They felt, however, that their departments were called upon to implement legal requirements without a clear capital market development policy.

Others appreciated the importance of the capital market, but they lacked detailed understanding of its working and specific ideas as to how market development should be encouraged.

Another official indicated in the 1985 interviews that the government understood the importance of developing the capital markets, and that it might welcome an initiative to study the capital markets and recommend steps to develop them, and in fact would be willing to participate directly in such a joint effort. However, he said that at that time the government itself was not contemplating initiating a request to USAID for such assistance, because of important political and policy considerations.

The new government has taken a different point of view, and seeks assistance on how to develop the capital market.

16. Securities Market Observers. Persons knowledgeable in securities market practices asserted that securities exchanges, brokers and the Securities and Exchange Commission were subject to significant inadequacies.

(a) Concerning securities exchanges, some asserted that they were subject to extensive malpractices (including manipulations, wash sales, improper conduct by stock exchange floor personnel, brokers with fictitious accounts, etc.). They alleged that securities exchanges were not professionally managed, operated on a club atmosphere rather than as self-regulatory organizations, were plagued by political infighting, were composed of members with different interests outside of exchange business and thus could not adequately represent industry interests, were unable to take positive steps to react to changing conditions to compete in the financial markets, and suffered from lack of forward planning.

(b) Concerning brokers, some asserted that they were not adequately trained, did not have professional standards, and had a short term outlook.

(c) Concerning the Securities and Exchange Commission, some asserted that it did not regulate the markets effectively; did not understand the securities markets in terms of their economic development significance; had antiquated regulations and rules; issued rules that were too sweeping (which were looked on by observers as being more like publicity gimmicks, but which interfered with brokerage activities because of their impracticability); lacked sufficient knowledgeable personnel; had not adequately protected the public; and had not developed guiding principles to govern securities markets.

C. Conclusion

From the above discussion of problems raised by various groups during 1985 and 1986 it is evident that capital markets in the Philippines need to be improved and that specific actions to improve them need to be analyzed in depth. Part of an action program should consist of obtaining the current views of persons representative of the above groups and other interested persons in order to determine the details of current problems and the possible actions that should be taken to deal with them.

OBJECTIVES OF FINANCIAL MARKET DEVELOPMENT

A. Purpose of Financial Market Development

Financial markets are important to economic development for the following reasons:

(a) Markets encourage savings by providing vehicles for investment;

(b) Markets assemble for use, or "mobilize", these savings;

(c) Markets allocate the savings to productive enterprises, to increase their capacity to produce and thus create more goods and jobs, and through competition for these savings by various enterprises, markets allocate them to enterprises which can provide the highest return for use of the funds, and which thus reflect comparative advantages of the country; and

(d) Markets provide investors with the ability (referred to as "liquidity") to sell their investments when they wish to obtain cash or to switch to other investments.

If a country's financial markets are adequately developed -- by offering a sufficient variety of savings and investment vehicles, both short and long term, through qualified financial intermediaries operating in an orderly market -- then greater funds will be available and will flow in economically desirable directions. On the other hand, if the markets are under-developed -- offering only limited investment opportunities, insufficient financial institutions and reduced liquidity -- then savings and investment will be deterred.

Among the causes of under-development is the absence of sufficient savings and investment in productive enterprises to increase per capita productivity. With lower productivity per capita, there are insufficient savings to invest in capital goods to increase productivity. "Capital" refers to capital goods, which are all goods used in production of other goods. A number of developing countries do have sufficient

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savings to invest in capital, but the financial systems are not sufficient to channel savings into productive enterprises. For these reasons, among other efforts to increase economic development, it is important to improve the financial markets to increase savings and capital investment.

Financial markets are dynamic -- they are continually changing to meet changing patterns of savings, fiscal conditions, institutional arrangements and availability of and demand for funds. Investors switch investments as opportunities change. This is so because the return or yield on financial assets changes as events occur, and investors reach differing views as to the meaning of these events and the impact they will have.

B. Organization of Financial Markets

In response to different needs of savers and types of demand for finance, varying methods of finance and markets have developed. Financial markets normally consist of two main segments: (1) the Money Market, a wholesale market for short-term loan finance, and (2) the Capital Market for long-term loan and equity finance. A table on the following page describes typical financial markets.

1. Money Market

Description The Money Market provides short term finance. The Money Market serves principally the needs of bulk users of funds, such as governments, banks, insurance companies and similar institutions. Such institutions must have a supply of funds to meet demands as they arise; they must also have a place temporarily to put to use their own excess funds. Thus, the Money Market provides short term funds to meet fluctuating needs. These funds are provided on a loan basis, and must be repaid relatively quickly.

The Money Market includes the following instruments: government securities (bills and notes), government agency securities, company commercial paper (short-term notes issued by companies with high credit ratings, to raise working capital), bankers acceptances, certificates of deposit with banks, and

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FINANCIAL MARKETS

MONEY MARKETS

Purpose: Provide loan funds (not equity) to meet short-term working capital needs.

Instruments

- Government Securities
- Commercial Paper
- Bankers Acceptances
- Certificates of Deposit
- Overnight funds

Institutions

- Central Bank
- Commercial Banks
- Dealers
- Money Market Mutual Funds

CAPITAL MARKETS

Purpose: Provide long-term funds to create capital, which consists of all goods (including plant and machinery) used in production of other goods.

NON-SECURITIES SEGMENT

Purpose: Provide long-term loan funds, non-negotiable

Instruments

- Loans
- Mortgages
- Leases
- Sale and Lease-back

Institutions

- Savings Banks
- Mortgage Banks
- Development Banks
- Insurance Companies
- Leasing Companies

SECURITIES SEGMENT

Purpose: Provide long-term equity and loan funds, in negotiable form, and provide liquidity to investors

Instruments

- Equity
- Equity Equivalents
- Debt Securities

Investors

- Institutional Investors
- Individuals

Institutions

PRIMARY MARKET

Purpose: New issues by companies to raise capital.

- Investment and Merchant Banks
- Brokers, Dealers
- Venture Capitalists
- Issuers
- Securities Regulatory Bodies

SECONDARY MARKET

Purpose: Trading in already issued securities.

- Stock Exchanges
- Brokers, Dealers
- Over-the-Counter Markets
- Clearance and Settlement Agencies
- Mutual Funds

repurchase agreements.

The Money Market involves the following types of institutions: commercial banks, merchant banks, dealers, Money Market mutual funds, and government central banks issuing government securities.

The distinction between the Money Market and the Capital Market can be easily blurred. It may be possible for companies in effect to raise long term finance in the Money Market through continuous issues of commercial paper. In addition, government notes (up to 7 years) and government agency securities are sold in the Money Market. Also, individual investors may place their funds in Money Market instruments, such as negotiable certificates of deposit and shares in Money Market funds. These changes have occurred in recent years during which certain regulatory barriers between market segments have broken down in response to savers' demand for higher returns.

However, one basic distinction continues: all Money Market instruments are debt, and it is only in the Capital Market that equity capital can be raised.

Benefits. Improving the Money Market through a wider range of investment media, improved financial intermediaries and greater liquidity, can provide the following benefits:

(a) Savings are continuously made available through the markets to institutions which can better use them. Funds can be drawn into the organized Money Market from unofficial markets, which often are substantial.

(b) Business enterprises have increased access to short term finance through issuance of commercial paper and similar short term instruments.

2. Capital Market

The Capital Market provides long term finance, for establishment and expansion of business enterprises -- to create means of production. Funds are provided on (i) a loan basis, in which interest must be paid at stated periods and the principal must be repaid at maturity, and (ii) an equity basis (shares), in which there is no promise to repay the funds, but a right to share in the profits of the venture paid as dividends. Thus, the providers of funds in the Capital Market undertake long term risk, expecting that the company will pay interest on the debt or dividends on equity shares.

Enterprises that seek finance compete in the Capital Market for scarce funds, offering different yields and rates of return to attract funds to themselves as compared to other enterprises. Enterprises which are consistently able to pay a higher rate of return are those which are better managed and more efficient.

The Capital Market consists of two segments: (1) the "Non-Securities" segment, and (2) the "Securities" segment. "Securities" refers to transferable evidences of investment (eg. share certificates).

(a) Non-Securities Segment

The Non-Securities segment of the Capital Market is designed to provide funds from financial institutions directly to enterprises and users of funds. Those enterprises that seek the funds negotiate directly with the financial institutions (eg. banks, insurance companies, etc.) that will provide the funds. The financial institutions usually hold the evidence of indebtedness until final payment, although they may rearrange their portfolio of loans, etc. by selling off part of them to other financial institutions. Therefore, the funds are not represented by negotiable securities certificates.

The Non-Securities segment involves loans and other interest or fixed-fee bearing finance, and does not include equity finance, which is risk finance.

The Non-Securities segment involves the following methods of finance: term loans, mortgages, leases, and sales and lease backs. It involves the following institutions: savings banks, mortgage banks, development banks, insurance companies and leasing companies.

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(b) Securities Segment

The Securities segment of the Capital Market is designed to provide finance to business enterprises not exclusively from institutions, but also from the public. The purpose is to encourage savings, and to mobilize savings for investment in productive enterprise.

These investors do not wish to commit their funds indefinitely. They must be able to sell off their investments when they need cash or wish to switch to another investment. Therefore, they require an investment which is negotiable -- a negotiable "security" certificate, such as a share or bond, which can be traded in a liquid market. The investor can then buy and sell the securities as his financial needs dictate.

Furthermore, the securities may represent loans, (ie. bonds and debentures) as in the Non-Securities segment, but represented by negotiable certificates. However, in addition, the Securities segment raises equity finance through equity shares, whereby the investor shares in the financial risk of the venture.

The instruments used in the Securities segment of the Capital Market consist of shares and stocks, bonds and debentures, and equity-related securities (so-called "equity equivalents") convertible into or exchangeable for shares.

Thus, the Securities segment of the Capital Market is distinguished by the fact that:

(a) The funds are long term.

(b) The providers of funds include the broad public beyond the financial institutions.

(c) Investors require negotiable securities, and liquidity.

(d) The securities include not only debt, but also equity shares.

The Securities segment has two major parts, first the original issuance of the securities by companies, and thereafter the investors' trading of the already issued securities. These two markets are referred to as: (i) the "new issues" or "primary" market, and (ii) the "trading" or "secondary" market. These markets are shown in the chart earlier in the text.

(i) New Issues Market. The new issues, or primary, market is the more important market from the point of view of economic development. In the new issues market, companies raise finance by selling to investors new issues of securities. The companies use proceeds from the sale of the securities to develop and expand "capital goods", which are all goods (including plant and equipment) used in the production of other goods. Thus, an increase in the company's capital goods means an increase in its ability to produce. For this reason, the new issues market is fundamentally important for economic growth.

Sales of new issues are conducted through financial intermediaries, consisting of investment and merchant bankers, brokers and dealers and others. These intermediaries arrange for the sale of the new issue to institutional and individual investors.

It is possible for companies to sell their new issue securities directly to the public or to existing shareholders. However, in most developed markets the sales are made through investment and merchant banks, which have the capacity to place the securities to the ultimate investors. Equally important, these institutions commit themselves, or arrange for commitment by others, to the issuing company that the entire new issue will be sold at a set price, thus assuring the issuing company that a fixed total amount will be raised by the new issue.

In sum, the new issues market provides business enterprises with the ability to raise long term finance for capital investment through issuance of debt securities, and, most important, equity securities (shares).

(ii) Trading Market. Once the securities have been sold in the new issues market, trading of the then outstanding (issued) securities occurs in the "trading market" or "secondary market". The trading is exclusively between investors (existing holders and new buyers), and thus "secondary" or "after" the primary issue. The issuing company is not a party to transactions in the trading market, except when it trades, if allowed to do so, for its own account.

The secondary market institutions consist of brokers and dealers who conduct buying and selling of securities for investors. The buying and selling is carried out in securities exchanges, and in over-the-counter markets (which refers to the fact that the securities dealer both buys and sells securities "over the counter" to and from his own inventory, like any merchant).

The trading market provides liquidity for investors, who must be able to sell their securities when they need cash or wish to switch to different investments, and provides savers with a mechanism to invest funds as they are obtained, without any involvement by the issuing company.

In addition to liquidity, the trading market provides an existing pool of investors to whom new issues may be sold in primary offerings, or to whom controlling shareholders may publicly distribute their shares. Also, the offering price may be determined based on the trading prices of already outstanding securities of the issuing company itself or of companies that are comparable to the issuing company.

Therefore, the new issues market is necessary to provide issues of securities to be traded in the trading market; and the trading market is necessary to facilitate pricing of new issues and to provide liquidity to purchasers who invest in new issues. Both markets are mutually reinforcing.

(c) <u>Benefits</u>

Improving the Securities segment of the Capital Market, through a broader range of investment media, improved financial intermediaries and greater liquidity, can provide substantial benefits, including:

(a) Savers have a broader range of ways to invest, liquidity to buy and sell as their needs dictate, and increased confidence in the market,

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and thus are encouraged to save.

(b) Business enterprises have access to a broader range of long term finance, including equity capital. Innovative methods of finance can be developed.

(c) Scarce finance is allocated by the market to those enterprises which are better able to put it to productive use. The cost of funds thus is based on the market cost.

(d) Financial institutions (banks, insurance companies, etc.) may sell off their portfolios of loans etc. represented by negotiable securities, to rearrange risk and obtain funds for further activities.

C. Less Developed Country Interest in Capital Market Development

As is evident, finance and investment flow through the Capital Markets, and the system is used to encourage and mobilize savings for productive use in the economy. If Capital Markets in developing countries are under-developed, needed finance will not be available for development of the economy.

1. Problems in a Number of Countries

Many of the reasons why developing countries seek to improve their Capital Markets have been expressed by knowledgeable representatives from such countries in an earlier international examination on related matters. Some of their concerns are set forth below. The discussion below is not addressed at the Philippines, but is provided to give a general understanding of the kinds of problems faced in a range of countries.

<u>Far Eastern Country</u> - "In [this country's] case, the inadequate supply of local equity capital and long term borrowed capital may, in my opinion, be attributed to the narrow base of its securities markets and the limited scope of

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investment banking. This makes it difficult at any time to raise substantial amounts of capital from the public despite the rise in the rate of savings in recent years.

"Public issues of stocks are seldom made; corporate bonds are almost nonexistent. Local equity capital is mostly obtained through (a) private channels, (b) reinvestment of retained earnings, and (c) rights issues [to existing shareholders] by publicly owned companies. Bank deposit and loan figures indicate that the public's savings are largely channeled to the commercial banks as time and demand deposits and used by the banks to provide short term and medium term credits to trade and industry. A considerable part of the funds is, however, not retained locally by the commercial banks but redeposited to banks abroad."

<u>South East Asian Country</u> - "Concomitant with the difficulties of generating good investment projects is the underdeveloped state of the domestic capital market. Investment banking, if it exists, is in its infancy; and investments in the form of securities are restricted to a relatively few good stocks and bonds."

<u>Middle Eastern Country</u> - "Commercial banks, which collect the major part of total financial savings, are not well suited to meet the long-term financial needs of industry. This is due both to lack of specialization and to liquidity considerations. A proliferation of financial institutions cannot always provide the best solution to the said problems, given the shortage of adequately qualified persons to staff new institutions, and the impact therefrom on the cost of money.

"The narrow margins for self-financing and the absence of a sufficient capital market lead most industrial enterprises into a situation of high leverage . . . Over-borrowing restricts the margin for further expansion of industry and renders enterprises less sound fiscally.

"Insurance, one of the most effective means for mobilizing national savings, as yet plays an infinitesimal role in the economy."

African Country - "There are probably a number of developing countries which have more capital generated or created within their economies than is being put to proper use. In other words, for some developing countries the question might be better stated by asking how can certain developing countries make better use of the capital available to them.

"It is felt that some capital could be created by public savings. This, however, is not done, as the amount saved is not invested in capital-creating industries, but to fulfill private desires such as building a house or acquiring property. Money set aside as savings normally gets withdrawn and used up for putting up buildings and on small property holdings. Thus public savings are not retained for capital growth."

Latin American Country - "One of the great problems is the absence of domestic capital markets, which could capture and direct local savings. In the case of [this country], there undoubtedly exists a need for creating trade promotion banks, of modernizing the laws regulating debentures, of creating credit companies for consumers, etc.

"Besides, the financial market is burdened with taxes, and there exist numerous legal provisions which make it difficult to create secondary markets for discounting, for the issue of bonds, for investment in securities, etc.

"Side by side with the institutional limitation, there exists the problem of adapting the activities of borrowing and of credit to the secular inflation of the economy [of this country]; besides, parallel to the inflation, a control is maintained over the legal interest rate, thus preventing the rate from rising with inflation; and thus, the rate of interest paid to the savers becomes negative."

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2. Actions by Other Countries

In recent years, developing countries have become increasingly aware of the need to encourage and mobilize domestic savings. Because of the increase in oil import costs in the 1970s, the recession in the early 1980s, and reduced ability to obtain, or the unpredictability of, foreign aid and borrowing, developing countries have come to understand that the economic growth they seek cannot be financed from limited government resources. Increasingly, development plans in these countries are based on the view that (to paraphrase) "the private sector must take a more active role in the development of the economy". Often this means that government has an economic development plan, such as new investment equivalent to 10 billion dollars over the plan period, but the government has concluded that traditionally available finance can cover only a limited portion of the targeted investment, for example 5 billion dollars. In these circumstances, the government concludes that "the remainder of the needed investment must come from the private sector".

This new investment must come through increased savings and better mobilization of these savings for productive enterprise. Thus, the domestic financial markets must be improved.

In addition, in developing countries there is usually a wide gap between the rich and the poor, with a limited group of very wealthy and a vast majority of poor. This is particularly true for countries that have recently acquired great wealth, such as through exploitation of natural resources, concentrated in the government or the hands of a few. Often such a country seeks to develop its financial markets to allow broader ownership of financial assets and to provide a greater sharing in the country's wealth, and thus encourage political stability.

In still other countries, government and private sector believe there are sufficient savings in the populace at large, but that the capital markets are not organized adequately, and that investors are not properly protected.

Following the above described needs to encourage the mobilization of increased savings, the thrust of financial market efforts in developing countries is

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most often focused on the Capital Market, where longer term finance, especially equity, can be obtained for establishment and expansion of business. The greater emphasis is placed on the "Securities" segment, where funds, particularly equity, can be obtained from the general public, whose savings are often invested in gold, jewelry, etc., or whose rate of savings may be lower than if broader investment opportunities were offered. Usually the securities market is the most under-developed, and its improvement over time can provide great benefits to the economy.

Many countries have undertaken financial market development programs in the last 10-15 years. They have come to see that financial market development can make a positive contribution to economic growth. Among countries following this approach have been: Korea, Taiwan, Malaysia, Thailand, India, Turkey, Greek Cyprus, Jordan, Egypt, Bahrain, United Arab Emirates, Oman, Kenya, Nigeria, Colombia, Ecuador, Chile, Brazil and Venezuela.

The developed countries have also evaluated the contribution of financial markets to economic growth, and more vigorously attempted to foster and stimulate further development of their capital markets to encourage savings and to better mobilize and allocate finance for productive enterprise. Among developed countries taking this approach to varying degrees are Sweden, France, Germany, Switzerland, Italy, England and the United States.

Draft Makati Stock Exchange Position Paper

Set forth on the following pages is a draft position paper of the Makati Stock Exchange. This paper was discussed with the Manila Stock Exchange during September 1985, and in October 1985 both Exchanges submitted a joint position paper to the President of the Philippines, a copy of which is attached as Appendix D-2.

The Securities Market: An Instrument for Capital Market Development

In the past six years, while many other developing countries in Asia experienced tremendous economic growth, the Philippines went through a period of harsh economic setbacks which were brought about initially by the severe rise in oil prices and followed by the deepest deterioration of the prices of its principal export commodities. To make matters worse, the flight of capital which began in 1983 exerted tremendous pressure on the country's foreign exchange reserves and forced the monetary authorities to declare a moratorium on its foreign debt payments and seek new financing and restructuring of its maturing obligations. The net effects to the economy were negative growth rates, unemployment, business contraction, high interest rates, etc.

While the economy began to decelerate in 1980, the financial markets experienced the biggest shock in its history when a Mr. Dewey Dee fled the country leaving almost a billion pesos in unsecured debt. The event triggered succeeding failures as financial assets of various institutions became worthless paper and investors either preterminated or withdrew maturing money market placements. The financial system tried to get its feet back on the ground, but many more failures this time among finance companies caused by similarly unscrupulous individuals went on unabated. The pressures on the system were of such magnitude that commercial and savings banks experienced liquidity problems. Non-performing bank assets began to surface and a number of banks had to be either closed or taken over by government. By 1984, the financial system was literally on the edge of complete disaster.

To mirror the economy, the stock market began its downhill slide. As prices of commodities worldwide began to deteriorate in 1980, market values of mining issues began to adjust to lower earnings. Failures of financial institutions came one after another and interest rates began to climb. Prices of commercial and industrial issues began to slip in order to adjust its dividend returns to prevailing interest rates and expectations of lower profits. Investors liquidated equity holdings and switched their investments to higher yielding fixed income securities. In 1983, the pressure on the foreign exchange rate began to mount. Investors continued to liquidate equity positions and converted peso proceeds to dollars. Eventually the demand for foreign exchange subsided in mid-1984 brought about by the sudden rise in interest rates through the floation of Central Bank and Treasury Bills at rates of over 40 percent. Investors' interest in the stock market practically disappeared as the reality of higher earnings from government securities succeeded in mopping up excess liquidity. It was a necessary measure to control the double digit inflation and the speculative demand for foreign exchange which previously sent the exchange rate to a high of 24 pesos to the dollar.

Those are the realities of economics and no stock market anywhere in the world could have withstood pressures of reduced earnings, financial uncertainty, and high interest rates. However, it is in the light of this reality that this position paper is written. The over dependence on debt and negotiable debt instruments provided the imbalance in the financial structure of the economic system. Excessive debt led the financial system towards a degree of extreme sensitivity to various economic pressures both internal and external.

The experience of the past years clearly shows the lopsided tendency in the development of the country's financial and capital markets. The concentration of resources in the banking sector and the investment and financial houses led to the high propensity for debt. Although the Investment Houses Law was passed with the intention of improving underwriting of new equity issues, such was not satisfactorily achieved. Investment houses in fact did more business in the money market, intermediating for borrowers and lenders through commercial paper issues. While the debt market took giant leaps, the equity market was left undeveloped. The situation was certainly not conducive for total development of the whole capital market.

It is therefore imperative that the government set out a strategy for a long term development of the capital market which will primarily involve the participants in the equity market. To begin such an endeavor, the securities industry presents to the government some proposals which will have far-reaching effects in the country's economic and social development particularly at this time when the country is just beginning to recover from the severe economic condition experienced in the past six years.

PROPOSAL I - Underwriting

With the passage of the Investment Houses Law in February 15, 1973 through Presidential Decree No. 129, an important activity, underwriting, was virtually removed from the stockbrokerage firms and became the preserve of Investment Houses. When new equity issues were subsequently floated in the market, stockbrokers became known merely as 'selling agents'. It was a lowly position in the financial structure yet they were the ones in direct contact with the investing public. Prior to 1973, stockbrokers were known to have underwritten equity issues either on a firm or best efforts basis. Many of these issues were among the more successful corporations in the country.

To regain not only their lost prestiege but more importantly to put back in place a basic function of their profession, the stock brokers should be allowed to underwrite and once again take the lead role in spreading and distributing ownership of enterprises to as many investors as possible thus fulfilling one of the basic objectives of government, the spreading of wealth.

PROPOSAL II - Unlimited Liability

Banks, investment houses, finance companies and other financial institutions exist under a corporate charter. Stockbrokerage firms are also corporations but, unlike all other financial institutions, their stockholders who own at least 95 percent of the outstanding capital stock of the corporation are required by the rules of the Securities and Exchange Commission to execute an undertaking making themselves jointly and severally liable without limitations for all the transcations and dealings of the said corporation.

Other financial institutions, particularly banks and investment houses, handle much larger volumes of business and carry more substantial liabilities in the form of deposits and deposit substitutes, but their stockholders' financial liabilities are limited only to the capital which each of them invested.

Contrary to its objective of protecting the public, the unlimited liability provision in the rules has not been used effectively in recovering investors claims against insolvent stockbrokerage firms. It has in fact stunted their growth. There are local and foreign investors who have expressed interest in putting capital in existing stockbrokerage firms but were turned off when informed of this provision.

The rule requiring an unlimited liability undertaking, which is like a sword of Damocles, should be removed in order to open the doors not only for fresh and larger capital, but also new investment technology, international exposure and sources of portfolio investments which the stock brokerage firms can tap to generate growth, efficiency and economies of scale.

PROPOSAL III - Increasing the Supply of Listed Securities

The supply of securities of productive and profitable corporations has been cited by various studies as one of the major problems of the securities market. During the years when the market was attractive and investors had excess funds, very few good issues were available. Investors were instead led to speculative issues and the end result was a loss in market confidence when many if not most of those issues were later found to be of doubtful value.

There are many corporations which are kept tightly held by small groups of investors. Although profitable, their corporate growth is limited due to lack of equity. Debt financing does not always provide the solution to capital needs and experience shows that in excessive proportion to equity, debt has a way of turning against the profitability of an entity especially during periods of credit tightness, high interest rates and temporary business setbacks. The slow growth in the corporate sector subsequently affects the aggregate economic development of the country.

The securities industry proposes that in order to strengthen the financial performance and viability of corporations, there is a need to investigate and analyze corporate financial structures. The objective is to strengthen them by striking a proper balance between debt and equity under conditions of risk and costs of capital. One very likely result of a stronger corporate structure as dictated by market forces is government relief from direct financing and debt guarantees.

In addition, a thorough study should be made in order to determine possible incentives for closed corporations to float shares to the public. Many developing countries particularly Korea use a combination of tax and borrowing incentives to induce corporations to allow the public to invest in them. Publicly owned corporations were provided with lower tax rates and better borrowing terms. Lower tax rates do not necessarily mean lower tax collections. With the right incentives, corporations can readily tap public investments in the form of new equity capital to finance expansions of capcity and markets thereby spuring growth and profits. This will mean increased tax collections.

PROPOSAL IV - Multinational Firms to Sell Shares to Filipinos

There are many multinational firms operating in the country. Most of them are wholly owned subsidiaries of corporations from developed countries and are engaged in the production and sales of consumer items, food, pharmaceuticals, agriculture and others. Although multinational subsidiary corporations provide employment, their net profits are all for the benefit of their principals which own the shares completely.

Aside from that, the Filipino workers under their employ are not given the opportunity to participate in stock option plans which is a common practice in the countries from which those multinationals originate. Thus, Filipinos are deprived of income from dividends, corporate growth and capital appreciation. Ironically profits generated by multinationals are derived from Filipino consumers.

India requires that multinationals must have resident or overseas Indians as investors in the local subsidiaries before they are allowed to do business. Inspite of its very stringent requirements in terms of ownership and business activities of multinationals, several recent tax and business reforms designed to catalyze growth and competition have shown positive results. Shares of multinational subsidiary companies offered to Indian nationals have been oversubscribed by as high as 135 times. This example shows how a positive and practical approach towards industrial development through the capital market of a country can be achieved. Indians who traditonally have kept their investments in gold or bank deposits have turned to the capital market.

It is therefore proposed that through an enactment of a law, the multinationals doing business in the Philippines must sell shares of its subsidiaries to the citizens of the host country to the extent of at least 30 percent. This will enable employees to avail themselves of a stock option plan and the local investors in general to share in the profits of the multinational subsidiaries and at the same time develop the capital market. A perfect example of host citizens reaping benefits from investments in multinational subsidiary companies is the Filipinization of telecommunications companies.

PROPOSAL V - Privatization

Over the last few months, the government has announced that it intends to sell to the private sector many of the corporations and financial institutions under its control and ownership.

This decision of government can very well be the start of a capital market development process. Given the ability to underwrite as stated above, the stock brokers should be given a chance to take a lead role in the disposal of government owned corporations. Rather than selling these corporate assets to one group or entity, the government should try with the assistance and customer base of the stock brokers to dispose of them to the public thereby catalyzing the spread of ownership and simultaneously develop the capital market of the country.

PROPOSAL VI - Foreign Portfolio Investments

The Philippines has been relatively successful in attracting foreign investments particularly during the last decade. However, much of the thrust was exerted towards attracting direct investments and loans from the international banking community. Oftentimes these investments carry with them certain unique concessions in one form or another.

What is needed is the internationalization of the securities market in order to attract foreign portfolio investors. Such a program will increase domestic savings flow into equity and attract foreign portfolio investors which are politically neutral requiring no more than protection through proper disclosure, strict auditing standards and guaranteed and efficient repatriation of capital, dividends and profits. To cite some examples, two developing Asean countries, namely Malaysia and Singapore, internationalized their securities markets and the outcome was their rapid economic growth.

The Philippines is a capital importing country and recent experience shows that an over reliance on bank loans is dangerous. The international pool of portfolio capital is potentially even larger than the funds earmarked for foreign investments by banks and multinationals and should be attracted to invest in the Philippine secutities market.

Although repatriation is guaranteed by law, such is not

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totally the case in practice. Foreign portfolio investors require the remittance of sales and dividend proceeds to be as fast as the inward remittance of their purchases. Experience has shown that outward remittance even of properly documented sales proceeds have taken as long as three weeks. Such a delay is unacceptable to international portfolio managers.

It is therefore proposed that the government together with the securities market participants embark on a program to analyze how foreign portfolio investments can be attracted back into the country with the objective of internationalizing the securities market. As an immediate measure, the proceedures for inward and outward remittance of investment funds should be simplified.

PROPOSAL VII - Capital Market Development Program

During the past decade, most developing countries particularly in Asia embarked on capital market development programs to support and fuel their growing 'tiger' economies. Twenty or twenty five years ago these countries did not even have a stock market to speak of or if they had, were undeveloped. Outside of Japan, the Philippines was the only country with a well organized stock market.

Now, countries like Taiwan, Korea, Malaysia, Hongkong and Thailand have well organized stock markets whose traded values are so huge in comparison to those of the Philippine stock exchanges. Their economies have grown at tremendous rates as their corporate sector competed in the international markets not only in product exports but also in services. A very important ingredient in their economic efforts was the development of their capital markets.

The Philippine economy is faced with a tremendous challenge in the coming years. Substantial adjustments in various sectors of the economy have to me made particularly in the banking sector which is still faced with liquidity shortages.

To avoid a repetition of the economic crisis which began in 1980 and to insure continued capital build up to fund the ever growing requirements of an expanding economy it is of utmost urgency that the government take serious steps in pursuing a capital market development program. Foremost is the declaration of a policy from government as to its commitment to such a program.

It is therefore proposed that a committee composed of high level representatives from government and private sectors be established to map out a strategy for capital market development. The Ministry of Finance can take a lead role in the endeavor since the program will involve studies and changes in tax incentives and the implementation of the Securities Act. Other members of the committee should include representatives from the Board of investments, the Central Bank and other ministries and agencies appointed by government.

Conclusion

Rather than brood over the past, the securities industry composed mainly of stockbrokers from the two operating exchanges, Manila and Makati, are prepared to take the challenge of building and developing a capital market to meet the needs of the economy. It recognizes its past failures and defects but is willing to overcome them by a new vision and a constructive program of reform. All that is needed is the willingness of government to assist in its efforts for it cannot do it alone nor does it have the resources.

Commentator's Letter Concerning Capital Market Development

Set forth in the following pages is a letter from David Sycip regarding possible improvements in the financial markets.

3 June 1985

Mr. Anacleto T. del Rosario
President
Delar Consultancy Services, Inc.
P. O. Box 895 MCC
Makati, Metro Manila

Dear 'Cleto:

Re: SYMPOSIUM ON CAPITAL MARKET

You have an impressive line-up of speakers, but I am afraid that if each one presents his paper as a standing-by-itself statement, rather than as a part of a symposium with a clearly defined purpose, the symposium is quite likely to lack both focus and thrust.

As I understand it the purpose of the symposium is to promote investments in corporate securities, mainly equity-type securities, as a form of saving by people whose income levels enable them to save, and who today - elect to save thru traditional savings forms (ordinary savings accounts, time-deposits) or short-term money market placements.

If the symposium is to produce useful, actionable proposals, it should address the following issues:

1. How can portfolio investors (as distinguished from involved-in--management investors) be encouraged to invest in corporate securities? Some of the measures could be:

   1.1 To better ensure that "outside-of-management" investors get a fair deal:

      1.1.1 Requirement of full disclosure by stock-exchange--listed corporations of all financial data, particularly information bearing on off-thetop off-takes (e g. management compensations and bonuses, procurement/purchasing arrangements, corporate investments, corporate loans, etc.).

      1.1.2 Rules to prohibit/penalize "insider-trading", enforced with integrity.

      1.1.3 Promote dissemination of investment information by qualified security analysts thru business pags of newspapers. Objective is to help investors become more knowledgeable about securities offered.

   1.2 Offer a broader range of corporate securities, beyond merely common and preferred shares (or debenture bonds) - e.g. participating preferred shares, income-sharing bonds, etc.

1.3 Provisions to ensure liquidity for investor would be a decisive feature for small investors. A well-developed stock market would ensure that, at some price, shares <u>can</u> be sold. Before stock markets can ensure liquidity, guaranteed purchase by an underwriting institution and/or by the issuing corporation at some preformulated price (in the absence of a trading activity set market price) may serve this purpose.

1.4 To encourage big investors to spread their investments rather than concentrate in a few corporations in order to gain the "benefits" of a board seat, exempt from income tax all cash dividends that represent less than, say, 0.1% of the cash dividend pay-out (this would "target" a desired 1,000 shareholders; for larger corporations it could be 0.01%, thus "targeting" 10,000 shareholders).

2. How can successful or promising corporations be encouraged to offer their shares to the public thru the stock exchange? Some measures that could be considered:

2.1 Offer 3-year loss carry-over for stock exchange-listed corporations (actually this should apply to all corporations, but the government could usethis as an incentive to list).

2.2 Treat cash dividend payments that are below, say 0.1% to 0.01% - scaled according to the capital of the corporation - of total cash dividends paid as a tax-deductible expense.

3. How can qualified financial institutions be encouraged to participate in such an investment-in-securities program? The institutions that can play a major role in such a program are the Universal Banks. Some measures that could encourage them to direct their efforts towards such a program:

3.1 Exempting income earned from underwriting, intermediating or in other ways related to servicing such a program from the 5% gross receipts tax.

3.2 Providing a final withholding tax on debenture bonds at the same rates as those on dividends (10% on corporate payees; 15% on individuals), and treating preferred cash dividend payments as a deductible corporate expense. This would provide issuers/underwriters with greater flexibility in designing financial packages.

3.3 Permitting underwriting firms to extend guarantees on debt or quasi-debt instruments without restrictive rules on collateral cover. Unsecured guarantees could be treated as contingent liabilities, equated with risk assets, but under a more generous multiple of equity - say, 2 to 3 times the ratio applicable to risk asset vs. equity of commercial banks.

3.4 Liquidity assistance from the Central Bank under lender-of--last-resort provisions (provided of course that the CB is adequately covered by collaterals: liquidity support should not be equated with bail-outs from insolvency).

3.5 If insurance against part of the underwriting risks can be purchased (effectively a loss-sharing arrangement) it should be useful. In a different context, the World Bank's Industrial Guarantee Loan Fund (IGLF) and the Philippine Export Guarantee Corporations "guarantees" were loss--sharing arrangements (coupled with funding).

The committee firming up the symposium will probably have suggestions of their own. I suggest that a Briefing Memo incorporating their suggestions and those I have listed (which they find acceptable) be given to the speakers so that their papers will have a substantially common focus and thrust - so that the output of the symposium will be more likely to match its purpose.

With warm regards.

Sincerely yours,

DAVID SYCIP

DS:hmc

Broker's Letter Concerning Capital Market Development

Set forth in the following pages is a letter prepared by Fred C. Hagedorn III, a leading broker on the Manila Stock Exchange, discussing issues and actions required to revitalize the securities markets.

27 September 1985

Mr. George Uy-tioco
Uytioco & Co., Inc.
7th Fl., Banco Filipino Bldg.
Plaza Cervantes, Manila

Dear Mr. Uy-tioco:

In line with our common undertaking with the other Manila and Makati stock brokers, ably assisted by a staff from the US AID, to arrive at a common concensus as to what can be done to develop the Philippine capital market, we are herewith submitting for consideration a paper prepared by Anscor Hagedorn Securities, Inc.. As we are primarily a stock brokerage firm, we have limited our discussion of the capital market to the field we are familiar with — the stock market.

Very truly yours,
ANSCOR HAGEDORN SECURITIES, INC.

FRED C. HAGEDORN III
President

Anscor Hagedorn Securities, Inc.
.th Floor, Builders' Centre Building, 170 Salcedo St., Legaspi Village, Makati, Metro Manila, Tel. no. 85-98-51
mber: Manila Stock Exchange

TOWARDS THE DEVELOPMENT OF THE PHILIPPINE STOCK MARKET

Introduction

In 1969, when the Philippine stock market may be said to have come of age from its humble beginnings in 1927 when five American businessmen started the idea of trading in shares of stock in a few gold mining companies on a black board resting against the side of a wall in a leased area beside the Bureau of Commerce office amidst the atmosphere of beer and warm camaraderie, total value of shares traded for that year of operations was ₱4,350 Million and the market had a capitalization of ₱8,237 Million. It went through two other boom years in 1973 and 1976 with ₱5,661 Million and ₱6,721 Million annual sales, respectively, to where it stands now at total sales of ₱1,304 Million for 1984 and a market capitalization of ₱15,417 Million as of August 30, 1985.

As the stock market is the barometer of a country's economy, it would be difficult to discuss the condition of the stock market without discussing the state of the economy. However we shall attempt to limit ourselves to a discussion on the development of the Philippine stock market as an attempt to address ourselves towards the problems of the economy could lead to all sorts of disgressions from our main focus, which is the stock market.

PART I: PRESENT PROBLEMS

A. Few Listings on the Stock Market

There are currently 130 companies listed on the Manila and Makati stock exchanges, at best some 15 to 20 are actively traded. In the peak years, there were some 120 actively traded stocks from a listing of less than 200 companies.

Anscor Hagedorn Securities, Inc.
6th Floor, Builders' Centre Building, 170 Salcedo St., Legaspi Village, Makati, Metro Manila, Tel. no. 85-98-51
Member: Manila Stock Exchange

The biggest deterent to the entry of the more successful private firms into the market has been their heavy reluctance to open up their business to the public. In the Philippine setting, a lot of the business enterprises, some of them the biggest in their fields in the country, are family-owned or family-controlled and have full intention of staying closed operations due to the desire to keep the profits within the family or due to the owner's unwillingness to be subjected to public scrutiny and criticism. On the other hand, the family set-up still heavily hangs over many Philippine companies and this spoils the image of the business and the saleability of its stock. However, we can point to two prominent examples of successful public offerings of formerly closed family corporations — the Soriano and the Ayala Corporations. Granted that market activity in these shares are currently disappointing, that, however, would be more symptomatic of the whole market and the entire economy.

The whole root of the problem lies in "attraction." Given the amenities and advantages of a closed corporation what incentives do we have to offer that outweigh such amenities and advantages? What can the owner who opens his business gain by such a move aside from an amplification of resources at the outset? This last question may not have been relevant ten or even five years ago. In these hard current economic times the question may no longer be so irrelevant. A lot of companies are squeezed for money and may be in debt up to what may be considered the upper range of prudence. But still the price of expansion will only be paid if the rewards are well worth it. That is to say that the owner will not be willing to give up partial control just for an increase in capital.

B. Limited Volume of Listed Stocks

Aside from a limited number of tradeable stocks, there is the further problem that only a percentage is the subject of day-to-day trading. The limited turnover curtails the scope of the market. The market likewise becomes irrationally hypersensitive to outside factors and influence causing intermittent and violent ups and downs and very long bearish spells. The mining and oil issues have the more broadly-based equity structures. However, when we consider the number of issues actively traded, the scope of the market is drastically reduced. Unfortunately at this point in our economic development, the mining and the oil sectors can not be counted on to spur economic recovery. The thrust will have to come from the commercial-industrial sector, the sector with the narrowest band of shares available for trade. If any public offering at this point in time is to expect to meet with any measure of success, it would have to come from this sector as the economic outlook for the Commercial-Industrials is far more optimistic than the outlook for the mining and oil exploration industries.

Aside from the C-I giants like San Miguel and PLDT whose stockholder profile is fairly broadly based, the rest of the C-I issues, including such notables as Anscor, Ayala, Globe Mackay, and practically all the commercial banks, have less than 30% of their stock available for trade in the market as the majority of the stock is held by its principal owners and institutions that hold it as permanent investment. Some of the lesser known C-Is could very well have up to only 5% to 10% of their stock available for trade — and being lesser known entities certainly contribute to an even further narrowing of their secondary market potentials. Add to this a dearth of information on this more closely held issues further compounds the problem of creating an active secondary market for these issues. The scope of an issue's secondary market certainly either enhances or detracts from the marketability of its primary issue.

C. Lack of Liquidity

Liquidity is an element of primary importance in the purchase of a security. The lack, therefore, of a strong secondary market detracts from the liquidity feature of a security and dampens the attraction for primary issues.

Is this lack of a strong secondary market due to a deficiency in the securities themselves — that they are not yielding enough or that they are characterized by slow growth — or is this lack of liquidity an offshoot to the absence of a meaningful financing mechanism that would induce investors to invest in the stock market?

Then again, is this inadequate secondary market a product of a deficiency in the trading system itself that fails to bring about a secondary market.

On the other hand, what attraction does the stock market have when compared to other investment options such as the money market, government securities, bank deposits, foreign currency, real estate and even jewelry. How do you entice an office employee to set aside a certain amount of his income to buy shares of stock? How do you convince the big individual investor to place more money in the stock market? How do you attract institutional investors to allocate more funds to the equities market?

Daily value turnover currently averages some US$120,000 a day in round trading. In the last market boom, daily transactions averaged over US$1.5 Million at today's rate of exchange. In Taiwan, daily trading in its depressed stock market has tumbled to US$12 Million as of June 1985. The Bangkok market which is much like ours in size and sophistication — 20 actively traded issues out of 97 listed companies — has a value turnover of a little under US$3 Million a day. In a country where coups have become commonplace occurrences, the Bangkok stock market has been increasingly attracting foreign investments from US$10.3 Million in 1982, to US$44.1 Million in 1984 and to US$33.7 Million for the first six months of 1985. For the first six months of this year, the MSE's total volume of business amounted to US$68 Million. However, 65% of this was accounted for by a negotiated change of hands of US$44 Million worth of stock in one listed company, leaving a balance of US$24 Million out of which foreign investment had a minor percentage.

D. Buyer Composition/ Psychology

Unlike other more sophisticated stock markets, ours is not dominated by a balance of pure investors and pure speculators as well as of the various types of investors i.e. high-income individuals, financial institutions, investment companies, pension funds, etc. Our market is characterized by the heavily biased institutional investor and the uninformed individual investor.

Institutional Investor Bias

Institutional investors, due mainly to biases built in government regulations, have their own peculiar investment preferences. Banks and insurance companies are partial to government securities which are eligible to meet reserve requirements/ agricultural loan requirements by banks or form part of government-defined admitted assets of insurance companies. Trust funds are generally a receptacle for bank written issues, if not yet invested in a few blue chips, particularly those giving regular and fixed or determinable earnings. The government would be expected to hold securities of companies in which it had a stake either as a lender or as a "pure development" prime mover.

Uninformed Individual Investors

A great number of individual investors go or have gone into securities investment trusting more on impressions, rumors, and hearsays rather than on the basis of an analysis of corporate data which, in the first place, is not readily available. At the outset, an unpleasant experience arising from a decision made on the basis of inaccurate information usually serves to place the investor out of the stock market forever.

E. Structural Imbalances in Financial Markets

A number of negative developments, particularly in the monetary and economic sectors conspire to thwart the development of the capital market.

Among others, the fixed income market continues to dominate the investment scene as money market rates hover way above the interest and income rates of long term securities or common stock. Unless the monetary authorities take a hand in stabilizing money market rates we cannot expect a more balanced and rationalized channeling of investments ensuing to the benefit of the capital market. The question should therefore be asked if there is a major deficiency in our financial infrastructure such that the allocation of financial resources are not efficiently, much less adequately, distributed through the various channels.

Despite the numerous bankruptcies and frozen investments arising from the collapse of quite a number of financial enterprises who accepted investment funds — from the time of the Dewey Dee caper to the more recent economic crunch brought about by the events in August 1983 — the government succeeded in siphoning off over P55 Billion in "idle" or investible funds. This vast pool of funds should certainly be available for tapping by the capital market.

To further complicate matters, there are now plans to set up a commodities market. The establishment of such a market in an economy with quite limited resources may be likened to installing a bathtub in one's "barong-barong." Resources could definitely be better used elsewhere. This type of a more sophisticated financial market should develop as a natural consequence of a maturation of a country's financial system — a stage we are a long way to achieving.

PART II: POSSIBLE SOLUTIONS

For any attempt to revitalize activity in the stock market to be meaningful, government must make a firm commitment to develop a mature capital market. Government must firmly believe that a healthy stock market is crucial to its plan for building up the economy. The development of a mature capital market will surely lead to a lessening of business dependence on loans as the main source of funds. In Taiwan for example, the government's idea is to encourage Taiwanese companies to raise capital in the stock market rather than through loans while enticing its population to invest in the stock market such that its pool of funds will grow large enough for companies to tap. A visibly serious attempt by the government to support the development of the local stock market should definitely add more points to the confidence factor on which both local and foreign investors heavily rely on.

A. Increase Listings on the Stock Market

A rundown of the top 1,000 corporations in the Philippines would show that only forty-eight companies are listed in the stock exchange. Any meaningful solution to the problem of why these companies have kept away from going public should primarily address itself to two basic criteria for why these companies have remained closed corporations.

One, is the owners' objective to keep the profits in — within the family, within the partnership. Two, is the owners' fear of public scrutiny.

Some of the measures to attract issuers to the market are herewith submitted for consideration:

1. A corporate income tax structure that more heavily taxes closed corporations than public corporations. For such a tax structure to be meaningful to the objectives of this paper and at the same time not result in the discouragement of the private entrepreneurial spirit of the small Filipino businessman, a cut-off level must be established as to the size of the corporation before such a biased tax structure becomes applicable. It may be more effective to leave smaller businesses in the hands of a few owners. For example, corporations with asset bases more than, say, P100 Million should be encouraged to go public lest the biased corporate income tax structure takes effect. (The P100 Million cut-off level is an arbitrary figure for the sole purpose of discussion. A further study will have to be undertaken to determine what would be a more equitable level.)

2. As an addendum to the above, a two-tiered withholding tax rate could be established whereby cash dividends paid by public corporations are subject to a preferential tax rate over dividends declared by closed corporations.

3. Require multinationals to open up a certain percentage of their equity to the public. The idea here is not that this would have to be a requirement for the multinational company to set up business here, but more of an approach from the taxation structure that would offer better tax incentives to multinationals willing to go public and on the other hand withhold such incentives if they were to be set up as strictly closed concerns.

4. Industrial firms seeking registration with the BOI may be required to open up their equity ownership to the public to the extent of at least 30%. This requirement would specifically apply to corporations with sizeable capital as, again, small enterprises would be better off left in the hands of a few owners. This requirement should perhaps be a condition precedent to registration instead of being a post-operative condition.

5. To take a cue from South Korea, ceilings could be placed on borrowings by large companies to force them to go to the capital market to raise additional funds either through new listings or rights offering. The recent Philippine experience of almost unbridled access to vast short term money market funds by public and private corporations has itself led to the downfall of a long list on these companies and the corresponding investors indicating that undue emphasis may have been given to this particular financing source. In hindsight we now realize that such liberal access to money market funds had resulted in companies borrowing from the money market funds which they should more prudently have raised in the capital market as those funds were in reality used for capital formation purposes.

6. To attract companies to raise funds through the stock market, another South Korean government scheme has been to allow stocks to be issued at market value for the first time. Hyundai, the giant South Korean conglomerate, has successfully undertaken a share offering under this scheme. (The Accountant's migraine is a price well worth

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paying for when compared to stirring the organization to profitability or so the South Koreans figure out.)

7. One of the proposals of the out-going Bankok Stock Exchange president, Mrs. Siriluck, called for the listing of some state-owned enterprises earmarked for privatization. Considering the scope of the portfolio of companies taken over by the government, such a proposal may be well worth considering for some of the more viable concerns.

8. As to the problem of the fear or unwillingness to be subjected to public scrutiny, companies, who despite definitive advantages in going public, still adamantly refuse or have some paranoia regarding opening up their equity would in all likelihood be better off staying closed as skeletons in their corporate closets probably abound. These are precisely the sort of firms that regulatory agencies must keep out of the market.

9. With regard to enticing already-public corporations to further open up their equity, such a development would have to naturally flow from an improvement in the market as a whole as these companies have already "broken the ice" so to speak. It would prove very complicated if we had to draw up rules for companies to go public and another set of rules for companies to go more public. A broadening of a public company's equity base should come as a natural outflow of a reading that the developing stock market is in good position to take in good quality offerings.

B. Attract Investors

1. By and large, the mere increase in the number of good quality stock listed in the market should beef up the number of blue chips thereby attracting investment.

2. To encourage individual investors, notwithstanding our gross taxation system, government could provide for some kind of a tax break if say, salaried and other fixed income wage earners save to buy stocks. Such tax credits could be applied against the gross income tax due for the year. Such a tax scheme could be temporary in nature for say two to three years until the

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objective of activating the market has been achieved. It is doubtful that the termination of such a tax scheme would turn back the market to its current state since the uptrend in trading activity by then would have built up enough of a momentum to keep the market going on its own.

3. The lowering of the tax rate on cash dividends paid by public corporations could attract investors with prospects of upping the yields on their investments. The decrease in government revenue arising from the lowering of the tax rate may well be compensated by an increase in government revenue arising from increased activity in the stock market. In other words, make-up in volume what you are not making anyway in rates.

4. The successful float of the short-term Central Bank and Treasury Bills to mop up excess liquidity in the local system as well as the successful float of unit trust fund shares by South Korea and Taiwan to attract foreign investors to indirectly invest in their stock markets (as their markets have restrictions on direct foreign investments) show proof that there are adequate local and foreign investible funds if only the stock market were made an attractive investment option. One advantage we have over the Seoul and Taiwan stock markets is that we are already open to accepting direct foreign investment.

5. To gain investor confidence, government should call for stricter supervision of the operations and accounting of public corporations. The Securities and Exchange of Thailand, for example, in its drive to elicit more attraction to its own stock market has introduced more stringent auditing and reporting requirements, and has stepped up its own market surveillance on inside traders and manipulators.

6. Though to some this may sound a little bit far-fetched, it may still be worth evaluating its merits. In order to further insure the success of the British government's privatization program, the London Stock Exchange is seriously considering the unusual step of advertising on television to attract investors to the market.

C. Ensure Liquidity

1. The government could establish a Merchant Bank

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to help companies raise money in the stock exchange. The bank would have enough capital to underwrite primary rights offering of companies going public. One of the rehabilitated government controlled banks could step nicely into such a role. This bank would likewise provide a special financing program for stock trading. These loans could be extended to eligible securities dealers, stock brokers, and individual as well as institutional investors much like the ground rules laid out by the Monetary Board Resolution No. 1073 under CB Circular 807 dated June 26, 1981. Funding assistance to set up such a bank could be requested from international organizations such as the World Bank or the US AID for that matter.

2. As an alternative, if not a supplement, to the above proposal, the Central Bank using a carrot-and-stick policy could encourage commercial banks to lend money for share purchases. Such loans however would have to be given at preferential rates for them to be attractive.

3. For a company to undertake a successful public offering, there must be adequate funds in the system to pick up the rights offering. With a credit mechanism cum tax incentive sweeteners more investors could be enticed to invest and lend a hand to the capital formation efforts while at the same time expanding the equity base of listed stocks ultimately calling for a wider distribution of wealth. If minority stockholders can have the assurance that they can turn to the market and liquify their investments at anytime, more people would be willing to take the risk of investing in the stock market.

4. Deficiencies in the securities themselves, such as low yield and slow growth may be remedied by government assistance. Tax amendments can be called for in crisis times to make companies more profitable. The withholding tax on cash dividends could be lowered, even on temporary basis just to up the yield of the security to attract buyers. As the economy shifts into normalization, rates could again be increased and tax reliefs lifted in the light of better economic times to which these measures would no longer be attuned to. Afterall, tax legislation should be more than just a means to provide government with revenues. Tax legislation must first and foremost, if it is to be the stable

provider for government, be attuned to the needs of the economy such that tax measures more responsive to the requirements of the times are implemented. As the requirements of an economy change so too should the tax legislation that was precisely installed for the proper regulation thereof.

D. Institutional Investor Bias

The institutional investor bias mentioned in Part I of this paper which was mainly a result of certain government regulations, could well be remedied by the tax amendments discussed above.

E. Uninformed Individual Investor

In this connection, the need for an educational campaign is apparent as many Filipino investors do not as yet have a proper understanding of the essentials, much less, the intricacies, of securities investments. Perhaps the introduction into the college curriculum of such a subject matter, much like Banking and Finance or Corporate Taxation which are currently offered, would do much in this respect.

Also, a felt presence of institutional investors would stabilize the market and make it less vulnerable to violent swings brought about by manipulators. As the uninformed individual investor tends to follow-the-leader, they easily fall prey to such manipulators. Heavy involvement by institutional investors would neutralize such moves.

F. Structural Imbalances in the Financial Markets

A discussion on this matter may have well been covered in the above discussions as this likewise touches on government taxation and incentives. It would be difficult to discuss the matter of attracting investors into the stock market without touching on the subject of remedying the structural imbalance in the financial markets as the answer to one is at the same the answer to the other problem.

The point to be stressed here would be that government should look at the entire financial system as a whole in adopting an integrated approach such that no one facet or investment option is sacrificed for the sake of another. Each segment of the financial system has its own role to play, its own objectives to fulfill, and its own value for existence in the total development of the system and policy determination and tax legislation should serve as the thrusts to help them attain these objectives. The need to correct existing inequities in the financial markets is the sole justification for a government's preferential treatment for one investment alternative over the others and such preferential treatment should cease once the inequities have been cured and the system can then be left to operate according to market forces.

ANSCOR HAGEDORN RESEARCH

ANNEX M 2

OVERVIEW OF THE CAPITAL MARKET

A. HISTORICAL DEVELOPMENT

A modern financial development of the Philippines started with the arrival of a few British and American merchant houses in the 1830s. The first commercial bank Banco of Espanol Filipino was established in 1851. In the latter half of the 19th century, two British banks, Chartered Bank (in 1873) and Hongkong and Shanghai Banking Corporation (in 1876) opened branches in Manila. American administration brought a more complete set of modern monetary and banking system at the turn of the century. In 1903, the Philippine Coinage Act was promulgated, which governed the currency regulations. In 1916, the government sponsored Philippine National Bank (PNB) was established. PNB extended both short-term and long-term credits to the agriculture and industrial sectors. However, PNB suffered a substantial loss during the recession in the aftermath of the World War II, the long-term financing functions were transferred to Agricultural and Industrial Bank, which was established in 1939. This was later absorbed by Rehabilitation Finance Corporation in 1947. In 1937, Government Service Insurance System (GSIS), was established.

The securities market started in the 1920s, with the establishment of Manila Stock Exchange in 1927. The Securities Act was promulgated in 1936. Early development of the market concentrated in the mining, particularly of gold, issues.

After the World War II, the Central Bank Act and General Banking Act were promulgated in 1948. Central Bank was established in January 1949. The 1950s saw the fast development of existing institutions and new entrance of various other type of institutions. Nine more commercial banks started the operation, joining the existing 12 banks. In 1952, Rural Bank Act was enacted, and by 1960, 160 rural banks were erected. Social Securities System (SSS) was set up in 1957. In 1958, Rehabilitation Finance Corporation was reorganized to form the Development Bank of the Philippines (DBP).

In the 1960s, the number of commercial banks further increased, reaching 39 by 1965. In the latter half of the 1960s, no new commercial bank was established, but the growth of total assets was fast. During this decade, many new types of financial institutions appeared. In 1963, Private Development Corporation of the Philippines (PDCP) started the operation. National Investment Development Corporation (NIDC) was also founded in the year as a subsidiary of PNB. Bancom Development Corporation which was created in 1964 contributed to the development of investment banking in the Philippines.

Private Development Banks' Act of 1964 was enacted and 28 private development banks were established by the end of the 1960s, with the financial assistance of DBP. The money market activities were increased in this period too, in particular, with the active participation of investment houses in mobilizing short-term funds for banks and leading corporations. The money market expanded mainly through the expansion of call money market, Treasury bills (TB), Central Bank Certificate of Indebtedness (CBCI), and DBP Progress Bonds. With this rapid development, the share of non-bank financial institutions increased.

In the 1970s and the early 1980s, Central Bank and Monetary Board increased their policy making and regulating functions. Major policies in the 1970s and the early 1980s undertaken by the Central Bank were: (i) high priority financing for export industries; (ii) establishment of specialized financial institutions in the priority areas; (iii) modernization of commercial banks through consolidation and foreign participation; (iv) strengthening of commercial bank capital structure, and acceptance of foreign capital participation; (v) introduction of offshore banking system; (vi) introduction of universal banking system; and (vii) deregulation of interest rates.

These reforms were mainly due to a series of studies and recommendations made by joint efforts between CB and multi-lateral organizations. CB's function was fortified in 1972, implementing the recommendations made by a joint IMF-CB Study. During the early 1970s, the money market development was given an impetus for rapid growth with the introduction of quasi-banking system and deposit-substitutes. In 1977, an offshore banking system was introduced. The OBU business expanded to reach $4,407 million in 1983.

However, the brisk activities of the money market resulted in lending to less creditworthy companies. In 1981, the market experienced a severe crisis when an established industrialist Dewey Dee absconded with an unpaid debt of ₱635 million. Many investment houses, including the Bancom Development Corporation, failed and many manufacturing companies were placed under the direct control of DBP, PNB and other government financial institutions. The government introduced various measures to regulate the market more closely, including the requirements of stand-by guarantee by commercial banks for these papers.

Introduction of the expanded commercial banking (ECB) system in 1980 was a departure from the preceding system in which short-term and long-term financings had been institutionally separated. In this modified universal banking system, commercial banks with an ECB license are given the power to play greater role in providing long-term funds. Number of commercial banks which obtained ECB license increased in 1981-83 to reach nine at the end of 1983. However, the economic conditions deteriorated in 1982 - 83 in the wake of high petroleum prices, lower export primary commodity prices, and higher interest rates. The declining condition was further precipitated by the political crisis in August 1983.

B. NON-SECURITIES MARKET

1. Financial Institution

The financial system of the Philippines consists of the Central Bank, banking institutions, and non-bank financial intermediaries. In addition,

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there are other financial institutions outside the system, namely private insurance companies, and specialized government non-bank financial institutions, such as social security organizations, and investment and holding companies. The structure of the financial sector of the Philippines is characterized by the dominant shares of commercial banks and specialized government banks, particular, the Development Bank of the Philippines (DBP). Commercial banks accounted for about 56 percent of the total assets of the financial sector in terms of total assets base in 1983. DBP contributed another 14 percent to the sector.

Central Bank of the Philippines

The Central Bank of the Philippines was established in 1948. It is empowered with various policy planning and implementation functions related to the financial sector. It issues official currencies; supervises and regulates financial institutions; manages official external accounts; and acts as fiscal agent of the Government. The monetary policies are determined by the Monetary Board which Central Bank Governor chairs, and are implemented through various policy instruments such as: (i) discounts rates; (ii) reserve requirement ratios; (iii) direct credit control, such as setting up credit ceilings, or allocating mechanism of direct loans or rediscounting credits to banks; and (iv) open market operation of government securities, including the Central Bank Certificate of Indebtedness (CBCI). CBCIs are medium-term bonds issued by the Central Bank.

The Central Bank exercises strong power over the financial sector as regulatory agency of the financial institutions. It grants, with the Monetary Board approval, licenses to financial institutions to establish an institution, to open branches, and to operate under special licenses. The Central Bank also examines the operations of these institutions regularly, places them under close supervision when their performance is unsatisfactory or violates prescribed policy guidelines, and revokes licenses when necessary.

Commercial Banks

There are 34 commercial banks operating in the Philippines, of which 28 are domestic private banks, 4 foreign bank branches, and 2 government owned banks (Philippine National Bank (PNB) and Veterans Bank). Of the 28 private banks, a few have foreign capital participation of varying degrees; five are controlled or effectively owned by government financial institutions.

Commercial banks are the largest group of the financial institutions, accounting for more than 56 percent of the total assets of the financial sector in 1983. Among them, PNB is by far the largest commercial bank, whose assets constitute about 30 percent of the total assets of commercial banks. Citibank's Manila branch is the second largest, accounting for some 9 percent of the total assets. Domestic commercial banks are in general small. Many of them are closely held family or group oriented undertakings, fulfilling the financial needs of business activities within the family or business group. All headquarters offices and 45 percent of some 1,400 branches are located in Manila. The larger ones however have an extensive branch network throughout the country, at least in the urban areas.

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Since the introduction of Expanded Commercial Banking (ECB) system, or commonly known as universal banking system, in 1980, commercial banks with ECB licenses are allowed to perform a larger role in providing long-term funds to the economy, by extending long-term credits, underwriting securities or making equity participation. The minimum capital requirement for ECB license is ₱500 million. Initially only PNB was qualified, but other banks also increased their capital base, either through mergers or foreign capital participation, to obtain the license. At the end of 1983, nine banks were operating under the ECB license. In early 1984, Veterans Bank was reorganized and obtained ECB license under the new name, Military and Veterans Bank. Universal banking functions could be performed either directly by the licensed bank itself, or through a subsidiary investment house.

Major source of commercial bank funds comprises demand, savings, and time deposits; deposit substitutes, which are mainly short-term promissory notes issued by banks; and borrowings from the Central Bank and other bank and non-banks. Since the early 1970s, banks and other financial institutions have been allowed to accept funds through deposit substitutes, which are essentially negotiable promissory notes issued by these institutions. The function is called quasi banking (QB). Deposit substitutes were outside the interest rate regulations of deposits, hence they grew very rapidly in the 1970s. This contributed to the rapid growth of the money market. The composition of fund sources was as follows at the end of 1983: demand deposits 22 percent; savings deposits 17 percent; time deposits 15 percent; and borrowings from the Central Bank 9.4 percent. It is observed that the Central Bank credits to commercial banks constitute an important segment of their funding.

Funds are used for loans and discounts, and securities investment. Commercial banks have to maintain reserve deposits with the Central Bank. The ratios for commercial banks, which have been effective since April 13, 1984, are 24 percent of demand, savings deposits, NOW accounts, and time deposits and deposit substitutes with maturity of less than 730 days; 6 percent of time deposits and deposit substitutes with maturity of more than 730 days. The ratios applicable for other institutions are similar to these. The reserve ratios have been raised continuously since the late 1960s. In particular, the same ratio has been applied to demand, savings, and time deposits of less than 730 days maturity, for commercial banks. They are also required to extend 25 percent of the loanable funds to agriculture and agrarian reform projects. However, they are exempted from this obligation if they purchase eligible government securities. Overdrafts facilities are not utilized as commonly as used to be. Instead short-term loans are usually rolled over. Banks are less willing to extend longer-term loans, because of the conceived high risks. There has been nevertheless a slight increase in medium- and long-term loans since 1980. Loans are normally secured by collaterals on fixed assets or inventories. Personal guarantees are also widely used. Investments in securities are mainly in government securities, most of which are to meet the reserve and agri-agra requirements.

Thrift Banks

Thrift banks comprise savings and mortgage banks, private development banks, and stock savings and loan associations. Although their evolutionary backgrounds are different, they are today performing more or less the same functions, mobilizing funds mainly through savings and time deposits; and utilizing them basically for housing and other consumer and small and medium scale industries oriented term lendings. The number of these institutions is large, but the contribution to the financial sector is only about 4 percent of the total assets in 1983. The growth of these institutions was rapid in the 1970s, when their assets expanded at 36.0 percent annually on average in 1974-80. The expansion rate for the whole banking institutions was 23 percent during the same period.

Thrift banks depend mainly on savings and time deposits for their funds. Since 1980, thrift banks have been also allowed to accept demand deposits, when approved by the Monetary Board. However, the dependency on demand deposits has remained low, constituting only 2 percent of the total deposits at the end of 1983. Private development banks depend also on the medium- and long-term borrowings from the government sources, usually from the Central Bank. In particular, multi-lateral loans for small and medium scale enterprises are often channeled through these institutions. Use of funds of the thrift banks concentrates on the loans and discounts for housing, and other mortgage financing for consumers and small- and medium-scale industries.

Rural Banks

Rural banks were established to promote the betterment of the rural sector, by providing credits to small farm holders and cooperatives. There were 949 rural banks at the end of 1983, but they are small, mostly single unit entities. Their total assets accounted for only 2.3 percent of the financial sector total at the end of 1983. Their sources of funds are mainly savings deposits and borrowings. The dependency on borrowings was high at 56 percent of the total liabilities at the end of 1983. This is mainly because they are a main conduit of government funds to the rural sector. Of the total outstanding borrowings of ₱4,025 million of the rural banks at the end of 1983, ₱3,934 million were loans and advances extended from the Central Bank. Because of their size, they are in particular vulnerable in tight liquidity conditions. In fact many rural banks encountered difficulties in late 1983 - 1984.

The Development Bank of the Philippines

The Development Bank of the Philippines (DBP) is the government owned development bank, which provides long-term loans for the high priority development projects. DBP also has been promoting private development banks by providing long-term funds and equities. DBP's operation expanded quite rapidly in the past. Loan and investment outstanding grew at 23 percent per annum between 1978 and 1983. Its total assets reached ₱56,530 million at the end of 1983, which accounts for 13.5 percent of the total assets of the financial sector. However, as will be discussed later, the loan and investment portfolio of DBP is not satisfactory. Its portfolio includes substantial amount of non-performing assets.

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Sources of DBP's funds are mainly borrowings from the Government, and international sources, including multilateral and bilateral aid agencies, and foreign private financial institutions. DBP used to issue long-term bonds, called DBP Progress bonds. The bonds had a provision to be exchangeable with preferred stocks of leading companies financed by DBP. This however was terminated, after the bonds suffered from liquidity problems, when DBP over-supplied the market with the bonds by issuing them to its borrowers in lieu of part of loan proceeds. DBP introduced Countryside Bills in 1974.

Investment Houses

The first investment house was established in 1936. However, it was in the 1960s that a number of other investment houses were established and their activities grew quite rapidly. Investment houses underwrite securities issues, and invest in various business activities in industrial and real estate projects through equity participation.

The growth of the investment houses was accelerated after the enactment of Investment House Law in 1973. The law prescribed a greater role for investment houses in long-term financing. Consequently, activities of investment houses grew fast in the 1970's. The total assets expanded at an average 14.4 percent annually in 1974-80. However, their activities were mostly concentrated in short-term financing, done through tradings of commercial papers and other money market instruments under quasi-banking licenses. The introduction of expanded commercial banking system in 1980 undermined their activities. The money market crisis in 1981 further weakened the positions of many of them. This in fact accelerated the reorganization of the sector, and many investment houses were consolidated with or placed under the control of commercial banks.

There were 14 investment houses operating in early 1984. Their contribution to the financial sector was only 1.5 percent at the end of 1983. This is a significant decline from 1980, when they accounted for 3.5 percent of total financial sector assets. Investment houses depend monstly on short-term borrowings for their funds, mainly through their quasi-banking functions. The funds are utilized for loans and securities investments. Private Development Corporation of the Philippines (PDCP) is the largest investment house, which accounts for 20-25 percent of the total activities of investment houses. But it is undertaking activities similar to those of private development banks.

Private Insurance Companies

There were 136 private life and non-life insurance companies operating in the Philippines at the end of 1983, of which 23 were life insurance companies, 108 non-life, and 5 re-insurance companies. Together they contributed 3.3 percent to the financial sector, on the basis of total assets at the end of 1983. The growth of insurance companies was moderately fast at 16.5 percent annually on average in 1974-83.

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The business activities of insurance companies concentrate in a few large companies. In life insurance, top two companies accounted for 58 percent of the total assets in 1981, and top 5 for 84 percent. In non-life insurance, top 3 companies accounted for 22 percent of the total assets also in 1981. Insurance companies utilize the funds for policy loans, investment in stocks and bonds. Bonds they invest are almost exclusively government securities and CBCIs.

Government Insurance Institutions

There are two government owned social insurance institutions: Government Service Insurance System (GSIS) and Social Security System (SSS). Both are social insurance scheme, providing life and non-life insurance services, workers' compensation, and pension funds. GSIS is for the government employees, and SSS for private sector employees.

GSIS was created in 1937. It operates life, non-life insurance and provides retirement insurance benefits. The outstanding investible funds of GSIS was ₱14.7 billion at the end of 1983. The funds are utilized to finance investment activities of government and semi-government organizations, normally through purchasing bonds and other securities, and extending loans to contributors and others. Investment decisions are made by Board of Trustees.

SSS was set up in 1957. The program which SSS operates consists of social security, medical insurance, and employees compensation. SSS's total assets was ₱16.2 billion. SSS utilizes its funds for investment in govenment securities and housing loans. Except for loans to its contributors, SSS makes only limited direct loans.

Leasing Companies

The first leasing company was established in 1957. Since then the leasing business grew quite rapidly to reach the total lease contracts outstanding of ₱1.0 billion at the beginning of the 1980s. Most of the leasing business is conducted by subsidiary companies of financial institutions, mainly private development banks, investment houses, and finance companies. Leasing companies depend on bank loans for their funds. Accordingly, they have been facing difficulties since later 1983, because of high interest rates conditions. The demand for leasing business itself is also experiencing contraction during the same period, because the lack of confidence among investors for the future of the economy has depressed the investment activities.

Other Financial Institutions

Finance companies were established in the 1950-70s. The governing law is Finance Company Law of 1969. They mobilize funds through the money market and borrowing from the commercial banks. Funds are utilized to finance purchase of consumer durables, automobiles, factoring, leasing, etc. Their business expanded fast in the 1970s, and the number of finance companies reached 372 at the end of 1981. But because of the money market crisis in

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1981, many companies failed. At the end of 1983, there were reported to be some 200 companies operating. The contribution to the financial sector was 2.8 percent on the basis of total assets at the end of 1983. Investment companies are engaging in investing, reinvesting and trading of securities. They are regulated by the Investment Company Act of 1960, which was enacted to regulate activities of mutual funds. Fund managers are institutional or personal administrators of funds of private pension funds, employees provident funds, or investment trust funds.

C. SECURITIES MARKET

This section gives a brief description of the two securities type capital markets, namely the bond market and the stock market. The characteristics of the markets in terms of their sizes, kinds of instruments, and trading activities will be summarized.

1. Bond Market

The bond market in the Philippines consists of the government securities market and the private bonds market. However, the bond market has been dominated by the government securities. Private bond issues have been, on the other hand, very limited in the Philippines. The most recent issue by private corporations was the debentures issued by the Paper Industries Corporation of the Philippines (PICOP) in 1977.

The growth of the bond market has been more or less along with the development of the government securities market, in particular, the Treasury Bill, and the Central Bank securities markets. Since the public issue of Treasury Bills (TBs) in 1966 with auction system, TBs have been most popular among the government securities. TBs were introduced into the market so that an efficient open market operation could be conducted by the Central Bank. TBs played a leading role in development of the bond and money market, until the introduction of the Central Bank Certificates of Indebtedness (CBCIs) in 1970. CBCIs are medium-term bonds, with market competitive coupon rates. Since then CBCI took over a leading role from TBs in the government securities market.

Major Instruments

The government securities comprise three major groups, that is, the national government issues, government corporation issues, and the Central Bank issues. At the end of May 1984, the total outstanding amount of the government securities issued through the Central Bank was ₱44.5 billion, of which the national government issues were ₱33.1 billion; the government corporation issues were ₱4.0 billion; and the Central Bank issues were ₱7.4 billion. In addition, there were ₱5.8 billion outstandings of DBP and LBP issues as of June 1984 which were directly placed.

Of the national government issues, the largest share was taken by the various treasury issues, accounting for more than 90 percent. The second largest share was claimed by Premyo savings bonds, but they accounted for only

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3 percent of the national government issues. The outstanding amounts of government corporation issues except for the DBP and LBP issues were small compared with those of the national Treasury issues. Among them, issues by National Development Company (NDC) and National Food Authority (NFA) were substantial. The Central Bank issues consist of two kinds. CBCIs were medium-term bonds, maturing in 3-5 years. CB bills were short-term bills which were introduced in May 1984, to absorb the excess liquidity from the market. The maturity ranges from 7 days to 210 days.

The Primary Issues Market

Most of Government securities are sold through the Central Bank. Although public corporations are in general authorized to undertake direct sales of their securities, the majority of them opt to utilize the CB sales network. Primary distribution of government securities are made through subscription, negotiated sales or underwriting, or auction methods.

The government securities are issued normally with the predetermined interest rates except for the recent issues of TBs and CB bills. The interest rates have been kept low for most of the securities. The Government has devised various measures to promote their sales. However, because of the low interest rates, the primary issues market has been limited mostly to commercial banks, and financial institutions. They form a captive market for these securities, basically created by the government regulations.

Most of the government securities are held by commercial banks and government financial institutions. Of the ₱50.8 billion outstanding at the end of 1983, 36.0 percent was held by commercial banks, and 26.7 percent by semi-government entities, most of which are government financial institutions. The government trust funds consisting mostly of Bond Sinking Fund (BSF) accounted for some 11 percent of the total. The private non-bank institutions, such as insurance companies and trust departments of banks which constitute a major part of institutional investors, accounted for some 9 percent of the total. Commercial banks and other financial institutions hold government securities to fulfill the legal reserve requirements. Many government securities are made eligible for the required reserves. Central Bank regulations provide that up to 75 percent of the required reserves could be held in the form of cash in vault or government securities, while at least 25 percent must be in the form of deposits with the Central Bank. Although reserve eligible government securities are limited to those which carry coupons of 4 percent or less, this gives commercial banks an incentive to hold government securities. At the end of 1982, nearly 30 percent of government securities held by commercial and thrift banks were for the reserve purpose.

There are other features which are intended to promote the sales of government securities to the financial institutions. They are agri/agra eligibility, insurance reserve eligibility, and tax exemptions. Each of these features are added to particular issues depending on the characteristics of each issue, such as purpose of financing.

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Secondary Market

Because of the low coupon rates, the secondary tradings of the government securities have been dormant except for a few issues, such as Treasury bills and CBCIs. The secondary market of government securities has developed along with development of a dealer network. A dealer network was formed under the organization called National Association of Government Securities (NAGSD), soon after the inception of the Treasury bills floating in 1966. NAGSD was composed of five commercial banks and two investment houses and was accredited by the Central Bank to form a nucleus of the TB market. Although its activities grew at the beginning, the activities slowed down and eventually halted in the wake of the government policy to allow government institutions to participate in the auction of TBs at lower discounts and higher volume. In the years from 1974 till 1981, no promotional efforts were made by the government for the sales of government securities. In 1981, the government renewed an effort to promote the sales, and in 1982 a new network of CB-accredited government security dealers (AGSD) was formed, consisting of 12 banks and investment houses. The number of accredited dealers increased to 15 by 1983.

The transactions of government securities in the secondary market became very active only in the past few years. The total secondary transactions among the accredited government securities dealers were ₱60.3 billion in 1982 and ₱51.08 billion in 1983.

Treasury bills were most heavily traded accounting for about 47 percent of the total trading volume. CBCIs accounted for 10 percent. Majority of secondary market transactions were in short-term and medium-term securities, and not in long-term bonds. In addition, a substantial amount of transactions have been made on a repurchase agreement (RP) basis. Figures on transactions outside the AGSD network are not available but it can be assumed safely that AGSD market constitutes the most of the whole secondary market. Since late 1983, secondary market transactions declined significantly because of the financial crisis. Consequently, financial institutions which want to hold or divest government securities in particular TBs and CB bills make direct transactions with the Central Bank. Moreover, dealer financing through the Central Bank has no longer been available since later 1983, which has brought dealers market activities to a near standstill.

Corporate Bonds

There are few corporate bonds which are publicly placed. As of August 1984, only PICOP convertible debentures are listed on the stock exchanges. Most of other corporate bonds are privately placed. The details of the private placement market are not available.

2. Stock Market

Historical Development

The Philippine stock market started in 1927 when the Manila Stock Exchange was incorporated as a voluntary non-profit organization patterned

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after the New York S˙ ck Exchange. In the pre-World War II days, the stock market activities were heavily dependent on the gold price, because the Philippines was one of the main suppliers of gold at that time. For example, the devaluation of the U.S. dollar on January 31, 1984, which increased gold prices from $20.66 to $35.00 per ounce, boosted securities trading as well as the activities in gold mining.

After the war, however, a fixed price on gold against rising production costs ruined gold mining as a major industry and at the same time dampened activities at the stock exchange. However, the sharp rise in copper prices revived tradings at the exchange in the mid 1950's. The average stock price of mining shares (the mining average index) went up from 85.10 in March 1954 to 426.28 in March 1956, although it declined to 107.40 in March 1958.

Around this time, individual and institutional investors were impressed by the growth of industrial activities in the economy and became increasingly interested in industrial shares. This supported the growth of the stock tradings further. From 1958 through 1959, a sudden rise in commercial and industrial average index took place as mutual funds and other financial institutions entered into the market. But this sudden infusion of funds into the market which was still thin in terms of available securities eventually led to the downfall of mutual funds.

The stock market showed some active trading after the martial law in 1972, when a couple of measures were taken such as reduction of transaction tax rate from 2 percent to 1/4 percent. The subsequent favorable economic situations brought about by the increase of copper prices ushered in a great cyclical bull market in 1973-74. The last boom in the market came in 1978-79, when expectations of domestic oil production were at their peak. Since 1980, the Philippine stock market's performance has been depressed, due to continuous disappointing developments: first, the boom in commodity prices ended in early 1980, second, the oil exploration almost ended up with disappointment of investors. The stock market condition has continued to worsen since the political crisis in August 1983 followed by an unprecedented financial debacle through most of 1984. However, since the February 1986 revolution, a renewed confidence that the new government has created has had its invigorating effects on the country's stock markets. Prices of actively traded issues are experiencing rapid uptrends, and a growing new interest in oil issues have become evident. A growing number of new companies have been listed at the stock exchanges. Much of the present bullish activity in the stock market can be traced to heavy buying from institutional buyers as well as from foreign groups, which have been gradually accumulating a portfolio of selected mining issues and commercial-industrial shares.

The Operation of the Stock Exchange

The Philippines has three stock exchanges, Manila Stock Exchange (MSE) established in 1927, Makati Stock Exchange (MKSE) established in 1965, and Metropolitan Stock Exchange (Metrex) opened in 1974. Metrex has remained defunct almost right after its inception. As of the end of 1983, the issues listed on the stock exchanges numbered some 200. A presidential decree issued

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in 1973 provided that a share listed on one stock exchange should automatically be listed on other stock exchanges. At the end of 1983, the total market capitalization of the two exchanges was ₱18.2 billion.

The Primary Market

The size of the primary issues market increased rapidly in the early 1970s, reaching ₱19.9 million in 1976, but has been declining since then. In 1982, the total amount of new issues was ₱0.57 million. Most of the issues of already established companies are right issues at par to existing stockholders. Since early 1986, new companies have been listed on the country's stock exchanges, resulting in a renewed uptrend in primary issues.

Other Features

Several stocks are listed on the New York and the Hongkong stock exchanges. The listing on the New York stock exchange (NYSE) dates back to the 1930s. Four shares listed on NYSE are Benguet Corporation, Atlas Mining, Marinduque, and PLDT.

Foreign nationals may purchase shares of most of the companies. The companies issue two classes of shares. Class A shares may be purchased only by the Philippine nationals, while Class B shares may be purchased by foreign nationals.

D. THE WORKINGS OF THE CAPITAL MARKET

The function of the capital market is to match the supply of and demand for long-term funds, mainly utilized for investment purposes. Two major segments of the capital market, namely the bonds and equity markets, have been described. This section describes and analyzes the demand for funds from the corporate sectors, the interest rate structure which influences the flow of funds, and the money market, which is to underpin the function of the capital market, mainly by aiding the efficiency in the tradings.

1. Corporate Finance

Corporate financing practices reflect the corporate management practices and the conditions of the capital market. In the Philippines, many corporations are still family oriented entities, where the control of the management is closely held within the families, or a group of individuals. This characteristic, combined with less developed conditions of the capital market, leads to a high dependency on debt financing. Furthermore, many corporations with long-term capital needs in domestic currency often depend on the foreign exchange borrowings.

Philippine corporations may be classified into four groups according to their capital structure and management style. The first group is government owned corporations which are enjoying liberal access to the long-term funds from the government. Their financial conditions, however, vary from well performing ones to loss making operations. Most of them are large entities with substantial capital investment. The second group is joint-venture companies between Philippine and foreign capital. They are often better and professionally managed than domestic companies. They are also listed in the high ranking category in the top 1,000 corporations of the Business Day listing. Among the domestic private corporations, there are a good number of companies, which are well managed, and have good performance records. They form the third group. Many of them are public corporations listed on the stock exchange. They have grown out of the traditional family oriented management style, in the course of corporate growth. The fourth group consists of generally small, family oriented traditional companies. They depend heavily on the financial resources of the families or friends for expansions. This limits their growth within their own means. These corporations are also difficult to discern from private proprietorship. Owners often place their interests above the growth of corporations.

Many Philippine corporations have high dependency on debt in their capital structure, or the high debt-equity ratio is prevalent. Debt-equity ratios was 4.66 on average of the top 1,000 companies in 1982. The average ratio was 2.33 if financial institutions were excluded. However, the ratios vary quite widely among corporations. In fact, there are many companies even in the top 1,000 group whose debt equity ratio exceeds 10.0.

High debt-equity ratios are consequences of many factors. Because of family oriented management practices, their access to the equity capital is limited. Banks are not hesitant to extend credits, when there is personal guarantee, even if borrowers have high debt-equity ratio. The high debt-equity ratio makes the corporations extremely vulnerable to the adverse external conditions. In 1982-83, high interest rates and low demand for their products doubly and severely hit these corporations. This also had damaging effects on the financial institutions which had extended credits to these companies.

Close family control of many corporations also generate a few negative impacts on the corporate sector growth. First, as mentioned earlier, their unwillingness to go public limits the access to the equity market, which restrains the growth of the corporations. Second, many corporate owners, who are also managers, put thei personal interest above that of the corporations. This often leads to high dividend payout ratios, reducing the growth of capital base of the corporations. This also makes the corporate owners opt to rely more on debt financing as discussed.

Many corporations often depend on foreign capital markets for their debt-financing. This is especially common among large, well established companies. Since most of their revenue bases are in domestic currency, this practice tends to increase the foreign exchange risk. This is in fact one of the remote causes of many corporations facing financial difficulties since 1983. The underdeveloped stage of the domestic capital market is the main underlying factor to cause this irregular practice.

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The corporations in the Philippines tend to borrow short-term to finance long-term investment. This is partly due to the high interest rate situation where borrowers are hesitant in entering into the long-term contracts at high interest rates. The liquidity ratio, namely current assets to current liabilities, of non-financial corporations was 1.01 in 1982, and those of many corporations were below 1.00. Ideal level is normally considered to be 2.00. Among the industry groups, agriculture, electricity, gas and water, mining and quarrying, transportation and communications all had the average liquidity ratio of less than one.

2. The Money Market

The money market in the Philippines is well developed in terms of the variety of instruments available, the level of activities, and the extent of market participants. The market was given an impetus for development in the early 1960s in the wake of peso devaluation. Commercial banks started an interbank call market to respond to the rapidly changing financial situations. It was in 1965 that the money market with participants from outside the banking system was introduced. The market developed quite rapidly because it was outside the regulated interest rate regime. In the 1970s, the money market development was placed under the control of the Central Bank, by the introduction of Investment House Law, the system of quasi-banking license and the deposits substitutes. Under these new system, the market flourished. However, the higher inflow of funds into the market forced it to find its outlet increasingly into companies of marginal or even doubtful quality. This led to the eventual downfall of the market in 1981 with the Dewey Dee case.

The Philippine money market consists of the following segments: (i) interbank call money market; (ii) Central Bank Certificates of Indebtedness (CBCI); (iii) Treasury Bills (TB); (iv) Promissory notes issued by banks and quasi-banks; (v) repurchase agreements; (vi) certificates of assignments; (vii) certificate of participation; and (viii) commercial papers issued by non-financial institutions, and financial institutions without quasi-banking (QB) licenses. Participants in markets (i)-(iii) are banks and non-bank financial institutions and participants in markets (iv)-(vii) are these institutions plus non-financial corporations, both private and public, institutional investors, and individuals.

The interbank call market is by far the largest, followed by the promissory notes market. These two combined account for over 80 percent of the money market transactions. Compared with them, transactions of CBCIs and TBs are very low. Since the outstanding amount of promissory notes is smaller than those of CBCIs or TBs, this attests an inactive secondary market of these government securities. In terms of participants, commercial banks are also the most active participants, followed by investment houses. In addition to the traditional use of the funds mobilized by the Government and financial institutions, securities dealers use the market to finance their inventories.

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OVERVIEW OF THE CAPITAL MARKET

A. HISTORICAL DEVELOPMENT

A modern financial development of the Philippines started with the arrival of a few British and American merchant houses in the 1830s. The first commercial bank Banco of Espanol Filipino was established in 1851. In the latter half of the 19th century, two British banks, Chartered Bank (in 1873) and Hongkong and Shanghai Banking Corporation (in 1876) opened branches in Manila. American administration brought a more complete set of modern monetary and banking system at the turn of the century. In 1903, the Philippine Coinage Act was promulgated, which governed the currency regulations. In 1916, the government sponsored Philippine National Bank (PNB) was established. PNB extended both short-term and long-term credits to the agriculture and industrial sectors. However, PNB suffered a substantial loss during the recession in the aftermath of the World War II, the long-term financing functions were transferred to Agricultural and Industrial Bank, which was established in 1939. This was later absorbed by Rehabilitation Finance Corporation in 1947. In 1937, Government Service Insurance System (GSIS), was established.

The securities market started in the 1920s, with the establishment of Manila Stock Exchange in 1927. The Securities Act was promulgated in 1936. Early development of the market concentrated in the mining, particularly of gold, issues.

After the World War II, the Central Bank Act and General Banking Act were promulgated in 1948. Central Bank was established in January 1949. The 1950s saw the fast development of existing institutions and new entrance of various other type of institutions. Nine more commercial banks started the operation, joining the existing 12 banks. In 1952, Rural Bank Act was enacted, and by 1960, 160 rural banks were erected. Social Securities System (SSS) was set up in 1957. In 1958, Rehabilitation Finance Corporation was reorganized to form the Development Bank of the Philippines (DBP).

In the 1960s, the number of commercial banks further increased, reaching 39 by 1965. In the latter half of the 1960s, no new commercial bank was established, but the growth of total assets was fast. During this decade, many new types of financial institutions appeared. In 1963, Private Development Corporation of the Philippines (PDCP) started the operation. National Investment Development Corporation (NIDC) was also founded in the year as a subsidiary of PNB. Bancom Development Corporation which was created in 1964 contributed to the development of investment banking in the Philippines.

Private Development Banks' Act of 1964 was enacted and 28 private development banks were established by the end of the 1960s, with the financial assistance of DBP. The money market activities were increased in this period too, in particular, with the active participation of investment houses in mobilizing short-term funds for banks and leading corporations. The money market expanded mainly through the expansion of call money market, Treasury bills (TB), Central Bank Certificate of Indebtedness (CBCI), and DBP Progress Bonds. With this rapid development, the share of non-bank financial institutions increased.

In the 1970s and the early 1980s, Central Bank and Monetary Board increased their policy making and regulating functions. Major policies in the 1970s and the early 1980s undertaken by the Central Bank were: (i) high priority financing for export industries; (ii) establishment of specialized financial institutions in the priority areas; (iii) modernization of commercial banks through consolidation and foreign participation; (iv) strengthening of commercial bank capital structure, and acceptance of foreign capital participation; (v) introduction of offshore banking system; (vi) introduction of universal banking system; and (vii) deregulation of interest rates.

These reforms were mainly due to a series of studies and recommendations made by joint efforts between CB and multi-lateral organizations. CB's function was fortified in 1972, implementing the recommendations made by a joint IMF-CB Study. During the early 1970s, the money market development was given an impetus for rapid growth with the introduction of quasi-banking system and deposit-substitutes. In 1977, an offshore banking system was introduced. The OBU business expanded to reach $4,407 million in 1983.

However, the brisk activities of the money market resulted in lending to less creditworthy companies. In 1981, the market experienced a severe crisis when an established industrialist Dewey Dee absconded with an unpaid debt of ₱635 million. Many investment houses, including the Bancom Development Corporation, failed and many manufacturing companies were placed under the direct control of DBP, PNB and other government financial institutions. The government introduced various measures to regulate the market more closely, including the requirements of stand-by guarantee by commercial banks for these papers.

Introduction of the expanded commercial banking (ECB) system in 1980 was a departure from the preceding system in which short-term and long-term financings had been institutionally separated. In this modified universal banking system, commercial banks with an ECB license are given the power to play greater role in providing long-term funds. Number of commercial banks which obtained ECB license increased in 1981-83 to reach nine at the end of 1983. However, the economic conditions deteriorated in 1982 - 83 in the wake of high petroleum prices, lower export primary commodity prices, and higher interest rates. The declining condition was further precipitated by the political crisis in August 1983.

B. <u>NON-SECURITIES MARKET</u>

1. <u>Financial Institution</u>

The financial system of the Philippines consists of the Central Bank, banking institutions, and non-bank financial intermediaries. In addition, there are other financial institutions outside the system, namely private insurance companies, and specialized government non-bank financial institutions, such as social security organizations, and investment and holding companies. The structure of the financial sector of the Philippines is characterized by the dominant shares of commercial banks and specialized government banks, particular, the Development Bank of the Philippines (DBP). Commercial banks accounted for about 56 percent of the total assets of the financial sector in terms of total assets base in 1983. DBP contributed another 14 percent to the sector.

Central Bank of the Philippines

The Central Bank of the Philippines was established in 1948. It is empowered with various policy planning and implementation functions related to the financial sector. It issues official currencies; supervises and regulates financial institutions; manages official external accounts; and acts as fiscal agent of the Government. The monetary policies are determined by the Monetary Board which Central Bank Governor chairs, and are implemented through various policy instruments such as: (i) discounts rates; (ii) reserve requirement ratios; (iii) direct credit control, such as setting up credit ceilings, or allocating mechanism of direct loans or rediscounting credits to banks; and (iv) open market operation of government securities, including the Central Bank Certificate of Indebtedness (CBCI). CBCIs are medium-term bonds issued by the Central Bank.

The Central Bank exercises strong power over the financial sector as regulatory agency of the financial institutions. It grants, with the Monetary Board approval, licenses to financial institutions to establish an institution, to open branches, and to operate under special licenses. The Central Bank also examines the operations of these institutions regularly, places them under close supervision when their performance is unsatisfactory or violates prescribed policy guidelines, and revokes licenses when necessary.

Commercial Banks

There are 34 commercial banks operating in the Philippines, of which 28 are domestic private banks, 4 foreign bank branches, and 2 government owned banks (Philippine National Bank (PNB) and Veterans Bank). Of the 28 private banks, a few have foreign capital participation of varying degrees; five are controlled or effectively owned by government financial institutions.

Commercial banks are the largest group of the financial institutions, accounting for more than 56 percent of the total assets of the financial sector in 1983. Among them, PNB is by far the largest commercial bank, whose assets constitute about 30 percent of the total assets of commercial banks. Citibank's Manila branch is the second largest, accounting for some 9 percent of the total assets. Domestic commercial banks are in general small. Many of them are closely held family or group oriented undertakings, fulfilling the financial needs of business activities within the family or business group. All headquarters offices and 45 percent of some 1,400 branches are located in Manila. The larger ones however have an extensive branch network throughout the country, at least in the urban areas.

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Since the introduction of Expanded Commercial Banking (ECB) system, or commonly known as universal banking system, in 1980, commercial banks with ECB licenses are allowed to perform a larger role in providing long-term funds to the economy, by extending long-term credits, underwriting securities or making equity participation. The minimum capital requirement for ECB license is ₱500 million. Initially only PNB was qualified, but other banks also increased their capital base, either through mergers or foreign capital participation, to obtain the license. At the end of 1983, nine banks were operating under the ECB license. In early 1984, Veterans Bank was reorganized and obtained ECB license under the new name, Military and Veterans Bank. Universal banking functions could be performed either directly by the licensed bank itself, or through a subsidiary investment house.

Major source of commercial bank funds comprises demand, savings, and time deposits; deposit substitutes, which are mainly short-term promissory notes issued by banks; and borrowings from the Central Bank and other bank and non-banks. Since the early 1970s, banks and other financial institutions have been allowed to accept funds through deposit substitutes, which are essentially negotiable promissory notes issued by these institutions. The function is called quasi banking (QB). Deposit substitutes were outside the interest rate regulations of deposits, hence they grew very rapidly in the 1970s. This contributed to the rapid growth of the money market. The composition of fund sources was as follows at the end of 1983: demand deposits 22 percent; savings deposits 17 percent; time deposits 15 percent; and borrowings from the Central Bank 9.4 percent. It is observed that the Central Bank credits to commercial banks constitute an important segment of their funding.

Funds are used for loans and discounts, and securities investment. Commercial banks have to maintain reserve deposits with the Central Bank. The ratios for commercial banks, which have been effective since April 13, 1984, are 24 percent of demand, savings deposits, NOW accounts, and time deposits and deposit substitutes with maturity of less than 730 days; 6 percent of time deposits and deposit substitutes with maturity of more than 730 days. The ratios applicable for other institutions are similar to these. The reserve ratios have been raised continuously since the late 1960s. In particular, the same ratio has been applied to demand, savings, and time deposits of less than 730 days maturity, for commercial banks. They are also required to extend 25 percent of the loanable funds to agriculture and agrarian reform projects. However, they are exempted from this obligation if they purchase eligible government securities. Overdrafts facilities are not utilized as commonly as used to be. Instead short-term loans are usually rolled over. Banks are less willing to extend longer-term loans, because of the conceived high risks. There has been nevertheless a slight increase in medium- and long-term loans since 1980. Loans are normally secured by collaterals on fixed assets or inventories. Personal guarantees are also widely used. Investments in securities are mainly in government securities, most of which are to meet the reserve and agri-agra requirements.

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Thrift Banks

Thrift banks comprise savings and mortgage banks, private development banks, and stock savings and loan associations. Although their evolutionary backgrounds are different, they are today performing more or less the same functions, mobilizing funds mainly through savings and time deposits; and utilizing them basically for housing and other consumer and small and medium scale industries oriented term lendings. The number of these institutions is large, but the contribution to the financial sector is only about 4 percent of the total assets in 1983. The growth of these institutions was rapid in the 1970s, when their assets expanded at 36.0 percent annually on average in 1974-80. The expansion rate for the whole banking institutions was 23 percent during the same period.

Thrift banks depend mainly on savings and time deposits for their funds. Since 1980, thrift banks have been also allowed to accept demand deposits, when approved by the Monetary Board. However, the dependency on demand deposits has remained low, constituting only 2 percent of the total deposits at the end of 1983. Private development banks depend also on the medium- and long-term borrowings from the government sources, usually from the Central Bank. In particular, multi-lateral loans for small and medium scale enterprises are often channeled through these institutions. Use of funds of the thrift banks concentrates on the loans and discounts for housing, and other mortgage financing for consumers and small- and medium-scale industries.

Rural Banks

Rural banks were established to promote the betterment of the rural sector, by providing credits to small farm holders and cooperatives. There were 949 rural banks at the end of 1983, but they are small, mostly single unit entities. Their total assets accounted for only 2.3 percent of the financial sector total at the end of 1983. Their sources of funds are mainly savings deposits and borrowings. The dependency on borrowings was high at 56 percent of the total liabilities at the end of 1983. This is mainly because they are a main conduit of government funds to the rural sector. Of the total outstanding borrowings of ₱4,025 million of the rural banks at the end of 1983, ₱3,934 million were loans and advances extended from the Central Bank. Because of their size, they are in particular vulnerable in tight liquidity conditions. In fact many rural banks encountered difficulties in late 1983 - 1984.

The Development Bank of the Philippines

The Development Bank of the Philippines (DBP) is the government owned development bank, which provides long-term loans for the high priority development projects. DBP also has been promoting private development banks by providing long-term funds and equities. DBP's operation expanded quite rapidly in the past. Loan and investment outstanding grew at 23 percent per annum between 1978 and 1983. Its total assets reached ₱56,530 million at the end of 1983, which accounts for 13.5 percent of the total assets of the financial sector. However, as will be discussed later, the loan and investment portfolio of DBP is not satisfactory. Its portfolio includes substantial amount of non-performing assets.

Sources of DBP's funds are mainly borrowings from the Government, and international sources, including multilateral and bilateral aid agencies, and foreign private financial institutions. DBP used to issue long-term bonds, called DBP Progress bonds. The bonds had a provision to be exchangeable with preferred stocks of leading companies financed by DBP. This however was terminated, after the bonds suffered from liquidity problems, when DBP over-supplied the market with the bonds by issuing them to its borrowers in lieu of part of loan proceeds. DBP introduced Countryside Bills in 1974.

Investment Houses

The first investment house was established in 1936. However, it was in the 1960s that a number of other investment houses were established and their activities grew quite rapidly. Investment houses underwrite securities issues, and invest in various business activities in industrial and real estate projects through equity participation.

The growth of the investment houses was accelerated after the enactment of Investment House Law in 1973. The law prescribed a greater role for investment houses in long-term financing. Consequently, activities of investment houses grew fast in the 1970's. The total assets expanded at an average 14.4 percent annually in 1974-80. However, their activities were mostly concentrated in short-term financing, done through tradings of commercial papers and other money market instruments under quasi-banking licenses. The introduction of expanded commercial banking system in 1980 undermined their activities. The money market crisis in 1981 further weakened the positions of many of them. This in fact accelerated the reorganization of the sector, and many investment houses were consolidated with or placed under the control of commercial banks.

There were 14 investment houses operating in early 1984. Their contribution to the financial sector was only 1.5 percent at the end of 1983. This is a significant decline from 1980, when they accounted for 3.5 percent of total financial sector assets. Investment houses depend monstly on short-term borrowings for their funds, mainly through their quasi-banking functions. The funds are utilized for loans and securities investments. Private Development Corporation of the Philippines (PDCP) is the largest investment house, which accounts for 20-25 percent of the total activities of investment houses. But it is undertaking activities similar to those of private development banks.

Private Insurance Companies

There were 136 private life and non-life insurance companies operating in the Philippines at the end of 1983, of which 23 were life insurance companies, 108 non-life, and 5 re-insurance companies. Together they contributed 3.3 percent to the financial sector, on the basis of total assets at the end of 1983. The growth of insurance companies was moderately fast at 16.5 percent annually on average in 1974-83.

The business activities of insurance companies concentrate in a few large companies. In life insurance, top two companies accounted for 58 percent of the total assets in 1981, and top 5 for 84 percent. In non-life insurance, top 3 companies accounted for 22 percent of the total assets also in 1981. Insurance companies utilize the funds for policy loans, investment in stocks and bonds. Bonds they invest are almost exclusively government securities and CBCIs.

Government Insurance Institutions

There are two government owned social insurance institutions: Government Service Insurance System (GSIS) and Social Security System (SSS). Both are social insurance scheme, providing life and non-life insurance services, workers' compensation, and pension funds. GSIS is for the government employees, and SSS for private sector employees.

GSIS was created in 1937. It operates life, non-life insurance and provides retirement insurance benefits. The outstanding investible funds of GSIS was ₱14.7 billion at the end of 1983. The funds are utilized to finance investment activities of government and semi-government organizations, normally through purchasing bonds and other securities, and extending loans to contributors and others. Investment decisions are made by Board of Trustees.

SSS was set up in 1957. The program which SSS operates consists of social security, medical insurance, and employees compensation. SSS's total assets was ₱16.2 billion. SSS utilizes its funds for investment in govenment securities and housing loans. Except for loans to its contributors, SSS makes only limited direct loans.

Leasing Companies

The first leasing company was established in 1957. Since then the leasing business grew quite rapidly to reach the total lease contracts outstanding of ₱1.0 billion at the beginning of the 1980s. Most of the leasing business is conducted by subsidiary companies of financial institutions, mainly private development banks, investment houses, and finance companies. Leasing companies depend on bank loans for their funds. Accordingly, they have been facing difficulties since later 1983, because of high interest rates conditions. The demand for leasing business itself is also experiencing contraction during the same period, because the lack of confidence among investors for the future of the economy has depressed the investment activities.

Other Financial Institutions

Finance companies were established in the 1950-70s. The governing law is Finance Company Law of 1969. They mobilize funds through the money market and borrowing from the commercial banks. Funds are utilized to finance purchase of consumer durables, automobiles, factoring, leasing, etc. Their business expanded fast in the 1970s, and the number of finance companies reached 372 at the end of 1981. But because of the money market crisis in

1981, many companies failed. At the end of 1983, there were reported to be some 200 companies operating. The contribution to the financial sector was 2.8 percent on the basis of total assets at the end of 1983. Investment companies are engaging in investing, reinvesting and trading of securities. They are regulated by the Investment Company Act of 1960, which was enacted to regulate activities of mutual funds. Fund managers are institutional or personal administrators of funds of private pension funds, employees provident funds, or investment trust funds.

C. SECURITIES MARKET

This section gives a brief description of the two securities type capital markets, namely the bond market and the stock market. The characteristics of the markets in terms of their sizes, kinds of instruments, and trading activities will be summarized.

1. Bond Market

The bond market in the Philippines consists of the government securities market and the private bonds market. However, the bond market has been dominated by the government securities. Private bond issues have been, on the other hand, very limited in the Philippines. The most recent issue by private corporations was the debentures issued by the Paper Industries Corporation of the Philippines (PICOP) in 1977.

The growth of the bond market has been more or less along with the development of the government securities market, in particular, the Treasury Bill, and the Central Bank securities markets. Since the public issue of Treasury Bills (TBs) in 1966 with auction system, TBs have been most popular among the government securities. TBs were introduced into the market so that an efficient open market operation could be conducted by the Central Bank. TBs played a leading role in development of the bond and money market, until the introduction of the Central Bank Certificates of Indebtedness (CBCIs) in 1970. CBCIs are medium-term bonds with market competitive coupon rates. Since then CBCI took over a leading role from TBs in the government securities market.

Major Instruments

The government securities comprise three major groups, that is, the national government issues, government corporation issues, and the Central Bank issues. At the end of May 1984, the total outstanding amount of the government securities issued through the Central Bank was ₱44.5 billion, of which the national government issues were ₱33.1 billion; the government corporation issues were ₱4.0 billion; and the Central Bank issues were ₱7.4 billion. In addition, there were ₱5.8 billion outstandings of DBP and LBP issues as of June 1984 which were directly placed.

Of the national government issues, the largest share was taken by the various treasury issues, accounting for more than 90 percent. The second largest share was claimed by Premyo savings bonds, but they accounted for only

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3 percent of the national government issues. The outstanding amounts of government corporation issues except for the DBP and LBP issues were small compared with those of the national Treasury issues. Among them, issues by National Development Company (NDC) and National Food Authority (NFA) were substantial. The Central Bank issues consist of two kinds. CBCIs were medium-term bonds, maturing in 3-5 years. CB bills were short-term bills which were introduced in May 1984, to absorb the excess liquidity from the market. The maturity ranges from 7 days to 210 days.

The Primary Issues Market

Most of Government securities are sold through the Central Bank. Although public corporations are in general authorized to undertake direct sales of their securities, the majority of them opt to utilize the CB sales network. Primary distribution of government securities are made through subscription, negotiated sales or underwriting, or auction methods.

The government securities are issued normally with the predetermined interest rates except for the recent issues of TBs and CB bills. The interest rates have been kept low for most of the securities. The Government has devised various measures to promote their sales. However, because of the low interest rates, the primary issues market has been limited mostly to commercial banks, and financial institutions. They form a captive market for these securities, basically created by the government regulations.

Most of the government securities are held by commercial banks and government financial institutions. Of the ₱50.8 billion outstanding at the end of 1983, 36.0 percent was held by commercial banks, and 26.7 percent by semi-government entities, most of which are government financial institutions. The government trust funds consisting mostly of Bond Sinking Fund (BSF) accounted for some 11 percent of the total. The private non-bank institutions, such as insurance companies and trust departments of banks which constitute a major part of institutional investors, accounted for some 9 percent of the total. Commercial banks and other financial institutions hold government securities to fulfill the legal reserve requirements. Many government securities are made eligible for the required reserves. Central Bank regulations provide that up to 75 percent of the required reserves could be held in the form of cash in vault or government securities, while at least 25 percent must be in the form of deposits with the Central Bank. Although reserve eligible government securities are limited to those which carry coupons of 4 percent or less, this gives commercial banks an incentive to hold government securities. At the end of 1982, nearly 30 percent of government securities held by commercial and thrift banks were for the reserve purpose.

There are other features which are intended to promote the sales of government securities to the financial institutions. They are agri/agra eligibility, insurance reserve eligibility, and tax exemptions. Each of these features are added to particular issues depending on the characteristics of each issue, such as purpose of financing.

Secondary Market

Because of the low coupon rates, the secondary tradings of the government securities have been dormant except for a few issues, such as Treasury bills and CBCIs. The secondary market of government securities has developed along with development of a dealer network. A dealer network was formed under the organization called National Association of Government Securities (NAGSD), soon after the inception of the Treasury bills floating in 1966. NAGSD was composed of five commercial banks and two investment houses and was accredited by the Central Bank to form a nucleus of the TB market. Although its activities grew at the beginning, the activities slowed down and eventually halted in the wake of the government policy to allow government institutions to participate in the auction of TBs at lower discounts and higher volume. In the years from 1974 till 1981, no promotional efforts were made by the government for the sales of government securities. In 1981, the government renewed an effort to promote the sales, and in 1982 a new network of CB-accredited government security dealers (AGSD) was formed, consisting of 12 banks and investment houses. The number of accredited dealers increased to 15 by 1983.

The transactions of government securities in the secondary market became very active only in the past few years. The total secondary transactions among the accredited government securities dealers were ₱60.3 billion in 1982 and ₱51.08 billion in 1983.

Treasury bills were most heavily traded accounting for about 47 percent of the total trading volume. CBCIs accounted for 10 percent. Majority of secondary market transactions were in short-term and medium-term securities, and not in long-term bonds. In addition, a substantial amount of transactions have been made on a repurchase agreement (RP) basis. Figures on transactions outside the AGSD network are not available but it can be assumed safely that AGSD market constitutes the most of the whole secondary market. Since late 1983, secondary market transactions declined significantly because of the financial crisis. Consequently, financial institutions which want to hold or divest government securities in particular TBs and CB bills make direct transactions with the Central Bank. Moreover, dealer financing through the Central Bank has no longer been available since later 1983, which has brought dealers market activities to a near standstill.

Corporate Bonds

There are few corporate bonds which are publicly placed. As of August 1984, only PICOP convertible debentures are listed on the stock exchanges. Most of other corporate bonds are privately placed. The details of the private placement market are not available.

2. Stock Market

Historical Development

The Philippine stock market started in 1927 when the Manila Stock Exchange was incorporated as a voluntary non-profit organization patterned after the New York Stock Exchange. In the pre-World War II days, the stock market activities were heavily dependent on the gold price, because the Philippines was one of the main suppliers of gold at that time. For example, the devaluation of the U.S. dollar on January 31, 1984, which increased gold prices from $20.66 to $35.00 per ounce, boosted securities trading as well as the activities in gold mining.

After the war, however, a fixed price on gold against rising production costs ruined gold mining as a major industry and at the same time dampened activities at the stock exchange. However, the sharp rise in copper prices revived tradings at the exchange in the mid 1950's. The average stock price of mining shares (the mining average index) went up from 85.10 in March 1954 to 426.28 in March 1956, although it declined to 107.40 in March 1958.

Around this time, individual and institutional investors were impressed by the growth of industrial activities in the economy and became increasingly interested in industrial shares. This supported the growth of the stock tradings further. From 1958 through 1959, a sudden rise in commercial and industrial average index took place as mutual funds and other financial institutions entered into the market. But this sudden infusion of funds into the market which was still thin in terms of available securities eventually led to the downfall of mutual funds.

The stock market showed some active trading after the martial law in 1972, when a couple of measures were taken such as reduction of transaction tax rate from 2 percent to 1/4 percent. The subsequent favorable economic situations brought about by the increase of copper prices ushered in a great cyclical bull market in 1973-74. The last boom in the market came in 1978-79, when expectations of domestic oil production were at their peak. Since 1980, the Philippine stock market's performance has been depressed, due to continuous disappointing developments: first, the boom in commodity prices ended in early 1980, second, the oil exploration almost ended up with disappointment of investors. The stock market condition has continued to worsen since the political crisis in August 1983 followed by an unprecedented financial debacle through most of 1984. However, since the February 1986 revolution, a renewed confidence that the new government has created has had its invigorating effects on the country's stock markets. Prices of actively traded issues are experiencing rapid uptrends, and a growing new interest in oil issues have become evident. A growing number of new companies have been listed at the stock exchanges. Much of the present bullish activity in the stock market can be traced to heavy buying from institutional buyers as well as from foreign groups, which have been gradually accumulating a portfolio of selected mining issues and commercial-industrial shares.

The Operation of the Stock Exchange

The Philippines has three stock exchanges, Manila Stock Exchange (MSE) established in 1927, Makati Stock Exchange (MKSE) established in 1965, and Metropolitan Stock Exchange (Metrex) opened in 1974. Metrex has remained defunct almost right after its inception. As of the end of 1983, the issues listed on the stock exchanges numbered some 200. A presidential decree issued in 1973 provided that a share listed on one stock exchange should automatically be listed on other stock exchanges. At the end of 1983, the total market capitalization of the two exchanges was ₱18.2 billion.

The Primary Market

The size of the primary issues market increased rapidly in the early 1970s, reaching ₱19.9 million in 1976, but has been declining since then. In 1982, the total amount of new issues was ₱0.57 million. Most of the issues of already established companies are right issues at par to existing stockholders. Since early 1986, new companies have been listed on the country's stock exchanges, resulting in a renewed uptrend in primary issues.

Other Features

Several stocks are listed on the New York and the Hongkong stock exchanges. The listing on the New York stock exchange (NYSE) dates back to the 1930s. Four shares listed on NYSE are Benguet Corporation, Atlas Mining, Marinduque, and PLDT.

Foreign nationals may purchase shares of most of the companies. The companies issue two classes of shares. Class A shares may be purchased only by the Philippine nationals, while Class B shares may be purchased by foreign nationals.

D. THE WORKINGS OF THE CAPITAL MARKET

The function of the capital market is to match the supply of and demand for long-term funds, mainly utilized for investment purposes. Two major segments of the capital market, namely the bonds and equity markets, have been described. This section describes and analyzes the demand for funds from the corporate sectors, the interest rate structure which influences the flow of funds, and the money market, which is to underpin the function of the capital market, mainly by aiding the efficiency in the tradings.

1. Corporate Finance

Corporate financing practices reflect the corporate management practices and the conditions of the capital market. In the Philippines, many corporations are still family oriented entities, where the control of the management is closely held within the families, or a group of individuals. This characteristic, combined with less developed conditions of the capital market, leads to a high dependency on debt financing. Furthermore, many corporations with long-term capital needs in domestic currency often depend on the foreign exchange borrowings.

Philippine corporations may be classified into four groups according to their capital structure and management style. The first group is government owned corporations which are enjoying liberal access to the long-term funds from the government. Their financial conditions however, vary from well performing ones to loss making operations. Most of them are large

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entities with substantial capital investment. The second group is joint-venture companies between Philippine and foreign capital. They are often better and professionally managed than domestic companies. They are also listed in the high ranking category in the top 1,000 corporations of the Business Day listing. Among the domestic private corporations, there are a good number of companies, which are well managed, and have good performance records. They form the third group. Many of them are public corporations listed on the stock exchange. They have grown out of the traditional family oriented management style, in the course of corporate growth. The fourth group consists of generally small, family oriented traditional companies. They depend heavily on the financial resources of the families or friends for expansions. This limits their growth within their own means. These corporations are also difficult to discern from private proprietorship. Owners often place their interests above the growth of corporations.

Many Philippine corporations have high dependency on debt in their capital structure, or the high debt-equity ratio is prevalent. Debt-equity ratios was 4.66 on average of the top 1,000 companies in 1982. The average ratio was 2.33 if financial institutions were excluded. However, the ratios vary quite widely among corporations. In fact, there are many companies even in the top 1,000 group whose debt equity ratio exceeds 10.0.

High debt-equity ratios are consequences of many factors. Because of family oriented management practices, their access to the equity capital is limited. Banks are not hesitant to extend credits, when there is personal guarantee, even if borrowers have high debt-equity ratio. The high debt-equity ratio makes the corporations extremely vulnerable to the adverse external conditions. In 1982-83, high interest rates and low demand for their products doubly and severely hit these corporations. This also had damaging effects on the financial institutions which had extended credits to these companies.

Close family control of many corporations also generate a few negative impacts on the corporate sector growth. First, as mentioned earlier, their unwillingness to go public limits the access to the equity market, which restrains the growth of the corporations. Second, many corporate owners, who are also managers, put their personal interest above that of the corporations. This often leads to high dividend payout ratios, reducing the growth of capital base of the corporations. This also makes the corporate owners opt to rely more on debt financing as discussed.

Many corporations often depend on foreign capital markets for their debt-financing. This is especially common among large, well established companies. Since most of their revenue bases are in domestic currency, this practice tends to increase the foreign exchange risk. This is in fact one of the remote causes of many corporations facing financial difficulties since 1983. The underdeveloped stage of the domestic capital market is the main underlying factor to cause this irregular practice.

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The corporations in the Philippines tend to borrow short-term to finance long-term investment. This is partly due to the high interest rate situation where borrowers are hesitant in entering into the long-term contracts at high interest rates. The liquidity ratio, namely current assets to current liabilities, of non-financial corporations was 1.01 in 1982, and those of many corporations were below 1.00. Ideal level is normally considered to be 2.00. Among the industry groups, agriculture, electricity, gas and water, mining and quarrying, transportation and communications all had the average liquidity ratio of less than one.

2. The Money Market

The money market in the Philippines is well developed in terms of the variety of instruments available, the level of activities, and the extent of market participants. The market was given an impetus for development in the early 1960s in the wake of peso devaluation. Commercial banks started an interbank call market to respond to the rapidly changing financial situations. It was in 1965 that the money market with participants from outside the banking system was introduced. The market developed quite rapidly because it was outside the regulated interest rate regime. In the 1970s, the money market development was placed under the control of the Central Bank, by the introduction of Investment House Law, the system of quasi-banking license and the deposits substitutes. Under these new system, the market flourished. However, the higher inflow of funds into the market forced it to find its outlet increasingly into companies of marginal or even doubtful quality. This led to the eventual downfall of the market in 1981 with the Dewey Dee case.

The Philippine money market consists of the following segments: (i) interbank call money market; (ii) Central Bank Certificates of Indebtedness (CBCI); (iii) Treasury Bills (TB); (iv) Promissory notes issued by banks and quasi-banks; (v) repurchase agreements; (vi) certificates of assignments; (vii) certificate of participation; and (viii) commercial papers issued by non-financial institutions, and financial institutions without quasi-banking (QB) licenses. Participants in markets (i)-(iii) are banks and non-bank financial institutions and participants in markets (iv)-(vii) are these institutions plus non-financial corporations, both private and public, institutional investors, and individuals.

The interbank call market is by far the largest, followed by the promissory notes market. These two combined account for over 80 percent of the money market transactions. Compared with them, transactions of CBCIs and TBs are very low. Since the outstanding amount of promissory notes is smaller than those of CBCIs or TBs, this attests an inactive secondary market of these government securities. In terms of participants, commercial banks are also the most active participants, followed by investment houses. In addition to the traditional use of the funds mobilized by the Government and financial institutions, securities dealers use the market to finance their inventories.

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ANNEX M3

EXPLANATORY MEMORANDUM

PHILIPPINE INVESTMENT NOTES

March 27, 1987

This memorandum has been prepared by the Government of the Philippines.

Inf. 36-5

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EXPLANATORY MEMORANDUM

PHILIPPINE INVESTMENT NOTES

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March 27, 1987

EXPLANATORY MEMORANDUM
REGARDING PHILIPPINE INVESTMENT NOTES

This memorandum contains an explanation of the role of Philippine Investment Notes ("PINs") in the context of the 1987-1992 financing package for external debt of Philippine borrowers owed to commercial banks.

I. Objectives of the PIN Program

The PIN program will give the Government of the Philippines an efficient mechanism through which to fund amounts of foreign exchange required from time to time to settle current interest payments on Philippine public sector external debt covered by the 1987-92 financing package. The Government intends through this program to conserve its foreign currency reserves in amounts corresponding to a portion of these current debt service payments.

The terms of the new debt instruments (PINs) that will be used to fund these interest payments will be designed to encourage the holders to redeem the instruments promptly after issuance for their full face value in Philippine Pesos in order to fund approved equity investments in the Philippines. PINs will therefore allow the Government to fund current interest payments due in

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foreign currency through the issuance of debt instruments intended for prompt conversion into local currency in connection with approved equity investments. The PIN mechanism thus accomplishes all of the following objectives:

1. It conserves significant amounts of the Philippines' foreign currency reserves.

2. It assists the Philippines in financing the country's economic recovery program from its own foreign currency resources, and reduces proportionally any future new money requirements.

3. It stimulates equity investment in the Philippines in approved projects.

PINs are designed to achieve these objectives by capitalizing on the extraordinary opportunity represented by the new Philippine debt conversion program1/ and the active secondary market in the trading of Philippine external debt obligations.

II. Summary of the PIN Program

A. Description of PINs2/

A Philippine Investment Note will be a non-interest bearing, foreign currency denominated obligation of the

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1/ The details of this program are set out in Central Bank Circular 1111, dated August 4, 1986, entitled "Program for the Conversion of Philippine External Debt Into Equity Investments".

2/ The proposed description of PINs contained in this memorandum may be adjusted in certain respects when the definitive Central Bank Circular describing the PIN program is issued.

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Central Bank of the Philippines (with a guaranty of the Republic of the Philippines) maturing 6 years from the date of issuance. PINs will be freely transferable, both to financial institutions and non-financial institutions. PINs will not be subject to any subsequent principal payment standstill or restructuring that may be sought by the Government of the Philippines. PINs may be redeemed at any time prior to maturity for their full face value in Philippine Pesos in order to fund an equity investment under Circular 1111. No fees will be assessed by the Government in respect of the portion of any such investment funded with the proceeds of a PIN redemption.

The Philippine Government anticipates that it will from time to time issue a limited quantity of PINs which may be acquired by investors in order to fund equity investments under Circular 1111. It is expected that these issuances of PINs will coincide with the interest payments due under the Philippine public sector Restructuring Agreements and the $925,000,000 Credit Agreement dated as of May 20, 1985. The Government intends to use the foreign currency proceeds from each such issuance of PINs to fund a portion of the current interest amounts payable under these Agreements.

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In this manner, the Government expects to reduce significantly the net call upon its foreign exchange reserves represented by the need to make current external debt service payments on commercial bank debt of public sector borrowers.

PINs will be offered for sale at a discount from their face value. In determining the appropriate level of discount applicable to any issuance of PINs, the Government will have regard to the level of investment activity under Circular 1111 at the time the PINs are issued, and to the prevailing secondary market discount for other items of Philippine public sector external debt. PINs may be issued through underwriting or placement arrangements with third parties as the Government deems appropriate.

For several reasons, the Government believes that PINs will be regarded as the preferred vehicle for funding equity investments in the Philippines through the debt to equity conversion program set out in Circular 1111. First, PINs are instruments expressly intended to be used in connection with debt/equity conversion transactions under Circular 1111. The nominal payment terms of a PIN (non-interest bearing; six year bullet repayment) are

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deliberately intended to render the instruments less attractive as long-term investment. PINs will have their maximum value to the holder if redeemed promptly after issuance, a result the Government wishes to encourage in order to accelerate equity investment in the Philippines.

Second, PINs will be issued in limited quantities on a regular basis, with due regard for prevailing market conditions and, in particular, the corresponding secondary market in general Philippine public sector credits. This will allow the Government to adjust the appropriate level of original issue discount from time to time in order to maximize the cash proceeds to the Philippines resulting from each PIN issuance, while creating a sufficient incentive for new investment in light of then prevailing market conditions.

Third, because investments funded through PINs would not carry fees under Circular 1111, PINs should trade in the current secondary market at least 5-10% above the price of general restructured Philippine public sector credits.3/

3/ Circular 1111 currently specifies a 5% flat fee for Schedule 2 Investments (i.e. investments in preferred sectors of the economy such as export production), and a 10% flat fee for Schedule 3 Investments (non-preferred investments).

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Finally, apart from pricing considerations, PINs will be attractive to financial intermediaries active in the secondary trading of sovereign credits and to their clients for another important reason. Unlike existing credit instruments that must be acquired on a case-by-case basis in the secondary market, PINs held by a financial intermediary in a trading portfolio can be made available at the precise time, and in the precise amount, required by the investor. There will be no need to negotiate separate assignment agreements with various sellers of restructured credits (including obtaining the consents of various parties to the assignments), and undergo the timing uncertainties and expenses that attend the negotiated purchase of restructured credits in the secondary market.

B. <u>Operational Mechanics</u>

The operational mechanics for implementing the PIN program will be kept as straightforward as possible and will be set out in detail in a forthcoming Central Bank Circular.

For administrative convenience, it is anticipated that PINs would be recorded in a book entry format by the Central Bank, with physical certificates available upon request by a holder. Because it is not expected that PINs will be outstanding for any significant time prior to redemption, the Government does not expect that holders

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will request physical certificates in the normal course.

PINs may be redeemed by the holders for their full equivalent value in Pesos (calculated at exchange rates prevailing on the date of redemption) on the closing date of a conversion transaction under Circular 1111 by telex notice to the Central Bank.

The operative legal text of a PIN will be set out in the Central Bank Circular relating to this program. This text will contain:

(i) an unconditional obligation on the part of the Central Bank to pay a specified amount of foreign currency to the registered holder of the PIN on the date six years following the date of issuance;

(ii) an unconditional guaranty of the Republic of the Philippines; and

(iii) a confirmation that the instrument is redeemable at any time for its full face value in Philippine Pesos (calculated at exchange rates prevailing on the date of redemption) in order to fund an approved equity investment under Circular 1111.

Each Restructuring Agreement signed by a Philippine public sector borrower in January or April of 1986, and the U.S. $925,000,000 Credit Agreement of the Central Bank dated as of May 20, 1985, will be amended to provide a mechanism under which interest paid to any creditor under those Agreements on an interest payment date may, upon instruction from the creditor, be debited by the Central Bank and applied toward the purchase of PINs for

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the account of that creditor. These PINs may thereafter be redeemed by the creditor in connection with its own equity investment in the Philippines, or transferred to third parties, by telex notice to the Central Bank.

III. Benefits of the PIN Program

Implementation of the PIN program will have the following benefits to the Philippines and to the commercial bank creditors of the Philippines.

A. To the Philippines

PINs will have the following important benefits for the Philippines.

1. Conservation of foreign exchange

To the extent that the PIN program will allow the Government to fund in the secondary market a portion of current interest payments due on public sector debt, PINs will conserve for the Philippines a substantial amount of foreign exchange over the term of the restructuring package.

2. Consequences for the Philippine economic recovery program

The Philippine economic recovery program will benefit by the PIN program in two respects. First, the conservation of foreign exchange referred to above will help the Philippines finance its future economic recovery from its own foreign exchange resources. Second, the Peso proceeds of each PIN redemption will be applied to fund equity investments in projects approved by the Monetary Board pursuant to Circular 1111. The Government will therefore be in a position to direct these resources into projects that will accelerate sound economic recovery.

3. Reduction of future new money requirements

Any external financing gap that the Philippines may experience in the future will be alleviated by the foreign exchange that the country will conserve through the PIN program. This will proportionally reduce the amount of new money that may be required to fill future financing gaps. Moreover, unlike a conventional new money borrowing, PINs will not add to the country's stock of external debt (because PINs will be designed for conversion into equity investments shortly after issuance).

4. Relationship to existing debt/equity conversion program

The Government has been told by institutions active in the secondary market that there is a relatively scarce supply of credits available to fuel Philippine debt/equity transactions. The introduction of new instruments (PINs) expressly designed for this purpose should help alleviate the current shortage of credits available for conversion.

B. To the Existing Commercial Bank Creditors of the Philippines

PINs will have the following important benefits

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for the existing commercial bank creditors of the Philippines.

1. <u>Significantly improved debt service flows</u>

Under the PIN arrangement, the debt/equity conversion program set out in Circular 1111 will for the first time be used to redeem obligations (PINs) that arise out of, or correspond to, <u>current interest payments</u> on Philippine public sector debt. In contrast, the external debt service relief experienced by the Philippines in connection with a conventional debt/equity conversion transaction involving an item of restructured debt is much more limited. Because the principal amount of the credit has already been rescheduled, the borrower saves -- in terms of current external debt payments -- only the amount of interest that would have accrued on the credit had it remained outstanding. When the debt/equity conversion involves the redemption of an instrument that was issued to fund a current interest payment, however, the resulting debt service relief is enhanced. In this latter case, the debt instrument subject to redemption represents an immediate cash savings for the country of an amount of foreign exchange corresponding to the current interest payment (rather than an existing principal obligation that has been rescheduled over a long term).

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2. <u>Enhancement of portfolio quality</u>

The anticipated revitalization of the Philippine economy resulting, in part, from (i) the conservation of foreign currency corresponding to PINs and (ii) the new equity investments by private investors that will ultimately be funded with PINs, should improve the Philippines' foreign exchange earnings potential and its medium to long term creditworthiness. Thus, PINs will facilitate a significant improvement in the asset quality of the Philippine portfolios held by the country's commercial bank creditors.

IV. Conclusion

The Government of the Philippines regards the implementation of the PIN program in conjunction with the current commercial bank financing package as in the mutual interest of both the Philippines and its commercial bank creditors. This arrangement results in <u>no</u> financial disadvantage to the banks, while conveying immediate and significant benefits to the Philippines. It is, in short, a voluntary financing mechanism that offers an opportunity to speed the Philippines' return to a sound financial position and improved creditworthiness. It also represents an important first step in returning the Philippines to the voluntary capital markets.

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International Science and Technology Institute, Inc.

Headquarters 1129 20th Street, N.W., Washington, D.C. 20036
202/785-0831 • Telex: 272785 ISTI UR • FAX 202/223-3865

PHILIPPINE AGRIBUSINESS INDUSTRIAL AND INVESTMENT COMPANY (PAIICO)

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By:

Leigh M. Miller, Team Leader
Sixto K. Roxas, Consultant
Robert J. Parra, Consultant

International Science & Technology Institute, Inc.
Washington, D.C. 20036

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I. Market Overview

A. The Economic Background

Up to the end of 1986 the continuous contraction of the Philippine economy over the previous 11 quarters had brought real domestic product and incomes back to the absolute level of 1980 and the per capita level of 1975.

The expressed goal of the Aquino Government therefore was to turn the economy around in 1986 and to establish a new growth path beginning in 1987. The goal was an average growth rate of 6.4% in real GNP from 1987 to 1992, or 4% per annum in real GNP per capita.

The NEDA expected to achieve these targets with gross national savings rate averaging 2.1% of GNP. A gross domestic investment rate running 16.6% of GNP can produce the target growth rate of 6.4% per year if the overall average incremental-capital-output ratio (ICOR) for the period can be kept as low as P2.6 per peso of GNP growth.

The historical level of the ICOR has been no lower than 4 and, in the years immediately preceding the 1983 crisis, has been as high as 9.

The maintenance of the planned level of capital efficiency will require two programs:

- o Heroic efforts to maximize the production and net added values from the revitalization of existing companies, and the employment of the stocks of assets already installed in the Philippine economy which, at present, are underutilized or idle; and

- o An emphasis on non-capital-intensive modes of capital formation.

With respect to the first, the Philippines had come through a long period of heavy capital spending. Particularly in the years following the establishment of an authoritarian regime in September 1972, fixed capital formation (at current prices) which had run at levels between 14% and 18% of GNP in the 1960s and was at 18% in 1972, jumped dramatically to an average of 26% of GNP from 1975 to the time of the 1983 crisis. Purchases of plant and equipment alone averaged 13% of GNP during that period.

In the nine years from 1975 to 1983, the Philippines imported $14 billion worth of capital goods, an average of $1.6 billion a year.

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But during that period of heavy investment, the annual growth rates of the economy in real terms went down continuously from 7.4% in 1976 to 6.9% in 1977, 5.8% in 1978, 5.6% in 1979, 5% in 1980, 4% in 1981, 1.2% in 1982, practically no growth in 1983 and continuous declines in 1984, 1985 and the first three quarters of 1986.

The financial crises that rocked the country in 1980 up to 1982 made it abundantly evident that some of the major capital investments of the period were non-viable for whatever reasons. The private companies were ending up in the books of private and government banks as nonperforming assets. The Government corporations were incurring increasing deficits that had become a major component of the GOP's own budgetary shortfalls.

Over the same period, the annual current deficit of the country's balance of payments went from $176 million in 1974 to a peak of $3.2 billion in 1982. By the time of the crisis following the Aquino assassination in August 1983, the total external debt of the country that needed to be rescheduled was some $23.5 billion.

The peso dollar exchange rate went from an average of P7.25 per dollar in 1975 to 7.51 in 1980, 7.9 in 1981, 8.54 in 1982, 11.11 in 1983 and then after the crisis, to 16.70 in 1984, 18.61 in 1985, and up to the current level of 20.50. The peso lost 65% of its value in that period, and U.S. dollar liabilities incurred in 1980 ballooned 2.8 times in peso equivalent.

With respect to capital intensity, it became evident as well that some of the major projects that were getting direct or indirect financing from the DBP and the PNB were undertaken not so much for the returns that could be gotten over time from the productive use of the assets but for the immediate profits that proponents could get from the overpricing of hardware purchases abroad. With this motivation, there was therefore a tendency to maximize the imported equipment components of projects.

These factors are responsible for the legacy that the Marcos regime has left the Aquino Government:

- o The external debt which had grown to $26.5 billion by 1986;
- o The long catalog of nonperforming assets in Government as well as private financial institutions;
- o The empty government coffers.

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The legacy of the Marcos regime for individual companies was devastating:

- companies' assets were systematically diverted offshore to private bank accounts or squandered on personal consumption;
- companies' capital goods were overvalued or overly expensive for the size and scale of operations;
- debt has zoomed because private companies' lenders passed on foreign exchange risks to them, and the decline of the peso could not be compensated for by increased prices;
- inexperienced and inefficient managers drove companies into the ground with mismanagement;
- market rigging schemes drove companies to the wall because they were not favored customers or lost markets and/or raw materials.

Many private companies had to be bailed out of bankruptcy by the GOP; others are unable to meet their payments on bank debt and are now nonperforming assets on the books of the Philippine banks -- both government and private. Everywhere in the Philippines, new private investment depended on "cronyism" and not upon carefully analyzed, market-oriented investment opportunities.

B. The Effect upon Financial Markets

In the period from 1965 to 1972, the country's financial markets had seen impressive development. An active intercompany call market developed with the intermediation of two new investment banks that opened in 1965. In 1966, the Government introduced weekly treasury bill auctions and a community of accredited government-securities dealers started to make active secondary markets in the bills. In 1967, the first commercial paper issue was floated and for the first time, a negotiable instrument of a non-financial company became available for public purchase. The use of this grew so rapidly that in 1972, the Central Bank commenced studies aimed at subjecting the dealership business to formal regulation. In periods when short term interest rates stabilized at reasonably low levels, new issues were placed in the capital market by underwriting syndicates and selling groups formed among the community of investment banks and stock brokerage houses. There were rights offerings, issues of convertible debentures and straight common stocks.

In February, 1973, under the martial law regime, the first of a series of decrees to regulate investment banks and the dealership business, was issued. This defined a new category of nonbank institutions, the investment house, and amended the Central Bank Act to place them under Central Bank supervision. Shortly thereafter, a whole series of regulations were issued subjecting the on-balance sheet operations of investment houses to various constraints. In April, 1975, a Decree amended the Securities Act to define commercial paper as a security the issuance of which would be subject to registration with the Securities and Exchange Commission. In June, 1977, a 35 percent tax was levied on interest on commercial paper.

The ambitious investment program launched by the Government from 1972, made it imperative that the allocation of financial resources come more firmly and directly under National Government and Central Bank control. Governor Gregorio Licaros assumed the Governorship of the Central Bank at the beginning of 1970 when the Philippines went through its first debt rescheduling (a modest one compared to present magnitudes: the total external debt was only $1.6 billion, and the rescheduled portion was only $260 million worth of maturities of the Central Bank's own debt). Under his administration, the Central Bank changed its role from being merely the manager of the monetary aggregates and the banker of last resort. It became in fact a major source of finance for the President's and the First Lady's projects. It built the Convention Center and most of the new hotels for the IMF and World Bank meetings in Manila in the mid 1970's, for example. In order to keep the level of net domestic assets on its balance sheet within the corset imposed by the IMF, the Central Bank took to using its own debt instrument, the Central Bank Certificate of Indebtedness or CBCI, instead of Philippine Government Treasury Bills, as the staple for its so-called operations.

It was no longer in the keeping with Government and Central Bank strategy to allow a truly free financial market to continue to develop in the country. The management of interest rates to maintain yield curves that would induce private investors to invest in longer term securities, had no place in that strategy. The CBCIs were made eligible for all sorts of special reserves of portfolio allotments required by Central Bank Circulars of the commercial banking system. This ensured that whenever the Central Bank needed to offset growth in domestic assets necessary to finance some government project, it could always place additional issues of the CBCI in commercial bank portfolios.

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The groundrules for the operation of the investment house and the financial market dealership community, were made more and more onerous. And in July, 1980, the policy rigorously separating commercial banking and investment banking functions, a policy reinforced by the decrees of 1973, were completely reversed, expanding the scope of commercial banks specially licensed as "Universal Banks" to include both investment banking and investment functions.

From 1980 to 1983, the economy suffered a whole series of financial crises that affected commercial banks, investment houses, finance companies, thrift institutions, and some of the major industrial and construction companies of the country. Those crises caused the transfer directly to the Government and its financial institutions, of a significant number of the entities that are now the subject of the so-called privatization program.

On August 21, 1983, the assassination of Benigno Aquino rocked the country. Given the succession of shocks and the distortions that had already weakened its financial system, the impact on the economy was disastrous. The flight of capital, combined with the suspension of the country's foreign credit lines, caused the country in October, 1983 to declare a moratorium on its external debts and to open the first of the series of restructuring negotiations.

The financial reforms and stabilization measures that became necessary following the crisis entailed a devaluation that increased the peso price of the U.S. dollar by over 50%. In monetary measures to mop up liquidity. The Central Bank issued its own certificates of indebtedness at rates that went as high as 45% per annum and effectively killed all primary and secondary trading in equities.

C. The Current Situation

The April 8, 1987 report of the Central Bank Governor to the President which covered the fourth quarter of 1986 declared that the economy had finally turned around. In that quarter, real GNP grew by 2 percent as compared to 1.7 percent in the third quarter. Real GDP jumped up by a healthy 3.3 percent.

The last reading on the performance of the Philippine economy during 1987 showed that the signs of recovery which became manifest in the fourth quarter of last year have become a definite surge this year. The revised NEDA figures gave a final tally of GNP growth for 1986 of 1.5% (compared to declines of 3.8% in 1985 and 5.5% in 1984).

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Early returns on the economy from the NEDA and the Central Bank indicate that GNP growth for 1987 was running 5.5% over a year ago during the first quarter, and GDP 5.8 %. The figures are up from the fourth quarter of 1986 when GNP grew 3.6% and GDP 3.3 %. And a definite turnaround from the declines of 1.1% in the first quarter of 1986 and 4.9% in the first quarter of 1985.

The banking system remained very liquid and commercial bank quoted rates for savings and time deposits dropped 90 and 170 basis points respectively. The interbank call loan rates that reflect the excess liquidity position of the system averaged 4.7% lower during 1986 than the previous year. That liquidity has continued into this year.

This year, during the first quarter, industrial production has grown 9.9 % in real terms, mining and quarrying 14.5%, construction 10.3% and manufacturing 9.7%.

Agriculture grew at a slower pace this year, however. NEDA attributed this to the effects of the drought on corn, coconut and sugar cane production.

II. Demand for Financial and Management Restructuring Services

Significant numbers of private businesses require large increases in investment due to severe undercapitalization, mismanagement, over-reliance on debt, and misallocation of funds.

Restructuring is particularly critical in agribusiness. The GOP's national economic policy emphasizes agribusiness development as its highest priority.

The restructuring of agribusiness investment, its expansion to meet domestic and traditional export needs, and the refurbishing of agricultural processing and distribution systems are all essential to the economic expansion the RP requires over the next few years.

The overall private investment has been at a low level in recent years. Foreign direct investment in the Philippines has been among the lowest of all major developing countries. Average direct investment during 1981-4 for the Philippines was .2% of Gross Domestic Product, when the average for the major developing countries was eight times that amount, or 1.65%. Only Turkey and Peru were lower.

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The only way that existing troubled businesses can be improved, dormant assets can be developed and non-performing and government-owned businesses can be resuscitated is to recapitalize them and bring in effective managers. Much of the existing plant and equipment investment in distressed companies has not been carefully reviewed by experienced managers to ascertain its real value. The values of plant, equipment, facilities and the business as a going concern have not been audited by experts in the field. Rather, many reviews of existing businesses have been simply "desk audits" without practical evaluations or "financial audits" without managerial reviews.

A. Corporate Market

There is a large market for financial and management restructuring services for Philippine corporations. The Philippine corporate sector encompasses four categories of companies:

- o Closed family corporations
- o Public Filipino controlled corporations
- o Government owned/controlled corporations
- o Wholly owned subsidiaries or joint ventures controlled by multinational corporations

The whole sector probably accounts for under 40% of the country's gross domestic product. 286 of the top corporations have over 50% of total gross revenues:

Corporations	P Billions 1985 Gross Revenues: Percentage (%)	Amount (P)
238 Multinationals	30%	P 118.50
48 Government	23%	90.00
Other	47%	186.50
TOTAL	100%	395.00

The majority of the other corporations are family owned and controlled, only a handful being listed public corporations. The corporate sector suffered severely from the financial crisis of 1983. Total net income of the Top 1000 firms dropped from P7.52 billion in 1984 to P1.01 billion in 1985. Of the 500 largest corporations, 74 lost money in 1984. In 1985, the number increased to 104. By 1985, 20 of the Top 500 corporations already showed negative net worth. Restructuring of many of these companies is essential to their long run profitability.

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Specific Market for PAIICO's Financial Services

Corporate clients for PAIICO would have the following characteristics:

- Corporations engaged in agriculture and/or manufacturing with strong growth opportunities, but are highly leveraged currently.
- Corporations with positive financial gross margin over previous years, and with low or negative, net income in the period 1984-6.
- Corporations with good past financial performance with negative net worth in 1984/85 that would likely participate in an expanding economy.

An examination of the client profile of the four categories of corporations -- closed family, public Filipino-controlled, government owned/controlled, wholly owned subsidiaries or joint ventures controlled by multinationals -- shows that the potential clients for PAIICO are likely to be sourced from the following:

Closed Family Corporations. Closed family corporations experiencing financial difficulty may be induced to restructure to improve their position by bringing in outside investors - often foreign investment. A few, stronger companies may be willing to list their shares on the stock exchanges. These corporations comprise the majority of the corporations in the country.

Public Filipino Controlled Corporations. Although public Filipino controlled corporations are already listed in the exchanges, several of these firms have experienced financial and operational difficulties over the past few years.

Government Owned/Controlled Corporations. Privatization of the government owned/controlled corporations that have been slated for privatization will yield a number of candidate clients for PAIICO. PAIICO would represent potential buyers in structuring technical and financial assistance packages that would lead to new investment.

Wholly Owned Subsidiaries of Multinational Corporations. These corporations are candidates for restructuring leading to public issue of shares as well as assistance in obtaining additional investment to reduce overleverage.

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The Top 500 corporations in the Philippines in 1985 (ranked according to gross revenue) range from the National Power Corporation with gross revenues of P19.4 billion in 1985 to St. Christopher Steel Corporation with gross revenues of P117 million. Of the Top 500 corporations, 74 corporations, or about 20%, lost money in 1985.

Arranging the money losing firms into industry classifications reveals that the following industries have been severely affected by the poor economic conditions:

1. Cement. In 1985, cement companies generally experienced losses. Eight cement companies in the Top 500 firms registered negative net income, as follows:

Atlas Cement Corp.	Hi-Cement Corp.
Iligan Cement Corp.	Rizal Cement Corp.
Pacific Cement Corp.	Island Cement Corp.
Floro Cement Corp.	Republic Cement Corp.

Two of the above companies, Republic Cement Corp. and Pacific Cement Corp., are listed public firms.

Cement companies are likely candidate clients for PAIICO. Cement production is strategic to the economic recovery of the country. Furthermore, several of the firms require equipment modernization to improve production cost operating efficiencies.

2. Textile Production and Garment Manufacturing. Ten textile production and garment manufacturing firms registered negative net income 1985, as follows:

Filipinas Synthetic Fiber Corp.	Imperial Textile Mills
Solid Mills Inc.	Aris (Phil.) Inc.
Capital Garments Corp.	Central Textile Mills
Allied Thread Co.	Bataan International Garments
Tag Fiber Corp.	

Filsyn is a listed public company.

Garment export is one of the top dollar earners for the Philippines, and these companies need additional investment and marketing assistance to enhance their value to the Philippine economy.

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3. Agricultural and Food Processing. Given the importance of the agricultural sector, a small number of firms are included in the list of the Top 500 corporations. Agricultural corporations are generally small and medium scale operations. The agricultural and food processing firms within the Top 500 that posted negative net income in 1985 were the following:

Monterey Farms Corp.	Century Canning Corp.
Red V Coconut Products	SMI Fish Industries Inc.
Hilongos Development Corp.	Blue Bas Coconut Corp.
Frabal Fishing & Ice Plant	Binalbagan-Isabela Sugar Co.

4. Multinationals. Poor economic conditions affected several multinational firms. The multinationals that registered negative net income in 1985 were the following:

Shell Gas Philippines Inc.	Feerochrome Philippines
Intel Philippines Mfg.	Canlubang Automotive Resources
Manila Mandarin Hotel	Singer Sewing Machine Co.
Jardine Davies Inc.	Reynolds Philippines
Kodak Philippines	Data General Philippines
Nobel Philippines	
TMX Philippines	

The above companies are all potential clients of PAIICO because of their difficult financial positions. The assistance given must be individually tailored to meet the needs of each company. The type of assistance given must include expert managerial assistance as well as financial engineering. PAIICO can provide such expertise.

B. Other Market Segments

The Philippine market has a number of specialized segments which could merit PAIICO's attention. Foremost among these are the companies being privatized by the GOP. These companies are divided into two basic groups.

1. Non-Performing Assets of Government and Private Banks:

Government of the Philippines (GOP) and private financial institutions require assistance in managing, restructuring and/or disposing of nonperforming assets (NPA's). Some companies are managed by creditor committees which do not have the necessary expertise in business management to supervise NPA's; they need direct managerial assistance, usually coupled with some additional equity investment.

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There is a large market for this type of activity now. The Development Bank of the Philippines (DBP) has reduced its size by approximately P60 billion in NPA's which have been transferred to the GOP. All of the Philippine companies owing the P60 billion are potential clients of PAIICO. It has been estimated that P10 - P25 billion in new investment is desirable to rehabilitate these companies. Those NPA's represent an enormous investment by the GOP and expert assistance is required to rehabilitate them.

Estimates vary as to the total size of all of the NPA's for private banks, but it is clear that there is a huge and continuing market for PAIICO's services.

2. Asset Privatization Trust (APT) Companies

A large proportion of the APT assets will be promissory notes of Philippine businesses with or without mortgages or other security. The APT plans to sell these notes to the highest bidder. Amounts offered by prospective purchasers of such notes will reflect the purchasers' estimates of the value of the underlying assets. A prospective purchaser's offer will also reflect the cost and delay in obtaining the assets through foreclosure.

The purchase of a promissory note with a right to foreclose will virtually require the concurrence of the present owner/operator of the business involved because otherwise, the purchaser merely will have bought a foreclosure law suit (a slow and expensive process) or a new negotiation with the ailing business' owner/operator to see how much the business can pay on the loan.

In this situation, an institution such as PAIICO, which represents a potential buyer, is extremely important for potential Philippine investors and is essential for any foreign investor. Without a buyer-oriented institution, the APT will be pushed towards accepting whatever the existing owner/operator bids.

The market for improved investment proposals among businesses and assets transferred to APT is as large as the APT portfolio. A representative list of assets currently being sold which totals over P16 billion for non-mining projects with identified amounts is attached as Attachment II.

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3. Investment Development Market

A combination of financial engineering and managerial analytical capabilities is lacking among Philippine financial institutions. It is particularly noteworthy that existing Philippine capabilities to restructure existing ailing companies are extremely thin. A number of different types of services must be combined to analyze investment proposals and place them with qualified investors. These include:

- financial engineering capabilities;
- managerial know-how;
- equity placement power;
- domestic and international market knowledge; and
- business and equipment valuation expertise.

No existing company provides a full line of these needed services in the Philippines on a sufficient scale to have any meaningful impact upon the market place.

- The five universal banks are not sufficiently integrated and do not have enough expert personnel;
- No investment house has the necessary broad financial capabilities, sufficient capital or the managerial/technical expertise;
- Government agencies do not provide merchant banking/technical skills to private buyers/investors and have conflicts because of many problem loans and investments; and
- Foreign investment bankers do not have the necessary managerial and technical expertise that is available directly in the Philippines.

C. Agro-Industrial Market

Agriculture play a dominant role in the Philippine economy. (Because of certain sensitivities in use of the word "agribusiness", this paper will frequently use "agro-industrial" instead.) A study of business opportunities in Philippine agriculture and a specific proposal to mobilize private investment to take advantages of those opportunities is the subject of a companion paper.

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The companion paper outlines the needs, reviews the demand for private investment in Philippine agriculture, notes the dearth of long term capital available to private sector entrepreneurs for agro-industrial projects, prioritizes agricultural investment opportunities, recommends an investment strategy, and sets out a feasible approach through an agro-industrial venture capital company. Reference is made to it for a full discussion of these issues.

It also should be noted that GOP economic policy is strongly oriented towards additional investment in agriculture as close to the basic producrion as is possible. In the meeting with Minister Ongpin on PAIICO, he strongly urged undertaking agricultural investments in the private sector on as decentralized basis as a possible.

The agro-industrial investment strategy recommended in the accompanying paper is very similar to the strategy recommended for PAIICO. There is a substantial overlap in the markets involved, because many existing agricultural industries have the same problems that the balance of Philippine industry has: disorganization, overreliance upon debt, management failures, inappropriately sized plants, foreign exchange burdens, etc.

A significant component of the NPA's of private and government banks, and the Asset Privatization Trust are agriculturally related businesses, e.g. over 40% of the first 50 projects put up for formal sale by the APT were agro-industrial in nature.

However, there is an additional category of agro-industrial projects that require the same type of services that are required in assisting the distressed industrial and commercial enterprises. Many agricultural enterprises are operating inefficiently, or are only marginally profitable, so that any downturn in prices is translated immediately back to the producer. The same kind of financial and managerial services that are applied to restructure ailing businesses can be applied to these marginal producers. PAIICO would be well placed to handle this type of demand. Bringing in more modern technology and production organization which applies those techniques already in use elsewhere can give Philippine agro-industry a tremendous lift in a relatively short time frame.

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In order to achieve success in the latter activity, it is essential to have financial backup. Most private businesses in the Philippines will have difficulty at this time in generating internal cash flow for investment purposes, as well as be reluctant to move from traditional methods of doing business. Private investment capital is necessary to achieve results.

However, there are two different time scales which are applicable to private investment in agro-industrial enterprises. One time horizon is similar to that of other industrial/commercial enterprises. In these cases, the company already exists and needs financial and administrative restructuring. The time scale involved allows rapid review preparation of an investment proposal, the contact of domestic and/or foreign investors (usually with expertise in the field), and negotiation of an investment.

Such activities fall within the normal services to be rendered by PAIICO. PAIICO should service this segment from its regular staff and in a similar fashion to other investment opportunities. These potential investments are included in the business plan for PAIICO that is presented herein.

Another investment time scale is involved for many agro-industrial investments. This requires investment for a longer period of time before the venture is sufficiently seasoned and can be sold. Agricultural processes are not as rapid as other types of commercial/industrial processes. Allowance for the growing cycle is frequently present: results take longer and conditions have more variables than in other industries.

For this reason, a separate investment window for longer germinating investments should be established under PAIICO's management. A separate funding source should be established to invest in those projects requiring a longer time frame than the normal PAIICO investment cycle which contemplates a six month investment identification, investment review and proposal development, and transfer to a third party investor. Although the PAIICO approach can make investments that take a longer time, these are on an exceptional basis.

Agriculturally related investments frequently take longer. In order to meet this need, USAID reviewed sympathetically a proposal for an entity called PAIDCOR. However, the proposed functions should be consolidated with those of PAIICO, and the underlying concept of a fund for agro-industrial investment can be maintained.

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This proposed private agro-industrial fund assisted by AID, which would be managed by PAIICO, would provide venture capital for investment in worthy agricultural projects in the private sector in the Philippines. The proposed name is Agro-Industrial Venture Capital Fund, "AIVC Fund".

In operation, the fund, AIVC, would operate upon similar guidelines to the ASEAN Venture Capital Fund in Thailand, which AID has assisted. PAIICO would not only manage the fund, but it would invest some of its own funds in AIVC. A venture capital fund for agricultural investment operated and managed by PAIICO would complement PAIICO's other activities and would allow a more efficient operation of each. PAIICO's own investment in AIVC would be sufficiently large to assure that the fund would be carefully managed.

It is recommended that the Fund raise capital from the private sector in the Philippines upon a matching formula from AID similar to the Thai AVC. The total capital recommended would be P130 million, of which, PAIICO would put up P30 million, private Philippine investors would put up P40 million and AID would match with P60 million.

Although this new fund will be the subject of separate papers, it is a very important part of PAIICO's overall approach to the effective mobilization of Philippine private resources.

III. Services of Philippine Agribusiness and Industrial Investment Company (PAIICO)

A. Business Concept of PAIICO

The business concept of PAIICO is that a private financial company will, for fees, act as an intermediary/broker in obtaining investors/buyers who will provide new capital and managerial expertise which will "turn around" existing distressed businesses in the Philippines. PAIICO will ordinarily identify and prepare potential investment opportunities for third party investors and receive fees in the form of both cash and equity "kickers" for arranging the investments.

PAIICO's objective will be to arrange for buyer/investors to purchase their interest in any project company as quickly as possible because its income largely depends upon the fees derived from such equity placements with third parties. It anticipates only modest income from investments. Its main income will come from the front end fees received in cash from placement of the investments with third parties and the subsequent capital gains received when the equity "kicker"

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is subsequently sold. PAIICO will be a financial services company, oriented towards rapid turnover of investments, thus making a significantly larger contribution to private investment mobilization through a multiplier effect than that of the usual investment company. It would not be an investment company nor a venture capital company because its income is realized from placement of securities with ultimate investors.

PAIICO will have to make early and direct bridging investments. These investments will be necessary when a company needs an immediate infusion of equity capital in order to continue in business while a sufficient turnaround takes place to allow new investors to be found. Little or no direct income will be received by PAIICO during that period.

PAIICO will be a commercially viable, self-sufficient private corporation. However, in the early phases it will need AID and other international financial institutional assistance because:

1. The nature of "turnaround" assistance for distressed Philippine corporations - particularly those being privatized - requires a longer time before profitability for PAIICO is achieved than other types of companies making loans and equity investments. Aid institutions have a longer time frame than other investors and are needed to provide a larger equity base which will give the extra time needed.

2. Credibility of PAIICO is enhanced through investment by AID and other developmental institutions. Governmental as well as private individuals must have confidence in the integrity of PAIICO because large writedowns of government or private investment will occur, and AID involvement will increase assurance that such individuals have.

3. In order to make a real impact upon the Philippine economy, it is necessary to start PAIICO upon a larger scale than would otherwise be the case. The additional investment by AID and other international investors will allow PAIICO to have a sufficient staff so that it may seek investors for a meaningful portion of the large number of ailing businesses being privatized, as well as to other troubled businesses.

B. PAIICO's Services:

Services Provided will include:

- technical and practical expertise in evaluating existing troubled businesses through business/management/engineering/technical audits and reviews of assets and businesses;

- financial engineering and restructuring advice; merchant and investment banking expertise;

- preparation of investment proposals and obtaining new domestic and/or foreign investment; and

- limited equity investment to provide bridging capital while obtaining long term capital or supplemental equity when needed to complete investment.

C. Business Activities

1. The Scope of PAIICO's Business

PAIICO's developmental approach is total: it will take an active role in structuring, promoting and starting up the projects it undertakes and will do all that is necessary to arrange for operating management (production, marketing and financial) and for capital in those businesses. Its emphasis on existing businesses - rather than start-ups - is part of a development strategy that is responsive to the current spectrum of opportunities and needs in the Philippines.

PAIICO will provide managerial/business "hands-on" expertise to evaluate potential investment situations which it will identify. Managerial talent is essential because financial expertise alone is insufficient to evaluate distressed business assets and assess a troubled company's value as a going business. These skills are particularly important in dealing with companies privatized by the GOP because the government ordinarily will be unable to shape the proposed project in a way that will most strongly appeal to buyers. An investor/buyer is generally not interested in conducting a search for potentially viable businesses, but will become interested in making an investment if presented with an investment proposal that has been well developed by both competent managers in the business and with expert financial advisers.

While general categories of potential investments can be established in advance, PAIICO's business activities will necessarily depend upon timely targets of opportunity. The universe of Philippine businesses requiring "turnaround" assistance is enormous, and PAIICO's task is one of selection - not finding opportunities. PAIICO will have as a high priority the placement of investments in privatized companies.

2. Front End Identification and Investigation of Potential Investments

PAIICO will have a unique ability to finance the initial investigation expenses of a significant number of investment opportunities. PAIICO's capital structure will allow it sufficient equity funds to pay for this necessary investigation process for a long enough period of time to enable the business to establish itself upon a self-sustaining basis.

Investment identification of new investments is time-consuming and full of failures. Most entrepreneurs in this field estimate that anywhere from five to fifteen investment opportunities must be reviewed before one investment situation is found.

In the Philippines, however, a higher ratio of "hits" to "misses" should be possible. Most of the potential investments reviewed will have been going concerns, and, under these circumstances, feasibility reports and analyses ordinarily will not be necessary.

Much of the plant and equipment is already in place and marketing, distribution and raw materials networks already have been established. The investment review, thus, can be accomplished much more quickly. Moreover, it is easier to locate potential investors for ongoing businesses.

This situation requires somewhat greater managerial and technical expertise than does the development of new investments. To meet this need, PAIICO will have a technologically oriented staff, such as plant managers, marketing directors, and exporters. These individuals will be able to make practical judgments about the viability of investments, and the resulting investment proposals will be more likely to receive a favorable reception from potential investors.

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Nevertheless, almost all investors will make actual investment decisions based upon their own investigation. But the practical experience of the staff of PAIICO will have two results: (i) only potentially viable investments opportunities will be offered, and (ii) its experience should winnow the range of investment opportunities to those which have the maximum prospects for success.

3. Equity Financing Guidelines

An essential service that PAIICO must offer is the ability to put up sufficient investment in selected cases so that investment development can occur.

This limited investment option may take several forms: (i) bridging facilities until investors can be found; (ii) purchase of minority equity positions to make an overall investment package possible, (iii) limited loans in conjunction with equity investments.

The investments made by PAIICO will be determined by the nature of the investment opportunities presented. In considering those projects requiring investments, PAIICO will pay particular attention to companies being privatized by the GOP because those are the most likely ones requiring "seasoning".

Investments will be made when they further the "turnaround" process, and they will not ordinarily be made for the investment return. (This does not apply to cash, which will, when available, be invested in short term liquid investments.)

The following guidelines will apply to PAIICO's investments:

1. Investments will be made:

   (a) in projects or companies that give promise of being commercially viable and profitable;

   (b) in agribusiness companies or projects, with emphasis upon those companies and projects which:

      - provide new technology, products, or organization for existing agricultural produce of the Philippines; or

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- make more efficient, provide better markets for, or otherwise improve agricultural outputs and inputs, agribusiness services, transportation of agricultural commodities, and research and development; or

- otherwise improve agribusiness markets, transportation, or prices farmers receive for their produce.

(c) in projects or companies with great potential for being placed subsequently with investors within one year but do not have investors willing to make such investment at that time, so long as management has defined a strategy for placing the project within such period;

(d) in projects or companies requiring additional Philippine investment in order to qualify under the Constitution;

(e) in projects or companies which need additional equity to complete the financing package so long as the PAIICO investment is not more than 20% of the total equity;

2. Investments ordinarily will be in the form of equity, but may be made through loans in those situations which require a senior position to equity, or provide better assurance that PAIICO will be able to place an investment in the project/company subsequently, or in conjunction with an equity investment, or for other similar objectives.

3. Investment emphasis will be placed upon agribusiness opportunities, particularly those assisting small farmers; and business opportunities, especially those assisting small businesses; those projects and companies being privatized by the GOP; and those investment opportunities that assist the rural population and expand employment.

The above investment guidelines shall be the policy of PAIICO, but may be changed from time to time by PAIICO's Board of Directors to allow PAIICO to adapt to a changing investment environment.

4. Debt/Equity_Swap_Service

PAIICO will assist prospective investors in finding investments for debt/equity swaps. The March, 1987 debt renegotiation provides for potential conversion of debt into equity through PINs. CB 1111 fosters a method of obtaining

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additional investment in Philippine private companies. However, assistance is necessary for most potential investors to take full advantage of this program. Several international banks have proposed funds into which Philippine debt can be swapped for shares in the fund. It is universally recognized that mechanisms to develop the large number of equity investment opportunities to meet this new need are not now present in the Philippines.

International banks have considerable difficulty in developing equity investments into which they can swap their debt because they do not have the necessary expertise and ability to find, develop and assess such investments by themselves. Furthermore, other investors, who can make the necessary effort, do not have the knowledge of the swap process to avail themselves of all of its most beneficial aspects. A new company such as PAIICO can render a needed service that will provide enormous impetus to the program.

D. Development Impact of PAIICO

AID's support of PAIICO can catalyze the private sector in the Philippines. PAIICO can play a major role in solving one of the major problems of developing countries: <u>the development of sufficient, well worked out and potentially profitable investment opportunities for domestic and foreign investors.</u>

In the Philippines, as in many LDC's, there is now a larger amount of private investment capital than there are investment opportunities. A major impediment to mobilization of those private resources is the lack of viable projects. Although investors often sound as though political, legal, or country economic constraints make them reluctant to invest, the most significant factor generally is the lack of apparent investment opportunities in each investors' field.

The size of the internal market, and economic position of the Philippines is sufficient to gain the attention of most investors, but they do not wish to start looking for investments from scratch. However, if presented with a project which has been shaped in advance, many investors will be willing to review it positively.

The project, however, must be shaped with the investor's perspective in mind.

PAIICO has been tailored to meet Philippine needs: it must be oriented towards the private investor's perspective because its income depends upon successfully placing investments. It addresses a major problem of the Philippine capital markets: insufficient well defined investment projects. It does this by institutionalizing this process and creating enormous leverage because it is aimed at finding other investors' funds and not merely investing its own. The usual approach is that of an investment company or venture capital company. Such organizations are useful, but they seldom provide real leverage for the money involved. (In fact, if they leverage through borrowing, they actually increase their risk.)

PAIICO is a significant step forward as a mechanism for solving this fundamental problem in LDC's of failure to mobilize private capital. By developing investment opportunities and then being required to sell them off to others in order to stay in business and be profitable, it multiplies the amount of private investment in the Philippines by a significant amount. Projections indicate that under conservative assumptions, the optimum approach to PAIICO's funding for AID would generate at least P4.25 billion ($210 million) in new investment in five years for an AID commitment of P90 million ($4.5 million) at the outset. This AID initiative can play a major role in the Philippine private economy in mobilizing funds.

The AID program will have an even profounder effect than just mobilizing private funds - domestic and foreign. The GOP has undertaken a major initiative vis-a-vis the private sector. Through PINs and Central Bank Circular 1111, a large source of equity funds has been opened up: debt/equity swaps based upon transferring external GOP debt into domestic private investment.

A major obstacle to this program's success is the lack of investment opportunities. This large pool of external funds (total external debt of the GOP is over $26 billion) must be able to find attractive domestic investment projects in order to reduce the debt and help alleviate the crushing debt burden. Several funds are contemplated which would have immediately investible funds in excess of $300 million. If this program is to have any chance of success, additional mechanisms for preparing investment opportunities must be developed as soon as possible. PAIICO will help in meeting this challenge, and Minister of Finance Ongpin recognized this in his enthusiastic response to the PAIICO proposal.

The impact of providing investment opportunities to the holders of the GOP external debt is two-fold: it not only increases private investment, but it will reduce the external debt service burden. This is particularly true if PINs are used as financing the investment because such instruments immediately reduce the current interest payment burden.

PAIICO will also provide a leadership role in the local financial community. No similar organizations exist, although a number have the necessary powers and could undertake the business if they desired to do so and had the necessary capital. PAIICO's successful example will cause others to emulate its success. The multiplier effect of the success of such an organization can have an even greater impact than that of its own investments.

PAIICO has been designed to have a multiplier effect because its viability is largely based upon its ability to turn over investments. In the Philippines, this is a crucial difference from past efforts. For example, numerous venture capital companies were started in Manila (including an IFC supported VCC), but they have failed to have any impact at all. Essentially, each venture capital company is independent from all others, and has no multiplier effect. The lack of effect upon the Philippine financial markets is obvious. (The economic decline also played a role, but was not a significant factor concerning the lack of a multiplier effect.)

PAIICO can play a significant part in the rehabilitation of Philippine industry. The inheritance from the Marcos regime of a disorganized and decapitalized industry requires rapid action. PAIICO is designed to act on behalf of investors in dealing with this problem. It can have an enormous influence upon the process of revitalizing industry and agriculture by identifying viable investment projects and dealing with the GOP or the existing creditors on behalf of buyers.

The GOP is not shaping the overvalued assets in its possession to achieve attractive investment offers. Considerable work must be done before such assets are capable of being shown to investors. PAIICO will provide this expertise, and the GOP will not only receive better prices for the assets being sold, but more of such assets will be put to productive use. The only alternative in many cases is to sell the assets for scrap, so their economic potential is completely lost.

As a practical and political matter, the entire privatization effort in the Philippines is in jeopardy. Assets which will only be scrapped or otherwise shut down will result in lost employment and other economic loss. The GOP will be reluctant to continue privatization if there is little or no economic future: PAIICO can be of real assistance in the privatization effort, and the head of the Asset Privatization Trust recognized PAIICO's potentially positive role in supporting the concept.

In the Philippines, agriculture remains the main industry. PAIICO's role in developing and selling investment opportunities in agribusiness will provide a major impact upon the overall economy. PAIICO would be a major private investment development vehicle in the Philippines. A number of prominent individuals have sponsored an attempt to establish such an entity called PAIDCOR. Such effort is being joined with PAIICO as the main new vehicle for private agro-industrial investment which would be independent from existing individual corporate or governmental biases, but would serve the entire investing public.

PAIICO would be able to view potential agribusiness investments unprejudiced by the usual handicaps caused by lines of business, land owning patterns, existing investments in unprofitable enterprises, and age old agricultural practices. The benefit of an unbiased evaluation of investment opportunities can be very large, in an agricultural country such as the Philippines.

The positive impact upon the Philippine economy of PAIICO stems from its intermediation role. In order to have a real effect, as well as have credibility in the marketplace, it must be of sufficient size to make the effort worthwhile, provide staying power so that the investment opportunities may be investigated and shaped, and then sold.

Two scenarios for PAIICO are being presented. Scenario A presents the optimum approach to the problem. Scenario A envisions an initial total capitalization of P315 million. Such capitalization will allow a rapid build up of effective investments as well as achievement of an adequate scale to have a very positive impact upon the Philippine economy. It is estimated that Scenario A will catalyze over P4.2 billion in new direct investment in five years. It will also have an even larger effect upon indirect investment because there will be additional and ancillary equity investment and loans involved. It is impossible to quantify this indirect amount, but it is estimated that it should be several times the direct investment.

Scenario A also will allow sufficient room for development of private agriculturally related investment. The crucial role of agribusiness both in the development of the Philippines as well as in reducing the security concerns in the countryside is obvious. Sufficient size, without being overly large, is necessary to achieve this objective.

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Scenario B involves a somewhat smaller capital of P245 million. This smaller amount results in a smaller average investment reviewed and sold, slower growth and a much smaller developmental impact. The impact is estimated at half of the total of Scenario A, or a total direct investment over 5 years of about P2.25 billion which would result from PAIICO's activities.

It is doubtful if the commercial risk is significantly changed by reducing PAIICO's size. Although the smaller size limits somewhat any administrative problems, the restricted cash availability probably increases some risks of illiquidity because there are fewer investments capable of being sold.

The biggest problem surrounding Scenario B is that the rate of return is less than that of Scenario A. Scenario A reaches a pretax rate of return on previous EOY net worth of 45% p.a. in the fourth year. Scenario B's pre-tax return on previous EOY net worth is only 36% p.a. in the fourth year. Scenario A's return is 25% more than Scenario B. In the third year, Scenario A has a pretax rate of return on previous EOY net worth of 14.4% p.a., whereas Scenario B's is only 8.6% p.a. Furthermore, Scenario A's cash position is much healthier than Scenario B's position throughout the entire 5 year period. (The comparative earning advantage of Scenario A would be enlarged if its cash position was run down to the same level as Scenario B.)

The earnings potential is important. Discounted cash flow during the early years is not good for both scenarios because of the income delays due to reliance upon capital gains. Although there is considerable fee earning upside potential for PAIICO the return is still relatively slow for a service business. It is also slower than most Philippine investors desire. Therefore, Scenario A is more attractive to local and international private investors.

One way to increase the attractiveness of the investment to private investors would be to restrict AID's equity return (see comparison with Asean Venture Capital Corp., where AID takes 50% of the risk for less than a market return). However, this proposal is based upon a free market equity return.

It is recommended the AID select Scenario A as the best vehicle for achieving its objectives.

IV. Administration of PAIICO

A. Income

This is a general discussion of revenue and expense. Pro forma projections are contained in Attachment No. 1 and they give the income detail and balance sheet results.

1. Revenue

PAIICO's revenue will have two main sources: (a) front end fees from successful investment placement, and (b) capital gains from the subsequent sale of equity "kickers" received for developing the investment opportunity. Occasionally, PAIICO will have other revenue sources, but they will not be central: capital gains from selling bridging investments, placement fees for placement activities of securities of established companies, or modest investment income. However, no trading income, underwriting fees or similar type of investment banking income is contemplated.

(a) Placement Fees

The gestation period for an average successful investment (of the type contemplated here) is estimated to be six months. This period would be short for start-up investments, but appears reasonable for the kind of restructuring investments contemplated. Much equity for most investments already has been raised, and PAIICO's search will be for incremental investment, e.g., rehabilitation, supplemental equipment or market development. Front end fees will ordinarily be paid upon successful placement of the investment, which is at the end of 6 months. The fees of P2 million in cash for an average investment of P35 million are low for developed countries for this type investment, and more closely conform to developing country standards.

The equity "kickers" are within the normal parameters for this type of work, although their increased value is hard to estimate. The equity "kickers" for each project are deemed to be sold after 2 years. However, if the companies in which

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the equity "kicker" has been given are doing well, there will be little incentive for PAIICO to sell the shares, unless there is pressure for funds. It should be a policy of PAIICO to sell shares at the earliest optimum time in order to maintain the highest rate of turnover possible.

When bridging investments are made, fees will not ordinarily be received until the bridging investment has been sold. Equity "kickers" received from sale of bridging investments are deemed sold after 1 year because of the relative maturity of the investment. (See paras. 4 & 5 Assumptions on pro forma projections)

(b) Start-up

PAIICO should be able to start up quite rapidly. There is a very large backlog of investment turnaround opportunities. (See above discussion under Demand for Financial and Management Restructuring Services.) During the first year, 12 successful projects are projected, and thereafter, the successful projects build up to 36 in the fifth year. This would appear to be a reasonable estimate considering the 6 month gestation period forecast. (PCIB stated that their average gestation period for privatization projects already done was somewhat over 3 months.)

(c) Equity Exit Opportunities

It is estimated that, after the initial start-up period, PAIICO's front end fees will cover its expenses, and its profit will depend substantially upon the equity "kicker" it receives as an additional fee. The equity received as a portion of the fee will ordinarily be in companies that are not registered on any stock exchange. Therefore, there will be considerable illiquidity in the investment. Nevertheless, PAIICO should be able to sell its equity relatively rapidly because it will have an intimate knowledge of that industry through its investment placement activities. In this regard, PAIICO's own investment turnover activities help overcome the problems of many other equity holders in developing countries (e.g. venture capital companies) by creating exit opportunities.

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Another PAIICO objective will be the flotation of more companies' shares on the major stock exchanges, and that will contribute to the liquidity of the shares received by PAIICO.

(d) Interest on Short Term Investments

There should be some investment income from short term cash investments made while it is awaiting use in PAIICO's main business. This is estimated at 10% p.a. on average investible funds during each year and is indicated in the income projections.

In addition, a 10% dividend on the proposed P30 million investment in the Agro-Industrial Venture Capital Corp. is projected in Year 3, 4, & 5.

2. Expenses

Investigations and evaluations of potential investments will be costly because a relatively large proportion of projects investigated will not result in investments. While individual investigations do not cost a great deal, the investment success ratio is estimated to be low and, therefore, the total costs can be relatively high.

It is estimated that a successful investment under Scenario A, will require an average expense of P1.4 million for an average investment of P35 million. It is also projected that unsuccessful investments will be turned down in the same month that they are brought to PAIICO at an average cost of P250,000. Under Scenario B, the comparable expenses are P1.2 million for a successful investment and P200,000 for a reject.

There will be a relatively long waiting period before income begins. Because of this delay, the equity investment in PAIICO must be large enough at the outset to allow a sufficient number of investigations and investments to be developed to allow PAIICO to become self-sustaining. If there is insufficient equity, PAIICO will have to try to raise money to sustain itself or operate upon a much more restricted basis, and that will mean a diversion of company attention away from its primary mission and towards increasing its immediate income or raising further equity.

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B. Equity Funding

1. Philippine institution with international support

PAIICO must be a Philippine institution to operate effectively in its marketplace. This means it must meet the technical requirements of the Philippine Constitution: 60% of the voting shares must be held by Philippine institutions or individuals.

At the same time, PAIICO must also be able to command attention for its investment proposals in the international marketplace. This requires backing from international financial and other institutions of stature, as well as Philippine ownership by institutions and/or individuals of good standing.

This type of support is necessary because:

First, it must be perceived within the Philippines that investment is being developed and placed by an institution of independent standing. This is important because in most cases either the GOP or the bank with non-performing assets is going to have to sell the asset or allow the investment in the company to take place at less than book value (as shown on the books of the company involved).

Shareholders of high standing are required to achieve this necessary independence. Foremost among such shareholders are the international assistance institutions: United States Agency for International Development (AID), Asian Development Bank (ADB), International Finance Corporation (IFC). These institutions are well known for their objectivity and avoidance of favoritism. Their backing is essential to the success of PAIICO.

Furthermore, because they are international development institutions they have a long range view towards investment. During the start-up period there will be a somewhat slower payback for investors in the organization than equity investors normally expect in developing countries. There is no increase in risk over normal commercial investment risk, but it is spread over a somewhat longer period of time.

Second, investment from local investors of high standing is needed to demonstrate the Philippine nature of PAIICO, provide local funding and refer potential projects. Although PAIICO will be a Philippine institution, it must also be seen as an independent company without ties to the past and one of undoubted integrity.

Third, international private institutions' sponsorship of a portion of the equity will be important because it would indicate clearly that PAIICO is a member of standing in the international investment community whose proposals merit consideration.

Many of the international banks already hold Philippine foreign exchange obligations, so their involvement should lead to further peso investments through the medium of PINs on CB 1111.

In order to meet the requirements of the Philippine Constitution, the equity shares have been divided into Common Shares and 4% Nonvoting Common Shares. Voting Common Shares will be held 60% by Philippine investors and up to 40% by international investors. These shares will be subject to certain restrictions as to dividends and sale because some shares will be purchased through PINs or Circular 1111. 4% Nonvoting Common Shares will also be held by international aid institutions.

The 4% Nonvoting Common Shares will have certain restrictions upon them in order that they will not qualify as equity under the Philippine Constitution and local laws and regulations. These restrictions will include a prohibition against voting, and a limitation upon dividend payments for at least three years. As compensation for loss of voting rights, a 4% interest/dividend rate would be payable and certain conversion rights into Voting Common Shares would be given for public issue, and also call rights for PAIICO on such shares based upon a multiple of four on trailing earnings, with a floor of the original purchase price. Conversion into voting Common Shares will be necessary for a public issue in order to obtain the full market value. Such arrangements will allow exit from such 4% Nonvoting Common Shares to be at an equity market value or approximation thereof. Such 4% Nonvoting Common Shares will participate *pari passu* in gains or losses on the shares.

The 4% p.a. payment shall be cumulative, but if dividends are paid to Class B shares, the 4% p.a. payments shall be offset against them.

It is the intention that the shareholders holding 4% Nonvoting Common Shares will have the rights and obligations indicated, but it may be necessary for legal reasons to denominate such interest in PAIICO as something else, e.g. 4% Convertible Preferred Shares, or 4% Convertible Subordinated Debentures.

2. Currencies

Primarily, PAIICO needs peso funding. Because PAIICO will provide services largely in the Philippines, it will require local currency for personnel and overhead costs.
There will be a smaller requirement for foreign exchange, which should be met by the international agencies. These hard currencies will be needed largely to contract for foreign experts when there is no local RP expertise available to review foreign market potential and investigate and evaluate investment proposals.

An innovative approach to the foreign exchange availability is proposed. Under the proposed AIVC Fund for agro-industrial investment, AID could provide a portion of its equity through a technical assistance line of credit for use only as needed. When the line is drawn upon, AID would treat it as a contribution to capital of the AIVC Fund. It is anticipated that this line of credit would fund specialized and technical activities for agribusiness investments. It is also anticipated that such outside experts may be necessary for foreign market development and similar types of endeavors.

3. Equity Requirements

The size of the equity funding necessary is dependent upon the overall mission of PAIICO. It is presently estimated that about P315 million would be necessary for the initial investment. Such an investment would be of sufficient size to make PAIICO a credible organization in the international marketplace, and give it sufficient capital to allow it to function until it reached a self-sustaining and profitable basis.

An estimate of a possible breakdown of the proposed equity investment at the outset is:

Voting Common Shares	Amount
Philippine banks & financial institutions:	P 75 million
Foreign banks & financial institutions;	50 million *
Total Voting Equity:	125 million

4% Nonvoting Common Shares	Amount
U.S. Agency for International Development: USAID**	P 50 million
PRE	40 million
International financial institutions:	100 million
Total Nonvoting Equity:	190 million
TOTAL:	315 million

* Available through PINs or CB 1111

The above capital base would allow PAIICO to act as a significant catalytic agent. The proposed $4.5 million (P90 million) investment by AID should cause a new investment flow of over $200 million (P4.2 billion) within a 5 year time frame, a multiplier of almost 50. Since many of these investments will catalyze effective use of several times that amount, the total multiplier is very large.

In addition, the Agro-Industrial Venture Capital Fund is proposed with a total capital of P130 million from three sources:

PAIICO	P 30 million
Private Philippine	40 million
AID-PRE	30 million
	P130 million

This is proposed in order to provide investment funds to private, agriculturally related companies with a longer time frame than PAIICO can provide.

This AIVC Fund, managed by PAIICO, will be more difficult to sell to private investors in the Philippines because it will have a much longer payback period and a probable lower rate of return. Agriculturally related businesses not only take longer to become really profitable, but have built-in restrictions against super rates of return. This latter condition occurs because most returns on agricultural investments are restricted since the ultimate prices are determined by exogenous circumstances, usually the world market price for the basic commodity involved.

In order that the local investor can be interested in the investment, the Thailand model for AVC is proposed. AID would receive a combination of a 4% p.a. interest rate plus a participation in the profits. AID's loan would also participate in the credit risk Pari Passu while it is outstanding.

The establishment of the AIVC Fund would greatly extend PAIICO's ability to mobilize private investment. It also is necessary so that PAIICO can meet the needs of the marketplace for investment in agriculturally related enterprises.

C. Investment Results

The pro forma financial projections for PAIICO indicate: a successful company that achieves profitability in the third year; adverse cash flow into the fourth year; the need for a rapid drawdown of the equity contribution; and the capability of making an important contribution to the Philippine economy through private investment.

The pro forma financial projections are contained in Attachment No. 1. Scenario A is based upon a total capital of P315 million. (Scenario B's is P245 million.) Because of the nature of PAIICO's business which obtains its income from fees paid by investment purchases, the time lag involved in obtaining income is significant. However, the expenses are largely personnel expenses and there is relatively little fixed overhead expense. This allows more flexible adjustment of costs to meet the amount of business being done.

The pro forma projections include overhead expenses such as rent, equipment, and office administration expense within the 50% overhead factor applied to direct project personnel expenses. (See Administration Post.) The only overhead separately stated is that of the Chief Executive Officer and his office, estimated at P3 million p.a.

The average sized successful investment is estimated at P35 million for Scenario A. (Scenario B's is P25 million.) This would appear to be a conservative figure in the light of the relatively small actual experience of some financial institutions who have dealt with restructuring APT or NPA's to date, and the size of the APT'S portfolio and NPA potential investments.

The income statement shows an interest expense for the 4% Convertible Nonvoting Common Shares. If the 4% p.a. yield is deemed a dividend under Philippine rules, such payments may not be so deductible. Such an approach would increase profits and render the increase subject to any taxes involved.

No dividends are shown because the company should retain its cash - at least through the fourth year.

No taxes are shown because the exact tax effects are not clear at this time since: the new Investment Code has not been promulgated, this is a new type of business and the effect of the application of the proposed V.A.T. in the Philippines is not yet clear. It is believed that present GOP taxes will not significantly alter the results.

Front end fees have been calculated at P2 million for each successful investment, and expenses of P1.4 million under Scenario A. These expenses are shown in year one as being P25 million because the expenses for each successful investment occur over a six month period, but during the first startup year, the only successful investments recorded will be in the second half of the year. Thereafter, each year will have a full complement of successful projects which will approximately balance out.

D. Administration of PAIICO

PAIICO would be structured administratively as a lean and flexible organization. The main staffing would consist of individuals with managerial expertise as well as some financial background.

1. Organizational costs

Organizational costs involved in establishing PAIICO have not been factored into the proforma projections. Much of the preliminary expenses involved in exploration of the feasibility of the proposed investment and preliminary placement memorandum have already been covered by AID. The next steps by AID will further reduce any additional costs.

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It is contemplated that a significant proportion of the actual placement costs will be met outof the proceeds of the placement itself.

2. Personnel Costs

Personnel costs are addressed in Attachment I, Personnel Costs and Organization, Post. These costs have been reviewed by the team in the light of Manila financial organization costs, and are believed to be conservative. The salaries indicated should be able to attract first class personnel of high technical capabilities.

3. Personnel Resources

The main emphasis would be upon the selection of a Chief Executive Officer. This office cannot effectively be filled until the main shareholders have been identified and substantial agreement reached. It is anticipated that the underwriter/placer of the shares will play a major role in the selection negotiation process. It is probable that potential Philippine investors will be strongly influenced by the choice of CEO, and their views will be very important. The final selection will be a negotiation between the major private Philippine shareholders subject to approval by AID.

The CEO must be a Philippine citizen with high standing in the financial and business community, acceptable to the GOP and all elements of commercial life, who preferably will have had senior administrative experience in a financial organization in the Philippines. It may be necessary to canvass the expatriate Philippine community to have someone from abroad to return.

Other senior officers should have had a variety of financial and commercial experience. It is probable that one or more officers should have had managerial and financial experience in rice, coconuts, textiles, construction, food processing, electronics, wood products and metals, as well as in commercial finance.

At present, there still is a fairly large pool of experienced talent that could be available. The economy has started back, but it still has a long way to go. In the review of PAIICO with the Manila business community, there was a substantial consensus that a new organization of high standing with a bright future could attract top notch personnel.

E. Sources of Funding

Three main sources of Philippine equity can be mobilized: universal banks and investment banks; family groups and selected individuals; commercial companies, particularly large agribusinesses.

1. Universal banks and Investment banks

The following assessment of universal and investment banks covers their potentiality for leadership investment roles:

Anscor: the Anscor group is the main investment bank with sufficient size, manpower and access to funds which could play a leading investment role in PAIICO. They are the largest investment bank and have backing from the Soriano family and Security Pacific Bank in California.

In preliminary discussions with Anscor about the concept earlier this year, they recognized the validity of the approach both as to commercial viability and overall desirability. They noted the large market for investments in APT assets and other companies to be privatized. Since that time, they have launched as manager, the Philippine Long Term Equity Fund as a $20 million fund to invest in the Philippines.

Very recently (July 13,1987), they have announced that $5 million of the PLT Equity Fund will be used to buy government firms whose shares Anscor plans to list on Philippine stock exchanges. Their action in attempting to "skim the cream" from the government owned asset market indicates the large size of the overall market for PAIICO's services. Only those assets being privatized which are in good financial and operating condition would be eligible for rapid listing on the stock exchanges. The vast majority of cases will require turnaround management, new investment and "seasoning" before that can take place. As PAIICO's market is directly complementary to Anscor's actions, Anscor should be a potential leader for investment in PAIICO.

BPI: this bank, although the Philippine's largest, should probably not be considered a top candidate. It tends to hold to its position as No. 1, and is not usually innovative and aggressive as may be best. As PAIICO is a new institution, it will need dynamic leadership and BPI may not be able to give it. However, it has been a leader in agro-industrial banking in the Philippines which is its strongest point. On balance this should be pursued, but not with high expectations.

Far East Bank: this would be a good candidate, particularly because of the Philam Life Co. relationship. The present political turmoil means that it requires careful consideration but it should remain a top candidate and be explored further.

PCIB: it has expressed caution on the concept because it is aiming towards fee income. Nevertheless, it could be an equity candidate.

Cocobank: this bank would be a leading candidate for a lead investment position if: one, the San Miguel ownership situation clarifies; and two, it would qualify as a private bank for AID purposes. It appears that the Cocobank stock ownership position in San Miguel has a reasonable chance of being clarified by the time that PAIICO stock would be actively placed. The ownership of Cocobank may only slowly be resolved. However, it appears clear that Cocobank is not intended to be a government bank so that AID's restrictions may not be violated. Ramon Sy has indicated strong interest in PAIICO in the past.

Metrobank: this bank does not seem to have high interest to date but should be pursued as a medium-high candidate for equity investment.

2. Family groups

There are numerous family groups - particularly those involved with agriculture, that would make top candidates. No attempt is made to list these at this time, because they must be approached carefully when AID is committed in principle to an approach. However, a few of the top candidates in this area are the sponsors of PAIDCOR.

In our earlier discussion with Secretary Ongpin on the design of PAIICO, the Secretary emphasized the importance of bringing the constitution closer to the countryside. Geographical consideration might be considered in selecting family groups to include, for example, key agricultural, industrial and commercial families in the Visayas and Mindanao. Having representation from Cebu, for example, would be important.

3. Other industrial or agribusiness groups:

There is some overlap of course between family and sectoral groupings. But some companies, e.g. the Anscor (San Miguel, Atlas group), are really somewhat more widely owned. Others have a stronger family identity - e.g. the Robina companies of Mr. John Gokongwei, the Shoemart of Mr. Henry Sy, the AG&P group of Mr. Roberto Villanueva, and of course, the Ayala group of companies of the Zobel family.

4. Local Leadership

This proposal is fortunate because it already is identified with an outstanding Philippine investment banker of high standing: Sixto K. Roxas, who has been a senior member of the team reviewing Philippine Capital Markets. As a founder and CEO of the first Philippine investment bank as well as a known member of its financial community for 30 years, Roxas has brought credibility and interest in the proposal. He has also been a longstanding member of the international financial community, (he was Vice Chairman of American Express Bank), and is an ideal person to be able to be the necessary champion for the concept in the business community.

F. Risk Analysis

The major risks for AID involved in the proposed PAIICO investment fall into the following categories:

1. Political risk
2. Market risk
3. Economic risk
4. Liquidity risk
5. Administrative risk
6. Investment risk

1. Political risk

There is considerable uncertainty about the future of the Republic of the Philippines. The political hazards are well known: significant armed rebellions in various parts of the country; a new government under a new constitution without a track record; low primary commodity prices with the resultant disaffection in rural communities.

Nevertheless, the political situation is improving: the new government's policies have stopped the deterioration in most places in the countryside.

However, it is doubtful if the political situation will severely adversely affect this proposed investment unless there is a drastic change for the worse. A financial services organization of this type works on targets of opportunity; it is not wedded to working on a narrow line of business. Within reasonable limits, it can flexibly respond to the political situation. If one area of the country is unsafe, PAIICO can switch its attention to another. If working in one industry becomes untenable, it is possible to move to another. The flexibility of dealing with turnaround investment can give considerable protection.

At the same time, if the political situation deteriorates too much, then potential investment may dry up. As indicated elsewhere, however, the Philippine market is large enough to have great attraction to potential investors, both domestic and foreign. If provided with well worked out investment proposals, many - if not most - investors interested in the industry will be willing to give the proposal good faith consideration.

Although a real risk, PAIICO can guard against most political risks except drastic deterioration through increased violent rebellion.

2. Market risk

PAIICO is a new enterprise - both because it is a startup and because it is unique in the Philippines. Although the analysis herein indicates that the market for PAIICO's services is vast, it is possible that no one will be willing to purchase the services despite the universal approval of the concept by the business and governmental communities.

All of the market analysis points to a real need for these services. There are existing organizations providing these services on a one-off basis. Each of those interviewed indicated that the market had not been saturated. Those involved in this type of activity are undercapitalized. The proposed capitalization of PAIICO would appear to provide it with sufficient staying power and funds enough to take successful action.

The main risk would appear to be that the time required for the investment opportunity development and placement is much longer than estimated. In such circumstances, the costs will be much larger than anticipated, and profitability will decline. This risk that the marketplace will not provide the type of investment opportunity projected is controllable by alert management. One of the advantages of a service company is that personnel can be matched to the business done.

Furthermore, no bank debt is contemplated. Thus, earnings on equity capital can offset to some degree a failure to find investments fast enough.

Although the market risk is present, competent management can cover that risk.

3. Economic risk

There is a substantial chance that the Philippine and/or the world economy will decline sufficiently to shut off investment flows and cause losses to businesses in which equity "kickers" and the selected investments are made.

This is the basic risk of all private investment. However, this business is several advantages over many others in protecting itself from the economic risk. First, the investments and potential investment opportunities should be diversified across a number of industries so that the chances of an overwhelming downturn are minimized. Second, as indicated above, the services industry can more flexibly meet changes in its business because it has practically no fixed investment. PAIICO can also ride out an economic storm because it does not have debt to service.

4. Liquidity risk

One of the more serious risks is the possibility of becoming illiquid because of an inability to sell investments - even if they are profitable. LDC markets are notoriously difficult for easy sales of investment, and such a possibility would freeze PAIICO's ability to continue in business. By definition there will be no public market for the securities, so sale will not be easy.

The way that this risk is manageable is through the twofold protection of vigilant management and careful selection of investments with due regard for exit opportunities. Competent management should be able to guard against illiquidity causing undue loss. The business of PAIICO is to find investors, so it has a better chance of finding exit opportunities than others.

5. Administrative risk

All financial organizations run risks of administrative failures: from embezzlement to bad judgment. Adequate administrative controls plus insurance can give peace of mind. But the only real antidote is the selection of a good and careful administrator. In addition AID should develop auditing techniques that cover other areas than financial audit. Even though AID does not want to be on the Board of

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Directors, it is recommended that AID appoint an adviser or advisers with experience in international financial matters to work at ways that AID can keep itself informed of the fate of PAIICO.

6. Investment risk

Securities offered in starting, new ventures are, of course, speculative and subject of a high degree of risk compared to other types of securities. AID could sustain a substantial or total loss of their investment. The following risks are the major investment risks:

Risks of New Investments. Investments in new projects offer the opportunity for significant capital appreciation but also losses due to lack of experience in the marketplace. Also, although subinvestments are only a part of PAIICO's business, there are risks associated with investment in subinvestments in an early stage of development, or with an adverse operating history; or an inability to turnaround those investments into profitable companies.

Lack of Correlation Between Book Value and Market Value of PAIICO Shares. It is possible that the market value of the PAIICO's common stock (if a significant market develops) will bear little or no relation to the market or book value of its underlying portfolio securities, or the resulting net asset value per share. As a result, it may not be possible for AID to realize the true value of his common stock.

Distributions. PAIICO's profitability is highly dependent upon long-term capital appreciation of its equity "kickers". To the extent that any income is derived from PAIICO's operrations, it will largely be used to fund continuing working capital needs rather than be distributed to stockholders.

Future Financing. If PAIICO is not as profitable as forecast, its growth may depend upon its ability to obtain additional financing rather than rely upon cash flow. No assurance can be given that PAIICO will be able to raise additional funds should they be required, or that such funds will be available on favorable terms.

G. Prospective Investments

1. APT Investments

The Asset Privatization Trust assets are composed of the Non-Performing Assets (NPA's) of the two largest GFI's: DBP and PNB with a transfer value of PHP 106 billion. The types of assets range from financial claims to physical properties to company shares.

While a majority of the assets are in the form of physical properties the more likely prospective opportunities for PAIICO will be among those that are financial claims against basically attractive companies. In the case of financial claims the purchase of the promissory note will require the concurrence of the present owner/operator of the business involved and therefore requires prior negotiation with them.

PAIICO can undertake an investigation of the attractiveness of the basic business fundamentals of the company concerned and from there design a project for promotion once it is convinced that an opportunity exists.

The tack PAIICO will take is the determination of the value of the financial claim if it were instead looked at as equity rather than debt. PAIICO will then negotiate with the present owners on the terms of its entry into their business and once an agreement is reached PAIICO bids for the claim with the prior consent of the owner that should it win, the claim will be converted to equity at the agreed conversion ration. An agreement covering management participation will also be covered in the negotiations.

PAIICO will therefore initially concentrate on those assets that are financial in nature and are against companies that are operating at a positive margin before interest costs and whose underlying business is promising.

Attachment II provides a representative list of assets currently being sold by the APT.

2. Agro-Industrial Investments

Aside from the APT assets there are many other assets now housed with various government agencies that have been approved for privatization. The holding agencies are in charge of arranging the privatization of the assets but final approval must be granted by the Committee on Privatization (COP). Among these are some excellent agro-industrial investments that PAIICO can immediately consider.

A list of government owned assets approved for privatization is included as Attachment II. Writeups of potential agro-industrial investments for PAIICO are also provided for in Attachment II and III.

SCENARIO "A"
PRO FORMA PROJECTIONS
ASSUMPTIONS

Based upon P35 million average successful investment

1. Equity: All of the initial P315 million capital in Class A and Class B is paid at the outset: each investor agrees to put up his equity conditioned upon others' contribution; in addition, the Agro Industrial Venture Capital Fund will require P100 million in investment.

2. Investment Timing: There is a six month gestation period for successful projects from initial investigation to investment. Each unsuccessful project has an average gestation period of 3/4 month.

3. Success Ratio: In years 1, 2, and 3, two successful projects are concluded per month beginning in the seventh month of year 1. In year 4 and thereafter, three successful projects are concluded each month. In years 1, 2, and 3, eight unsuccessful projects take place each month. In year 4 and thereafter, six unsuccessful projects occur each month. See Attachment I, "Total Number of Projects Reviewed Each Year" which summarizes these assumptions.

4. Types of Successful Projects: PAIICO engages in three types of business activities vis-a-vis selected projects: (i) placement of equity to third parties; (ii) taking of equity positions for its own account; and (iii) booking of relatively short-term bridging investments. Placements of equity to third parties are anticipated to average P35 million. In contrast, three categories of PAIICO direct investments are assumed to occur: the first averages P5 million each; the second averages P10 million, and the third averages P20 million. Finally, short-term bridging investments average P20 million each. Attachment I, Projects Reviewed, Total Projects Reviewed and Direct and Indirect Investment Volume tables provide some quantitative measures of the relative importance of each category of successful project.

These assumptions are conservative: all investments are considered successful, but the gain of only 100% is far less than normal and more than compensates for the 100% success rate because these are almost entirely seasoned investment situations.

5. Front End Fees and Capital Gains: Average front end fees for each successful equity placement are estimated at P2 million (e.g., 5 3/4% of P35 million) plus equity shares in resulting company.

   Equity shares received as fees in successful placements are valued at P4 million and are assumed to be realized two years after the cash fees are received, except that bridging investments' equity "kicker" is realized one year after successful placement because the target company has had a total of two years to mature similar to other placements.

   Direct investments made by PAIICO are of three types (see above). Investments of P5 million and P10 million are deemed to be sold for P10 million and P20 million, respectively, in two years; while the P20 million investments are deemed to be sold for P40 million in three years.

   Bridging investments are assumed to result in no capital gains. Rather, front end fees similar to the successful equity placements are projected, i.e., P2 million in cash fees plus equity shares negotiated at P4 million two years after the receipt of the cash fees. Four bridging investments are made in year 1, five are made in year 2-3, and six are made each year thereafter.

6. Project Costs: The average cost of the successful projects is estimated at P1.4 million for Scenario A and P1.2 million for Scenario B. (See Attachment I, "Personnel Costs & Organization" for calculation.) Successful project costs are averaged over the 6 month period in the last half of years 1 and 2. An average cost of P250,000 is estimated for each unsuccessful project for Scenario A and P200,000 for Scenario B.

7. All overhead support, administrative, consultant and outside costs are averaged and included in each project, except that the CEO and unallocated ancillary staff cost of P3 million is expensed separately.

8. Tax effects have not been considered because the new Investment Code has not been promulgated. There is no distribution of earnings.

9. Investment income is calculated as 10% per annum on average investible funds for years 1-5 as follows: P200 million, P100 million, P50 million, P50 million, P50 million, 4% non-voting, and P200 million, respectively.

10. The common stock has been given a 4% p.a. expense for 10 years, but there is no cash effect during the first 3 years because payment has been deffered, and level payments of interest and accrued interest are made thereafter. The conversion feature has not been given consideration.

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SCENARIO "A"
PRO FORMA INCOME STATEMENT
(P MILLIONS)

Fiscal Years	1	2	3	4	5
Income:					
Investments	20	10	8*	8*	23*
Front end fees	16	46	48	70	72
Equity sales (fees)	-	-	48	96	96
Capital gains (P5 M)	-	-	5	10	10
Capital gains (P10 M)	-	-	-	20	20
Capital gains (P20 M)	-	-	-	20	40
	36	56	109	224	261
Expenses:					
Interest expense**	(8)	(8)	(8)	(8)	(8)
Successful projects	(25)	(34)	(34)	(50)	(50)
Unsuccessful projects	(24)	(24)	(24)	(18)	(18)
Other overhead	(3)	(3)	(3)	(3)	(3)
	(60)	(69)	(69)	(79)	(79)
Profit (loss)	(24)	(13)	40	145	182
Cumulative profit (loss)	(24)	(37)	3	148	330
Cash flow:					

* Includes 10% dividend on Agro-Industrial Venture Capital Fund investment of P30 million.

** Assumes 4% interest paid on Class B Nonvoting Shares is expensed.

SCENARIO "A"
PRO FORMA BALANCE SHEET
(P'000,000)

End of Fiscal Year	1	2	3	4	5
Assets:					
Cash/Securities and Work in process	164	69	52	154	333
Investments at Cost					
Bridging	80	100	100	120	120
Equity	25	95	160	180	180
A.I.V.C. Fund*	30	30	30	30	30
Total Assets	299	294	342	484	663
Liabilities:					
Accrued Interest	8	16	24	21	18
Class B Nonvoting					
USAID DA/106	50	50	50	50	50
Bureau for Private Enterprise	40	40	40	40	40
International Institutions	100	100	100	100	100
Shareholders Equity:					
Philippine investors	75	75	75	75	75
Foreign investors	50	50	50	50	50
Retained Earnings	(24)	(37)	3	148	330
Total Liabilities	299	294	342	484	663

*Agro-Industrial Venture Capital Fund:	Profit Participation	Capital Contribution
AID - PRE 4% Loan	10-20%	P 60 million
Private Philippine	20-55%	40 million
PAIICO	20-25%	30 million
	100%	130 million

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ATTACHMENT I

SCENARIO "A"
TOTAL NUMBER OF PROJECTS
REVIEWED EACH YEAR

Year	Successful	Unsuccessful
1	24	96
2	24	96
3	24	96
4	36	72
5	36	72

ATTACHMENT I

SCENARIO "A"
SUCCESSFUL PROJECTS REVIEWED

Year	Successful Projects Reviewed	Bridging Investments Reviewed	Total	Unsuccessful Projects Reviewed
1	20	4	24	96
2	19	5	24	96
3	19	5	24	96
4	30	6	36	72
5	30	6	36	72

Note:

(1) PAIICO Direct Investments (see below) not included because no expense specifically allocated since such investments are by-products of successful projects or other reviews.

(2) Bridging Investments average P20 million and last one year.

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ATTACHMENT I

SCENARIO "A"
SUCCESSFUL INVESTMENTS

Year	Placements of Successful Projects	Placements of Bridging Investments	PAIICO Direct Investments	Total
1	8	-	2	10
2	19	4	6	29
3	19	5	6	30
4	30	5	6	41
5	30	6	6	42

Footnotes:

(1) Each placement of equity averages P35 million except for PAIICO Direct Investments;

(2) Three categories of PAIICO Direct Investments are assumed: the first averages P5 million each; the second P10 million and the third P20 million, and they are equally divided in numbers, except in year 1 when only one P5 million and one P20 million are made;

(3) The front end fees and capital gains on equity "kickers" are based upon the above successful projects as placed by PAIICO. The front end fee is earned in the year the investment is placed. The equity "kicker" is deemed sold two years after placement, except that bridging investments are deemed sold one year after placement with outside investors;

ATTACHMENT I

SCENARIO "A"
DIRECT AND INDIRECT BUSINESS VOLUME
(in P'000,000)

Year	Placements of Equity	PAIICO Direct Investments (1)	Bridging Investments	Total
1	280	25	80	385
2	630	70	100	800
3	630	70	100	800
4	980	70	120	1,170
5	980	70	120	1,170
TOTAL				4,325

Footnote:

(1) PAIICO makes six direct investments each year: two for P5 million; two for P10 million; two for P20 million <u>except</u> for the first year when one each is made for P5 million and P20 million.

SCENARIO "B"
PRO FORMA PROJECTIONS
ASSUMPTIONS

Scenario B assumptions differ from Scenario A in the following ways:

1. Equity base of PAIICO is P245 million instead of P315 million; in addition, the Agro Industrial Venture Capital Fund will require P100 million in investment.

2. Average size of an equity placement is P25 million instead of P35 million;

3. The success rate is more modest in Scenario B. The differences in the number of successfully concluded projects is summarized below.

Year	Scenario A	Scenario B
1 (months 7-12)	2	1
2 & 3	2	1 1/2
4 - 5	3	2

The number of unsuccessful projects per month is reduced in order to retain the same ratios of success to failure:

Year	Scenario A	Scenario B
1 (months 7-12)	8	4
2 & 3	8	6
4	6	4

4. Front end fees are smaller in Scenario B, i.e., P1.5 million rather that P2.0 million. Scenario B fees are based on an average placement commission of 6% of P25 million;

5. Fewer bridging investments are made in Scenario B e.g., two rather than four in Years 1; four rather than six in Years 2-3, and five rather than six in Year 4 and thereafter.

6. Investment project cost: Average cost of successful projects is estimated at P1.2 million. Average cost of unsuccessful projects is estimated at P200,000.

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ATTACHMENT I

SCENARIO "B"
SUCCESSFUL INVESTMENTS

Year	Placements of Successful Projects	Placements of Bridging Investments	PAIICO Direct Investments	Agro-Industrial Venture Capital Company	Total
1	4	-	2	1	7
2	11	2	4	-	17
3	14	4	4	-	22
4	16	4	4	-	24
5	19	5	4	-	27

108 investments in 5 years totaling P__billion in direct investment

Footnotes:

(1) Each placement of equity averages P35 million except for PAIICO Direct Investments;

(2) Two categories of PAIICO Direct Investments are assumed: the first averages P5 million each; the second P20 million, and they are equally divided in numbers;

(3) The front end fees and capital gains on equity "kickers" are based upon the above successful projects as placed by PAIICO for successful projects and bridging ivestments.

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SCENARIO "B"
SUCCESSFUL PROJECTS REVIEWED

Year	Successful Projects Reviewed	Bridging Investments Reviewed	Total
1	10	2	12
2	14	4	18
3	14	4	18
4	19	5	24
5	19	5	24

Note:

(1) PAIICO Direct Investments (see below) not included because no expense specifically allocated since such investments are by-products of successful projects or other reviews.

(2) Bridging Investments average P20 million and last one year.

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SCENARIO "B"
PRO FORMA BALANCE SHEET
(P'000,000)

End of Fiscal Year	1	2	3	4	5
Assets:					
Cash/Securities and Work in process	148	48	28	77	197
Investments at Cost					
Bridging	40	80	80	100	100
Equity	25	75	120	140	140
Agribusiness investment	30	30	30	30	30
Total Assets	243	233	258	347	467
Liabilities:					
Accrued Interest	6	12	18	15	12
Class B Nonvoting					
USAID DA/106	50	50	50	50	50
Bureau for Private Enterprise	20	20	20	20	20
International Institutions	75	75	75	75	75
Shareholders Equity:					
Philippine investors	60	60	60	60	60
Foreign investors	40	40	40	40	40
Retained Earnings	(9)	(24)	(5)	87	210
Total Liabilities	243	233	358	347	467

Agro-Industrial Venture Capital Fund:	Profit Participation	Capital Contribution
AID-PRE	10-20%	P 60 million
Private Philippine	70-55%	40 million
PAIICO	20-25%	30 million
	100%	130 million

ATTACHMENT I

SCENARIO "B"
PRO FORMA INCOME STATEMENT
(P MILLIONS)

Fiscal Years	1	2	3	4	5
Income:					
Investments	15	10	8*	8*	13*
Front end fees	6	20	27	30	36
Equity sales (fees)	-	-	24	72	72
Capital gains (P5 M)	-	-	5	10	10
Capital gains (P20 M)	-	-	-	20	40
	21	30	64	140	171
Expenses:					
Interest expense**	(6)	(6)	(6)	(6)	(6)
Successful projects	(11)	(22)	(22)	(29)	(29)
Unsuccessful projects	(10)	(14)	(14)	(10)	(10)
Other overhead	(3)	(3)	(3)	(3)	(3)
	(30)	(45)	(45)	(48)	(48)
Profit (loss)	(9)	(15)	19	92	123
Cumulative profit (loss)	(9)	(24)	(5)	87	210
Cash flow:					

* Include dividend on Agro-Industrial Venture Capital Fund stock of 10%.

** Assumes 4% interest paid on Class B Nonvoting Shares is expensed.

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ATTACHMENT I

SCENARIO A & B
PERSONNEL COSTS & ORGANIZATION

This calculation of successful and unsuccessful project costs is based upon an average successful investment.

Successful Projects	Scenario A	Scenario B
1 officer @ 3 1/2 man-months @ P100,000/mo. including expenses	P350,000	P 300,000
1 support personnel @ 3 1/2 man-months @ P25,000/mo.	87,500	75,000
1 secretary/administrative assistant @ 3 1/2 man-months @15,000/mo.	52,500	45,000
1 consultant @		
2 1/2 man-months - local @ P100,00/mo. including expenses	250,000	200,000
3/4 man-month - foreign @ P200,000/mo. including expenses	150,000	125,000
	890,000	745,000
Overhead @ 50%	445,000	372,500
Average cost of Successful Project	P1,335,000	P1,117,500

Unsuccessful Projects		
1 officer @ 3/4 man-months @ P100,000/mo.	P 100,000	75,000
1 support @ 3/4 man-months @ P25,000/mo.	25,000	18,750
1 secretary/AA @ 3/4 man-months @ P15,000/mo.	15,000	11,250
1 consultant @ 1/4 man-months @ P100,000/mo.	25,000	20,000
	P 165,000	125,000
Overhead	82,500	62,500
Average cost of Unsuccessful Project	P 247,500	187,500

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The overall supervision by the Chief Executive Officer is calculated separately. All other staff and support costs are included in the overhead applied to individual projects.

CEO including expenses/year	P2,000,000
Secretary/Administrative Assistant/year	250,000
Support Personnel, etc P800,00/year	750,000
	P3,000,000

ORGANIZATION

SCENARIO A

Based upon the investments received under Scenario A, the staffing of PAIICO would be:

	Years 1 - 3	Years 4 - 5
CEO and staff	4	4
Officers	13	15
Support staff	13	15
Secretary/AA	13	15
Administrative staff	5	5
	48	54

SCENARIO B

Based upon the investments reviewed under Scenario B, the staffing would be:

	Years 1	Years 2 - 3	Years 4 - 5
CEO and staff	3	4	4
Officers	6	8	11
Support staff	6	10	11
Secretary/AA	6	8	11
Administrative staff	4	4	11
	25	34	41

Attachment I

INVESTMENT TERMS OF 4% CONVERTIBLE CLASS B NONVOTING COMMON SHARES

Major features of the P190 million 4% Convertible Class B Nonvoting Shares include:

(1) three year grace period on interest and principal; with 4% interest on grossed up outstandings paid semiannually, thereafter. Principal is repaid in one lump sum ten years from drawdown. See subparagraph (3) below which discusses conversion rights;

(2) no dividends will be paid by PAIICO during first three years of operation (Circular 1111 prohibits Philippine companies from paying dividends to those investors providing equity through a debt-for-equity swap. PAIICO may have such investors);

(3) conversion rights are as follows,

(a) after four (4) years, right to one public offering of shares at PAIICO's expense equal to the Class B Nonvoting Shares;

(b) piggyback rights each public offering by PAIICO for 25% of the Class B Nonvoting Shares;

(c) after four (4) years, right to convert to Voting Common Shares at time of sale to others at any price with remaining shareholders having rights of first refusal;

(4) after four (4) years, call by PAIICO at 4 times trailing annual earnings but not at less than par, nor if excercise of previous notice to exercise conversion rights;

(5) Pari passu sharing of losses between Class A and Class B Nonvoting Shares.

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International Science and Technology Institute, Inc

Headquarters: 1129 20th Street, N.W., Washington, D.C. 2003
202/785-0831 ••Telex: 272785 ISTI UR ••FAX: 202/223-386

ATTACHMENT II

PROSPECTIVE PAIICO INVESTMENT PROJECTS

List of APT Projects
List of Government-Owned Assets Approved for Privatization
List of Potential Investment Projects

U.S. and Overseas Offices

Arlington, Virginia • Lewes, Delaware • Dakar, Senegal • Colombo, Sri Lanka • Rabat, Morocco • Cairo, Egypt

ATTACHMENT II

REPRESENTATIVE LIST OF APT FINANCIAL CLAIM ASSETS

COMPANY NAME	CLAIM VALUE (PHP Millions)
Lederoide Products (Phils.), Inc.	141.9
Menzi Development Corporation	243.0
Clavecilla Radio Systems, Inc.	22.3
Creste Monte Wood Products, Inc.	625.0
Cresta Monte Shipping Corp.	402.6
Cagayan Sugar Corporation	1,320.2
Bukidnon Sugar Milling Company	1,707.8
Eastern Paper Mills, Inc.	11.4
Davao Sugar Central Company	120.8
Golden Country Farms, Inc.	200.0
Sta. Ines Melale Forest Products Co.	127.8
Agro-Industrial Development Co of Silay	123.5
United Doctors Medical Center Corp.	46.3
Isarog Pulp and Paper Co.	405.1
Tolong Sugar Milling Co.	296.3
United Planters Sugar Milling	617.3
North Davao Mining Corp.	7,355.4
Trebel Industries, Inc.	10.8

ATTACHMENT II

LIST OF GOVERNMENT-OWNED OR CONTROLLED CORPORATION
APPROVED FOR PRIVATIZATION

CORPORATION	AREA OF ACTIVITY	DISPOSITION ENTITY
I. National Development Company (DTI)		
1. Asia Industries, Inc.	Machinery/equipment distribution	NDC
2. Batangas Company, Inc.	Land ownership	NDC
3. Beta Electric Corporation	Electrical products and equipment manufacturing	NDC
4. First Chicago Leasing and Equipment Credit Corp.	Lease financing	NDC
5. GY Real Estate, Inc.	Land ownership	NDC
6. Inter-Island Gas Service, Inc.	LPG Marketing	NDC
7. International Corporation Bank, Inc.	Commercial banking	NDC
8. Kamayan Realty Corporation	Land ownership	NDC
9. Luzon Integrated Services	Security services	NDC
10. Manila Gas Corproation	Production/distribution of piped gas	NDC
11. Marina Properties Corporation	Land development (reclamation area)	NDC
12. Mindanao Textile Corporation	Garment manufacturing	NDC
13. NDC-Guthrie Estates, Inc.	Palm oil plantation	NDC
14. NDC-Guthrie Plantations, Inc.	Palm oil plantation/processing	NDC
15. Nadeco Realty Corporation	Land ownership	NDC
16. National Precision Cutting Tools, Inc.	Production of high quality industrial tools	NDC
17. National Shipping Corporation of the Philippines	Cargo shipping	NDC
18. Negros Occidental Copperfield Mines, Inc.	Copper mining	NDC
19. Pagkakaisa Gas Storage Corporation	Gas transportation	NDC
20. Philippine Associated Smelting & Refining Corporation	Copper smelting and refining	NDC
21. Pinagkaisa Realty Corporation	Land ownership	NDC
22. NDC Plantations, Inc.	Agro-forestry plantation	NDC
23. NDC-Nacida Raw Materials Corporation	Procurement of raw materials for Nacida-registered enterprises	NDC
24. National Chemical Carriers, Inc.	Shipping agent, mining and crewing services	NDC
25. National Marine Corporation	Overseas cargo shipping	NDC
26. National Slipways Corporation	Ship repair and maintenance work	NDC
27. National Steel Corporation	Steel production	NDC
28. National Stevedoring and Lighterage Corporation	Stevedoring, lighterage & port agent operations	NDC
29. National Trucking and Forwarding Corporation	Trucking, freight forwarding and warehousing	NDC
30. Philippine Phosphate and Fertilizer Corporation	Fertilizer production	NDC
31. Philippine Pyrite Corporation	Production of pyrite concentrates	NDC
32. Refractories Corporation of the Philippines	Production of basic refractories	NDC
33. Semirara Coal Corporation	Coal mining	NDC
34. Tacoma Bay Shipping Corporation	Ship owning and leasing operations	NDC
35. The Energy Corporation	Management of stock investments	NDC
36. Usiphil, Inc.	Machinery/equipment distribution and servicing	NDC

CORPORATION	AREA OF ACTIVITY	DISPOSITION ENTITY
II. Philippine National Oil Company		
1. Bataan Refinery Corporation	Oil refining	PNOC
2. Bislig Coal Corporation	Coal mining	PNOC
3. Energy Development Corporation	Geothermal energy exploration and development	PNOC
4. Energy Drilling, Inc.	Geothermanl/oil drilling services	PNOC
5. Energy Supply Base, Inc.	Supply base operations	PNOC
6. Filoil Industrial Estates.	Land ownership	PNOC
7. Filoil Refinery Corporation	Oil refining	PNOC
8. Malangas Coal Corporation	Coal mining	PNOC
9. National Coal Authority	Blending/stockpiling of coal	PNOC
10. PNOC Coal Corporation	Coal mining	PNOC
11. Petro TBA Corporation	Marketing of automotive accessories	PNOC
12. Petron Tankers Corporation	International oil tanker operations	PNOC
13. Petrophil Corporation	Marketing of petroleum products	PNOC
14. Petrophil Tankers Corporation	International oil tanker operations	PNOC
15. PNOC Crude Oil Tankers, Inc.	International oil tanker operations	PNOC
16. PNOC Marine Corporation	Shipbuilding and repair	PNOC
17. PNOC Oil Carriers, Inc.	International oil tanker operations	PNOC
18. PNOC Shipping and Transport Corporation	Domestic oil tankering	PNOC
19. PNOC Tankers Corporation	International oil tanker operations	PNOC
III. National Economic Development Authority		
1. Associated Bank	Commercial banking	DBP
2. Bancom Insurance Brokers, Inc.	Insurance brokerage	SSS
3. Basin Dredging and Development Corporation	Dredging and reclamation	LSBDA
4. Bicolandia Sugar Development Corporation	Sugar milling	PNB
5. Coco-Chemical Philippines, Inc.	Coconut oil milling	PNB
6. Century Holding Corporation	Bank holding company	SSS
7. Century Bank	Commercial banking	SSS
8. Commercial Bank of Manila	Commercial banking	GSIS
9. Eastern Visayas Agricultural Projects, Inc.	Swine/poultry/farming	PRDSC
10. Hotel Enterprises of the Philippines, Inc.	Hotel ownership/management	GSIS
11. Meat Packing Corporation of the Philippines	Meat processing/canning	GSIS
12. National Realty Development Corporation	Real estate management	PNB
13. National Warehousing Corporation	Warehousing	PNB
14. National Service Corporation	Manpower services	PNB
15. NIDC Oil Mills, Inc.	Coconut oil milling	PNB
16. Philippine Airlines, Inc.	Commercial air transport	GSIS
17. Philippine Exchange Company, Inc.	Insurance agency	PNB
18. PNB International Finance Ltd.	Deposit taking company	PNB
19. PNB Venture Capital Corporation	Venture capital company	PNB
20. Philippine Shipyard Engineering Corporation	Ship repair and fabrication of steel products	PNB
21. Pilipinas Bank	Commercial banking services	APT
22. The Manila Hotel Corporation	Hotel operation and management	GSIS
23. Union Bank	Commercial banking services	SSS

CORPORATION	AREA OF ACTIVITY	DISPOSITION ENTITY
IV. Ministry of Human Settlements		
1. Agro-Livestock Commercial Development Corporation	Swine and goat breeding, manufacture of dairy products	NABCOR
2. Builder's Brick, Inc.	Brick production, construction	HSDC
3. Carmona Woodworking Industries, Inc.	Sawmilling services	NUDCO
4. Davao Agri-Business Development Company, Inc.	Tree farming	HSDC
5. Davao Equipment Manufacturing Corporation	Metal casting, foundry and fabrication	KKK-PCA
6. Food Terminal, Inc.	Food trading, processing, storage, real estate management	DFA
7. Furniture Manufacturing Corporation	Wood furnishing, interior decoration	NUDCO
8. INCA Coffee Estate Corporation	Coffee plantation	NABCOR
9. Integrated Feed Mills Corporation	Feed production	SPDA
10. Kaunlaran Food Corporation	Dehydrated fruit processing and marketing	NABCOR
11. Marawi Resort Hotel	Hotel operation	SPDA
12. Mindeva Coco-Coir Industries, Inc.	Production of coco-coir products	SPDA
13. Mindeva Refrigeration Industries, Inc.	Ice production/cold storage	SPDA
14. Monte Maria Poultry Farms, Inc.	Poultry farm operation	SPDA
15. Mountain Springs Development Corporation	Swine raising	KKK-PCA
16. Maunlad Savings and Loan Association, Inc.	Savings and loan association	HICC
17. Northern Foods, Inc.	Tomato paste production	KKK-PCA
18. Panoan Prawn Development Corporation	Prawn pry and larvae raising	SPDA
19. Philippine Fruit and Vegetables Industries, Inc.	Tomato paste production	HSDC
20. Philippine Genetics, Inc.	Cattle breed upgrading and dispersal	NABCOR
21. Ridge Resort and Convention Center, Inc.	Resort and convention facility management	HSDC
22. San Carlos Fruit Corporation	Fruit puree production	HSDC
23. Shoe Technology Corporation	Footwear manufacturing	TRC
24. Woodkoal, Inc.	Fuel briquette production	KKK-PCA
25. Woodwaste Utilization and Development Corporation	Construction material production from logging wastes	HSDC
26. ZNAC Rubber Estate Corporation	Rubber tree plantation	NABCOR
V. Office of the President		
1. National Sugar Refinery	Sugar refinery management	APT
2. Phividec Panay Agro-Industrial Corporation	Plantation farming/fertilizer production and trading	APT
3. Republic Transport and Shipyard Corporation	Sugar terminal and shipyard operations	APT
VI. Department of Agriculture and Forestry		
1. Gasifier Equipment Manufacturing Corporation	Gasifier equipment and farm machinery fabrication	DFA
2. Philippine Cotton Corporation	Cotton farming	DFA
3. Philippine Dairy Corporation	Development of dairy industry and milk/dairy products production	DFA
VII. Department of Tourism		
1. Leyte Park Hotels, Inc.	Hotel operation	APT
VIII. Department of Finance		
1. Philippine Amanah Bank	Commercial banking services	APT
IX. Department of Transportation and Communication		
1. Metro Manila Transit Corporation	Passenger bus operation and leasing	APT

ATTACHMENT II

Potential PAIICO Agro-Industrial
Investment Profiles

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INVESTMENT PROFILE

PHILIPPINE FRUIT AND VEGETABLE INDUSTRIES INC.

and

SAN CARLOS FRUIT CORPORATION

PRESENT PRODUCT LINES : Tomato Paste, Mango Puree

POTENTIAL PRODUCT LINES : Other Fruit Purees

I. PROJECT BACKGROUND

A. The tomato paste project (Philippine Fruit and Vegetable Industries, Inc.) was an offshoot of a strategic intervention scheme conceived by the Human Settlements Development Corporation (HSDC) for the countryside. The original concept formulated by HSDC sought to establish mini-agro-industrial estates in agricultural schools scattered all over the country in what was termed then as the Bagong Lipunan Sites and Services Level II program (BLISS II). Level I addressed the problem of rural housing. Level III endeavored to generate electric power through dendro-thermal and mini-hydro energy sources. The whole BLISS concept was a development strategy to provide an integrated shelter cum livelihood, energy and ecological improvement program in the rural areas. BLISS II focused on the livelihood aspect. The agricultural schools were to be the jump off points for technology dissemination and livelihood development.

With the teachers and students as potential supervisors and laborers and the rural communities surrounding the school as the target beneficiaries, BLISS II hoped to cover seventy seven sites in all the provinces of the Philippines. The first seven sites were selected on the basis of how economically depressed the community was, the intensity of the insurgency problem, the adaptability of particular technology to the area and the potential social impact the project would create.

In early 1979 the BLISS II program was launched. One of the earliest projects was the tomato and coffee planting projects in Claveria National Rural High School (CNRHS) in Northern Mindanao.

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An initial investment amount of ₱1 million per site was provided by HSDC for the BLISS II program. The tomato and coffee projects in Claveria thus began on this capital base. Some 33 hectares were planted to coffee utilizing ₱300,000. The rest were spent for planting off season tomatoes for the Manila market. Farmers in the areas surrounding the school were organized to plant tomatoes with the backing of a trading organization. Two years later, investments in Claveria were increased to over ₱3 million to accommodate field experimentations on process-type tomato seeds from Taiwan. Later on, HSDC decided to put up the processing plant in Pangasinan to take advantage of "glut" tomato harvests during the peak season leaving Claveria for off-season production.

The shift to Pangasinan was preceded by some experimental studies on the adaptability of the Taiwanese tomato varieties in the province. HSDC decided to invest ₱50 million in a tomato paste plant in the same project site as its mango puree operations in San Carlos City. HSDC incorporated this project into the Philippine Fruit and Vegetable Industries Incorporated (PFVI) hoping to borrow funds from the Technology Resource Center to finance two-thirds of the project cost. The loan never came and HSDC was forced to finance the project with 100% equity backing. The management of PFVI also opted to plant tomato seeds from Southern California because of success reports on the U.S. varieties. PFVI and San Carlos Fruit Corporation (the mango plant) entered into a management arrangement where the former would manage both tomato and labor projects and absorb half the management and labor costs while the latter rented its facilities to the former.

B. The mango project (San Carlos Fruit Corporation) was established in December 1, 1981 by a group of private entrepreneurs who approached the Regional Action Officers of Region I of the National Livelihood Program (Kilusang Kabuhayan at Kaunlaran or KKK) for loan financing. The proponents were exporters of fresh mangoes who noted the rapidly increasing demand for mango paste, puree and pulp in the world market. They also realized that a large volume of their export mango rejects went to waste especially during the glut months of the mango season in Pangasinan, one of the key centers of mango growing and trading in the Philippines. They saw the opportunity of setting up a mango processing factory to convert the smaller or the more blemished and therefore <u>unexportable</u> mangoes into internationally tradeable products. However, the investment requirements were high and they were reluctant to place their much needed working capital for mango-trading into the riskier production area. They only had ₱120,000 for equity investment whereas the total original project cost was around ₱9.2 million. The Regional Action Officer subsequently packaged the project. The entrepreneurs put in ₱120,000 in common stock, a private foundation another ₱80,000 and ₱9.0 million loan from the KKK.

The project originally envisioned utilizing the hot-pack system of packaging the product.However the proponents decided to shift to a fully aseptic processing and aseptic packaging technology. The project therefore needed more financing. A year late, in November 1982, the Human Settlements Development Corporation was invited to invest ₱140,000 in common shares and ₱1 million in preferred shares to meet the financing shortfall. Meanwhile the private foundation increased its paid-in common shares to ₱140,000 thereby chalking up a total paid-in common stock of ₱400,000. Meanwhile, the KKK had increased its loan to San Carlos Fruit Corporation (SCFC) to ₱12.6 million. The losses during the first year of operations (1983) required additional working capital necessitating additional short-term borrowing from the private foundation of ₱1 million. By October 1983, SCFC had total equity of ₱400,000 in common shares, ₱1 million in preferred shares, ₱12.6 million in long term debt and ₱1 million in short term loan.

In preparation for the next mango season (1984) SCFC requested HSDC for an additional ₱8 million in loans or preferred shares. However, HSDC refused unless the investment were in common shares and unless it assumed majority control. HSDC also stipulated that the KKK loans be restructured to a fourteen-year repaymet term with a one-year grace period. The loan by this time totalled ₱15 million including interest and penalty charges. HSDC did not believe in the managerial capabilities of SCFC and insisted on putting a Comptroller in. The Presidency was still retained into the original private proponent.

Before the third year of its commercial operations (1985) SCFC entered into a management merger and site co-location agreement with PFVI. Both SCFC and PFVI were placed by HSDC under the control of an agribusiness holding company, the National Agribusiness Corporation (NABCOR) which it fully owned. Today, July 1987, SCFC is 96% controlled in terms of common stock while PFVI is 100% controlled by HSDC through NABCOR.

II. PROJECT PERFORMANCE

A. Tomato Paste

1. First Cropping Year 1984-85

During the 1984-85 cropping year, a decision was made to use varieties from the Asian Vegetable Research and Development Center (AVRDC) in Taiwan following the experience of BLISS II personnel in Claveria, Misamis Oriental. The AVRDC varieties performed very well in Claveria. However, although no large-scale trial plantings were made in Pangasinan, the varieties were nevertheless utilized. A small percentage of the total area utilized was planted to Southern California varieties.

For the whole season, a total of 8,126 metric tons of fresh tomatoes was produced for the processing plant. These came from a total of 410 hectares for an average yield of 19.5 tons per hectare. The purchase price set by PFVI for the tomato product was ₱1.00 per kilogram for the first 18 tons and ₱0.75 for the harvest in excess of 18 tons.

Unfortunately, despite the initial success in the agricultural operations, the processing facility was not commissioned on time, resulting in the spoilage of tomatoes, their sale to the Northern Foods Corporation (NFC) factory (the only other tomato paste manufacturing company in the country with twice the capacity of PFVI) and the dumping of tomatoes in the fresh market. This resulted in tremendous losses for the company and necessitated a re-evaluation of the whole project.

2. Second Cropping Year 1985-86

Before the start of the second tomato crop, a reprogramming activity was performed. Prices to farmers were reduced to ₱0.80 per kilogram less 10% handling expenses.

Because of expected higher yields, it was decided that the number of farms solicited for the second year would be reduced. The areas nearer to the plant were given priority to save on hauling expenses.

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There was a decision to change tomato varieties for commercial planting. This stemmed from the realization that although the AVRDC varieties performed creditably, the Southern California varieties, planted on a limited scale, outperformed the AVRDC varieties. The paste produced by the Taiwan varieties was orange instead of red, and the viscosity level was not at par with standards.

The subsequent results were encouraging. A majority of the varieties had good yields and were suitable for processing. Average yield results moved up to 22 tons/hectare. This time, the processing facility was operational, although not at full capacity. Despite frequent breakdowns, the company managed to produce almost 300 tons of tomato paste in the second cropping year.

3. Third Croping Year 1986-87

As the company geared for its third year of operations, the lessons it learned from previous years proved very valuable. Once again, a reprogramming of operations was made. Prices were further reduced to ₱0.60 per kilogram for the first 20 tons moving up to ₱0.65 for the next 10 tons, ₱0.70 after that, to a final ₱0.75 per kilogram for yields above 40 tons.

The results of the third cropping year showcased PFVI's advancement in agri-operations technology. Tomato production totalled 7,039.5 tons produced from 266.37 hectares for a yield average of 26.428 tons/hectare. Some farmers in fact harvested more than 50 tons per hectare with a few getting over 80 tons. The overall average was brought down by the yields in "early-planting" areas. These areas were conceived to produce tomatoes before the peak harvest period commenced. The forecasted lower yields were expected to be compensated by higher selling prices if sold as fresh tomatoes.

With the reduced prices, the company made a decision that farmers with low yields would no longer be allowed to participate in the program.

For the third cropping year, the company decided to use only the top three varieties based on their experience in the previous year.

4. Tomato Paste Processing

Shown below is the trend in the processing of raw tomatoes from the first three cropping years.

Cropping Season	Raw Tomatoes Processed	Total Paste Production	Recovery Rate
	(MT)	(MT)	(%)
1984-85	166.4	15.2	9.1
1985-86	2,456.9	276.6	11.3
1986-87	5,726.0	717.0	12.3

It can be seen that paste production has been rising and that the company expects to reach more than half its capacity in 1987-88.

5. Financial Performance

PFVI has been losing money since its inception. However, the losses was cut down to only ₱3 million in 1986-87. The company hopes to make money in the fourth cropping season when tomato paste production goes beyond 1,000 MT.

B. Mango Puree

SCFC mango puree production increased from 1983 to 1985 but dropped in 1986 following the February 1986 revolution in the country. This went back up again in 1987. Being a government corporation, operations were affected by the shift in the political leadership.

	1983	1984	1985	1986	1987
Mango Puree Production in MT	504	924	1120	381	1112
Raw Materials Processed in MT	1200	2341	2000	n.a	n.a
Recovery Rate	42%	39%	56%	n.a	58%

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The 1987 output of SCFC was expected to generate profits of ₱3 million which would compensate for the losses of PFVI. The two corporations combined would therefore be at break even point.

It can be noted from the recovery rates given above that SCFC has been able to improve operations with the PFVI machineries which were used starting 1985.

III. PROJECT POTENTIAL

Since the PFVI and SCFC operations take place between January to May there really is unused capacity betwcen July and December. Multinational companies as well as local firms have approached NABCOR to process other fruits and vegetables during this period. Product potentials include:

1. Papaya juice
2. Banana juice
3. Guyabano
4. Calamansi
5. Guava
6. Jams and jellies

The company can also go into powdering operations with some additional investments. Or it can tap the consumer market directly by producing in smaller packages rather than its industrial 25-kilogram aseptic packaging.

The output of 1,500 MT of mango puree and 1,500 MT of tomato paste are very realistic targets for the next season. Good profits could be earned just from these two basic lines. If you add the other fruits, the corporate overhead can be spread!

IV. INVESTMENT REQUIREMENTS

The total costs of the two plants (SCFC and PFVI) including pre-operating expenses, working capital and start-up costs come up to ₱100 million.

Most offers for purchase of the two companies range between ₱50 to ₱60 million.

A working capital fund of ₱20 million should be able to run the company for one cycle.

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V. FACT SHEET

	PHILIPPINE FRUIT & VEGETABLE INDUSTRIES, INC.	SAN CARLOS FRUIT CORP.
LOCATION :	Plant Barrio Pagal San Carlos City Pangasinan Head Office/Sales 15th Floor, Producers Bank Bldg. 8737 Paseo de Roxas Makati	Same as the left column

BASIC DESCRIPTION:

Established :	March 4, 1984	December 1, 1981
Major Products :	TOMATO PASTE fresh tomatoes	MANGO PUREE, guyabano puree, papaya puree, guava puree, passion fruit juice, jams & jellies
Uses of Products :	sauce for sardines sauce for pork and beans catsup sauce for pizzas sauce for home, hotel & restaurant use	ice cream flavoring, jams & jellies, juices, confectioneries pastry fillings & flavoring

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Markets :	A. Domestic	A. Domestic
	1. sardines manufacturers	60%
	2. pork and beans manufacturers	
	3. hamburger, fried chicken & hotdog parlors, pizza and other fastfood outlets	
	4. repackers of paste and sauce	
	5. hotels and restaurants	
	B. Export	B. Export
	(not yet exporting)	40%
Major Facilities :	1. Multipurpose equipment for processing tomato paste, mango, guyabano and other fruit purees.	
	2. 3 boilers - 200 Bph, 150 Bph, 80 Bph	
	3. 3 transformers - 250 kwh.	
	4. land area - 1.8 has.	
	5. Main factory building, warehouse, powerhouse, office, staff residences.	
	Laboratory complete with refractometer, colorimeter, Ph meter Microscope and Bacto Isolation Room	
	Water storage tanks of 80,000 capacity and 15,000.	
Total Assets :	₱63.3 million	₱34 million
Total Equity :	₱16.7 million	₱2.6 million

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INVESTMENT PROFILE

AGRO-LIVESTOCK COMMERCIAL DEVELOPMENT CORPORATION

PRESENT PRODUCT LINES : Breeders and fattened swine

POTENTIAL PRODUCT LINES : Feeds

I. PROJECT BACKGROUND

Agro-Livestock Commercial Development Corporation (ALCDC) was incorporated in March 1983 with an authorized capitalization of ₱56 million and a paid up capital of ₱35 million. The project was intended to supply breeders to farmers surrounding the swine farm through a dispersal process.

Situated in the Floridablanca National Agricultural School (FNAS), the long term objective was to build up facilities to eventually enable the school to function as a Swine Institute that would provide swine breeding and raising technologies, train students for the purpose, and help rural communities upgrade their income levels through swine production.

The swine breeding and growing operations are contained in about 25 hectares of land under Usufructory Agreement between the Ministry of Human Settlements and FNAS. The Agreement allows the company to use the idle land for a period of 25 years renewable for another 25 years and permits it to develop the site including the construction of buildings and structures thereon. In exchange a lease payment is stipulated.

The farm is located in a thinly populated barrio in Floridablanca, about two kilometers away from the main road.

The buildings and structures at the site comprise of two (2) modules, each one capable of handling 500 sows and gilts and their offsprings for a total of 1000 sows. Each module is composed of a sow barn, a gestating house, a farrowing house and a nursery building. These are utilized as follows:

1. Sow barn - consists of 32 boar pens (1 boar per pen) and 20 pens for sows and gilts (7 to 8 sows and/or gilts per pen). Actual breeding is done in the sow

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barn, hence newly weaned or dry sows, replacement gilts and newly-bred (usually up to 30 days) sows and gilts are housed in the sow barn.

2. Gestating House - All bred sows and gilts which have been confirmed pregnant thirty (30) days after breeding are transferred from the sow barn to the gestating house. The building has 280 gestating stalls for individual animals. By design movement of animals in the stalls is restricted to minimize stress during pregnancy.

3 Farrowing House - a week before the expected date of delivery, pregnant sows and gilts are transferred to the farrowing house to familiarize them with the "delivery room." The animals stay in the farrowing house on the average of 28 days after giving birth within which the mother pig nurses its sucklings. The farrowing house has 120 individual farrowing stalls.

4. Nursery House - From the farrowing house, the sucklings are normally weaned from their mothers after 28 days and transferred to the nursery house. The sows on the other hand are returned to the sow barn where they undergo the dry to breeding stages. The piglets, now called weanlings, stay in the nursery house until they reach about 70 days in age. The nursery house has fifty six (56) pens and each pen can hold about fifteen (15) weanlings.

The third module in farm is the growing area comprised of identical growing buildings and two (2) testing houses. Seventy-day old weanlings from the nursery are classified as either market or breeder hogs using a strict selection criteria. Market hogs are transferred to the growing buildings where they stay until they reach the market age of 180 to 195 days depending on weight. Each growing building has thirty six (36) pens stocked at the rate of fifteen (15) growers per pen. Breeder hogs, on the other hand, are transferred to the testing houses where they are closely supervised and monitored as to the quality requirements of good breeding animals. Testing House I can accomodate sixty (60) boars and three hundred (300) gilts while Testing House II can hold four hundred twenty (420) gilts at any point in time. Gilts are grown from six to eight months in age while boars are grown from eight to ten months in age before they are marketed.

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Outside the strict quarantine area of the breeding and growing sections, the selling house and showhouse stand about a hundred meters apart. Slaughter hogs for sale are reserved in the selling house for about sixteen (16) hours without feeds. The selling house can hold two hundred (200) heads at any point in time. A representative group of hogs ready for sale as breeders, on the other hand, are displayed beyond glass windows of the showhouse. Buyers can select their breeders from the showhouse or select directly from the Testing Houses. Needless to say, buyers are required to take a bath in the Shower Room and wear company provided gowns before they are allowed to enter the Testing Houses.

Fronting the dirt road is the highly fenced Feedmill. The Feedmill was designed to prooduce the feds requirement of a 1,000 sow-level farm based on a six-hour milling and mixing operations. Adjoining the feedmill is the main warehouse also designed to accomodate ingredients and mixed feeds of the company's size of operations plus an adequate provision for buffer stocks. However, for reasons to be discussed later, the company is virtually on a hand-to-mouth basis as far as feeds production and consumption is concerned.

Other buildings and structures at the site consist of the following:

Farm Office - houses the Farm Manager, finance, administration, veterinary, production records and general services/maintenance employees.

Motor Pool - convertible garage for the ten-wheeler (20 tonner) and the six-wheeler (10 tonner) trucks; also the area for repair and carpentry works.

Bunk House - housing for farm workers; about 50% of the farm workers reside within the vicinity and about half of them stay at the bunk house.

Manager's House - for the Farm Manager and overnight visitors.

Lagoon - connected by free-flowing canals from the piggery buildings to contain water and animal waste.

Perimeter Fence - consist of concrete fence on certain areas and barbed wires connected to poles in other areas.

The original breeding stocks of the company arrived at the farm in August 1983. The breeers were imported from various parts of the United States and were transported to the country via chartered airplane. Each gilt has an invoice value of US$277 while each boar cost US$377. The composition of the company's original breeding stocks as compared to the present herd composition folows:

	Original		Present	
Breed	Boars	Gilts	Boars	Sows & Gilts
Yorkshire	45	850	6	636
Duroc	10	120	15	156
Landrace	6	20	40	106
Hampshire	4	10	1	6
Landrace/ Yorkshire (LY)	-	-	-	-
	65	1000	62	1000

Characteristically, the company's breeders are categorized under the classical pure breeds possessing the following qualities:

Yorkshire - a female line breed that farrow and raise large litters hence considered the "Mother Breed." Yorkshires are white and large-framed.

Duroc - a male line breed, red in color with shades ranging from light to dark, rugged and highly resistant to stress, possesses superior growth rate and feed efficiency and very competitive with crossbreeds in rate and economy of weight gain.

Landrace - traditionally a female line whose boars are also agressive, white-colored and long-bodied, prolific and possesses good mothering abilities, sows farrow litters with highest birth and weaning weights.

Hampshire - a male line considered the "leanest of all breeds", black-colored with a noticeable white belt that runs across its shoulder and extends to the forelegs, possesses excellent loin eye.

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As of July 31, the following schedule reflects the breeding program which the company practices.

	TOTAL	YY	DD	LL	HH	LY	DLY
Bred Sows/Gilts	732	86	109	70	2	395	70
Nursing Sows/Gilts	135	19	24	17	2	71	2
Dry Sows/Open Gilts	103	23	18	12	1	40	9
Replacements	30	2	5	7	1	-	15
	1000	130	156	106	6	506	96

Noticeably, the company is engaged in pure-breeding (YY, DD, LL, HH), two-way cross-breeding (LY) and three-way (DLY) cross-breeding. The pure-breeding activity (36%) is inteded for the production of replacement stocks and purebreeds for sale as breeders. The two-way cross-breeding (54%) is for the procreation of a commercial breed, a mother stock which when crossed with a male line boar produces good quality market hogs, both as replacement and female for sale. The three-way cross-breeding (10%) is a showcase of the economic advantages of using the company's breeders in a commercial fattening operation. Hogs produced in this manner are more in number per farrowing (higher litter size), possess better by hybrid vigor (less mortality rate) and ideal weight gain on less feeds.

II. PROJECT PERFORMANCE

The productin performance of the swine breeding and growing operations since 1984 can generally be stated as far below its potential. The 1984 performance, however, can be judged as average considering the attendant task of balancing the factor of production at that time. The year 1985, though, saw a significant drop in almost all important indices of production. Farrowing index which measures the number of times each sow give birth in a year plunged to 1.87 times in 1985 compared to 2.01 in 1984 and the target of 2.1 for the year. Farrowing rate ratio of animals that farrowed compared to animals bred also dropped significantly from 74% in 1984 to 63% in 1985. Litter-size per farrowing was low at 8.14 piglets and was further compounded by a very high 40% mortality rate for birth to market. These, among other indices, reflect the effects of the disease related to

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the animals' reproduction capability that hit the farm during the year, poor traffic of animals resulting to congestion and a host of other factors.

In 1986, the operations started slightly better than that of 1984 but significant improvements have yet to be attained especially in the areas of mortality, farrowing rate and litter-size. A summary of the production performance of company from January 1984 to June 1986 is shown in Annex 1.

As conceived ALCDC is supposed to operate on a level of 1000 sows and gilts at any point in time. This translates into about 7,000 to 8,000 offsprings at any given time notwithstanding the limited growing capacity which was originally planned for expansion by the middle of 1985. Hence, the feedmill and the warehouses were constructed to support the operations at such levels.

As actual operations unfolded, however, the company was forced to a hand-to-mouth existence as far as feeds production and consumption is concerned despite the low production level in the piggery. The heavy losses placed too much strain in the company's liquidity position drastically reducing ingredients and mixed feeds level from a month's requirement in 1984 to a one week equivalent during most part of 1985 and 1986. Downtime due to machine breakdowns and power interruptions especially during wet seasons led to instances when custom mixed feeds had to be purchased. Worst there were a few occassions when certain animals had to feed on mere rice bean and molasses for a day or two instead of the regular ration. Finally, the poorly attended breakdowns of the feedmill drastically reduced attained capacity to a level that is slightly higher than feed consumption level thus dampening efforts to achieve buffer mixed feed stocks even when ingredients are available.

The company had a total deficit in its retained earnings of ₱7.7 million as of June, 1986. ALCDC reported that their 1987 operations are doing very well and they expect profits for the current operating year.

III. PROJECT POTENTIAL

The company seems to be at the turnaround stage and can be a profitable venture. An aggressive breeding and dispersal program can up sales along with the establishment or leasing of grow-out facilities outside of the farm itself but in nearby localities. This would expand the revenue generating potential of the firm.

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The feedmiling section can be centralized and produce the company's full requirements especially if a tie-up is made with the Agri-Operations of Philippine Fruits and Vegetables Industries (its sister company in NABCOR). For example corn and sweet potato can be grown to take care of everyday requirements.

IV. INVESTMENT REQUIREMENTS

Since the project is under a Usufruct Agreement then a buy-out of the physical facilities (land and buildings) is not possible. However an operating lease agreement can be worked out. Presently the company is operating on a thin working capital of ₱10 million, which if inreased to ₱20 million could instantly raise revenues and profits.

V. FACT SHEET

AGRO-LIVESTOCK COMMERCIAL DEVELOPMENT CORPORATION

LOCATION	:	Floridablanca, Pampanga
BASIC DESCRIPTION	:	
Year Established	:	1983
Terms of Usufruct	:	Fifty (50) years
Major Products	:	Purebred boars and cross-bred gilts (Landrace, Yorkshire, Duroc and Hampshire) for sale as swine breeders; the balance after selection are sold as market hogs; ALCDC also offers management and technical services in the areas of feed formulation, herd health management, veterinary and extension services.
Markets	:	swine breeders and raisers; market traders for fattened hogs, local meat processors.
Major Facilities	:	2 sow barns 2 gestating buildings 2 farrowing houses 2 nursery houses 4 growing houses 2 breeder testing houses 1 show house 1 feed mill (9 tons/day) 1 unit 187-KVA genset 2 office buildings 3 staff houses
Total Assets	:	[illegible] million

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ANNEX I

AGRO-LIVESTOCK COMMERCIAL DEVELOPMENT CORPORATION

SUMMARY OF PRODUCTION PERFORMANCE
JANUARY 1984 TO JUNE 1986

	1984	1985	1986	TOTAL
I. POPULATION				
Boars*	62	65	60	65
Productive Sows and Gilts*	880	981	920	950
Replacement Gilts	52	27	33	50
Total Piglets Born	13487	15077	7204	17556
Total Progeny Mortality	2517	6043	2154	2633
Total Hogs Sold				
Breeders	146	1269	216	1440
Market Hogs	4978	8328	3846	12335
II. BREEDING				
Total Gilts/Sows Bred	2085	2915	1366	2660
Average Weaning to Breeding Days	22	31	29	21
Conception Rate at 30 days	87	87	85	90
114 days	83	81	84	87
Total Abotion/Premature	N/A	162	49	48
III. FARROWING				
Total Sows/Gilts Farrowed	1543	1851	904	1995
Farrowing Index	2.01	1.87	1.97	2.10
Farrowing Rate	74	63	66	75
Total Piglets Born	14547	16723	8013	18180
Average Litter-Size (Live)	8.74	8.14	7.97	8.80
Stillbirth, Mummified, Abnormal	1060	1606	809	924
Total Piglets Born Alive	13487	15117	7204	17556
IV. WEANING				
Total Sows Weaned	1367	1613	867	1890
Average Lactating Days	29	29	28	28
Total Piglets Weaned	10664	11886	6322	15975
Average Piglets Weaned/Sow	7.80	7.28	7.29	8.01
Average Weaning Weight (kgs.)	5.81	5.80	6.14	6.10
Average Weaning Age	29	30	28	28
V. MORTALITY				
Pre-weaning Mortality Rate	14	22	16	9
Post-weaning Mortality Rate	5	18	14	6

*Average

INVESTMENT PROFILE

ZNAC RUBBER ESTATE CORPORATION

PRESENT PRODUCT LINES : Latex, cuplumps and coagula

POTENTIAL PRODUCT LINES : Rubber blocks

I. PROJECT BACKGROUND

The project is the outcome of a fifty-year Usufruct Agreement entered into by the Ministry of Human Settlements, the Ministry of Education and the Technology Resource Center. The Zamboanga del Norte Agricultural College (ZNAC) was one of the first seven sites the BLISS II (Agribusiness for Livelihood) Program of MHS instituted. The area falls under the declared and tested rubber belt of Mindanao.

The project is sited within the municipality of Tampilisan, Zamboanga del Norte, which is 187 kilometers from Dipolog City and 180 kilometers from Zamboanga City.

As originally conceived the project was supposed to have three separate components, namely:

1. An "anchor" plantation of 1,000 hectares;
2. The surrounding smallholder rubber areas; and
3. A processing unit with motorpool which shall be responsible for latex, coagula and cuplump collection and the infrastructure network of roads.

The "anchor" plantation is supposed to be situated on 1,000 hectares of contiguous hilly to undulating land from ZNAC which shall act as the nucleus estate for encouraging improved cultivation of rubber in surrounding areas and the dissemination of rubber tree growing, tapping and processing technology.

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II. PROJECT PERFORMANCE

A total of 305 hectare have already been planted within the anchor's estate plantation, 100 hectares each in 1979, 1980 and 1981, all with the use of bare root budded stumps. Another 5 hectares were developed in 1982 with the use of polybag planting technique which is intended to be used for the project's expansion to 1000 hectares for introduction to outcroppers. Polybag rubber is bare-root budded stump planted in plastic bag where it is allowed to grow in a nursery until ready for field planting.

High mortality rates were experienced on the 300 hectares already planted due to the use of bare root planting. The nine-month drought experienced in 1983 together with the "invasion" of cogon and hagonoy (tall grass or weeds) which competed heavily with the seedlings for soil nutrients aggravated the problem. The absence of an internal road access to the project continues to remain a deterrent.

Cogon grass has already been brought under control with the application of glyonosphate while the condition of the trees is expected to improve through proper nutrition by means of fertilizer applications and better maintenance. The 300 hectares require substantial rehabilitation. Because of this the rubber tapping schedule has been delayed.

III. PROJECT POTENTIAL

The rubber trees are due for tapping. There is a potential to plant 700 hectares in ZNAC. In 1984, a study was made on the ZNAC project and it was deemed feasible to plant the remaining 700 hectares and put up three dryers of 750 pounds per hour capacity. The demand for block rubber from tire and other manufacturers has been growing and the study expected the trend to continue. The project intends to produce block rubbers (SPR 5 and SPR 30) equivalent in quality to internationally accepted standards. A good portion of the sales is targetted for the export market.

IV. INVESTMENT REQUIREMENT

In terms of 1984 Pesos the company estimated the project cost to total ₱36 million to complete the project. Presently the company has total assets of ₱7.7 million funded by equity.

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V. FACT SHEET

ZNAC RUBBER ESTATE CORPORATION

LOCATION	:	Zamboanga del Norte Agricultural College Reservation Tampilisan, Zamboanga del Norte

BASIC DESCRIPTION

Year Established	:	1979-1982
Established Area	:	305 hectare rubber plantation
Term of Usufruct	:	Fifty (50) years from 1979
Rubber Clones Used	:	RRIM-600 (80%); GT-1 (20%)
Major Products	:	Coagula and Cuplumps
Uses of Products	:	delicate hospital equipment balls vehicular tires industrial equipment tennis courts commercial rubber bands drive course of roads of some industrialized countries
Markets	:	Domestic rubber companies operating within the 20 km. radius of the plantation; traders in raw rubber Export (not yet exporting)
Major Facilities	:	office/staffhouse 305 hectares planted to rubber 695 available under usufruct agreement for expansion
Total Assets	:	₱7.764 million
Total Equity	:	₱7.671 million

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INVESTMENT PROFILE

INCA COFFEE ESTATE CORPORATION

PRESENT PRODUCT LINE : Coffee beans

POTENTIAL PRODUCT LINE : Processed coffee beans

I. PROJECT BACKGROUND

The project was initiated by the BLISS II Program (Agribusiness for Livelihood) of the Ministry of Human Settlements. It sought the establishment of a nucleus estate of coffee trees in the Iloilo National College of Agriculture (INCA) in Lambunao, Iloilo and the tapping of surrounding coffee plantations to supply the needs of a coffee processing plant for the local and export markets. The plan called for the production of 330 MT of coffee beans from the nucleus estate, 300 MT from an outcroppers association and 88 MT from other resources. the project hoped to produce 10% Grade I green beans, 40% Grade 2 and 30% Grade 3.

The project was started in 1979. Some 110 hectares with over 100,000 trees were cultivated. It was envisioned to serve as the technology output for coffee growing and processing in Iloilo. The design included the full participation of small coffee planters surrounding the agricultural school.

II. PROJECT PERFORMANCE

There is no significant output yet from the plantation. The company planted 150,000 trees but only 104,000 survived. The initial planting produced stunted trees because shade trees were not used. However, subsequent plantings yielded better results with ipil-ipil trees as shade trees.

III. PROJECT POTENTIAL

The plantation is about ready for the commercial production of coffee beans. Some limited harvesting has been done.

The trees have to be rehabilitated to achieve their full potentials. At full production sales of ₱10 million a year are expected if the total project concept is carried out.

IV. INVESTMENT REQUIREMENTS

The company estimated a total cost of ₱14.5 million to complete the project broken down as follows:

Existing plantation/assets	₱6.6 million
Equity outlays outlays and pre-operating expenses	3.2
Working capital	
- Plantation	1.6
- Procurement	1.6
- Operating Expenses	1.5
	₱14.5 million

V. FACT SHEET

INCA COFFEE ESTATE CORPORATION

LOCATION	:	Iloilo National College of Agriculture (INCA) Reservation (now part of West Visayas State University Lambunao, Iloilo

BASIC DESCRIPTION

Year Established	:	1979-1984
Area Established	:	110 has.
Terms of Usufruct	:	Fifty (50) years for 1000 has.
Tree population	:	150,261 trees
Variety planted	:	White Plus Robusta
Major Products	:	Green Coffee
Uses of Products	:	Beverages/Flavoring
Markets	:	Domestic and export a. Domestic - local traders/ buyers/exporters b. Export - coffee importing countries of ICO
Major Facilities	:	Office/Administrative Bldg., Staffhouse, drying pavement, storage shed
Total Assets	:	₱6.709 M
Total Equity	:	₱6.656 M

INVESTMENT PROFILE

DAVAO EQUIPMENT MANUFACTURING CORPORATION

PRESENT PRODUCT LINES	:	Job Orders on Industrial casted, fabricated and mechanized products
POTENTIAL PRODUCT LINES	:	Agricultural, irrigation, mining, logging and industrial machines, parts, implements, equipment, etc.

I. PROJECT BACKGROUND

The Davao Equipment Manufacturing Corporation (DEMCOR), a foundry and metalworking company was purchased by the Human Settlements Development Corporation (HSDC) in 1983 from the Private Development Corporation of the Philippines (PDCP) which had foreclosed on the company. HSDC paid ₱4.5 million for DEMCOR. The company was in turn leased by HSDC to the Processing Center Authority (PCA, another government corporation) for ₱1.22 million per annum for a period of six years with an option to purchase. PCA wanted to tap the market potentials for agricultural machineries, equipment and implements in the agriculturally-bustling island of Mindanao located in the southern portion of the Philippines. Unfortunately, PCA entered the field at a very unopportuned time. The Philippine economy including the promising agricultural sector, suffered its worst recession years after World War II. The market collapsed heavily for capital and durable goods. PCA's investment with a metal scrap-recycling venture to augment DEMCOR operations sapped the company's resources further because of that venture's failure. To sustain operations, DEMCOR resorted to servicing irregular job orders and took on industrial casted, fabricated and mechanized products.

II. PROJECT PERFORMANCE

DEMCOR's sales performance was dismal, covering only ₱166,000 per month in 1984 and 1985. Plant capacity utilization fell below 15%. A negligible gross profit margin of 6% hardly covered the huge operating and administrative expenses, disabling PCA from meeting its lease obligations with HSDC.

III. PROJECT POTENTIAL

When HSDC bought the assets from PDCP the assets were hardly used and most were still brand new. The property is sitting on prime land in Davao City. It has the capability to produce metal products of good quality since it has precision machines and equipment.

The CA made some preliminary studies in 1986 and forecast the financial performance of DEMCOR for 1987 to 1990. The projections were premised on the recovery of the national economy, particularly the agricultural sector. There were signs that the government's program to invest heavily in countryside development would boost the rural areas.

<u>In Million Pesos</u>

	1987	1988	1989	1990
Net sales	8.5	9.2	10.0	10.9
Less: Cost of Production	4.5	4.9	5.3	8.7
Gross Profit	4.0	4.3	4.7	5.2
Less: Admin & Mktg. Exp.	1.8	2.1	2.4	2.8
Net Income Before interest and taxes	2.2	2.2	2.3	2.4

IV. INVESTMENT REQUIREMENTS

To acquire DEMCOR, a possible offer of ₱5 million might be sufficient to [illegible] all the assets. HSDC would have to reclaim the company from PCA. Another ₱3 to ₱4 million would be needed for working capital purposes.

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V. FACT SHEET

DAVAO EQUIPMENT MANUFACTURING CORPORATION

LOCATION : Davao City

BASIC DESCRIPTION:

Year Established	: 1983
Major Products	: Metal products
Uses	: Agricultural, irrigation, mining, industrial, logging other usages
Markets	: Government agencies, private companies, farmers
Major Facilities	: Foundry and metalworking machineries and equipment
Total Assets	: ₱5.1 million (HSDC)
Total Investment	: ₱5.8 million (HSDC excluding PCA)

INVESTMENT PROFILE

KIDDIE SHOES CORPORATION

PRESENT PRODUCT LINES : Children's shoes

POTENTIAL PRODUCT LINES : All types of Footwear

I. PROJECT BACKGROUND

The company was primarily established to manufacture and market different types of children's shoes made of various materials. It started operations in July 1982. Initial marketing efforts of the project have been concentrated on establishing a strong domestic base. The ultimate objective is to export 70% of the produce and 30% for the domestic market.

Kiddie shoes is owned by private stockholders who put in ₱5 million, with preferred stock from the Human Settlements Development Corporation amounting to ₱700,000 and ₱900,000 from private individuals and a long term loan from the Technology Resource Center of ₱7 million.

The firm is utilizing Italian technology and equipment to produce shoes with automatically designed insole (arch-formed) which is considered an important facet of a properly designed children's shoes.

II. PROJECT PERFORMANCE

The company reported sales of ₱0.8 million for nine months ended March 31, 1983. This climbed to ₱1.6 million for the next fiscal year. By 1986 sales reached ₱7.6 million but declined in 1987 to ₱4.5 due to extreme working capital difficulties.

As of July 1987 Kiddie Shoes had total assets of ₱18.7 million. The company showed liabilities of ₱21 million and a stockholders' deficit of ₱2.3 million.

Sales went mostly to the domestic market. However, the company has been sending samples of shoe products to the European markets (because it produces French sizes).

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III. PROJECT POTENTIAL

The company has modern shoe-making equipment housed in a modern factory. A lot of machines is given in Annex I.

The company has suffered from lack of financial resources and this has prevented realization of sales potentials. An investor with good export market contacts can easily turn the Company around. The Company believes it can sell a potential of ₱2 million a month or ₱24 million per annum. Given the company's dire financial straits a good price may be gotten for the acquisition of assets or shares.

IV. INVESTMENT REQUIREMENTS

Kiddie Shoes stockholders are willing to sell out to recoup their investment of ₱5 million while HSDC and TRC would like to at least recover principal and accumulated dividends or interest. This would be in the vicinity of ₱10 million for TRC and ₱1 million for HSDC. Working capital requirements would be about ₱5 million if sales of half the capacity is attained.

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V. FACT SHEET

KIDDIE SHOES CORPORATION

LOCATION	:	People's Technology Complex Carmona, Cavite

BASIC DESCRIPTION

Year Established	:	1982
Major Products	:	Children's shoes
Markets	:	Mainly local but with large export potential
Major Facilities	:	Land Building Machines and equipment (See Annex I)
Total Assets	:	₱18.7 million
Total Equity	:	(₱2.3 million deficit)
Contact Person	:	Luis M. Hernandez Chairman of the Board Kiddie Shoes

ANNEX I

KIDDIE SHOES CORPORATION

SCHEDULE OF PRODUCTION EQUIPMENT AND MACHINERIES

CUTTING

MACHINE	BRAND	MODEL
Swing Beam Clicking Press	SITPA	23 tons
Swing Beam Clicking Press	SITPA	14-16 tons
Swing Beam Clicking Press	SITPA	23 tons
Swing Beam Clicking Press	SITPA	14-16 tons
Straps Cutting Machine		

PREPARATION

Automatic Upper Perforating Machine	ORMAC	
Upper Leather Skiving Machine	ELLEGI	CLRC
Uper Splitting Machine	OMSA	
Lining Numbering Machine	OMO	481/8
Straps Folding Machine		1035
Hydraulic Insole Moulding Machine	BANF	1078 P
Upper Thermoplasltic Cement Folding Machine	ELEGI	15 R
Upper Leather Skiving Machine	ELEGI	
Leather Sole Skiving Machine	ELEGI	
Perforating Machine	TECHNOSHOE	

SEWING

Automatic Eyelet Applying Machine	SPS	
ZIGZAG S.M.	ALFA	102-503
ZIGZAG S.M.	ALFA	102-503
S.N.F.B. Sewing Machine	ADLER	196
S.N.F.B. Sewing Machine	ADLER	67-62-T
S.N.F.B. Sewing Machine	ADLER	96-142
S.N.F.B. Sewing Machine	ADLER	67-8063-T
Single Needle Post Type Sewing Machine	ADLER	68-52-L/04
Single Needle Post Type Sewing Machine	ADLER	68-52 S/04
Moccassin Braiding Machine	ADLER	166-1
SNFB Sewing Machine	ALFA	175/679
SNFB Sewing Machine	ALFA	175/679
SNFB Sewing Machine	ALFA	175/679
SNFB Sewing Machine	PFAFF	141 VRGO LMH
DNFB Sewing Machine	PFAFF	142 VR 82 B
DNFB Sewing Machine	PFAFF	142-113B/S
DNFB Sewing Machine	PFAFF	242-6/01-BL
SNFB Sewing Machine	PFAFF	134-6
Binding Machine	PFAFF	3335-958/01
bartacker		

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	BRAND	MODEL
R & D		
Hand Pattern Shears		100
Pattern Grading and Cutting Machine	OVIC LINCE	
Single Needle Flat Bed Sewing Machine	ALFA .	175/679
Holes Making Device		
ASSEMBLY		
Toe Puff Activating & Upper Moistening Machine	RECES	
Toe Part Pulling Over & Lasting Machine	CERIM	K 78
Flash Type Cement Reactivating Machine	ELECTRO-TECHNICA	133
Heel Seat Lasting Machine	BRUSTIA	
Lasting Conveyor	ROMANO	225 meters
Air Compressor	TOSHIBA	60 Gallons
Scouring Machine	CAP	27029
Air Compressor	FUJI	SHP/111 LTRS
Lasting Conveyor	ROMANO	27 METERS
Counter Moulding Machine	ZEUS	Single Statn
Heel Seat Moulding Machine	ZEUS	2 Station
Hydraulic Sole Press	BANF	PV 2
Pounding Up Machine	ZIGMA	78 AMG
Sole Attaching Press	GINEV	
Sole Attaching Press	GINEV	
Universal Roughing Machine	HESPERIA	
Thermocement Toe Puff Forming & Applying machine	SIGMA	N 177
Toplift Mailing machine		
Reactivating Oven	EMC	Loc Fabrictd
Heat Setter	ELECTRO-TECNICA	127
Humidifier For Toe Puff	SIGMA	
STANDBY UNITS		
Toe Lasting Machine, Hand Operated	RICAV	
Heel Attaching Machine		66 AST
Belt Cementing Machine	FV	D 38
Heel Scouring and/or Lasted Botom Roughing Machine		
Mechanical Brand Stamping Machine	OMO	481
Mechanical Box Marking Machine	OMO	481 C
Manual Cement Heel Seat Lasting Machine	RICAV	
Overlocking machine	RIMOLDI	
Single Side Pasting Machine		TS805
Roller Type Laminating Pressing Machine		
Strap Cementing Machine	TECHNOSHOE	d 37

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	BRAND	MODEL
Loose Upper Roughing Machine	CAP	
Taping & Reinforcing Machine	CIUCANI	
Sewing Machine/Post Type	ADLER	67511
Genset	GM DETROIT	135 KW
Reactivating Tunnel		

INJECTION DEPARTMENT

Injection Machine	LORENZIN	SP/45 TRIPLEX
Air Compressor	CURTIS	40 Gallons
Refregmation Unit	LORENZIN	RF 9

International Science and Technology Institute, Inc.

Headquarters: 1129 20th Street, N.W., Washington, D.C. 20036
202/785-0831 • Telex: 272785 ISTI UR • FAX: 202/223-3865

COMPARING AND CONTRASTING LAAD, BVP AND PAIICO

(a/o July 20, 1987)

U.S. and Overseas Offices

Arlington, Virginia • Lewes, Delaware • Dakar, Senegal • Colombo, Sri Lanka • Rabat, Morocco • Cairo, Egypt

Comparing and Contrasting LAAD, BVP and PAIICO

(a/o July 20, 1987)

Business Purpose

Latin American Agribusiness Development Corporation ("LAAD") since 1977 makes short and long term loans to privately owned and operated agribusiness enterprises, particularly (but not necessarily) those involved in non-traditional exports. In its area of operation, it is regarded as a pioneer in the provision of long term loans to producers of non-traditional exports. LAAD relies primarily on interest-differential income for its livelihood.

Business Venture Promotion ("BVP") takes equity positions in newly organized, non-traditional exporters. Those positions, eventually, are to be liquidated in the very buoyant Bangkok Stock Exchange at multiples of between 10 and 20 times earnings. BVP was organized around the end of the first quarter of 1987. It has yet to book its first deal, although six or seven equity placements are pending. BVP is a venture capital company relying primarily on large capital gains for its profits.

Philippine Agribusiness and Industrial Investment Corporation ("PAIICO"), once organized, will place equity with third parties in return for fees or, itself, take short term equity positions ("bridge" investments) and longer term equity positions ("direct" investments) in industrial and agribusiness projects which have significant capital gains possibilities. Some of these positions will be liquified through private placements; others, through public placements. PAIICO is an investment bank or financial services company, relying more on fees than capital gains for its livelihood.

Structure

LAAD is located in Coral Gables, Florida. It has three operating subsidiaries in South America, Caribbean and Central America respectively. Another subsidiary, a marketing company is located in Coral Gables. The latter firm, for a fee, identifies export markets for firms located throughout the hemisphere. AID generates around 3-4% p.a. from its loans to LAAD.

BVP, with an initial capitalization of $6,000,000 (50% derived in the form of equity from six Thai banks, 50% in the form of an income note from AID--does not have any operating subsidiaries. The terms of the income note are such as to permit AID to make around 20% p.a. on its investment assuming optimal conditions related to subproject selection, entry and exit positions.

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Considerable pre-organizational work was done to select suitable Subprojects.

PAIICO, without operating subsidiaries, will have an initial capitalization of around $15,000,000--one-third of which would be provided by private investors. Although the donors (AID and ADB) are providing the balance two-thirds risk capital, they will be entitled to a more generous share of the profits than is the case with the BVP structure described in the previous paragraph. Essentially the rewards of the donors are equivalent to those of the private equity holders. Thus, returns of around 20-40% p.a. are feasibly for AID. As was the case with LAAD, little pre-organizational work will be dedicated to Subproject evaluation and selection.

Capitalization

AID has provided each of the LAAD operating companies with many millions of dollars of loans at highly concessional interest rates of 3 and 4% p.a. Normal conditionality of AID financing requires LAAD to contract for "counterpart" financing from international commercial lenders, for example $1 for every $3 received from AID.

Notiwthstanding, a new AID policy for providing assistance to the LDC financial intermediaries was issued in 1985. It states that below-market interest rates attached to AID loans, such as those provided by AID to LAAD, constitute the equivalent of a grant to the owners of LAAD (defined as the difference between the concessional rate of interest and the marginal cost of funds to the U.S. Treasury for similar maturities). It appears that such grants are to be avoided although it is not known whether AID will continue to rationalize in some way its loans to LAAD.

As indicated previously, BVP capitalization is approximately $6,000,000, 50% of which is provided by AID through an income note. Since BVP is owned by six Thai banks, its capitalization can easily be increased to accomodate new Subprojects. It should be pointed out that AID, however, will likely not participate in new increases of capital through issuance of new income notes. The International Finance Corporation ("IFC"), however, has indicated great interest in taking AID's place in a subsequent second round, when and if that occurs.

PAIICO's capitalization will be done through normal equity infusions and convertible preferreds purchased by donor agencies. Private equity holders have not yet been identified, but are likely to emanate from one, or more, of the following groups:

--one of the larger Philippine banks;
--private family groups, particularly Chinese;
--foreign holders of sovereign debt wishing to convert

that obligation into an equity holding in the new PAIICO.

PAIICO will be organized before the end of the first quarter, 1988.

Staffing

Each of the LAAD operating subsidiaries has a staff of around four professionals and one or two secretaries. Overall, LAAD appears to have around fifteen official and five to ten non-official staff.

BVP's staffing is one permanent Managing Director, two secretaries, assisted by seven members of the Board of Directors. Emphasis during pre-organizational period on eight Subproject selections and evaluations permitted small staffing during first one to two years.

PAIICO will consist of around 40 official and non-official staff at inception.

Market

Generally, LAAD in contrast to BVP or PAIICO, is not a project developer. It depends on third parties to solicit loans.

LAAD lends to enerprises that might not otherwise be able to borrow from commercial sources. By one estimate, 90% of all loans made by LAAD are rescheduled, indicating the high degree of risk involved in their target market.

BVP takes equity positions in start-up enterprises that export non-traditional exports. BVP is very involved in project development--this is its reason for being. It identifies glitches in the Thai economy and designs Subprojects that meet the needs. It recruits foreign techologies and first rate local operating partners into a subproject that commercially addresses the glitch.

BVP will not make an equity investment in a Subproject unless a first rate local operating company is also involved in the ownership. Although BVP is a "project developer," it seeks confirmation from quality local firms that its judgment is sound. Using this methodology, chances for mistakes are reduced considerably. Because of its shareholders, BVP is able to get large Thai operating firms to participate in the evaluation of its business concepts.

PAIICO places or takes equity positions in turn around situations involving distressed industries. Nature of the market requires heavy involvement in project development work. This makes PAIICO similar to BVP and dissimilar to LAAD. If PAIICO is ultimately owned by a bank, similarities to BVP will be more pronounced.

Modus Operandi

LAAD does not involve itself in project development work i.e., it is not catalytic. It is dependent on third parties to approach it for loans. It tends to search out customers that cannot borrow from other commercial sources. Its development impact arises from its ability to provide long term funds to such customers. Specific results focus on foreign exchange generation, job creation and impact on rural incomes.

BVP first identifies products that enjoy demand in international projects, selects a technology for producing or processing that product, preliminarily evaluates results, selects a large, local operating company whose mainline business is synergistic with that being proposed, awaits the decision by the local operating company to participate, etc. The methodology is very much in line with the capabilities and attributes brought to the party by the shareholder banks. Specific results will focus on new enterprises created that solve particular problems, measured by foreign exchange generation, job creation and impact on rural incomes.

PAIICO, it is expected, will apply the same basic methodology with emphasis on markets first, quality participants subsequently. Specific results are likely to focus on number of distressed industries turned around, foreign exchange generated in the process, jobs preserved and impact on rural incomes.

MANILA STOCK EXCHANGE
MONTHLY REVIEW

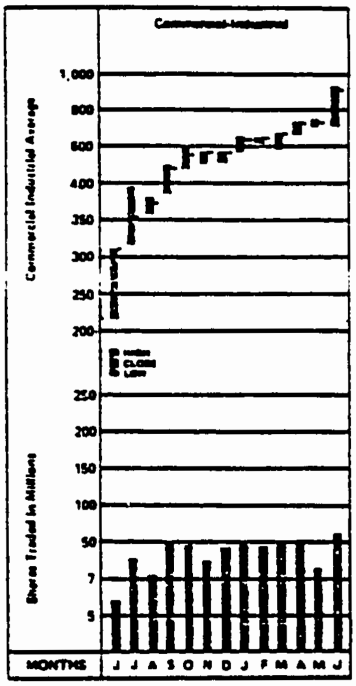
ANNEX M5

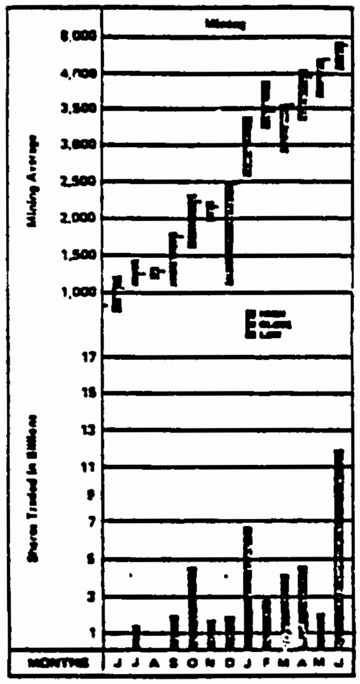
PUBLISHED BY THE MSE RESEARCH & PUBLICATIONS DEPT., TEL. 40-88-67; 40-87-74

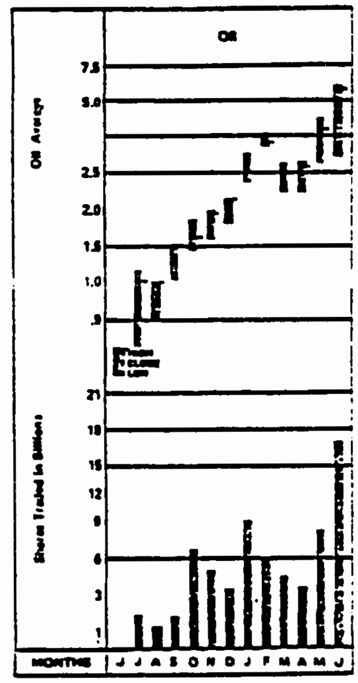
VOL. 39 NO. 6

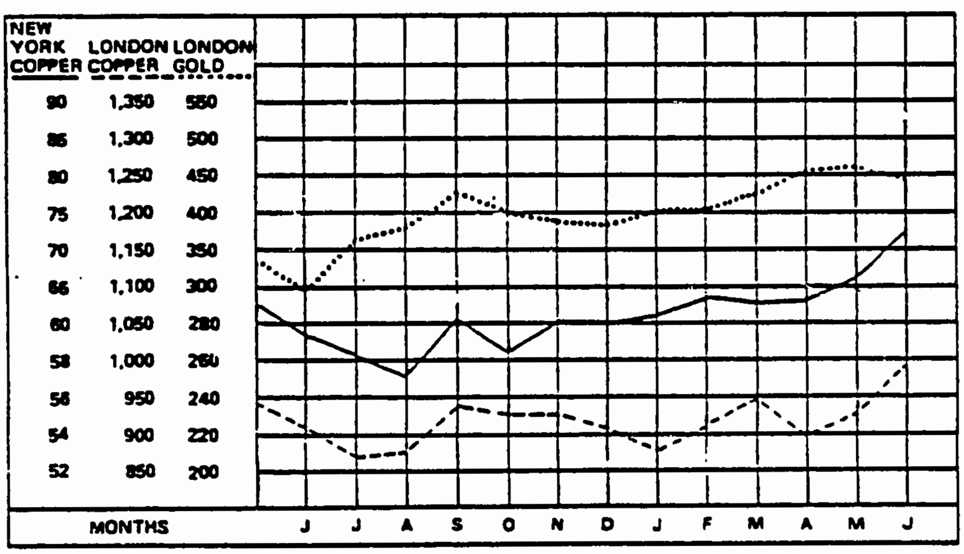
MANILA STOCK EXCHANGE BLDG.
PRENSA ST., COR. MUELLE DE LA INDUSTRIA
BINONDO, MANILA

JUNE 1987









AVERAGES FOR JUNE 1987

PARTICULARS	OPEN	HIGH	LOW	CLOSE	VOLUME	VALUE
COMMERCIAL-INDUSTRIAL . . .	710.70	937.08	710.70	931.15	59,831,125	P 783,713,974.00
MINING	4,393.67	7,267.22	4,373.15	7,054.38	12,098,561,162	911,622,681.48
OIL	3.272	5.989	3.254	5.811	16,829,815,000	556,986,395.00
OVERALL COMPOSITE INDEX . .	613.59	950.37	613.59	930.50		
GRAND TOTAL					28,988,207,287	P2,252,323,050.48

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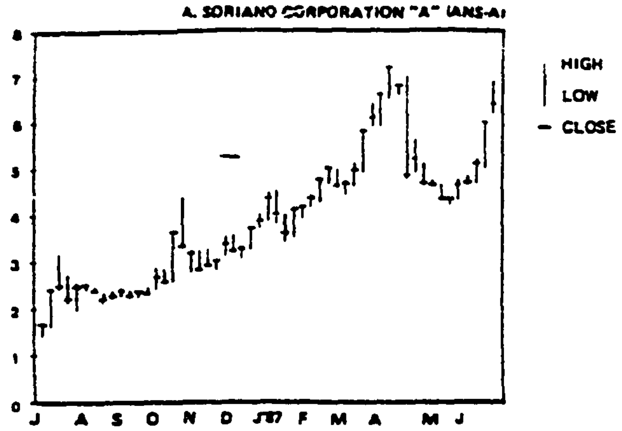
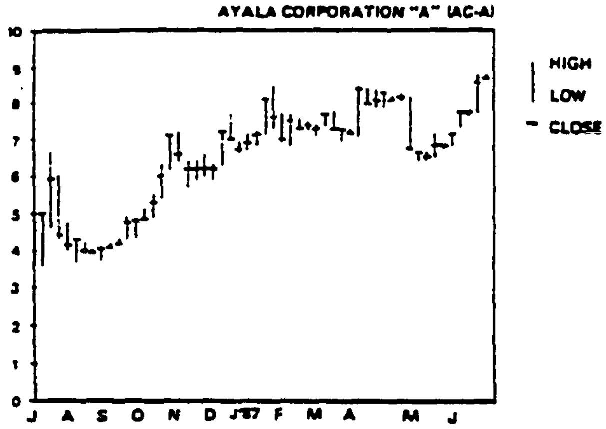
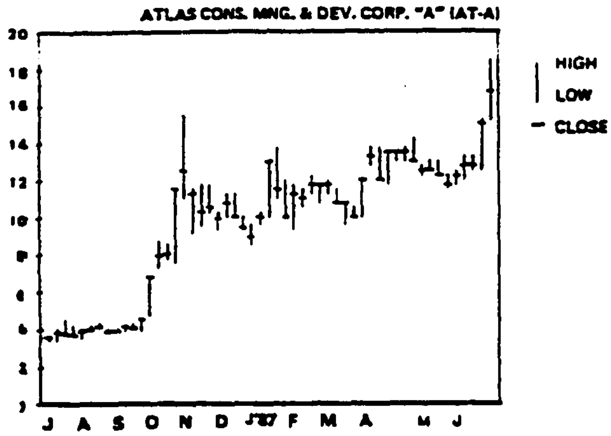
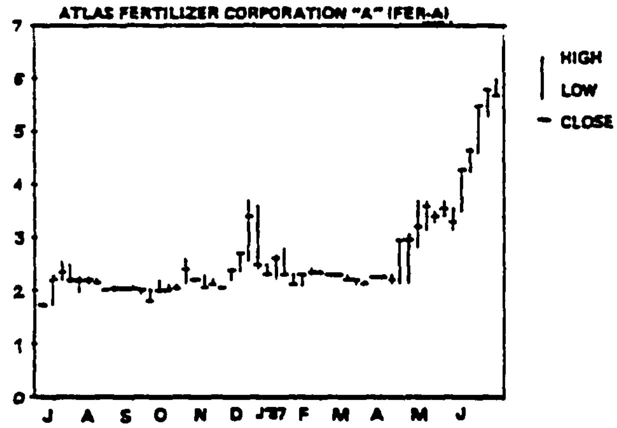
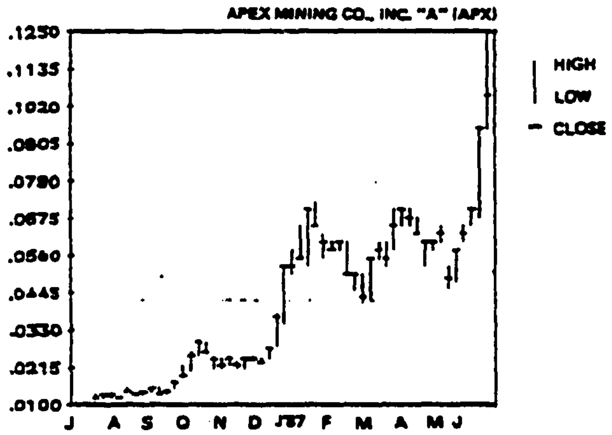
Market Price Action Charts of Selected Issues

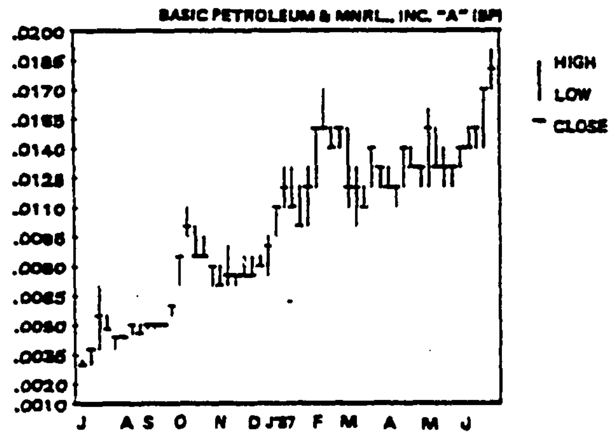


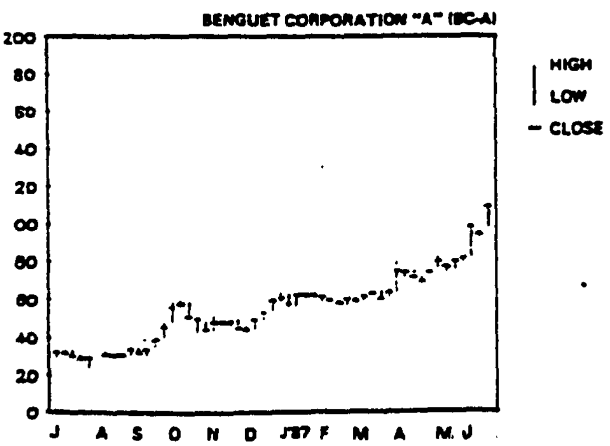


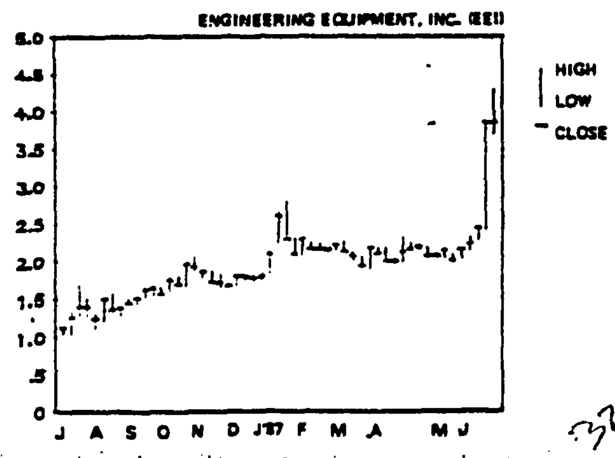


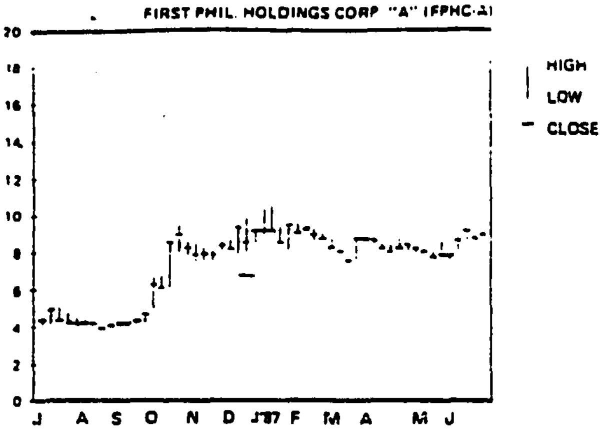


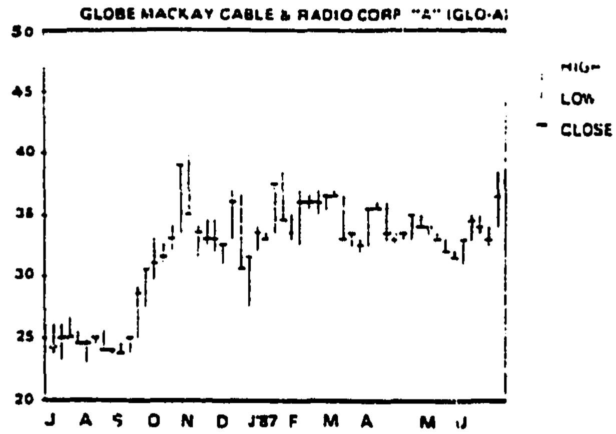


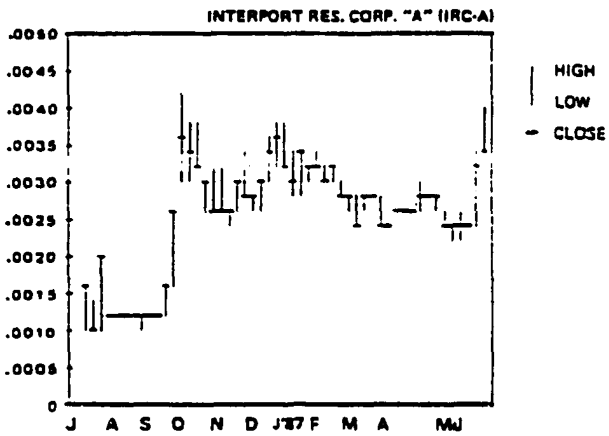


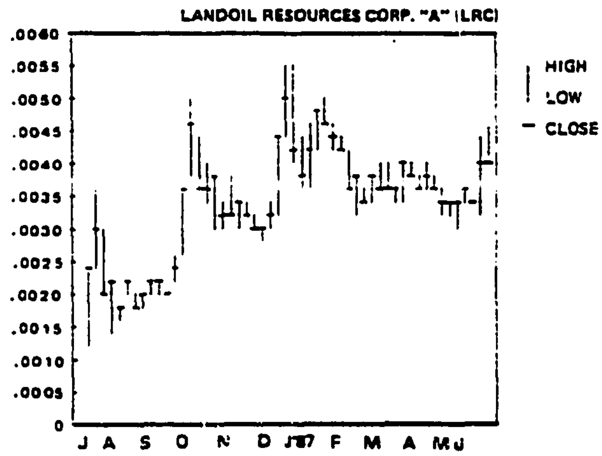


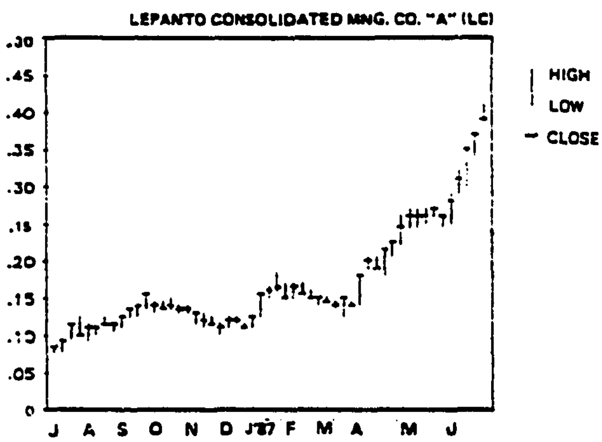


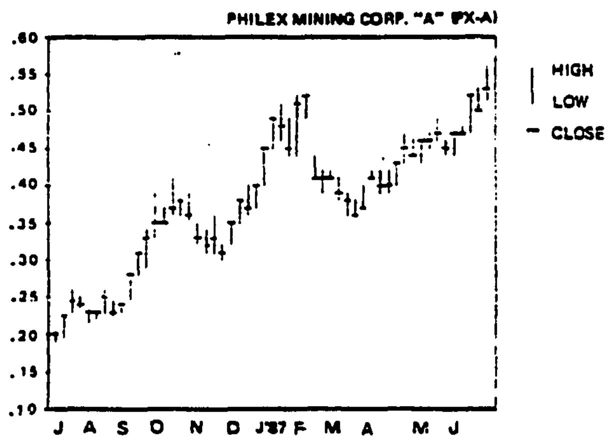


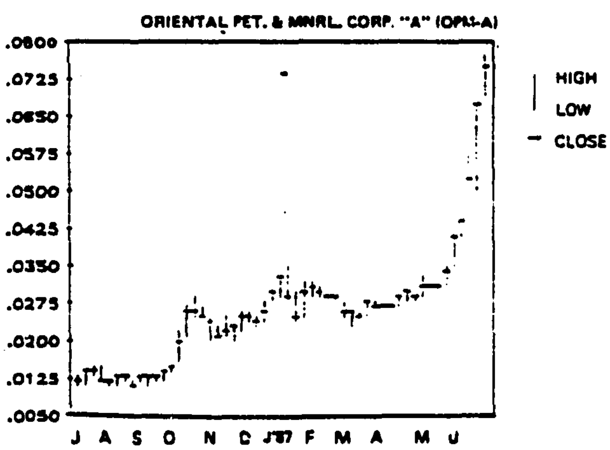


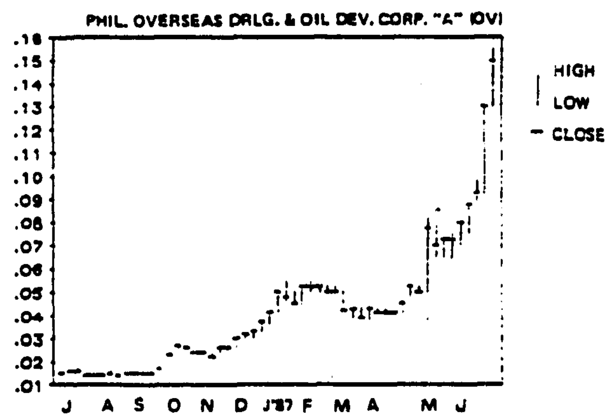












NOTE: The information set forth herein was obtained from sources which we believe reliable but we do not guarantee its accuracy. Neither the information nor any opinion expressed constitutes a solicitation by us of the purchase or sale of any securities.

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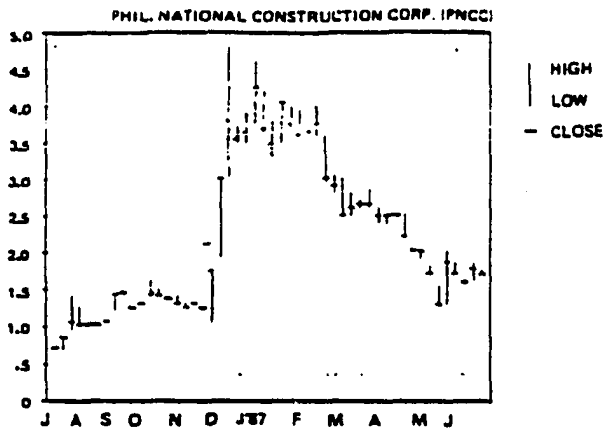
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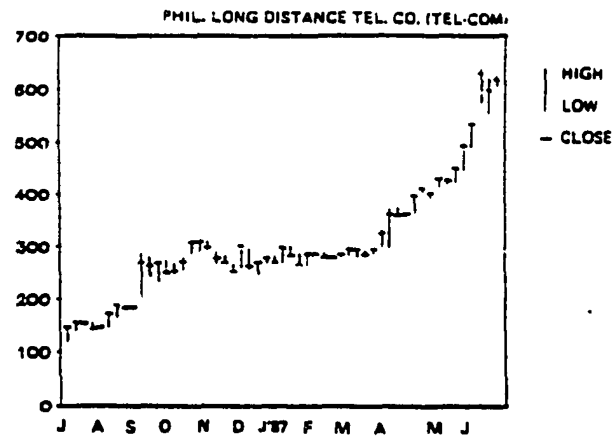
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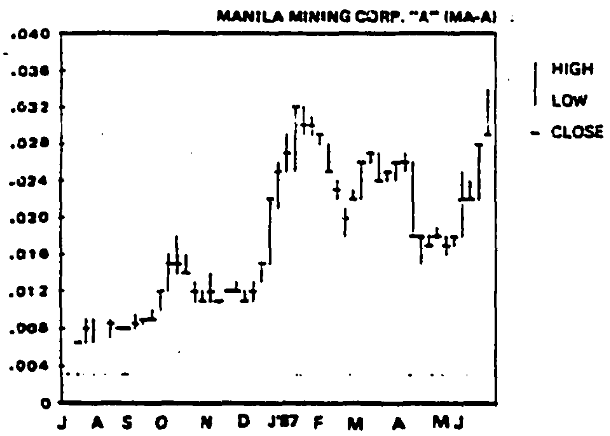
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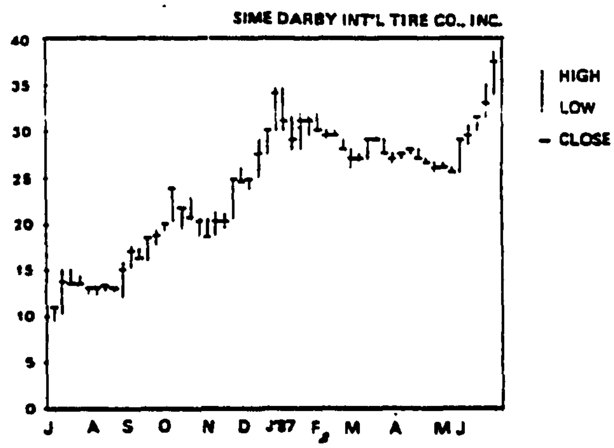
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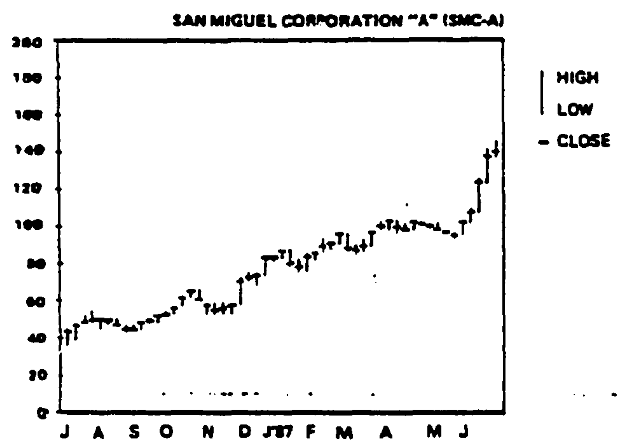
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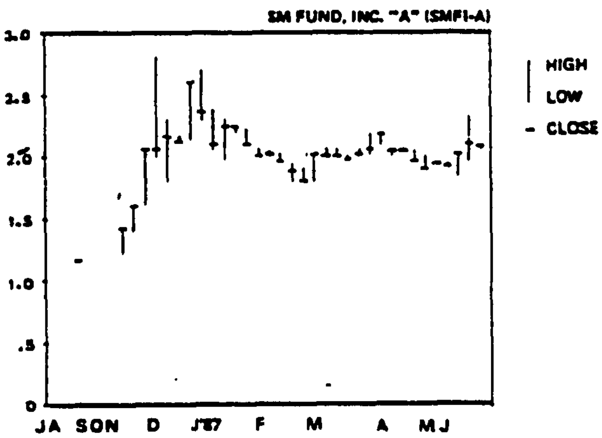
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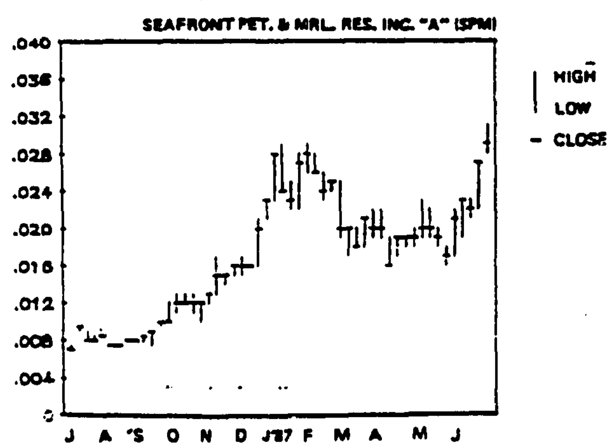
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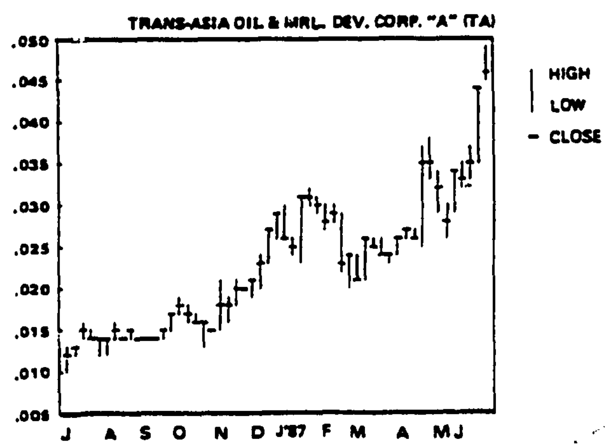
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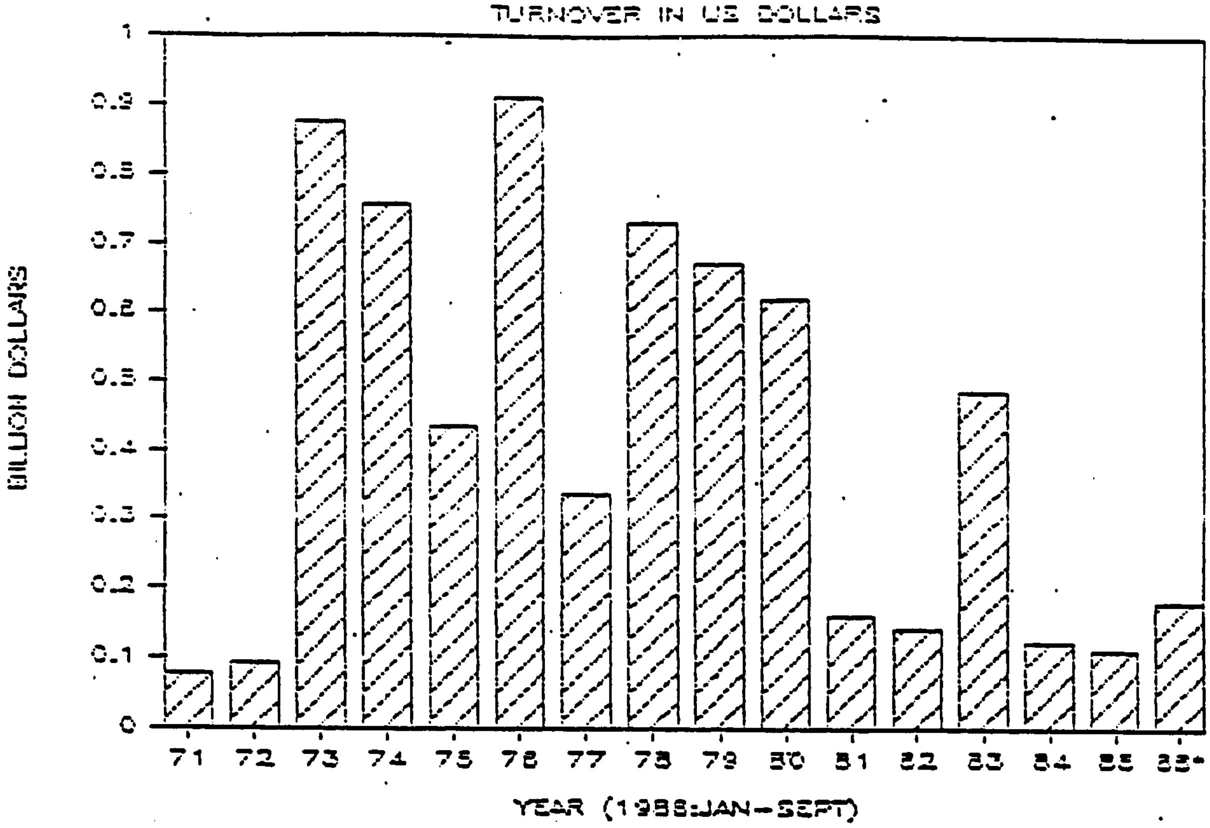
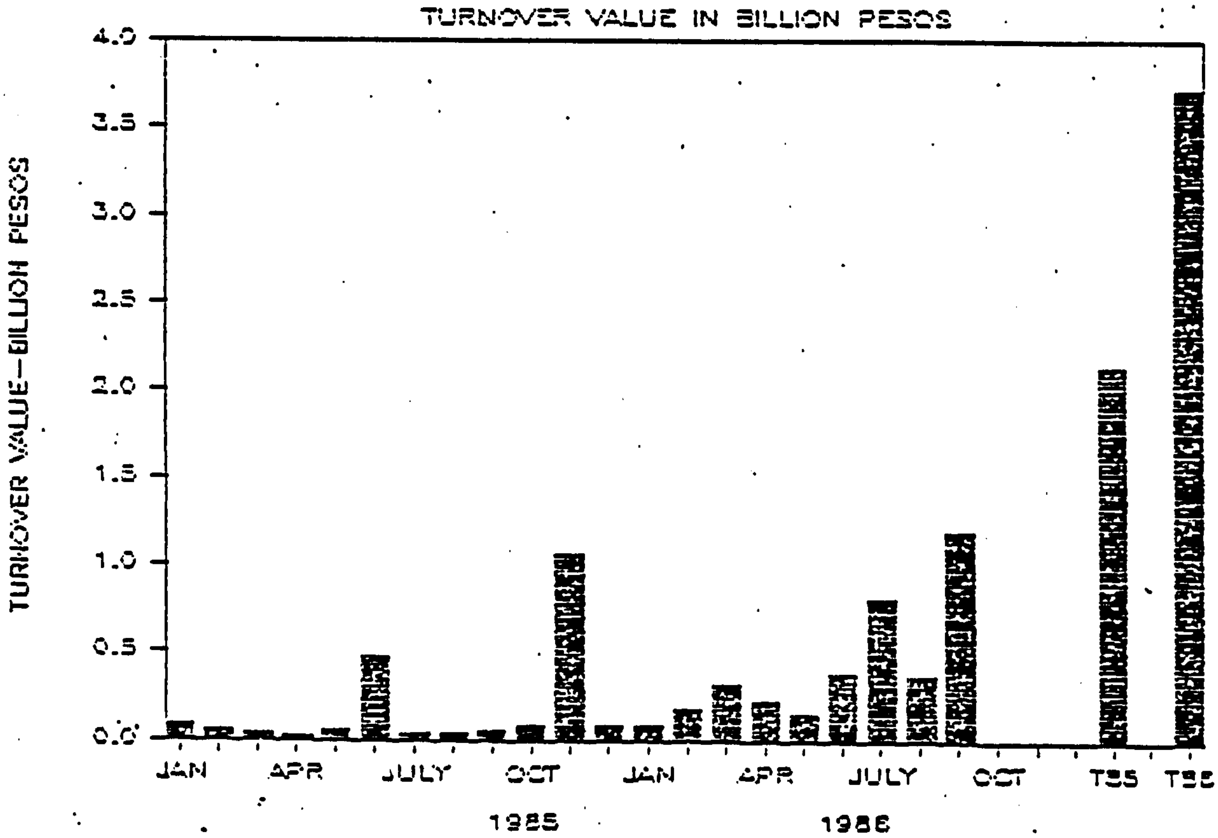
PHILIPPINE STOCKMARKET

TURNOVER IN US DOLLARS



PHILIPPINE STOCKMARKET 85–86

TURNOVER VALUE IN BILLION PESOS



ANNEX M6

DESCRIPTION OF PHILIPPINE AGRIBUSINESS INDUSTRIAL AND INVESTMENT COMPANY (PAIICO)

An appropriate combination of financial, engineering and managerial analytical capabilities is lacking among Philippine financial institutions. Capabilities to restructure existing ailing companies are extremely limited. A number of different types of services must be combined to analyze investment proposals and place them with qualified investors, including:

- Financial engineering capabilities;
- Managerial know-how;
- Equity placement power;
- Domestic and international market knowledge; and
- Business and equipment valuation expertise.

No existing company provides a full line of these needed services in the Philippines on a sufficient scale to have meaningful impact on the market:

- The five universal banks are not sufficiently integrated and do not have enough expert personnel;

- No investment house has the necessary broad financial capabilities, sufficient capital or the managerial/technical expertise;

- Government agencies do not provide merchant banking/technical skills to private buyers/investors and have conflicts because of many problem loans and investments; and

- Foreign investment bankers do not have the necessary managerial and technical expertise that is available directly in the Philippines.

Several members of the private sector have proposed to establish a new private company, named the Philippine Agribusiness Industrial and Investment Company (PAIICO). The objective of PAIICO will be to mobilize private term capital for investment in: 1) firms slated for privatization; 2) financially distressed privately-held firms; and 3) new and existing agro-industrial enterprises. With these objectives, PAIICO will have two basic functions. The first will be to act as an intermediary/ broker in obtaining investors/buyers who will provide new capital and managerial expertise which will "turn around" existing distressed businesses. The second will be to invest in and manage an agro-industrial fund that would provide investment capital for investment in agricultural projects of high return potential.

"Turnaround" Window

PAIICO's "turnaround" window will, for fees, act as an intermediary/broker in obtaining investors/buyers who will provide new capital and managerial expertise which will turnaround existing distressed businesses in the

Philippines. It will identify and prepare potential investment opportunities for third-party investors and receive fees in the form of both cash and equity kickers for arranging the investments. Its emphasis will be on existing businesses, rather than start-ups-- a strategy that is responsive to the current spectrum of opportunities and needs in the Philippines.

Services provided by the company will include:

- Technical and practical expertise in evaluating existing troubled businesses through business/management/ engineering/technical audits and reviews of assets and businesses;

- Financial, engineering and restructuring advice; merchant and investment banking expertise; and

- Preparation of investment proposals and structuring new domestic and/or foreign investment including utilizing the GOP's Debt/Equity Swap (Central Bank Circular III) and Philippine Investment Notes (PINs) Programs.

The "turnaround" window will also provide limited equity investment while it obtains long-term capital, or supplemental equity when needed to complete investment transactions.

This limited investment option may take several forms; (i) bridging facilities until investors can be found; (ii) purchase of minority equity positions to make an overall investment package possible, (iii) limited loans in conjunction with equity investments.

The investments made by PAIICO will be determined by the nature of the investment opportunities presented. In considering those projects requiring investments, PAIICO will pay particular attention to companies being privatized by the GOP because those are the most likely ones requiring "seasoning".

Investments will be made when they further the "turnaround" process, and they will not ordinarily be made for the investment return. (This does not apply to cash, which will, when available, be invested in short term liquid investments.)

The following guidelines will apply to PAIICO's investments:

1. Investments will be made:

    (a) in projects or companies that give promise of being commercially viable and profitable;

    (b) in agribusiness companies or projects, with emphasis upon those companies and projects which:

        - provide new technology, products, or organization for existing agricultural produce of the Philippines; or

- make more efficient, provide better markets for, or otherwise improve agricultural outputs and inputs, agribusiness services, transportation of agricultural commodities, and research and development; or

- otherwise improve agribusiness markets, transportation, or prices farmers receive for their produce.

(c) in projects or companies with great potential for being placed subsequently with investors within one year but do not have investors willing to make such investment at that time, so long as management has defined a strategy for placing the project within such period;

(d) in projects or companies requiring additional Philippine investment in order to qualify under the Constitution;

(e) in projects or companies which need additional equity to complete the financing package so long as the PAIICO investment is not more than 20% of the total equity;

2. Investment emphasis will be placed upon agribusiness opportunities, particularly those assisting small farmers; and business opportunities, especially those assisting small businesses; those projects and ocmpanies being privatized by the GOP; and those investment opportunities that assist the rural population and expand employment.

The above investment guidelines shall be the policy of PAIICO, but may be changed from time to time by PAIICO's Board of Directors to allow PAIICO to adapt to a changing investment environment.

Candidates for PAIICO's "turnaround" window will be firms with the following characteristics:

- Firms engaged in agriculture and/or manufacturing with strong growth opportunities, but which are currently highly leveraged;

- Firms with positive financial gross margins over previous years, and with low or negative net income in the period 1984-1986; and

- Firms with good past financial performance with negative net worth in 1984-1985 that would likely participate in an expanding economy.

An examination of the market reveals four categories of corporations--government owned/controlled and acquired assets, closed family, public Filipino, controlled and wholly owned subsidiaries or joint ventures controlled by multinationals--in which potential candidates of PAIICO's "turnaround " window can either be financially restructured or purchased outright.

Government-Owned/Controlled Corporations (GOCCs) and Acquired Assets. Privatization of the GOCCs and acquired assets that have been slated for privatization will attract a number of clients for PAIICO's services. PAIICO would represent the potential clients in structuring management and financing packages for the acquisition of GOCCs and acquired assets under the GOP's Privatization Program.

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Closed Family Corporations. Closed family corporations experiencing financial difficulty may be induced to restructure by bringing in outside investors. A few, stronger companies may be willing to list their shares on the stock exchanges. These corporations comprise the majority of the corporations in the country.

Public Filipino-Controlled Corporations. Although public Filipino-controlled corporations are already listed in the exchanges, several of these firms have experienced financial and operational difficulties over the past few years.

Wholly Owned Subsidiaries of Multinational Corporations. These corporations are candidates for restructuring leading to public issue of shares as well as assistance in obtaining additional investment to reduce overleverage.

Agribusiness Investment Window.

A private agro-industrial fund will provide investment capital for in high-return agricultural projects in the private sector. The proposed name for this window is the Agro-Industrial Investment Fund, "AIIF".

AIIF will invest in debt convertible into, or accompanied by warrants to purchase, equity securities, and equity instruments of new or existing Philippine companies. Targeted companies would offer reasonably attractive medium-to long-term prospects of growth and capital gains from undertaking agro-industrial projects which improve rural incomes and raise the efficiency of agricultural resource use in the Philippines. Investment in these companies would help: (a) introduce new, improved technology in farm inputs, culture practice, harvest and post harvest systems, including transport, drying, storage, and processing; (b) introduce new crops or develop new uses for existing products; and (c) improve the efficiency of production, marketing, purchasing and/or finance through new organizational modes or institutional structures.

The prototypes of projects suitable for AIIF investments range across the entire landscape of Philippine Agro-Industry -- from upland dry agriculture to deep sea fishing in the 200-mile extended economic zone. The projects that offer the highest social returns are those that impact the principal sources of national livelihood--rice, corn, coconuts and fisheries.

It is not proposed that AIIF go into actual crop production or aquaculture ventures. Instead, it will focus on projects that supply inputs or postproduction facilities and services. These areas, besides being better suited to the analytical, financial, engineering design and investment monitoring techniques of an institutional investment fund, are also the most strategic staging areas for improving the economic organization, the productivity and efficiency of the primary sectors.

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More specifically, AIIF will seek to invest in:

- Existing profitable companies whose position in the agro-industry sector makes them strategic staging points for a rationalization project in a specific sector and area;

- New companies formed from AIIF initiatives, where it has found promoting partners of established track records and experience who stake substantial capital of their own and share in the downside risks;

- Existing companies that are in financial difficulties for reasons that do not negate the basic soundness of the business line or the potential benefits for the rural sector, but are remediable by the injection of fresh capital, management or technical assistance and where reasonable prospects exist for achieving the investment objectives over a span of two to five years;

- Projects that involve initial capital investments in the range of $100,000, and, over the life of the project inclusive of follow-on investments, no more than $2.0 million. These projects should typically have reached their maturity in three to seven years and be able to yield a profitable divestment at their maturity. Divestment may be through private placement or public offerings. The projects ideally should be capable of replication or scaling up. Once the viability of the modules has been established, AIIF will leave the replication and scaling up to other private groups assisted by the banks and regular financial markets; and

- Financial intermediaries that are strategic in the development and improvement of rural capital markets, in the mobilization of rural savings and linkage between formal financial institutions and traditional agriculture.

PAIICO must be a Philippine institution to operate effectively in its marketplace. This means it must meet the technical requirements of the Philippine Constitution: 60 percent of the voting shares must be held by Philippine institutions or individuals.

At the same time, PAIICO must also be able to command attention for its investment proposals in the international marketplace. This requires backing from international institutions of stature, as well as Philippine ownership by institutions and/or individuals of good standing.

This financial support is necessary because:

First, it must be perceived within the Philippines that investment is being developed and placed by an institution of independent standing. In most cases, either the GOP or the bank with nonperforming assets is going to have to sell the asset or allow the investment in the company to take place at less than book value (as shown on the books of the company involved). Shareholders

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of high standing are required to achieve this necessary independence. Foremost among such shareholders are the international assistance institutions: AID, ADB, and IFC. Furthermore, because they are international development institutions they have a long-range view towards investment. During the start-up period there will be a somewhat slower payback for investors in the organization than equity investors normally expect in developing countries. There is no increase in risk over normal commercial investment risk, but it is spread over a somewhat longer period of time. Donor backing is essential to the success of PAIICO.

Second, investment from local institutions of high standing is needed to demonstrate the Philippine nature of PAIICO, provide local funding and refer potential projects. Although PAIICO will be a Philippine institution, it must also be seen as an independent company without ties to the past and one of undoubted integrity.

Third, international private institutions' sponsorship of a portion of the equity will be important to indicate clearly that PAIICO is a member of standing in the international investment community whose proposals merit consideration. Many of the international banks already hold Philippine foreign exchange obligations, so their involvement should lead to further peso investments through the medium of the PINS or Debt/Equity Programs.

Sources of Capital
Philippine Private Sector

Three main sources of Philippine Private Sector equity can be mobilized including:

- Universal and investment banks;
- Family groups and selected individuals; and
- Commercial companies, particularly large agribusinesses.

These sources of equity will contribute to the equity capitalization of PAIICO representing 60 percent of the voting Common Shares.

Foreign Banks and Financial Institutions

The primary investors in this category of shareholders are expected to be the international banking community with debt exposure in the Philippines. Many are expected to utilize the GOP's Debt/Equity Swap Programs to swap their debt exposure and make equity investments. PAIICO is a prime candidate as an equity investment vehicle for the international banks because they do not have the necessary expertise and ability to find, develop and assess such investments for themselves. Accordingly, they have had difficulty in identifying and developing equity investments into which they can swap their debt. As stated above, PAIICO will provide that service for the International Banking Community.

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PAIICO Capitalization

PAIICO's capital requirements are primarily for pesos. There will be a relatively small requirement for foreign exchange needed largely to contract for foreign experts when local expertise is not available to review foreign market potential and investigate and evaluate investment proposals. The capital requirement for PAIICO is estimated at ₱415.0 Million or $20.75 Million1/. A breakdown of the proposed capital structure of PAIICO is presented below:

Voting Common Shares	Amount	U.S. $ Equivalent (Million)
Philippine banks & financial institutions:	₱ 75 million	$ 3.75
Foreign banks & financial institutions:	50 million	2.50
Total Equity:	₱ 125 million	$ 6.25
4% Convertible Preferred Shares		
Agency for International Development:	₱ 90 million	$ 4.50
Donor Agencies:	100 million	5.00
Total Equity:	₱ 190 million	$ 9.50
TOTAL:	₱ 315 million	$ 15.75

In addition, the AIIF is proposed with a total capital of ₱130 million from three sources:

PAIICO	₱ 30 million	$ 1.50
Private Philippine	40 million	2.00
AID-PRE	60 million	3.00
	₱ 130 million	$ 6.50

1/ PAIICO investment in AIIF will be sourced from the original ₱125 million PAIICO investment by Philippine and Foreign banks and financial institutions.

Investing separately in AIIF is proposed in order to provide investment funds to private, agriculturally related companies with a longer time frame than the PAIICO "turnaround" investment window can provide.

In order to meet the requirements of the Philippine Constitution, the equity has been divided into Common Shares and quasi-equity or Convertible Preferred Shares*. Voting Common Shares will be held 60% by Philippine investors and up to 40% by international investors. These shares will be subject to certain restrictions as to dividends and sale because some shares will be purchased through the PINs or Debt/Equity Swap Programs.

The quasi-equity or convertible preferred shares will be held by international donor institutions. The convertible preferred shares will have certain restrictions upon them in order that they will not qualify as equity under the Philippine Constitution and local laws and regulations. These restrictions would possibly include a prohibition against voting, and a limitation upon dividend payments for at least three years. As compensation for loss of voting rights, for example, a 4 percent interest/dividend rate could be payable and certain conversion rights into Voting Common Shares be given for public issue, and also call rights for PAIICO on such shares based upon a multiple of four on trailing earnings, with a floor of the original purchase price. Conversion into voting Common Shares would be necessary for a public issue in order to obtain the full market value. Such arrangements would allow exit from such 4 percent convertible preferred shares to be at an equity market value or approximation thereof. Such 4 percent convertible preferred shares would participate pari passu in gains or losses on the shares.

The 4 percent annual payment shall be cumulative, but if dividends are paid to the Convertible shares, the 4 percent annual payments would be offset against them.

Staffing

PAIICO will be structured administratively as a lean and flexible organization. The staff will be technologically oriented with management experience, composed of persons such as plant managers, marketing directors, exporters and financiers. Initial staff recruitment will place primary emphasis upon the selection of a Chief Executive Officer (CEO). This office cannot effectively be filled until the main shareholders have been identified and substantial agreement reached. It is probable that potential Philippine investors will be strongly influenced by the choice of CEO, and their views will be important. The final selection will be a negotiation between the major private Philippine shareholders, subject to approval by AID-PRE.

*Quasi-equity is referred to here for illustrative purposes only and to provide an assumption basis for illustrating a possible corporate structure for PAIICO and demonstrate returns that are possible given a certain scenario.

The CEO must be a Philippine citizen with high standing in the financial and business community, acceptable to the GOP and all elements of commercial life, who preferably will have had senior administrative experience in a financial organization in the Philippines. It may be necessary to canvass the expatriate Philippine community to have someone from abroad to return.

Other senior officers should have had a variety of financial and commercial experience. It is probable that one or more officers should have had managerial and financial experience in rice, coconuts, textiles, construction, food processing, electronics, wood products and metals, as well as in commercial finance.

At present, there is a fairly large pool of experienced talent available. In a review of the PAIICO concept with the Manila business community, there was a substantial consensus that a new organization of high standing with a bright future could attract top notch personnel.

ECONOMIC AND FINANCIAL ANALYSIS OF PAIICO

This section includes: a) discussion on the economic impact of the turn around company; b) highlights of illustrative financial analysis of the turn around company and the venture capital window; c) a discussion on pricing of non-voting quasi-equity investments.

I. Economic Impact

Benefits from the "turn around" company, PAIICO, will also take the form of increased incomes as a result of increased levels and efficiency of investment in the economy. These indirect benefits can be expected from the two major types of PAIICO functions, i.e., actual rehabilitation of ailing companies and performance of investment services. If PAIICO's services are utilized for some of the parastatals to be privatized, the benefits of privatization and budget deficit alleviation are likely to increase and become more certain. Additional benefits may be expected from the catalytic effect of PAIICO's activities. PAIICO will not only directly speed up the privatization and turn around process for selected corporations but also, through demonstrated profitability, possibly encourage independent, similar private sector undertakings.

PAIICO will have an even profounder effect than just mobilizing private funds - domestic and foreign. The GOP has undertaken a major initiative vis-a-vis the private sector. Through Philippine Investment Notes (PINs) and Central Bank Circular 1111, a large source of equity funds has been opened up: debt/equity swaps based upon transferring external GOP debt into domestic private investment. A major obstacle to this program's success is the lack of investment opportunities. This large pool of external funds (total external debt of the GOP is over $28 billion) must be able to find attractive domestic investment projects in order to reduce the debt and help alleviate the crushing debt burden. Several funds are contemplated which would have immediately investible funds in excess of $300 million. If this program is to have any chance of success, additional mechanisms for preparing investment opportunities must be developed as soon as possible. PAIICO will help in meeting this challenge.

The impact of providing investment opportunities to the holders of the GOP external debt is two-fold: it not only increases private investment, but it will reduce the external debt service burden. This is particularly true if PINs are used as financing the investment because such instruments immediately reduce the current interest payment burden.

PAIICO will also provide a leadership role in the local financial community. No similar organizations exist, although a number have the necessary powers and could undertake the business if they desired to do so and had the necessary capital. PAIICO's successful example will cause others to emulate its success. The multiplier effect of the success of such an organization can have an even greater impact than that of its own investments.

PAIICO has been designed to have a multiplier effect because its viability is largely based upon its ability to turn over investments. In the Philippines, this is a crucial difference from past efforts. For example, numerous venture capital companies (VCC) were started in Manila (including an IFC supported VCC), but they have had little impact. Essentially, each venture capital company is independent from all others, and has no multiplier effect. The lack of effect upon the Philippine financial markets is obvious. (The economic crisis also played a significant role, but was not a factor concerning the lack of a multiplier effect.)

PAIICO can play a significant part in the rehabilitation of Philippine industry. The inheritance from the Marcos regime of a disorganized and decapitalized industry requires rapid action. PAIICO is designed to act on behalf of investors in dealing with this problem. It can have an enormous influence upon the process of revitalizing industry and agriculture by identifying viable investment projects and dealing with the GOP or the existing creditors on behalf of buyers.

The GOP is not shaping the overvalued assets in its possession to achieve attractive investment offers. Considerable work must be done before such assets are capable of being shown to investors. PAIICO will provide this expertise, and the GOP will not only receive better prices for the assets being sold, but more of such assets will be put to productive use. The only alternative in many cases is to sell the assets for scrap, so their economic potential is completely lost.

As a practical and political matter, the entire privatization effort in the Philippines is in jeopardy. Assets which will only be scrapped or otherwise shut down will result in lost employment and other economic loss. The GOP will be reluctant to continue privatization if there is little or no economic future: PAIICO can be of real assistance in the privatization effort, and the head of the Asset Privatization Trust recognized PAIICO's potentially positive role in supporting the concept.

In the Philippines, agriculture remains the main industry. PAIICO's role in developing and selling investment opportunities in agribusiness will provide a major impact upon the overall economy. PAIICO would be a major private investment development vehicle in the Philippines. A number of prominent individuals have sponsored an attempt to establish such an entity called PAIDCOR. Such effort is being joined with PAIICO through AIIF as the main new vehicle for private agro-industrial investment which would be independent from existing individual corporate or governmental biases, but would serve the entire investing public.

PAIICO would be able to view potential agribusiness investments unprejudiced by the usual handicaps caused by lines of business, land owning patterns, existing investments in unprofitable enterprises, and age old agricultural practices. The benefit of an unbiased evaluation of investment opportunities can be very large, in an agricultural country such as the Philippines.

The positive impact upon the Philippine economy of PAIICO stems from its intermediation role. In order to have a real effect, as well as have credibility in the marketplace, it must be of sufficient size to make the effort worthwhile, provide staying power so that the investment opportunities may be investigated and shaped, and then sold.

II. Highlights of PAIICO and AIIF Financial Analysis

A. PAIICO

PAIICO will be a private financial company which will act as an intermediary/broker in obtaining investors/buyers to provide new capital and managerial expertise for turning around existing distressed companies in the Philippines. PAIICO will arrange for buyers/investors to purchase their interest in any project company as quickly as possible because its income depends largely upon the fees derived from such equity placements for third parties. PAIICO will take an active role in structuring, promoting and starting up the projects it undertakes and will arrange for all operating management and capital requirements in those businesses. Its main income will come from the front end fees received in cash from placement of the investments with third parties and the subsequent capital gains received when the equity "kickers" are subsequently sold.

Major assumptions used in the financial viability analysis of PAIICO for a ten-year projection period are:

1. All of the initial capital is paid at the outset.
2. Selection ratio of initiated projects is one out of five during the first three years and one out of three thereafter. All selected projects are successful, i.e. 100 percent "good well" ratio.
3. Gestation period for selected projects is six months; for rejected projects, 3/4 month;
4. PAIICO engages in three types of business activities for its selected projects.
    a. placement of equity to third parties;
    b. taking of equity positions for own account (direct investments); and
    c. booking of short term bridging investments.
5. Conversion period of equity kickers: two years for outside placements; one year for bridging investments.
6. Appreciation factor for direct investments is 2 times;

7. Seasoning period for small and medium sized direct investments - 2 years; for large investments - 3 years.

8. Income from the AIIF - see discussion below): managerial fees of 2 percent on the average net asset value of AIIF and dividends actually paid on PAICO investment of $1.5 million in AIIF. The AIIF Scenario III results are used for dividend income assumptions.

9. Dividend payout ratio of 50 percent starting in the fourth year.

10. 4 percent interest per annum on quasi-equity.

11. Income tax of 40 percent.

12. In calculating the internal rates of return, it is assumed that operations would stop at the end of year 10, the investments outstanding at the end of that year are revalued on the basis of the same potential appreciation assumed for each of the investment categories, and the potential gain is added to the surplus.

The analysis presents two scenarios for purposes of sensitivity analysis. The major differences in assumptions between the two scenarios are shown below.

	Scenario A	Scenario B (scaled down)
Equity base (million pesos)	315	245
Distribution of Equity (%)		
Common Stock		
Philippine Equity	24	24
Foreign Equity	16	16
Quasi Equity		
ADB	16	20
Others	44	38
Average Size of Equity Placements (million pesos)	35	25
No. of Project Starts Per Year	120 for yrs 1-3 108 for yrs 4-10	30 for yr 1 90 for yrs 2-3 72 for yrs 4-10
No. of Outside Placements Per Year	8 for yr 1 19 for yrs 2-3 30 for yrs 4-10	4 for yr 1 11 for yr 2 14 for yr 3 16 for yr 4 19 for yrs 5-10

No. of Direct Investments Per Year		
Type I	2	2
Type II	2	0
Type III	2	2
No. of Bridging Investments Per Year	4 for yr 1 5 for yrs 2-3 6 for yrs 4-10	2 for yr 1 4 for yrs 2-3 5 for yrs 4-10

The results of the internal rate of return analysis are as follows:

	Scenario A	Scenario B
Internal Rate of Return	20.2	18.2

The results of the IRR analysis indicate that under both scenarios, PAIICO should be sufficiently financially attractive to investors. The higher IRR for Scenario A reflects the higher average size of investments of @35 million compared to Scenario B's @25 million. This also reflects the larger scale operations of Scenario A relative to Scenario B which affords higher coverage of fixed cost, that is, lower operating costs per unit of investment. The size of equity placements of @35 million under Scenario A appear to be conservative in relation to the experience to date of some financial institutions which have dealt with restructuring the nonperforming assets (NPAs) through the Asset Privatization Trust (APT), the size of the APT portfolio, and the size of the potential investment in NPAs.

B. AIIF

AIIF will invest in debt and equity instruments of new or existing Philippine companies that offer reasonably attractive medium to long term prospects of growth and capital gain from undertaking agro-industrial projects.

The venture capital process starts with the establishment of the technical, economic and commercial viability of a venture in a specific microenvironment, sees it through the promotion stage, procurement, construction and installation of plant and equipment, recruitment of management and staff, training, start-up of commercial scale operations, nursing the operations to maturity, seeing the company through its operating and earnings record, and establishing its market value. At that point the venture phase ends and AIIF divests itself of the company.

AIIF will have three prototypes of venture investments, with the following major assumptions:

Type	Description	Seasoning Period	Project Selection Ratio
I	Short Gestation and Simple Projects	3 years	1/10
II	Medium Gestation	5 years	7/100
III	Long Gestation	7 years	3/100

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The analysis also assumes that not all of the investments will turn out as expected and a fail ratio is assumed of one of every four investments.

The starting capital structure of AIIF is assumed as follows: 4 percent non-voting quasi-equity - $3 million; private Philippine subscribers $2 million; and PAIICO $1.5 million for a total capitalization of $6.5 million. The AIIF will be structured as a closed-end Investment Trust to be managed by PAIICO.

Internal Rate of Return Analysis is conducted using valuation of AIIF assets at the end of the 10th year for three scenarios, as follows:

	Base Case	Scenario II	Scenario III
No. of Prefeasibility Studies Initiated per Year	50/yr	40 for yrs 1-3 50 for yr 4 60 for yrs 5-10	40 for yrs 1-3 50 for yr 4 60 for yrs 5-10
Dividend Payout (%)	50	50	50 for yrs 3-6 75 for yrs 7-10
Income Tax (%)	40	40	40
Investment Appreciation Factor (times)			
Type I	2	2	3
Type II	2	2	4
Type III	4	4	4

	Base Case	Scenario II	Scenario III
Internal Rate of Return (%)	14.3	11.6	20.4

The returns determined for the base case are not very attractive by Philippine standards since the financial instrument has no liquidity provision and the investments are locked in for ten years. Scenario II enables AIIF to live within the interest earnings until the first year Type I projects can be liquidated and produce their capital gains. The investment strategy will need to focus on projects that give larger capital gains, as in Scenario III.

C. Factors Affecting PAIICO and AIIF Financial Performance

1. Operational Factors

PAIICO's and AIIF's performance depends on two major sets of factors:

a) The efficiency of the project selection process - the average cost of selection per project, the success rate, and the quality of the projects selected, and in the case of AIIF, the quality of partners selected.

b) The quality of the managers selected, the effectiveness of the monitoring and the combination of good management and luck that makes it possible to realize profit expectations.

2. Risk Factors

The major risks for investors in both PAIICO and AIIF include: a) political, b) market, c) economic, d) liquidity, e) administrative, and f) investment.

a. Political risk

There is considerable uncertainty about the future of the Republic of the Philippines. However, it is doubtful if the political situation will severely affect these proposed investments unless there is a drastic change for the worse. Financial services organizations of this type are not wedded to working on a narrow line of business. Within reasonable limits, they can flexibly respond to the political situation. If one area of the country is unsafe, PAIICO can switch its attention to another. If working in one industry becomes untenable, it is possible to move to another. The flexibility of dealing with turnaround investment can give considerable protection.

At the same time, if the political situation deteriorates too much, then potential investment may dry up. However, the Philippine market is large enough to have great attraction to potential investors, both domestic and foreign. If provided with well worked out investment proposals, many investors interested in the industry will be willing to give the proposal good faith consideration.

Although a real risk, PAIICO and AIIF can guard against most political risks except drastic deterioration caused by increased violent rebellion.

b. Market risk

PAIICO is a new enterprise - both because it is a startup and because it is unique in the Philippines. Although the market for PAIICO's services is vast, it is possible that no one will be willing to purchase the services despite the universal approval of the concept by the business and governmental communities.

The PAIICO and AIIF market analysis points to a real need for these services. There are existing organizations providing these services on a on-off basis. Each of those interviewed indicated that the market had not been saturated. Those involved in this type of activity are undercapitalized. The proposed capitalization of PAIICO would appear to provide it with sufficient staying power and funds enough to take successful action.

The main risk would appear to be that the time required for the investment opportunity development and placement is much longer than estimated. In such circumstances, the costs will be much larger than anticipated, and profitability will decline. This risk that the marketplace will not provide the type of investment opportunity projected is controllable by alert management. One of the advantages of a service company is that personnel can be matched to the business done.

Furthermore, no bank debt is contemplated. Thus, reduced earnings on equity capital can offset to some degree a failure to find investments fast enough. Although the market risk is present, competent management can cover that risk.

c. Economic risk

There is a substantial chance that the Philippine and/or the world economy will decline sufficiently to shut off investment flows and cause losses to businesses in which equity "kickers" and the selected investments are made. This is the basic risk of all private investment. However, this business has several advantages over many others in protecting itself from the economic risk. First, the investments and potential investment opportunities can be diversified across a number of industries so that the chances of an overwhelming downturn are minimized. Second, as indicated above, the services industry can more flexibly meet changes in its business because it has practically no fixed investment. PAIICO can also ride out an economic storm because it does not have debt to service.

d. Liquidity risk

One of the more serious risks is the possibility of becoming illiquid because of an inability to sell investments - even if they are profitable. Markets in less developed countries are notoriously difficult for easy sales of investment, and such a possibility would freeze PAIICO's ability to continue in business. The way that this risk is manageable is through the twofold protection of vigilant management and careful selection of investments with due regard for exit opportunities. Competent management should be able to guard against illiquidity causing undue loss.

e. Administrative risk

All financial organizations run risks of administrative failures: from embezzlement to bad judgment. Adequate administrative controls plus insurance can give peace of mind. But the only real antidote is the selection of a good and careful administrator.

f. Investment risk

Securities offered in starting new ventures are speculative and subject of a high degree of risk compared to other types of securities. The following risks are the major investment risks:

1) Risks of New Investments. Investments in new projects offer the opportunity for significant capital appreciation but also loses due to lack of experience in the marketplace. Also, although subinvestments are only a part of PAIICO's business, there are risks associated with investment in subinvestments in early stages of development, or with an adverse operating histories, i.e. it may not be possible to turnaround those investments into profitable companies.

2) Lack of Correlation Between Book Value and Market Value of PAIICO Shares. It is possible that the market value of the PAIICO's common stock (if a significant market develops) will bear little or no relation to the market or book value of its underlying portfolio securities, or the resulting net asset value per share. As a result, it may not be possible for investors to realize the true value of their common stock.

3) Distributions. PAIICO's profitability is highly dependent upon long-term capital appreciation of its equity "kickers". To the extent that any income is derived from PAIICO's operations, it will largely be used to fund continuing working capital needs rather than be distributed to stockholders.

4) Future Financing. If PAIICO is not as profitable as forecast, its growth may depend upon its ability to obtain additional financing rather than rely upon cash flow. No assurance can be given that PAIICO will be able to raise additional funds should they be required, or that such funds will be available on favorable terms.

III. <u>Pricing of Non-voting Quasi-Equity Investment in PAIICO and AIIF</u>

While the actual terms will depend on the outcome of negotiations, non-voting equity share investments in PAIICO and AIIF are planned to be provided along the lines of a quasi-equity peso denominated loan bearing a fixed interest and consolidated and made part of the principal at final maturity. The consolidated principal will be paid at one time at the end of the tenth year. In addition to the interest, presently being thought about at four percent per annum, the instrument will be entitled to a percentage share in the profits. While the profit motive may not be of prime importance to non-voting equity investors involvement, the profit sharing feature is intended to encourage continued operating efficiency as financial performance improves and to provide resources at market oriented rates while sharing the involved risks. Under these terms, primarily because of consolidating interest into quasi-equity capitalization, however, non-voting equity shares in PAIICO and AIIF capitalization will increase in proportion relative to that of common shares over time. If profit sharing is based on value of non-voting shares proportion to capitalization, the returns to private common shareholders will not be as attractive, hence there is a need to set a ceiling on the shares in profit of non-voting equity investors.

On the other hand, non-profit or non-voting equity investors should not subsidize the operations nor lose money, if the ventures are successful. Accordingly, there is a need to set a floor on these investors' share in the profits. The four-percent interest in the quasi-equity may be satisfactory while PAIICO and AIIF are not yet earning. However, once profits turn up, it may be advisable to determine a floor on the shares that, together with four percent interest, would cover the opportunity cost of funds for other non-voting equity investors and would approximate the market value of the resources being provided.

ANNEX M7

Securities and Exchange Commission
MINISTRY OF FINANCE
REPUBLIC OF THE PHILIPPINES

SEC TODAY

SEC TODAY

HISTORICAL BACKGROUND

The local stock market boom in 1936 fueled investor gullibility and spawned not a few fly-by-night corporations and get-rich-quick operators. Consequently many investors lured by the promise of instant wealth but uninformed about the nature of the securities they were buying lost their fortune overnight. There was, therefore, an urgent need for an institutional mechanism precisely to safeguard public interest.

Such a mechanism was the Securities and Exchange Commission, created pursuant to Commonwealth Act 83, otherwise known as the Securities Act as enacted on October 26, 1936. The Commission staffed with only a few technical personnel started operating on November 11, 1936, under the executive supervision of the Department of Justice. It did what it was mandated to do—a thorough analysis of every registered security, a scrutiny of the financial condition and operations of every applicant for a security issue, strict screening of every application for a broker's or a dealer's license, close supervision of stock and bond brokers and stock exchanges.

During the Japanese Occupation, the SEC was abolished by the Philippine Executive Commission. It was, however, reactivated after the restoration of the Commonwealth government. Subsequently, the executive supervision of the SEC was transferred to the Department of Commerce and Industry on October 21, 1947 by virture of Executive Order No. 94.

The first Commissioner was Ricardo Nepomuceno who served until 1945. The subsequent Commissioners were Filemon Cosio (1945-1949), Mariano Pineda (1951-1970), and Arcadio E. Yabyabin (1970-1975).

PERIOD OF EXPANSION AND REORGANIZATION

Sweeping changes in the economic and business environment required an improvement in the ability of public institutions to deal with them. And the SEC was no exception. On September 29, 1975, President Marcos implemented the reorganization of the SEC into a new collegial body. Appointed Chairman was Angel Limjoco, Jr. The Associate Commissioners were Julio A. Sulit, Jr. and Sixto T. J. de Guzman, Jr.

The SEC acquired additional powers to make it a better instrument of national economic development. Presidential Decree No. 902-A of March 11, 1976 transformed the SEC into a quasi-judicial body whose orders or decisions when made en banc are appealable only to the Supreme Court for review. Also, the administrative supervision of the SEC was placed under the Office of the President.

From a collegial body of three, the SEC was expanded to include two additional Commissioners pursuant to Presidential Decree No. 1758 which was promulgated on January 2, 1981. Two new departments were likewise created—the Prosecution and Enforcement Department and the Supervision and Monitoring Department.

To align the thrusts and activities of the SEC more with the overall economic and financial programs of the government, the supervision of the Commission was finally assigned to the Ministry of Finance by virtue of Executive Order No. 708 dated July 27, 1981. In mid-1981, President Marcos revamped the SEC. On August 1, 1981 he formally inducted as the new Chairman of the Commission Manuel G. Abello, a successful law practitioner and a noted civic leader. Four Associate Commissioners were also sworn into office—Rosario N. Lopez, Julio A. Sulit, Jr., Gonzalo T. Santos, Jr. and Jesus J. Valdes.

PRESENT JURISDICTION

Today, the Commission has absolute jurisdiction, supervision and control over all corporations, partnerships and associations in the Philippines in keeping with its primary mandate to protect public interest.

It administers and enforces the Revised Securities Act, the new Corporation Code of the Philippines, the Partnership Law, the Investment Company Act, the Financing Company Act, the Omnibus Investments Code, and Presidential Decrees 167, 218, and 902-A.

The SEC also implements other laws and Presidential Decrees in coordination with other branches and agencies of the government. Some of these laws are the Retail Trade Nationalization Law, the new Insurance Code, the Rural Banking Act, the Mining Act, the Food and Drugs Act, and Presidential Decrees 113, 117, and 678.

The SEC exercises the following powers over corporations, partnerships and associations: registration and licensing, supervision and regulation, investigation, and adjudication. The Commission also renders interpretative and advisory assistance to persons, both natural and juridical, engaged in the securities business and on the organization of business firms.

Under PD 902-A, the Commission has the original and exclusive jurisdiction to hear and decide cases involving fraud and misrepresentation committed by directors and officers of corporations which may be detrimental to the interest of the public. In addition, the Commission is empowered to: look into the intra-corporate problems of corporations; issue injunctive relief, subpoena, subpoena duces tecum; impose fines and penalties as well as to suspend or revoke, after notice and hearing, the certificate of any corporation, partnership, association; deny application for registration of any corporation, partnership, or association, if it is determined, after consultation with other government agencies notably the BOI and the Central Bank that the applicant's establishment and operations are inconsistent with the declared national economic policies.

THE ORGANIZATION

The Commission is a collegial body composed of the Chairman and the four Associate Commissioners. Its policies, rules and regulations are implemented thru the various operating departments whose activities are coordinated by the Executive Director.

1. *The Chairman*

   He exercises general executive control, direction and supervision over the work and operations of the Commission and its members, board, units, personnel and all of its administrative business. He also presides over the meetings of the Commission.

2. *The Associate Commissioners*

   Each Associate Commissioner oversees and supervises the operations and activities of the departments under his supervision and makes necessary reports and/or recommendations to the Chairman and/or the Commission.

   Each of the four Associate Commissioners supervises two departments on a rotation basis while the Chairman supervises one department.

3. *The Executive Director*

   He implements the policies, rules and regulations promulgated by the Commission; coordinates and supervises the activities of the different units and reports to the Chairman and/or the Commission on the operation of such units.

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4. *The Secretary to the Commission*

He is in charge of all the administrative business of the Commission. He is the recorder and official reporter of the proceedings of the Commission and the custodian of all Commission records, proxies, reports, minutes and other documents and papers filed with the Commission. He administers oath on matters coming under the jurisdiction of the Commission.

5. *Corporate and Legal Department*

Takes charge of the registration of domestic corporations and partnerships, their by-laws, amendments, increases and decreases of capital stock, number of directors, dissolutions, merger/consolidation/quasi-reorganization of corporations; grants or revokes licenses of investment companies, investment houses, financing companies, off-shore banks, foreign or multinational corporations to engage in business or establish regional headquarters in the Philippines; and renders opinions on legal matters affecting corporations and partnerships.

1) *Corporate and Partnership Division*

Processes and approves incorporation papers and by-laws, articles of partnerships, their various amendments, changes in capital structure, number of directors, dissolutions, applications for license of financing companies, investment companies, investment houses, off-shore banks, foreign and multinational corporations to engage in business or establish regional headquarters in the Philippines, in accordance with the Corporation Code, RA 5980, RA 2629, PD 218, PD 1034 and other applicable laws and decrees.

2) *Legal Research and Special Services Division*

Conducts research and renders opinions on queries about the provisions of the Corporation Code, Presidential Decrees and other special laws implemented by the SEC; gives advisory assistance regarding procedures for incorporation, merger, consolidation, reorganization or restructuring of corporate organizations; interprets the rules and regulations implemented by the SEC and undertakes special studies on intricate problems submitted to the Commission by the transacting public and other government agencies and instrumentalities.

3) *Corporate Reorganization Division*

Processes and approves application for merger/consolidation/quasi-reorganization of corporations, including increases and decreases in capital stock, number of directors, amendments, dissolutions as a result of such merger/consolidation/quasi-reorganization of corporation; issues certificates of percentage of Filipino investments in corporation or partnerships, transfer of subscription rights.

4) *Corporate Regulation Division*

Oversees and regulates the operation of financing companies, investment houses, investment companies and other financial intermediaries as well as foreign corporations and regional headquarters to the end that their operations conform with the objectives of the respective laws creating them; directs the terms and conditions as may be deemed necessary for the protection of consumers/investors in these companies; participates in and conducts hearings whenever necessary to determine safety of investment in such companies; determines which of these companies should be allowed to renew their licenses or otherwise revoked/suspended; and adopts such other measures and regulations to effectively enforce the foregoing.

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6. *Examiners and Appraisers Department*

Handles the financial and accounting phase of operations of the Commission in connection with the registration of corporate organization papers and their amendments, the registration of securities, increases or decreases of capital stock of corporations or those resulting from merger, consolidation, quasi-reorganization of corporations and spin-off, the investigation of corporations for probable violation of laws, decrees and other special laws being enforced by the Commission.

Analyzes and evaluates statements of sources and application of funds and annual financial statements of corporations; and conducts researches, studies and renders opinions on accounting and financial matters.

1) *Field Audit and Analysis Division*

Examines the financial condition and other financial reports of corporations whose securities are offered for sale to the public; examines the statement of sources and application of funds submitted by newly registered corporations; analyzes the financial condition of foreign companies applying for a license to do business in the Philippines as well as those applying for cancellation or withdrawal; examines books of accounts and related records and documents of corporations subject of complaints filed with the Commission.

2) *Valuation and Appraisal Division*

Handles the examining function of the department including evaluation of appraisal reports on properties in connection with applications for issuance of additional shares of stock, merger, consolidation and quasi-reorganization of corporations and spin-off registration of securities including investment plans and contracts, proprietary rights and the like; conducts researches and studies, prepares and renders opinions on queries concerning accounting matters.

3) *Verification and Processing Division*

Examines paid-up capital of corporations being registered and examines books of accounts and record of corporations increasing their authorized capital stock; examines financial statements of corporations decreasing their authorized capital stock or dissolving their corporate existence.

4) *Financial Statements Division*

Analyzes periodical financial statements and reports filed by corporations with the Commission to determine compliance with the laws, decrees and rules and regulations being enforced by the Commission; systematically files and keeps the financial statements and reports submitted periodically to the Commission by corporations and gathers and collates data on financial statements of corporations for statistical purposes; issues certification on the financial statements.

7. *Brokers and Exchanges Department*

Handles the registration/licensing, regulation and supervision of stock exchanges, stock brokers, dealers, securities salesmen, futures commission merchants, floor brokers, commodity futures associations, commodity pool operators and commodity futures advisors/solicitors; processes application for registration of securities and request for exemption from such registration; processes listing application of companies for trading of their securities on the stock exchanges; and performs other related functions.

1) *Registration and Licensing Division*

Analyzes and processes application for registration of securities and request for exemption from such registration; evaluates petition for increase in the offering prices of securities, verifies petition for approval of stock option plans, petition for revocation of

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registration of securities and suspension of license to sell securities; records registration of securities and renders opinions and advisory assistance relative to its over-all functions.

2) *Securities Trading Regulations Division*

Analyzes and processes application for registration/licensing of stock exchanges, brokers, dealers, salesmen and application for listing of securities, including withdrawals; analyzes member-firms' financial conditions; conducts examination-audit of their operations and activities and initiates appropriate action per finding and observation.

Observes trading in the floor of the stock exchanges and facilitates issuance and delivery of stock certificates; ferrets out unlicensed brokers, dealers and salesmen; detects deceptive and manipulative activities and practices; and ensures that no unregistered securities are being floated to the public; monitors compliance with the terms and conditions of permits to sell securities.

3) *Commodity Futures Operations Division*

Evaluates the application for registration/ licensing of futures commission merchant/ broker; registers/licenses futures commission merchants/brokers; supervises the operations of registered brokers' trading activities (transactions); enforces SEC rules and regulations governing futures commission merchants and salesmen; and recommends policies, guidelines, rules and regulations to the Commission for effective regulation and supervision of the industry.

8. *Money Market Operations Department*

Handles the registration of short and long term commercial papers; determines the amount of commercial paper issues; coordinates with the industry and other government agencies in the formulation of rules and regulations affecting the commercial paper market.

1) *Registration and Assistance Division*

Processes and evaluates application for the registration, increases/decreases and/or renewals of short and long term commercial papers and bonds; determines the financial capability of co-issuers to meet and service obligations upon maturity; clears and approves the printing of required and applicable commercial paper format.

Conducts conferences and extends advisory assistance to prospective registrants. Examines the books and records as need arises of corporation registration through field audit.

Coordinates with other three divisions or departments on discrepancies on violations uncovered in the analysis of the applications.

Controls releases of approved permits.

2) *Debt Securities Transactions and Evaluation Division*

Conducts periodic verification and inspection of books of corporations whose commercial papers are traded in the market or being kept in inventory by the lenders to determine correctness of representation made and indicated in the registration statement; status of every commercial paper they issued, traded and negotiated;

Makes thorough analysis of issuer's financial condition and result of operation based on the information gathered in the audit for the consumption of investors.

Coordinates with and refers matters to other departments particularly the SMD, CLD and EAD involving audit findings.

Imposes and assesses penalty fines for violations of the rules and circulars implementing PD 678, as amended.

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3) *Commercial Paper Systems Division*

Establishes systems for preparing and storing information about commercial paper issuers to help or guide investors and protect their investments; reviews and compares report of issuers and dealers of commercial papers to determine veracity of representations made and compliance with the existing rules and regulations on registration of commercial papers; and sets up a records system with constant updating for management evaluation, planning and policy determination.

4) *Financial Policy and Research Division*

Conducts continuing studies on money market trends, structure and behavior to serve as bases for proposal for new governmental measures designed to promote the growth and streamline the operation of the money market industry; and consolidates, analyzes and synthesizes all financial and statistical reports, opinions and other documents gathered from their sources.

Processes and evaluates application to print commercial paper forms.

Determines and discloses alleged violations if any committed under circulars No. 2 and 5 and section 3b (2) of the Rules on Registration of Commercial Papers.

Receives, classifies and files new registration papers and books and all relevant papers from RAD, CPSD, DSTED, and from the immediate Director for MMOD confidential records and files.

Undertakes close monitoring of quarterly structural ratios in order to adequately oversee the operational activities of registrants, especially their debt servicing functions to protect the investors.

Undertakes legal evaluation of new applications and/or renewal to issue commercial papers.

9. *Investments and Research Department*

Develops and maintains data systems—either manual or machine—on new investments in newly registered corporations and partnerships and in expansions of existing entities; foreign investments in domestic corporations, branches, subsidiaries of foreign corporations, and multinational headquarters; and securities markets.

Computes financial performances and monitors management information, that is, statistics in the different departments of the SEC.

Consolidates, collates and analyzes statistical data; conducts researches, statistical studies and surveys; and takes charge of all activities relative to the processing of data for computerization purposes.

1) *Investment Analysis and Planning Division*

Analyzes/collates/integrates data on corporate and partnership investments, foreign investments, corporate financial performance, securities industry and statistics on SEC operational activities for management information.

Undertakes policy researches on corporate, industry development issues, micro and macro economic studies, and surveys in coordination with the Statistics Division for the promotion of investments and protection of the investors.

Develops/implements methodologies for economic evaluation of investments and formulates proposals, revisions, suggestions for the introduction or improvement of system, formats and programs of the department.

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2) *Investment Statistics and Research Division*

Provides statistical data and economic information to management for planning and policy-making purposes; develops and maintains a program of statistical data production on corporate investments and finance, business performance, and economic contributions of the corporate sector; uses statistical methods in the collection, analysis and interpretation of quantitative data.

Designs and develops appropriate reporting formats based on the information needs of management and other users; identifies new directions and approaches in the statistical programs of the SEC; keeps abreast of and evaluates the development of national economic policies and business practices; and reviews various economic and financial reports and papers to ensure their consistency and compatibility with the SEC policies, objectives and plans.

Conducts ad hoc researches, special studies, and surveys in consonance with data needs of the SEC.

3) *Publications Division*

Prepares and publishes the SEC Bulletin, Statistical Report, SEC Quarterly, annual reports, monthly reports, Rules and Regulations and other publications.

Attends to the requirements of regularly held press conferences, and to the needs of newsmen and researchers.

Classifies and analyzes documents to determine whether the contents thereof may be disclosed to the public.

10. *Supervision and Monitoring Department*

Supervises the activities of all corporations, partnerships or associations registered with the Commission; monitors the requirement of the laws and mandatory provisions of the SEC pertinent to the corporations, partnerships and entities authorized, licensed and/or granted franchises by the Commission; integrates, analyzes and evaluates ongoing activities or operations of such entities; coordinates with and recommends for appropriate action matters falling within the functions of the department, pursuant to the provisions of PD 1758 promulgated on January 2, 1981.

1) *Division "A"*

Supervises all domestic corporations and partnerships registered with the Commission in all matters pertaining to their compliance with appropriate laws, rules and regulations of the Commission as well as their by-laws.

2) *Division "B"*

Supervises the activities of foreign corporations, partnerships, investment houses, investment companies, financing companies and other financial intermediaries and monitors the faithful compliances with all pertinent rules and regulations issued and terms and conditions imposed by the Commission.

3) *Division "C"*

Supervises the activities of issuers of commercial papers and monitors the faithful compliance with all rules and regulations, terms and conditions of the Commission.

4) *Division "D"*

Supervises the operations of stock market and commodity futures market and monitors the faithful compliance with all rules and regulations, terms and conditions of the SEC.

11. *Securities Investigation & Clearing Department*

Adjudicates through speedy inexpensive and fair trial of all intra-corporate cases filed with the SEC; conducts legal researches and studies on cor-

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porate practices and controversies and compilation of research materials; handles the enforcement of laws under its jurisdiction and the rules and regulations, decisions, orders or rulings promulgated pursuant thereto and the punishment of transgressors of such laws and regulations; and holds in custody all current case records, evidences, documents, reports and evaluates records on appeal.

1) *Litigation and Adjudication Division*

Conducts necessary trial and hearings in accordance with the rules and procedures of the Commission and the Rules of Courts of all cases filed with the Commission; receives and evaluates evidences presented, and as directed by the Commission recommends and/or promulgates and issues orders, decisions, ruling or judgment thereon after trial.

2) *Jurisprudence and Research Division*

Supports the Department and other divisions under it with the needed and required materials and tools to enable the Commission to promulgate and issue sound and intelligent decisions, orders or rulings on the cases before it and augments and provides the Commission's technical staff on appealed cases.

Conducts continuing program of study, research and the compilation of decisions and opinions on important and leading cases, both local and foreign, on corporate and partnership practices, problems, controversies and cases with the aim of contributing to the development of much needed Philippine jurisprudence primarily centered on corporate practices and problems.

3) *Docket and Process Division*

Supervises and controls all records of cases filed with the Commission; maintains entries in docket books, record books on judgments, appealed cases, writs and processes; monitors reports as well as transmits or elevates case records on appeal to the Commission en banc and/or to the Supreme Court.

Receives records and maintains pleadings in connection with all cases filed with the Commission and prepares and serves summons, subpoenas and notices, writs and other legal processes including decisions, rulings or orders of the Commission and sees to it that such legal processes are complied with.

12. *Prosecution & Enforcement Department*

Investigates possible violations of laws enforced by the Commission and the rules and regulations promulgated pursuant thereto; files and prosecutes civil or criminal cases before the Commission or other courts of justice involving violations of the statutes administered by the SEC and its rules and regulations.

Coordinates with and aids other government agencies in the effective prosecution of other cases wherein coordinated efforts are called for; and enforces all SEC laws by prosecuting erring corporations, partnerships and associations in accordance with the pertinent rules on procedures.

1) *Complaints and Investigation Division*

Receives complaints on violations of laws enforced by the SEC and the rules and regulations promulgated thereunder; initiates proper investigation of corporations and partnerships or persons, their books, records and other properties and assets, involving their business transactions.

Conducts investigations as well as gathers data from intelligence agencies of the government on the business background of officers and directors of corporations, stock brokers, dealers, salesmen, commodity future merchants, floor brokers, pool operators, advisors and such other persons involved in infraction of laws, decrees, rules and regulations being enforced and administered by the SEC.

Reports and recommends appropriate action and measures thereon.

2) *Prosecution Division*

Files and prosecutes civil and criminal cases before the Commission and other courts of justice involving violations of laws and decrees enforced by the SEC and the rules and regulations promulgated thereunder.

Prosecutes erring officers of corporations and partnerships, commercial paper issuers or persons in accordance with the pertinent rules on procedures; coordinates with and aids other government agencies in the effective prosecution of cases wherein coordinated efforts are called for.

3) *Case Records Control Division*

Exercises general supervision and control over all records of cases filed with the Department; dockets and maintains case records, record book on judgment, appealed cases, and writs and processes; and compiles decisions and opinions on important and leading cases on corporate and partnership practices for utilization in the disposition of cases filed with the Department.

13. *Administrative & Finance Department*

Takes charge of administrative activities; serves as clearing house for information for corporations and partnerships and associations or foreign corporations; prepare budgets, collects fees, handles accounting, personnel, records, property, library, medical and dental; handles receiving and releasing of all applications for registration and gives certifications and performs other related functions.

1) *Budget and Fiscal Division*

Prepares annual, supplemental, or special, budget estimates, fiscal plans, financial and budgetary reports, requests for change in financial plans of fund releases; collects and receives all payments for filing fees and services charged from registrant corporations and the general public; prepares payrolls, vouchers, checks and treasury warrants.

2) *Accounting Division*

Keeps books of account of the Commission reflecting the financial conditions of the Office; prepares trial balance and monthly reconciliation of accounts; certifies availability of funds and allotments against which the expenditures and obligations may properly be charged; and records financial transactions taking into account allotments, disbursements, collections, deposit bills, warrants, etc.

Processes payrolls, vouchers, P. D., W. O. Checks and verifies all supporting papers and documents; takes charge of remittances, GSIS, BIR, and other government agencies.

3) *Administrative Division*

Handles all incoming communications, records, letters, documents received through the mail; processes and screens all communications before forwarding them to the different departments for action; handles the mailing of all outgoing communications, bulletins, documents, etc.; answers routine queries, referrals, transmittal letters of approved documents for registration, etc.; takes charge of the library facilities, courtroom, etc., and handles the dissemination of office circulars, orders, memos and others.

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4) *Supply and Property Division*

Determines the needs of the Commission for office equipment and supplies and takes charge of their procurement; undertakes periodical inventory of office equipment; and follows-up requisitions for supplies and materials needed.

5) *Records Division*

Operates in the area of specialized corporate/partnership records management and on corporate/partnership data gathering and information; attends to researches, credit investigators, students and others; receives and classifies documents filed by corporations/partnerships for use by the various SEC operating departments; releases approved/acted upon documents/papers; and prepares and issues certified true copies of documents/paper on file with the Commission.

6) *Personnel Division*

Takes charge of the recruitment, selection and placement of appointees for screening of the Promotion and Selection Board, for signature of the Chairman, and for transmittal to CSC; updates service records including leave/credits; and processes resignations, terminal and maternity leaves, retirements and requests for transfer filed by SEC employees.

Securities and Exchange Commission

SEC BUILDING, EDSA (NEAR ORTIGAS AVE.)
GREENHILLS, MANDALUYONG, METRO
MANILA TELS. 70-67-69 • 79-61-58

OFFICIALS

MANUEL G. ABELLO
Chairman

ROSARIO N. LOPEZ
Associate Commissioner

JULIO A. SULIT, JR.
Associate Commissioner

GONZALO T. SANTOS, JR.
Associate Commissioner

JESUS J. VALDES
Associate Commissioner

EDIJER A. MARTINEZ
Executive Director

ELNORA E. ADVIENTO
Secretary to the Commission

CORAZON MORANDO
Director
Corporate and Legal Department

FELICIANO A. ARBAN
Director
Examiners and Appraisers Department

CONRADO GALINATO
Director
Brokers and Exchanges Department

NORMA I. DE LA ROSA
Director
Money Market Operations Department

IRENEA V. TIENZO
Director
Investments and Research Department

FE ELOISA E. GLORIA
Director
Supervision and Monitoring Department

EUGENIO E. REYES
Director
Securities Investigation and Clearing Department

SIXTO V. VILLANUEVA
Director
Prosecution and Enforcement Department

JESUS N. MEDALLA
Director
Administrative and Finance Department