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Presentation by Afsar Ebrahim, Deputy Group Managing Partner, BDO Mauritius, at the public session on the *Role of intermediaries in facilitating long-term financing through capital markets*

- Perspective from Mauritius and East Africa: Issues and challenges in raising LTF through capital markets
- Preponderance of debt financing in Africa.
- Does the supply of LTF generally match the need for capital?

Following the financial crisis, the focus of policymakers and regulators has been on financial stability. I will refrain from going into the debate about the role of regulators and policymakers in the build up to the financial crisis but suffice it to say that we are still exposed to a repeat of a similar crisis. We in Mauritius have been lucky with our prudential regulatory norms compared to the light touch regulation that prevailed in certain developed economies prior to the crisis. As a result, policymakers and regulators are still trying to bridge a credibility gap and, so far, they have not convinced us that, in terms of economy recovery, all is well and the future is bright .As the order of the day is very much the high degree of uncertainty, there is no confidence level in looking beyond a certain horizon time frame The world economy appears on the surface stable, the political landscape seems hazy and, deep down, it has all the ingredients of us being in a shifting sand mode.

Those financial intermediaries that have the money to lend know best about the state of international finance and their local economy. They are insiders. I tend to believe that they are themselves not convinced about where the world economy or their local economy are heading. The focus is very much on the short term. The status quo to maintain financial stability seems to be the mantra.

To maintain financial stability, the buzz word is deleveraging or shoring up balance sheets. This is prompting corporate to mop up the liquidity from the market with higher yielding corporate bonds. This is moving away from commercial banks to capital markets. These bonds are being favoured by pension funds, insurance companies and individuals who need long term assets to match their long term needs. Is deleveraging promoting uncertainty or weakening the financial intermediaries?

Every economy especially those in the emerging markets like Mauritius and East Africa are at different stages of their economic development. Yet, we are all being subject to global rules and regulations to promote financial stability. It's like driving cars with the hand brakes on. This uniformity in policy making is hampering development. Emerging economies like Mauritius and East Africa are dying for long term funding to meet Infrastructure development and project financing to sustain their development from low income to middle income countries. Yet, financial intermediaries are focusing on short term and funds mobilization is also on a short term outlook.

As policymakers and regulators continue to preach prudence about the economic outlook, the outcome of the financial crisis remains fresh in investors mind. Committing funds for long term remains challenging. In addition, the cost of mobilizing long term funds and the cost of deploying those funds are tricky for those who want to balance the risk and reward of making long term finance a successful investment. Risk pricing is a science which is not well mastered. Financial modeling cannot ascertain all the risks and opportunities

However, the changing political landscape and leadership position, especially in Africa, is resulting in a new economic order. The Development Bank of South Africa is doing a great job in providing long term financing to SADC countries. The Chinese foray in Africa is matched by long term financing for infrastructure. Those of you who have flown into Mauritius for this conference have seen our airport, which was designed by the French, managed by the French, built by Chinese contractor but funded in the main by China EXIM bank. A true success, a true model of the partnership that is emerging. However, the requirements for long term financing are much, much more than this.

In Mauritius and in East Africa, debts are provided in the main by commercial banks whose definition of long term is 7 years for business but exceptionally will go to 10 years unless it is a personal mortgage. (Across Africa, almost 60 percent of bank loans are for less than one year, and less than 2 percent are for more than 10 years).[1] There is a lack of financial instruments that can meet the long term needs of investees and are liquid enough to match investors´ risk profile. Mauritius and East Africa are not like the US, which has a mature bond and equity market.

Corporate bonds tend to have longer maturities than bank loans. In developed markets, the weighted average maturity of high-yield bonds and investment-grade bonds is 7.7 years and 8.0 years respectively, compared to 4.2 years for bank loans.[2] But corporate bond markets in Africa are small and illiquid. In many countries, they are limited by cumbersome regulation. For example, some regulators require credit guarantees before issuing bonds, which makes bonds an

[1] Thorsten Beck, Samuel Munzele Maimbo, Issa Faye, and Thouraya Triki, *Financing Africa: Through the Crisis and Beyond* (Washington, DC: The World Bank, 2011).
[2] Group of Thirty, *Long-term Finance and Economic Growth* (Washington, DC: Group of Thirty, 2013).

expensive form of finance. [3] In Mauritius we have had a series of listed bond issues that have been well received by the market.

Equity remains a stable long term form of financing which capital markets can provide. However, Mauritius and East Africa lack depth in their capital markets to provide the liquidity that investors want as an insurance policy when they make a long term call. This is a confidence issue as there is no strong belief that all will be well in the long term. We are too much in a mode of control risk that we have been brain washed to see the long term as a glass half empty as opposed to half full. This is where policymakers and regulators have a long way to go towards instilling confidence in the market. There are positive signs though. Many stock markets in Africa have undertaken regulatory and institutional reforms to increase activity. For example, restrictions on foreign investor participation have been relaxed. Tax incentives are also used: in Tanzania, for example, equity-issuing companies benefit from a reduced corporate tax rate for three years if at least 35 percent of their equity is issued.[4]

In addition, there is a need to provide for secondary markets to promote the liquidity of long term financial instruments. Mauritius and East Africa are yet to have the regulatory framework for securitization.

Long term financing contributes to long term stability as it can stimulate the much needed economic growth in emerging markets and the stability of cash flow, unlike cyclical hot flows that have contributed to the financial crisis. Long term capital flows will boost investment and if regulators and policymakers combine to facilitate regional capital flows, we shall have not only a prosperous and stable local economy but also a prosperous and stable regional economy.

[3] Beck et al., *Financing Africa: Through the Crisis and Beyond.*
[4] Ibid.