02109

FOREIGN PORTFOLIO INVESTMENT CONFERENCE

Report to the ANC

Strictly confidential

1. Overview of the conference

The conference can be regarded as a success in view of

- the better-than-expected turnout (100 participants, compared to the planned 60)
- the good participation in the working groups
- the successful dialogue between the parties
- the very favourable press coverage.

This places the DEP in a good position to exploit the openings made at the conference in the coming weeks.

It was good to hear of several initiatives being promoted by financial institutions, which had not come to light before.

The Cosatu delegation - although notified by Cosatu only at the 11th hour - was strong and fairly representative.

Some things were not achieved at the conference, however:

Firstly, we were not able to communicate our position on economically targeted investment (though not for want of trying). Many of the participants still believe that one can have <u>social spending</u>, or one can have <u>investment</u>, but that there is no connection between the two. The main aim of the conference was indeed to convince the institutions that this view is hidebound and old-fashioned, that there is a large overlap between spending which creates jobs and develops infrastructure, etc, and spending which yields commercial returns.

Further effort is needed to educate the financial sector on this point. Of course, some of the institutions have seen the light and they appear in Section Three.

Secondly, inadequate attention was given to forex risk. No-one is going to invest in South Africa kwowing that the rand is going to depreciate, without some compesnation or protection. The group dealing with this issue was very small. Further attention needs tobe given to this matter urgently.

Thirdly, many players are not convinced that any money raised by our initiative could be usefully spent. There is after all a plentiful supply of indigenous savings at present. Two responses are required. One, the financial sector must begin to take some responsibility for this problem, and not merely say that "it's not our role". Two, the machinery does exist to put very large sums "into the ground", and this is discussed in detail below. These points need to be communicated more effectively to the financial sector.

The missing link

It is well known that there is a structural failure in the link between savings and investment. Savings are well-mobilised in South Africa, but have inadequate outlets and are not turned effectively into productive investments.

The common cry is that the "machinery" does not exist, to turn savings into investments. In the case of housing, this undoubtedly has some truth.

Three types of "machinery" do exist, however, but have been neglected. They have the capacity of getting many billions "into the ground" quickly and economically.

Only one type of such "machinery" was adequately discussed at the conference: property developments in black areas. It seems likely that one or possibly more vehicles to facilitate **commercial property developments in black areas** will shortly be launched: they have the capacity of investing perhaps up to R1 billion in the next few years. This will increase living standards, reduce the cost of living and reduce travelling times for a significant number of township dwellers. There will also be a useful job creation spinoff, though necessarily temporary.

The sceond type of machinery is **the small and medium sized company.** The background is this: almost as many South Africans are unemployed as have jobs. We therefore have to create as many jobs in, say, the next twenty years as have been created in the past 340 years (taking 1652 as the beginning of capitalist South Africa). Creating extra jobs at existing companies - of which there are tens of thousands - will obviously be cheaper and quicker than forming new companies (though this must happen too). These companies are a priceless national asset which should be given every reasonable assistance for expansion. They have the infrastructure, staff and experience to employ more staff. Capital must be made more easily available to them, and also cheaper. (This does not mean subsidies - it requires mainly certain structural changes in the markets).

The conference heard one or two ideas in this connection. It is noteworthy that the unions have again taken the lead in this field, and have been been discussing a fund to provide capital to expanding smaller companies with a large life assurer. These negotiations were broken off at the instance of the assurer.

Much greater efforts should be made to increase the supply and reduce the price of capital to small and medium-sized companies.

Thirdly, the **white local authorities** constitute a very large and capacious "machine" for urban infrastructural development. They are probably under-utilised and could be required to service the black communities as well as the white areas without a great reduction of standards. Productivity increases would enable their resources to be stretched much further. Two obstacles remain: firstly, the political dispensation for local authorities has not yet been clarified. And secondly, local authorities are altogether unable to raise loan finance. The government no longer guarantees local government bonds. They are therefore wholly unable to borrow money from the risk-averse life offices. A change in government policy, or an innovative instrument acceptable to the life offices, would change the picture dramatically.

2. Reports from the working groups

<u>Foreign Investment Platform</u>

The Group agreed that

1. It would be desirable to establish a "platform" to market South Africa as an investment destination for foreign investors. The platform should not be limited to portfolio investors only, but should also include marketing to

potential direct investors, lenders and development aid granters. The platform should relate to a "defined range" of potential investments.

2. The group did not feel competent to define the range because it was not adequately representative. However the group did feel that the defined range should exclude the extreme left and the extreme right. By way of example the extreme right would be a short-term investment in a project in Botshabelo and an investment of the extreme left would be a non-income generating social upliftment project.

3. Despite the platform's limitation to a defined range, the platform as platform would not intervene either negatively or positively in the motivation for an investment outside the defined range. However this would not preclude a member of the platform by either motivating or opposing an investment outside the defined range. Within the defined range however all members of the the platform would support the investment.

4. The platform would be essentially a co-operative platform for marketing South Africa as an investment opportunity. It would be attempt to constitute itself as a challenge for such investments and the primary motivation and challenge would be the specific institution motivating the investment.

5. The platform would discuss and where appropriate seek to influence South African policy makers on South African policy which is prejudicial to foreign investment in South Africa.

6. The platform would also discuss and where appropriate take a position on economic and social policy and structure which is conducive or prejudicial to foreign investment.

7. A steering committee which is representative of the potential parties to the platform should be established as a matter of extreme urgency to define the range of the platform and motivate membership of the platform and determine how it will function.

8. The group did not feel competent to suggest who should be members of the steering committee as the steering committee must be representative and the roup itself was not representative enough to be able to suggest membership.

<u>New Financial Instruments</u>

The Working Group firstly considered the issues of **marketability and liquidity,** which were critical to the foreign investor.

- Specific suggestions were the need for:

    * measures to make socially acceptable investments more attractive to investors;

    * careful assessment of the risk/reward ratios;

    * the possibility of securitisation, i.e pooling of municipal bonds, etc, which was well known to US investors;

    * the probable need for Government guarantees;

    * subjeting new instruments to the assessment of a ratings agency;

    * the desirability of having instruments issued by well known and reputable South African public and private corporations and for such corporations to undertake the making of markets in these instruments; and

    * regular communication was required with foreign investors on local financial instruments andf on the markets.

Foreign investors with a higher risk aversion, and their exposure to both currency and country risk, propably required a more generous return and shorter maturity stocks than the local investors.

However, low interest rates abroad (the 30 year US bond is now at a 30 year low at around 6,5%) might make yields that appear low to the local investor, acceptable to international investors, particularly because of the yields enhancing effect of the financial rand system.

Local investors, particularly the contractual savings industry, were likely to take a longer term view of investment returns because of their pension fund and long term insurance commitments, etc. Accordingly, they would propably accept lower yielding and longer term instruments than the foreign investor. The **perception** of the correct yield was debated in the working group. It was suggested that the South African institutions perhaps required too higher a yield. On the other hand, it was indicated that the uncertainties associated with new social type investments, at this point in time, demanded relatively high yields. The Eskom EPN issue was mentioned as an example - where 12% option was preferred to the 6% revenue sharing option by the majority of investors - although this was still below the normal Eskom long term bond yield at the time of issue.

It was believed that the risk of **prescribed investment** requirements (with all the distortions this presented and Zimbabwe was quoted as a example), would encourage the South African institutions to consider favourably, the voluntary investment of funds into social type instruments.

The granting of **tax free** status to social investment was debated. Two factors were against this:

* pension funds did not pay tax in any case; and

* the granting of tax free status to some investments and not to others created distortions in both the fiscal and inteerst rate structures and should be avoided.

The **pooling** of social type investments into a single issue was desirable, i.e. the National Housing Forum could raise money at a cental level for on-lending to smaller institutions, communities and agencies involved in the housing sector, for instance. A umbrella fund for community development programmes was also mentioned.

Linked units, offering investors the option of high and low coupon instruments with varying degrees of risk were supported. The attraction of **revenue linked units** (linked to the revenue of regional, municipal and local authorities) for infrastructure and other services provided by these bodies was favourably considered.

Equity instruments. Development funding of business and employment creating activity might be better served by equity as opposed to debts instruments. Equity instruments would enable investors to share in the profit of successful business enterprises created through finance granting by such equity funds.

The poor record of **venture capital funds** and instruments in South Africa was cited as a detriment to equity funds and pointed to the need to create bodies that would reduce the risk of venture capital investments, i.e. through pooling or securitising venture capital projects.

<u>New investment vehicles</u>

The working group identified and discussed a number of issues that need to be addressed further. Accordingly, the key issues were referred back to the conference organizers for further deliberation.

Existing Investment Vehicles:

• Existing development institutions such as the SBDC and SAHT were identified as possible investment vechiles. However, it was felt that these were unsatisfactory in a number of respects:

a. From a structural perspective, the institutions were viewed as excessively bureaucratic, inefficient and politically tainted.

   Furthermore, there appeared to be extensive duplication amongst many of the institutions. It was consequently agreed that they needed to be restructured in order yto become more focused, possibly on a regional basis to ensure closer contact with the target communities.

b. From an institutional investor perspective it was felt that there was insuffient opportunities for investment in the existing institutions. Only a small amount of development directed bonds had been issued. A greater role for the financial institutions was thus recommended.

c. Finally, from a community perspective, the existing institutions were found to be most deficient. There was unanimous agreement on the need for greater community involvement and consultation. Development should view the targeted communities as equal partners in the process and thus grassroots interaction, community feedback and clear accountability were essential.

Role of Financial Institutions:

The increase in the negotiated funds market was expected to place increasing pressure on financial institutions to help develop suitable investment vehicles. The fiduciary duty of the institutions was highlighted and the implicit requirement that funds be handled in a responsible, risk averse manner. Concern was expressed about the short term nature of performance comparisons and the debilitating effect this had on the ability of institutions to undertake market related long term investments where initial yields were below market rates.

Foreign Investment:

The importance of foreign investment was stressed, not only for the capital it would deliver but also the skills and expertise it would bring. A need for detailed presentations to American investors was identified. Concern was expressed as to the lack of a single co-ordinating body adressing this area. It was noted that a Commission of Economic Reconstruction and Development was under development and that this body may serve this purpose.

There was divergence as to the optimum degree of co-operation between competing investment vechiles targeting foreign investment. Some argued for greater participation in order to avoid "recreating the wheel" and maximise the effectiveness of the presentations to the potential foreign investors. However, others preferred unrestricted competition. It was felt that the issue of the extent of co-operation was particularly important one that warranted further consideration by the organizers.

Job Creation

It was again unanimously agreed that sustainable job creation be a priority for any new investment vehicle. Many other development initiatives (such as low-income housing) would not succeed if the target market did not have a regular income. Small business creation was identified as the most cost-effective manner of creating new jobs and thus the urgent need a fundamental restructuring of the SBDC (with its 70% lending to white business) was again emphasized. A further obstacle to small business is the investor orientation of South Africa's capital markets i.e. they are designed to raise R1bn in capital but are inefficient at raising small amounts such as R1m.

Venture capital was also viewed as an important mechanism. Despite the poor track record of venture capital in South Africa, it was apparent that at least two institutions were developing venture capital type investment vehicles.

A final point made by the working party was the need for the greater political support for the various investment vehicles. It was suggested that some form of kick-start, such as a tax concession, be utilised to "get the ball rolling".

Management of forex risk

The group was poorly attended, which did not reflect the importance of the topic.

It was felt that exchange controls were distorting the market and making South Africa an unattractive investment venue.

The followiung ideas were raised:

1. Offshore zero coupon dollar fund will not only protect the capital invested, but will also reduce country risk.

2. An offshore investment fund investing in, say, European fixed interest securities, could achieve the same result as (1) above.

3. Natural hedges.

4. Debt/equity swaps

The following esoterics were also mentioned:

1. Currency options

2. Currency swaps.

Finally, the potential role of overseas agencies, especially United States Agencies such as IFC, POIC, USAID and the World Bank and IMF, needed to be explored.

Compliance with US investors' requirements

Two categories of investors were identified:

1. Portfolio investors, e.g. pension funds

2. "Direct" investors, e.g. MNC's

The following requirements apply to both categories of investors:

1. Consensus on lifting of sanctions. South Africans need to sent clear and unambiguous signals; and should be heard to be speaking with one voice when the time for lifting sanction is right.

2. They need political stability. The current spate of voilence needs to be eliminated or at least reduced.

3. Sustainable macroeconomic policies. Guarantee against expropriation.

4. Elimination of dual exchange rate. However, it was felt that this can only be done when internal situation has stabilized. Furthermore, research needs to be done about the macroeconomic impact of the removal of this system.

5. Create appropriate instruments for different categories of investors. Liquid, high return and dollar denominated instruments are preferable. Government guarantees of debt instruments are essential to success.

6. Local borrowers need to be credible in respect of management and performance. Restructuring of existing institutions is important.

7. Concern about lack of structures to support emerging entrepreneurs, especially Blacks.

8. Create an investor information centre.

3. Potential partners in the Platform

A number of companies are either working on suitable investment products, or are anxious to join the Platform. This is a preliminary list from our knowledge of the players; there might be more.

Theta Securities

This is a new company consisting of the former Projects Division at UAL. They were responsible for creating CHIPs and EPNs. They are particularly interested in devising ways of minimising forex risk, which have been discussed with us. They probably have a number of other projects under consideration.

Our view is that their participation is vital in solving the forex problem - foreign investors will all want answers to this.

Contact person: Daan Wandrag

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Alexander Forbes

The Negotiated Benefits Division is promoting a property unit trust to invest in commercial property in black areas. They are planning to use UAL as managers; in fact UAL will control and own the venture. They want black provident funds to put up the money, but obviously it will be attractive to foreign investors.

We regard their plans as incomplete and insuffienctly researched: there are numerous practical problems which have not been dealt with. We are also of the view that unions would prefer to control their own property fund.

Negotiations are under way therefore to establish whether this project can be amended to fit in with the unions' own possible fund.

Contact: Peter Theunissen

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Simpson McKie Inc

• They propose a bond issue, called the Good Hope Loanstock, of $5 billion. It will be guaranteed by using about half the money to purchase zero coupon bonds offshore. The balance will be brought in through the finrand to fund "community development" and "venture capital" projects.

Like so many of these projects, it is not clear who will find and manage the underlying projects; we may end up with lots of money we cant spend. The funding mechanism assures investors of low forex risk, but does not add to South Africa's forex reserves. In fact, its main effect will be to free up local currency for the target projects.

Contact: Bill Yeowart

Telephone: 011 836 7415
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Frankel Pollak Vinderine

This company has not disclosed the exact nature of the instrument it is proposing.

Contact: Mike Brown

Fax: 011 836 0402

Kaplan Stewart Inc

Malcolm Stewart has a proposal to create an Enterprise Board as part of the Johannesburg Stock Exchange. Very small companies could be listed here to raise really quite small sums of money, prhaps as little as R300 000. Sponsoring brokers would be compelled to put up a percentage of the capital themselves, and would also be compelled to make a market in the shares.

Contact: Malcolm Stewart

Johannesburg Stock Exchange

There are plans to open up the market to smaller companies and to increase liquidity but these have not been publicly disclosed.

Contact: Roy Anderson

Community Growth Fund

This will be an attractive prospect for the smaller private investors wishing to invest in quality JSE stocks which have also been socially screened. They will however incur forex risk if they invest directly.

The CGF is managed by Syfrets Managed Assets.

Contact: Mark Anderson

Telephone: 021 471 677
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Community Income Fund

This will place investments in infrastructural developments as and when suitable bonds become available. This will include electrification, township upgrading, water supply and possibly housing. In the meantime, relatively progressive issuers such as Eskom and the Umgeni Water Board might be selected. When the DBSA and SA Housing Trust, for example, have been reformed, their issues will also become attractive.

This fund will suit the smaller private investor who seeks a pooled fund. The forex risk must be considered, however.

This fund is already packaged and awaits only union approval. It will be managed by the Old Mutual investment department.

Contact: Mark Anderson

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SAICOR

This is the New York operation managed by Peter Jardine. He will be setting up several entities to facilitate investment in South Africa. We are negotiating with him on two of them, which would effectively be carbon copies of the CGF and CIF.

These funds will target a relatively small number of very large US institutional investors such as pension funds. They have to place their funds in US-domiciled entities.

The plan is that the unions' own company, Unity, will screen SAICOR's investments in the same way that it does for the CGF and CIF. That gives the investor the satisfaction of knowing that the chosen investments have been cleared by the unions.

Many details still have to be worked out.

Contact: Peter Jardine

Standard Merchant Bank

Their investment managers have consistently performed extremely well over a period of years. They are now having discussions with us on the question of a development capital fund. This would be controlled by the unions but managed by SMB; its main aim would be to fund job-creating expansion projects at smaller companies.

There is a great deal of work still to be done on this project, but SMB have in any case asked to be included on the Platform.

Conatc: Alastair McLuckie

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Capital Partners

This is a new, small company which finds "capital partners" for smaller companies. It acts on behalf of Fedlife at present, which has established a Capital Fund with R50 million to fund such companies. Most of their seven ventures so far have been management buyouts, but they also look for development capital, expansion capital, replacement capital etc.

They have expressed a willingness to work together with a union-controlled Job Creation Fund and we may pursue this if that project is taken further.

Contact: Anthony Ball

Telephone: 011 482 1836

Investec and Fedlife

Investec Merchant Bank and Fedlife are investigating the feasibility of a new instrument to finance low-cost housing. Discussions have been held with the SA Building Federation. No details are currently available.

Contact: Peter Cahi

Community Banking Project

The target for this project is the vast number of people who have no bank facilities. The aim is to provide low-cost services to low-income earners. A further aim is to ensure that depositors' savings are re-cycled to the communities from which they came. Co-operation is being sought from the four major banks; it seems likely that a large computer facility will have to be bought or contracted.

A community trust will plough some profits back into the affected communities. The bank will be a mutual.

Contact: Bob Tucker

Telephone: 011 332 8132
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Land Investment Trust

This non-profit subsidiary of the New Housing Company (itself a spin-off of the Urban Foundation) aims to use private sector capital to buy land for low cost housing. It has already raised a considerable sum from provident funds, payingreasonable returns with risk partially guaranteed.

Contact: Taffy Adler

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National Stokvels Association/Peoples Income Fund

The Peoples Income Fund is a unit trust managed by the Board of

- Executors and investing in gilts. Stokvels are invited to invest their reserves in the Fund, which is then used as collateral for loans made by First National Bank. The Independent Development Trust has provided a further guarantee of R10 million.

  Contact: Steven Japp

• Community Property Fund

This is still at the conceptual stage. It will be a convertible loan stock company owned by the trade unions. It will issue deventures and purchase or fund commercial and industrial property in black areas, adjacant to black areas or in the inner city. Southern Life have agreed in principle to place certain existing properties in the fund in exchange for paper, in order to get the project off the ground.

The firm of H Penny and Co. are advising Labour Research Service in putting this project together.

It is hoped that it can be merged with the Alexander Forbes initiative. Either project has the capacity to absorb very large sums of money.

Contact: Gordon Young

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Job Creation Fund

This would be a development capital or expansion capital fund controlled by the unions. Provident funds would place up to 2,5% of assets in this fund. It would support smaller listed companies and unlisted companies It is still in the planning stage.

It will be managed by a large institution, and will use any consultants, including the SBDC or Capital Partners, who are able to introduce good prospects. The managers will be required to share the risk.

The unions could be expected to impose three conditions: jobs are created or saved, the company recognises the union, and basic minimum labour standards are maintained.

Contact: Gordon Young

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Investment Development Unit

This is a project of the Life Offices Association. It aims to find socially desireable investment opportunities which at the same time offer market-related returns to the institutions. Its first issue was the Electrification Participation Notes, which raised R750 million successfuly. The investor takes a slight risk on the performance of Eskom in installing and selling

- electricity, with no cap to potential gains.

It is hoped that EPNs will later become marketable, which would make them attractive to foreign investors. Unfortunately, there is a foreign exchange concern about this.

A second issue under study is a housing bond. This project also involves the New South Africa Housing Association, which would administer the funds at wholesale level, and community development trusts which would operate at retail level.

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