

## **Speech – Barbados Chamber of Commerce – April 27, 2010**

Good afternoon ladies and gentlemen. I wish to thank the Barbados Chamber of Commerce for granting me the privilege of addressing you today on the topic

“Capital Markets as an engine of growth for the Barbados Economy.”

This topic is one which I feel strongly about as I believe that we, as business persons and a nation, stand at the precipice of an important time in our economic and national development. The traditional ways of doing business can no longer obtain as we encounter competition both regionally and internationally. In addition, as our nation and our business environment continue to grapple with the spinoff effects of the worldwide economic recession, we need to look at capitalizing on the potential opportunities which present themselves. Increased emphasis on research and development and product innovation are vital for business survival but should the traditional forms of finance be utilised to propel these initiatives?

My presentation will hopefully provide some thought provoking ideas in the area of capital markets that will aid you in getting your business through the challenges of the existing business environment. Therefore, let us begin....

The Oxford University Press defines a capital market as “a market in which long-term capital is raised by industry and commerce, the government, and local authorities. The money comes from private investors, insurance companies, pension funds, and banks and is usually arranged by issuing houses and merchant banks.

Stock exchanges are also part of the capital market and provide a market for the shares and loan stock that represent the capital once it has been raised. It is the presence and sophistication of their capital markets that distinguishes the industrial countries from the developing countries, in that this facility for raising industrial and commercial capital is either absent or rudimentary in the latter.”

Within the capital markets context and the financial arena, a stock exchange and in particular, a national stock exchange is seen as one of the crucial elements essential for a growing, dynamic national economy.

One of the core functions of a stock exchange is to connect entities with surplus funds, to others who require capital. An exchange also facilitates the entire continuous trading and wealth creation process; thus stimulating economic growth and development.

The stock market fulfils a number of vital functions. These include:

1. They aid in price discovery through the generation of transparent prices
2. They facilitate efficient allocation of resources
3. They promote sound risk management and corporate governance structures within publicly listed organisations.

Beakert and Harvey , in their research paper “ Capital Markets an Engine for Economic Growth” contended that underdeveloped and poorly functioning capital markets are a deterrent to foreign investment due to the illiquidity of the market which can as a consequence make the cost of trading expensive. This illiquidity and high transaction cost also effects the capital raising efforts of large domestic corporations and encourages them to seek capital investment from more developed foreign markets”.

Ovidiu Stoica in his paper entitled “The Role of Capital Market in the Economic Development” contends that “the good functioning of the capital market is vital in the contemporary economy, in order to achieve an efficient transfer of monetary resources from those who save money towards those who need capital and who succeed to offer it a superior utilisation, the capital market can influence significantly the quality of investment decisions. The gathering of temporary capitals that are available in the economy, the reallocation of those that are insufficiently or inefficiently used at a certain moment and even the favouring of some sectorial reorganizations, outline the capital market’s place in the economy of many countries.”

Consequently, a well functioning capital market requires the support of strong institutions backed by a well developed legal, accounting, legislative and regulatory framework.

In addition, there should be the following supportive structures:

1. Accurate , timely and readily accessible information
2. Properly aligned incentives
3. Knowledgeable investors
4. Expert and efficient intermediaries
5. Strong issuers
6. Robust technological and physical infrastructure

How is the economic development of a country characterized? And by extension, what is the link between a stock exchange and economic development? Mohammed Momoh

(2007) defined economic development “as the achievement of a quality of life for the average citizen of a country that is comparable to that enjoyed by the average citizen of a country with a modern economy. Furthermore he contended that it is a process of transformation in structures which ultimately impact on the living standard of the people. It is the noticeable change over time of real output of goods and services in an economy.”

How can the stock exchange play a role in economic development?

Ovidiu Stoica notes that the stock market facilitates the investments in financial instruments, their circulation and mobility and through the “offered suppleness sustains indirectly the economy’s financing by the help of the primary market.” The stock exchange therefore inspires trust to participants, confers legality to operations and trust to obtain the best price at the moment. The stock exchange credibility is sustained also by regulations and assumed deontology rules...”

Consequently, the existence of a vibrant stock exchange facilitates:

1. Portfolio diversification
  2. Reduces moral hazard
  3. Provides a mechanism for the change of ownership without impacting on the capital initially invested.
  4. Fosters a culture of innovation
- Several researchers have concluded that stock market development is positively associated with economic growth.

So, given the benefits highlighted above, what has hampered the development of stock markets regionally and more importantly here in Barbados especially given that most of these stock exchanges have been in existence for over two decades?

From a regional perspective, generally illiquid markets characterized by low trading volumes and small number of listed companies in some markets has hampered the ability of the capital markets to play a vital role in supporting economic development.

From a Barbadian perspective, the Barbados Stock Exchange has been challenged with the following issues:

1. Shares in listed companies held by large institutional investors
2. The need to revamp the existing Rules and legislation that govern the capital markets to make it more competitive and attractive to would be investors
3. Generally unsophisticated investors who are risk averse and have not embraced the stock market as a wealth creation opportunity.
4. Issuers who have generally not embraced the forums of providing readily available information to investors beyond the traditional means of the annual general meeting.
5. Regulatory bodies not providing information to the market on issues pertaining to legislation and investor protection on a consistent basis
6. An under developed brokerage community
7. Takeover and merger activity which has resulted in delistings on our board
8. A business community apprehensive of listing given the potential for increased corporate disclosure and perceived fear of takeover .

9. More recently, financial and stock market crisis in international jurisdictions which have affected investor confidence in the stock markets therefore limiting the efforts of the BSE to encourage the stock market as a sound wealth creation mechanism.

What can be done to mitigate these challenges?

It is imperative that the business enablers view the capital markets and by extension the BSE as a mechanism for business and economic development in Barbados. This however cannot be achieved if certain mechanisms are not in place. The regulators role is crucial in the development of the capital market as they can play a pivotal role in public education programs to foster confidence in the markets. In addition, they can spearhead initiatives which seek to develop the market and raise these issues at the political directorate level so that these reach successful conclusions. The Rules of the BSE have taken a significantly long time to be approved. We are currently at the final stages of the process and anticipate formal approval this year. The existence of up to date rules which reflect international best practice is a vital component of a successful capital market. In addition, reviews are currently underway to amend legislation most notably The Securities Act and The Mutual Fund Act. Much progress has been made but it is important that these be raised higher on the agenda of all concerned due to the implications for Barbados to be able to compete internationally as a jurisdiction of choice for foreign investors.

The BSE has made significant financial resources available in educating the general public on investing and to some extent progress has been made in this area. While we are not able to quantify the impact of our educational sessions to the volume of trading

on our Board we have witnessed increased levels in public participation, which suggests that persons are interested in this mechanism as a source of investment opportunities. However, we have recognized that we must also refocus our efforts on the business community and other market practitioners if we are to truly reap a significant turn around in trading activity on our board which during the period 2008 to 2009 have reflected approximately 87 % decreases in trading volume and a 91% decrease in trading value. We have developed a brochure “Going Public” which we will disseminate over the year to inform potential issuers on the benefits to be derived from listing. In addition, we will be rolling out our marketing programs to raise our corporate profile and target the business community and other key practitioners in the business environment e.g. attorneys-at-law and accountants in this exercise.

We have developed a number of initiatives which we believe will aid in economic development. We will now discuss the main initiatives on our agenda.

### **Caribbean Exchange Network**

CXN is a trading network created as a result of a strategic alliance between the participating Exchanges and Depositories. This alliance originally consisted of the Barbados, Jamaica and the Trinidad and Tobago Stock Exchanges which are party to the Regional Caribbean Exchanges Network Agreement and the terms and conditions incorporated into that Agreement.

The vision of the CXN is to create a common Caribbean securities market via an alliance through which the Exchanges and market participants offer their services with few obstacles. The aim is to implement a common cross-border trading system with harmonized trading rules and access requirements.

The main rationale for the creation of the CXN is:

- To bring together the small fragmented markets in the CARICOM region;
- Improve liquidity;
- Enhance price discovery;
- Encourage greater participation by Issuers, Intermediaries, and Investors
- Provide an additional channel for encouraging and mobilizing domestic savings;
- Foster the growth of the domestic financial services sector;
- Provide savers with greater opportunities to protect themselves against inflation;
- Increase the overall efficiency of investment;
- Reduce the corporate dependency on borrowing and improve the gearing of the Regional corporate sector

The technology behind the CXN environment will allow market participants access to other jurisdictions via a connection to their domestic Exchange. As a result, brokers will be able to access financial instruments in other jurisdictions. This facilitates a single point of liquidity and removes the need for financial instruments to be listed on multiple

Exchanges. Consequently, there would be easier access to a broad range of products and services for international investors, companies and members alike.

This is an exciting opportunity and heralds the first step towards regional capital market integration. We have received approval from the Regulators and are currently fine tuning our plans with the aim of a full launch by the second quarter of 2010.

### **International Securities Market**

The BSE is actively pursuing the listing and trading of international securities similarly to what presently obtains in the Bermuda, Cayman and Channel Islands capital markets.

This initiative provides enormous opportunities which include:

- An increase in the market capitalization of the BSE thereby contributing to international exchange recognition status by Revenue Canada and other jurisdictions
- Providing a valuable market for listings of financial structures namely, Real Estate Investment Trusts, Hedge Funds, Registered Retirement Savings Plans and Limited Partnerships
- Capitalizing on long established double taxation treaties and bilateral investment treaties with international jurisdictions
- Providing an ongoing source of income for the BSE to facilitate the long term development of the capital market
- The provision of foreign exchange to the Barbadian economy thereby facilitating economic and national development and

- Increasing Barbados' profile as a vibrant sophisticated international financial services jurisdiction.

We have achieved significant progress on this project. Our international consultants met with members of the international business community and international market practitioners in 2008 and 2009 to gauge the need for such a facility.

Following our initial reviews, a business plan and legislative review was prepared which was forwarded to our Regulator and the various ministries who will play a vital role in this initiative. Additionally, a task force was established to deal with the multifaceted issues surrounding the creation of the market and to ensure that at all stages the needs of the business community were considered in its development. We are presently awaiting word from Government to determine our future course of action. Government intervention is necessary to ensure that our legislation is competitive with other international markets which have a similar product offering and to provide some level of assistance in making this product a reality.

### **Dematerialization of Government Paper**

The Ministry of Finance has already enacted the relevant legislation to facilitate the dematerialization of Treasury Bill issues and this process has been running smoothly for the past five years. Discussions have already commenced with the Accountant General, the Central Bank of Barbados and the Ministry of Finance to include other Government debt issues i.e. Treasury Notes, Debentures, Savings Bonds and Tax Refund Certificates. However, some legislative changes will be required before a transfer of the

debt registry functions to the BCSDI. It is envisioned that these instruments will also become dematerialized depository holdings. The BSE would then be in a position to pursue initiatives geared at streamlining the issue of these securities and promoting a secondary market. This also provides an exciting opportunity for potential investors to have additional investment vehicles at their disposal and can pave the way for the eventual listing and trading of corporate debt. Right now the process of trading government paper is extremely cumbersome and we believe that with the BCSDI managing the registers of government debt and dematerializing those issues it would augur well for the development of a vibrant secondary market for government paper. We are hoping with this in place it would spur the development of a secondary market for commercial paper. These developments would provide new ways for government and the private sector to raise capital and more importantly it would provide institutions and individuals with surplus funds greater opportunity to optimize the returns on their funds and greater diversification in their portfolios. This initiative would create greater breadth and depth to our markets and act as a catalyst for the development of more innovative products.

### **Investment in new technology**

We have invested in new information technology systems in order to strengthen our trading and settlement capabilities and to offer a number of value added services. In 2009, the Barbados Central Securities Depository (BCSD) decided to replace their

existing CSD system, and after a review of available products on the market, the decision was taken to implement Percival Software Limited 's Depend.

At the same time, the Barbados Stock Exchange (BSE) also replaced its core trading system. PSL were able to provide seamless integration between Depend and the new trading system to support the tightly coupled environment with the locking of securities in the seller's account during pre-validation of each order entered.

Our regional counterparts, the Eastern Caribbean Stock Exchange, the Trinidad and Tobago Stock Exchange and the Jamaica Stock Exchange have also expressed an interest in this trading and settlement software. Matter of fact they all watched with interest the successful launch of the new systems on March 29, 2010 when we hosted personnel from the ECSE and TTSE on that date to witness our go-live. These new systems will allow us to add more value to the market and we embarked on this initiative to give us the ability to support the other strategic initiatives that we have embarked upon.

We have invested in our people through local and regional training in order that the service we provide is world class.

### **Other Initiatives**

There are a number of other initiatives we have embarked upon in January 2008 the BCSDI became a full member of the Association of Central Securities Depositories of the Americas (ACSDA), this membership ensures that our market is known and

recognised internationally and it gives us an opportunity to learn from the experiences of other markets. During 2009 we made ourselves more visible in the local market by becoming members of Barbados International Business Association and your organisation the Barbados Chamber of Commerce and Industry. Joining these two organizations is twofold it allows us to play our part in assisting in the development of our own markets and supports our strategic long-term goal of making the Barbados capital market the premier market in the region and the market of choice for the international business person. We have achieved “correspondent status” with the World Federation of Exchanges. This means that we would have access to WFE information and meetings allowing us the opportunity to interact with markets that are ahead of us in their development thereby learning from their experiences. It is our intention to become a full member of WFE all in an effort to bring international recognition to our market.

We are also exploring the possibility of having accounts with Depository Trust and Clearing Corporation out of the US market and Clearstream and Euroclear out of the European market. We want to provide through our depository the facility whereby persons in the offshore sector can deposit securities which they trade in international markets but wish to be able to move them back and forth across markets through the BCSDI. We want to offer international custodial services

In addition, last October, our Deputy General Manager, journeyed to Singapore to begin the process of the BCSDI becoming a member of Association of National Numbering Agencies. Membership to ANNA will mean that we will be able to number all the securities issued in this market allowing us to forward this

information to the global repository. The advantage to this market is that our securities would be globally recognised. We will be finalizing this membership process in June 2010 when we make a presentation to the General Assembly.

However, all these initiatives are naught if we are unable to effectively communicate to the government and the business community on the significant benefits to be obtained in utilising the stock exchange as an engine of growth toward economic development.

If government can offer tax and other incentives to companies who list this would not only facilitate economic development but improve the governance structures of firms.

The dematerialization of government paper would offer further opportunities for locals to purchase government debt instead of utilising the traditional sources of savings like bank accounts and credit union accounts, which all have their role in developing our market. This would as alluded to before, pave the way for the listing of other debt instruments thus fuelling economic activity.

The changes to relevant legislation would make Barbados more attractive to foreign investors and propel our initiatives such as the international securities market which after an initial period could prove to be a significant source of foreign direct investment and raise our international profile even further. The creation of a standing committee to deal with all aspects of commercial law will ensure that our legislation remains in line with international best practice and is a crucial feature in stimulating economic

development. The proposed establishment of a Financial Services Commission is also an important step in this process. However, it is important that the FSC is properly resourced, and is balanced in the execution of its mandate. While it must perform a regulatory role it must play its part in capital market development. There are some conflicts with the FSC Bill and existing legislation and it will be necessary to ensure that these issues are quickly resolved so that the FSC becomes a reality in the near future. The creation of a national forum which addresses the various factors influencing economic development is also vital to this exercise.

Most importantly, businesses must not be daunted by the opportunities which present themselves by listing on the BSE. Let us now dispel the common myths associated with listing....

A public offering by firms can lead to a desired diversification and allow business owners to engage in business opportunities that they would not have had the financial resources to achieve due to illiquid stock of a closely held company. In addition, through public offerings, the true value of a company's stock is known thus allowing existing owners with the opportunity to cash in on the value of the stock and diversify risks. Publicly listed companies can utilise this status in retaining the best employees in the industry and offer incentives schemes such as bonus, options and other stock programs.

Some companies contend that listing results in a loss in control of their operations that they have worked hard over the years to maintain. This is not so. Companies can chose to list a certain percentage of shares or offer only a specific class of shares while essentially retaining control. These options not only prevent a loss in control but also

minimise the potential for takeover action. Others contend that listing requires greater disclosure of a company's operations and increased reporting obligations. While this may be so, this in turn results in overall improvements in the internal financial and corporate governance structure of the company and raises the bar for company management. Government regulators should also be aware of these advantages and educate potential issuers to the market in this respect.

The utilisation of a public offering of equity also has several advantages over traditional bank financing. These include no repayment obligation, no interest obligation and no collateral requirement. These advantages should be weighed with the increased compliance costs associated with financial and material reporting and the costs of going public.

Barbados ranked number 47 in the Global Competitiveness report published by the World Economic Forum of 2008-2009 up from 50 for the prior period. We have been ranked as a country in a high stage of development joining countries such as USA, United Kingdom, Canada and Singapore in this category. Our regional counterparts Trinidad and Tobago and Jamaica were featured in the low stage of development category. This is a tremendous achievement as a small nation but we must not rest on our laurels. There is still much work to be done. We need to adopt a team approach to economic development. The Social Partnership is a step in the right direction. However, we need to further embrace our capital markets as an engine of growth.

Aje and Jovanovic (1989) concluded in their research that "it is even more surprising that more countries are not developing their stock markets as quickly as they can as a means of speeding up their economic development." Our regional neighbours, Trinidad

and Tobago and Jamaica have realized the role of the stock market and are diligently pursuing the creation of international financial centres and the development of investment instruments to widen the scope of their markets. So why have we not grasped the opportunity to utilise our indigenous stock market as an engine for growth? To quote our esteemed professor Mr. Avinash Persuad, the train is in the station.... We must therefore not let this vital opportunity pass us by. Ladies and Gentlemen, it has been a pleasure. Thank you very much for your time and attention and I wish you a good afternoon.

**Marlon E. Yarde**

**April 27, 2010**