IGC
Growth Week

Finance Session

Purpose of the Finance Programme

- Understanding role of financial markets and institutions in economic development
- Designing financial regulation to promote economic growth
- Improving access to finance

Finance Programme Themes

- Entrepreneurship and SME financing
- Finance and the state
- Financial intermediation, shadow banking and financial regulation
- Access and finance for the poor

Last Year

- Focus on mobile banking and access to finance

This Year

- Financial intermediation, shadow banking and regulation

Topics and Speakers

- First Part – Chair: Colin Mayer

  Shadow banking and non-bank finance corporations – Sabri Öncü

  Break

- Second Part – Chair: Greg Fischer

  Regulation and mortgages in emerging markets – Tarun Ramadorai

  Institutional investors and trading on emerging markets – Rajesh Chakrabarti

Purpose of this Session

- To debate the policy implications of the three areas
- To identify research topics that might be undertaken by the finance programme in these areas
- To establish what is required in the way of data and other resources to promote research
- To discuss other areas of research by the finance programme

Sabri Öncü

- Head of Research at Centre of Advanced Financial Research and Learning, Reserve Bank of India, in Mumbai
- Will present “The Growth of a Shadow Banking System in Emerging Markets: Evidence from India” joint with Viral Acharya

Questions on Sabri Öncü Paper

- What is the functional difference between banks and NBFCs given that NBFCs can still perform Diamond’s delegated monitoring function?
- What is the performance of NBFCs?
- How can performance be evaluated over the long-term?
- How exposed is the banking sector to NBFCs?
- Does it make sense to have a regulated and unregulated banking sector?
- What type of data are available and required?
- What questions should be addressed?

Tarun Ramadorai

- Professor of Financial Economics at the Saïd Business School, University of Oxford
- “How Do Regulators Influence Mortgage Risk? Evidence from an Emerging Market”

Rajesh Chakrabarti

- Executive Director of the Bharti Institute of Public Policy at the Indian School of Business and a fellow of the Wharton Financial Institutions Center
- “Institutional Trading Strategies and Contagion around the Financial Crisis”

Foreign Ownership of Listed Firms – with Andrew Charlton and Wendy Carlin

- Approximately 23% of listed firms in the world are owned by another firm and 8% of these are foreign owned
- In the US, 3% are foreign owned and 4% owners of foreign firms
- In the UK, 9% are foreign owned and 9% owners of foreign firms
- In China, 14% are foreign owned

Scale of Foreign Ownership

- Foreign ownership is significant but by number not overwhelming
- Some countries are much more open and dependent on foreign ownership than others
- By size foreign ownership is much larger - average number of employees of standalone firms is 8,000, of foreign owned firms is 7,200 and of owners of foreign firms is 74,600

Implications of Foreign Ownership

- There are two implications of ownership – finance and control
- Subsidiaries have access to internal as well as external capital markets
- Subsidiaries of multinationals have indirect access to parent and as well as domestic capital markets
- Multinationals allocate resources across as well as within countries

Financial Resources

- Parents have assets and annual cash flows of around ten times those of subsidiaries and are based in countries with larger stock markets
- The investment of subsidiaries is approximately 10% higher as a proportion of their assets than of standalone firms or parents

Two Theories

- Information theories – proximity assists in efficient resource allocation
- Influence theories – proximity imposes non-economic political and social considerations which diminish efficiency in resource allocation

Allocation of Resources

- In firms with above average investment opportunities and average financial resources, investment is 14% higher in multinational subsidiaries than in standalone firms
- In firms with below average investment opportunities and above average financial resources, investment is 8% lower in MNEs than in standalone firms

Response to Shocks

- In the Asian crisis between 1996 and 1998, foreign owned firms cut their investment by 51% while domestically owned firms cut theirs by 28%
- More generally, during recessions foreign subsidiaries cut their investment by approximately twice the amount of domestic firms

Responsiveness to Investment Opportunities

- Subsidiaries that have access to parent firm resources and foreign markets are more responsive to investment opportunities and less affected by capital market constraints
- But subsidiaries are more exposed to alternative investment opportunities that are available globally as well as domestically

The Significance of Distance

- The average distance between a foreign owned subsidiary and its parent is 40% of half of the circumference of the world
- Subsidiaries operate in countries with less developed financial markets, and in a recession investment falls by more in firms in countries with less developed markets
- Investment also falls by more (50% more) in subsidiaries that are distant from their parents

Interpretation

- Location and distance matter
- Distance may make for more objective decision taking (less influence costs)
- Therefore foreign owned firms at arms length from their parents may allocate resources more efficiently

Implication of Rajesh's Paper and These Observations

- Nature of ownership matters
- In particular there is a difference between foreign and domestic ownership of both financial institutions and corporations for financial and real investment decisions
- Foreign institutional investors more trend followers than domestic investors.
- Can this be interpreted as liquidity?
- What does it imply about performance – short and long-term?
- Foreign corporate investors more economically motivated, less subject to influence

IGC Finance Research Agenda

- Entrepreneurship and SME financing
- Finance and the state
- Finance and regulation
- Access and finance for the poor

Entrepreneurship and SME Financing

- How does entrepreneurship differ across countries?
- What have been the most successful examples of entrepreneurship and development of an SME sector?
- What forms of financing are most applicable?
- How can a more active provision of equity finance be encouraged?
- Is funding provided on too short-term basis and what can be done to extend the maturity of finance?
- What is the institutional structure that is best suited to entrepreneurship and SME financing?
- What role should venture capital and private equity play in entrepreneurship finance?
- How can information provision through, for example, credit bureaus be enhanced?
- How important are stock markets and initial public offerings and how can the appropriate balance of control between different parties be determined?
- What type of banking system is best suited to the development of SME sectors and what function should local and international banking play in this process?

Finance and the State

- How should large scale infrastructure and utility projects be funded?
- How can the provision of long-term equity finance be promoted?
- What assurances need to be given to equity investors in long-term, large scale investments?
- What should be the balance between bank and bond finance and to what extent are regulatory requirements going to affect the costs of these forms of finance?
- How can partnerships between private and public sectors be best promoted and funded?
- Under what circumstances is public ownership going to be necessary to correct private capital market failures?
- How can the successful delivery of social objectives by private capital markets and institutions be best encouraged?

Finance and Regulation

- How do fiscal and monetary policies get transmitted through the financial sectors of these economies? What role is played by banks in this transmission?
- Are the NBFCs better than commercial banks in SME lending? If yes, how should regulation view the expansion of NBFCs and their future role relative to the perimeter of regulation?
- Why do fixed income government and corporate bond markets remain relatively undeveloped in emerging markets? Are there structural reasons—such as tight regulation of commercial banks, high liquidity requirements to meet government fiscal needs, lack of depth in institutional forms in fixed income (due to tight regulation) —that are stunting their growth of fixed income markets?
- How can domestic mortgage markets be promoted?

Access and Finance for the Poor

- What are the actual costs and benefits of the various financial products used by poor individuals to meet their financial needs?
- What needs are currently unmet?
- What are the barriers—market failures, regulation, etc.—to meeting these needs?
- What additional services in the areas of microfinance and mobile banking would be beneficial?
- What the barriers to an extension of mobile banking?
- How are financial markets for the poor organized?
- What do financial service providers actually do to screen and monitor clients? How are decisions made within these firms?
- Why are current programmes on financial literacy not working and what can be done to improve them?
- Can remittances be used as an "on-ramp" to formal financial access for recipients and if so, how?
- What can be done to lower the costs of sending and receiving remittances?

IGC Finance Research Programme Agenda

- Are these the rights topics
- Are there others that should be included?
- Are there some that should be dropped?
- What is required to promote research in these areas in the form of data and other resources?