

Surviving the Inevitable: Companies Shift Focus on Risk Management

The recent financial crisis and current global economic recession has highlighted how poor risk management practices can severely impact and undermine the viability of a business, industry and destabilize the financial system. Whether it is a financial or non-financial institution, it is important that there is a focus on risk management.

Recognizing its role of being an effective regulator the Capital Markets Development Authority (CMDA) has over the past two years advocated improved risk management practices and disclosures. This means that market participants need to regularly report and disclose their major business risks, and how they are mitigating or managing them. Recent global trend reveal that companies are now reviewing their approach to risk management, placing a more strategic focus on its implementation and deployment. As a result, risk management promises to become an integral part of planning and running a business.

What is Risk?

Risk refers to future conditions or circumstances that exist outside of the control of the organization which could potentially have a negative impact if they occur. Risk is part and parcel of every business irrespective of, whether it is large or small. Organizations therefore develop and put in place systems to ensure that their operational activities are not overly exposed to risks that could threaten the viability of their business.

Different types of Financial Risks

Business activities entail a variety of risks which can be broadly categorized into market risk, credit risk and liquidity risk.

Market, Credit & Liquidity Risk*

Market risk is the risk that the value of an investment will decrease due to moves in market factors. The four standard market risk factors are:

- Equity risk - the risk that stock prices will change.
- Interest rate risk - the risk that interest rates will change.
- Currency risk - the risk that foreign exchange rates will change.
- Commodity risk - the risk that commodity prices (e.g. metals) will change.

Credit risk is the risk of loss due to a debtor's non-payment of a loan or other line of credit (either the principal or interest (coupon) or both).

Liquidity risk is the risk that a given security or asset cannot be traded quickly enough in the market to prevent a loss (or make the required profit). Liquidity risk¹ arises from situations in which a party interested in trading an asset cannot do so because nobody in the market wants to trade that asset.

Source: www.wikipedia.org

Why risk management failed

It is widely acknowledged that much of the failure around past and current risk management practices point to a lack of understanding about the discipline and how it should be applied correctly. The recent financial crisis has highlighted the dangers of managing various risk types in isolation, each with its own set of tools, applications and models.

Hence much of the failure around risk management lies in the inability to have a more holistic view of risk management and understanding the inter-dependencies of risk across different lines of business.

Businesses need to ensure that risk

management trickles down from high-level business strategy, objectives and goals to the operational facets of the organization, so that all employees, at all levels, gain a company-wide perspective on risk.

Linking Compensation with Risk Management

Compensation practices at large financial institutions have been seen to have contributed to the financial crisis that began in 2007. High short-term profits led to generous bonus payments to employees without adequate regard to the longer-term risks they imposed on their firms. The lack of attention to immoral practice led to extreme levels of compensation in the industry.

This deficiency calls for action by global supervisory and regulatory agencies to ensure that compensation practices in the financial industry are sound. One such agency, called the Financial Stability Board (FSB), comprising of senior representatives of national and international financial authorities, is an appropriate regulatory vehicle for promoting sound compensation practices.

The FSB have developed the "Principles for Sound Compensation Practices"¹ which require compensation practices in the financial industry to align employees' incentives with the long-term profitability of the firm. Implementation by firms will be reinforced through supervisory examinations at the national level.

Genuine Process Vital

It is important for companies to bear in mind that the principal objective of risk management is to reduce the downside risks and minimize lost opportunities from risks facing the business, and not simply to come up with processes that appear to do so in order to comply with corporate governance requirements.

Good, genuine risk management processes will comply with requirements but, more importantly, will also be improving the quality and returns of the business.

¹ More information on this Principle can be accessed on <http://www.financialstabilityboard.org>

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UPCOMING EVENTS

"Seminar for Understanding & Exercising your Right as an Investor"

Dates to be confirmed

Is Fiji's Capital markets ready for an Investor Association?

Continued from last Issue...

"In our investor association article last quarter, we covered the need for an investor association in Fiji and gave example of shareholders activism in the United States and Europe. This article will provide further examples in Asia, Australia and New Zealand. We will round up this issue re-iterating the need for promoting shareholders activism in Fiji."

Shareholder Activism in Asia

Shareholder's Association in Asia picked up momentum after the 1997 financial crisis together with the introduction of compatible rules and regulations to enhance corporate transparency and accountability. Corporate law is actually more shareholder-friendly in Japan than in America or Britain. In theory, Japanese shareholders can vote directly on dividends and executive pay. They can even oust the entire board without cause. Foreigners now own 28% of Japanese firms' shares. They have called on managers to use large cash reserves to increase dividends or buy back shares. Around 30 companies faced shareholder resolutions in 2007, almost twice the 2006 figure. Activists have also demanded revisions to articles of incorporation and the unwinding of recently established "poison pill"¹ measures aimed at preventing hostile takeovers. After years of policy reforms and corporate restructuring that helped turn around the economy, Japanese companies have little debt and are making record profits. But strong operational management has exposed poor financial practices. Despite their strong financial position, many firms offer shareholders little returns. The cash and securities held by Japanese firms are equal to 16% of GDP; in America the long-term average is around 5%. And Japanese companies' return on equity is around 9%, compared with between 14% and 17% in America and Europe².

The rise of institutional investor activism is changing the corporate governance landscape in China. Over the past five years or so, Chinese institutional investors have been involved in the governance of their portfolio companies. These activism efforts have brought some corporate governance rules into practice in the marketplace. As a result, interests of minority/tradable shareholders were better safeguarded, and shareholder value increased. Moreover, institutional activism has played an important role in improving Chinese corporate governance standards. However, shareholder activism remains limited in China. Despite the

¹ A strategic move made by a company in order to make itself seem a less attractive prospect to another company attempting a hostile takeover of it

² The Economist, Jun 28th 2007

recent increase in institutional activism, the degree of institutional engagement with listed companies remains low (Chao, 2006:294).

In Malaysia, the Minority Shareholders Watchdog Group (MSWG) was initially funded through the Malaysian Capital Market Development Fund and had been operational since January 2004. It was formed with the following objectives³:

- Becoming a forum for minority shareholders' to share their experiences in the context of the Malaysian Code on Corporate Governance and the Securities Commission's Disclosure Based Regime and the Capital Market Master plan, and thereafter to build databank on minority interests and corporate governance matters and to conduct continuous on-going research on those subject matters.
- To become the THINK-TANK and RESOURCE CENTRE for minority interests and corporate governance matters in Malaysia and thus, become the centre and focal point of knowledge on these subject matters which will be made readily accessible and available from our computerized databank.
- To DEVELOP and DISSEMINATE the educational information of corporate governance.
- To become the PLATFORM to initiate collective shareholder activism on unethical or questionable practices by management of the public listed companies.
- To continuously MONITOR for breaches and non-compliance in corporate governance practices by public listed companies that may be detrimental to the rights and interests of the minority shareholders and to disclose current practices to stakeholders and publicize such matters. Hence supporting the government's drive for globalization and foreign investment.

Shareholder Activism in Australia & New Zealand

Shareholder activism has now become a focus of lobby and interest groups seeking access to public policy both in Australia and New Zealand. Australian companies are under increased scrutiny through a range of legislation passed through the federal parliament, such as the on-going Corporate Law Economic Reform Process (CLERP), now rolling in its 10th phase. The regulations now passed include a Socially Responsible

³ <http://www.mswg.org.my/mission.html>

Investment (SRI) product disclosure obligation for financial planners and investment product providers, which is expected to encourage greater awareness of environmental and social issues in relation to corporate operations.

The Australian Securities and Investment Commission (ASIC) produced governance guidelines, which companies are already obliged to acknowledge in annual reports. As such, shareholder activists are finding their job is getting easier as companies are forced to disclose more and more about their operations and culture and to think more deeply about the implications of their actions.

The Australian Stock Exchange (ASX, 2003) Principles of Corporate Governance and Best Practice Recommendations calls on companies to 'respect the right of shareholders'. By right of this power, shareholders have the 'capacity to effect or affect organizational outcomes. Under the current structure of public companies in Australia, shareholders elect Board members, as their representatives, to provide overall guidance to the company and to provide an objective check on management. Therefore, the dominant model of shareholder participation being practiced in Australia is one of representational participation as a form of democracy.

In New Zealand, the approach was to set up a process to engage companies in a non-confrontational way. The NZ Shareholders Association meets regularly with many chairmen and CEOs of public companies and organised shareholder visits to most prominent companies for members. This increases the dialogue between company managers, boards and small shareholders. The end outcome of this is a better engagement between ownership and management and a better understanding of each other's position on issues⁴. While their approach may be different, their objective is the same and when combined with voting power the outcomes have seen useful board evolution in thought and processes.

Lessons learnt in promoting shareholder activism for Fiji

The findings from this research reveal the following:

- Through activism, shareholders across the globe are demonstrating a desire to play a more active part in the decision-making of the public companies in which they invest and are often prompted by poor performance of these companies.
- The right of shareholders to participate in some form is inherent in their right of ownership and should be protected through

⁴ NZ Shareholders Association

regulation. The current structure of public companies for example in Australia allows shareholders to elect Board members, as their representatives, to provide overall guidance to the company and to provide an objective check on management. Therefore, the dominant model of shareholder participation being practiced in Australia is one of representational participation as a form of democracy.

- Investor's activism promotes good corporate governance and encourages greater transparency. Better governance means stronger securities markets. Stronger markets play a more productive economic role.
- Legislation could be reviewed to ensure minority shareholders are represented on Boards as is the case in Australia.
- Shareholders activism is a private

enforcement of public law. The Regulator can bring proceedings to establish facts, and this can help inform shareholders proceedings.⁵

Conclusion

From the research and our own observations here in Fiji it is evident that individually investors/shareholders feel marginalized to take action against a large corporation. Investor associations provide a voice for investors to getting resolutions to address problems, improve corporate governance standards, and disclosures by public companies. Investors in the capital markets generally do not have access to independent sources of information that has been critically analyzed, on which they can make informed decisions and respond accordingly. An independent investor group acts as a watchdog and can be an ef-

⁵ Steven Lewis, Feb 2008, Slater & Gordon Lawyers

fective channel for disseminating information through websites and the media.⁶

Although Fiji's capital markets are small and still growing, encouraging investors' activism would support the Authority's initiatives to adopt improved corporate governance practices by stakeholder in the industry. Setting up an independent body to monitor and combat against abuses by insiders against the interests of minorities is important, as they have done in Malaysia. For such an initiative "to be effective, it must not only be structurally independent it must also be perceived to be independent, working for the benefit of minority shareholders".⁷ The Malaysian model is recommended where a Minority Shareholders watchdog Group was set up with partial funding assistance through the Regulatory body's development fund.

⁶ Malaysia Capital Markets Master Plan

⁷ Malaysia Capital Markets Master Plan

What Will Your Retirement Be Like?

Even if it seems a long way off, it pays to plan for your retirement as early as possible. The type of retirement that you will have will depend largely on your health, finances and what you want to do during your retirement years. According to some population studies, the average life expectancy in Fiji or the average number of years a person can expect to live is around 70 years. Therefore one can assume that if a person retires from work at 55 years, he or she will need to have sufficient funds to maintain themselves for at least 15 more years.

People are living longer than ever, which means retirements can be longer. They say that by 2013, men will be expected to live until they are 84 and women until they are 87 – so retirement could be for 30 years or more. That's a long time, so it is important to plan ahead and ensure that you have accumulated enough funds to last their retirement years.

Most workers in Fiji are members of the Fiji National Provident Fund (FNPf) and will be eligible for a pension or lump sum payment upon reaching the age 55 years. To be eligible for the FNPf pension scheme, the FNPf member needs to be aged 55 or over and must have completed 10 years of membership.

The challenge when planning your retirement is to work out how much you will need to live on every month and whether your FNPf funds are sufficient to cover your needs. For most people this may not be enough so they will need to save and invest to generate that extra income.

The FNPf pension rate has been regressively reduced by 1 percent every year from 25 percent in 1999 to 15 percent in 2008. A further reduction is expected based on a recent pension scheme review by the FNPf.

The FNPf pension scheme provides a good building block to fund your retirement. You may need to consider other options as alternative sources of income:

- **Your private savings:**
income from investments such as shares, unit trust and bonds
- **Insurance endowment policies**
- **Small business or part time employment:**
you may be able to keep working part time, as long as you have the skills and capacity
- **Renting out your property**
- **Gifts or inheritance.**

Retirement planning is more than saving money for old age or having a pension or retirement plan at work. It is the time and preparation you put into making sure that the time spent after you decide to leave the workforce is fulfilling, enjoyable and healthy.

LICENSING RENEWALS

New License

- Mr Aisea Wainiqolo was issued a new license to act as a broker/ dealer representative for the FHL Securities Limited (FHLS) from 15 April 2009 to 31 December 2009.

Stock Exchange License

- The South Pacific Stock Exchange (SPSE) was granted a license to conduct the business of a securities exchange from 30 September 2008 to 31 December 2009.

Unit Trust License (Principal)

- Fijian Holdings Property Trust (FHPT) to conduct or carry on the business of unit

trust for the period the next six months beginning 29 May 2009 to 31 December 2009.

Investment Advisor License (Principal)

- Fiji Stock Brokers Limited (FSB) to conduct the business of investment advisor for the period of one year from 31 December 2008 to 31 December 2009.

Investment Advisor License (Individual)

- Mr. Rick Croker to act as an investment advisor from 17 May 2009 to 31 December 2009.

- Mr. John Ridgway to act as an investment advisor from 31 December 2008 to 31 December 2009.

Investment Advisor License (Representative)

- Mr. Dinesh Shankar to act as an investment advisor representative for the Fiji Stock Brokers Limited (FSB) from 19 December 2008 to 31 December 2009.
- Mr. Deven Magan to act as an investment advisor representative for the Westpac Banking Corporation Limited (WBC) from 13 May 2009 to 31 December 2009.

Broker/ Dealer Representative License

- Mr. Sanjay Dewan to act as a broker/dealer representative for Kontiki Stockbrokers Limited (KSB) from 16 May 2009 to 31 December 2009.

Broker License Representative

- Ms Elenoa Qalotaki to act as a broker representative for the Fiji Stock Brokers Limited (FSB) from 29 February 2009 to 31 December 2009
- Mr. Dinesh Shankar to act as a broker representative for Fiji Stockbrokers Limited (FSB) from 16 May 2009 to 31 December 2009

Unit Trust Representative License

- Ms Elenoa Lalabalavu to act as a unit trust representative for the Fiji Holdings Trust (Management) Limited (FHTML) from 15 April 2009 to 31 December 2009.
- Mr. Sowani Tuidrola to act as a unit trust representative for the Fiji Holdings Trust (Management) Limited (FHTML) from 12 May 2009 to 31 December 2009.
- Ms Rowena Fong to act as a unit trust representative for the Fiji Holdings Trust (Management) Limited (FHTML) from 29 May 2009 to 31 December 2009.

Regulatory Updates:

During the quarter, the CMDA received 3 complaints and undertook 6 investigations on potential breaches of the CMDA Act, Regulations and Rules.

News in Brief

Risks Management Workshop

The CMDA completed a two days workshop on Risk Management on 24-25 June, 2009. The workshop was attended by 25 representatives from government, financial institutions and corporations. The workshop was facilitated by Mr. Andrew Butler from the Securities & Investments Institute Asia Pacific (SiiA).

Amendment to CMDA and Unit Trust Act

The Authority is currently working on reviewing the current CMDA and Unit Trust Act. The revised Act will be distributed to market intermediaries for their review and comments once completed.

CMDA 2008 Annual Report Released

The Authority has finalized for the publishing of its 2008 CMDA Annual report. The Annual Report will be ready for distribution to the public after it is tabled in cabinet.

Westpac Retirement Expo

The CMDA participated in a retirement expo organized by the Westpac on Saturday 6th June 2009 at their main branch in Suva. The exhibitors that participated agreed that this first exhibition was a success and that similar expos should be organized regularly at least once or twice a year.

Nausori High School Career Expo

The CMDA participated in a career expo organized by the Nausori High School on 26th June. Over 300 students were able to access information on the career opportunities in the capital markets as well as general information on investing and the school poster competition that was recently organized by the Authority.

Kadavu Provincial Meeting

The CMDA was invited to conduct a presentation at the Kadavu Provincial Annual General Meeting, held on 23rd April 2009. The presentation focuses on good corporate governance and shareholding structure and financial accountability.

Securities Licensing Exam

The CMDA has successfully organized and supervised the final examination of the Securities Licensing Course on 22nd April 2009. The exam was held at the PSC training centre in Nasese. The next examination data is scheduled for 22nd September 2009.

FHL Governance Audit

The CMDA is working closely with the South Pacific Stock Exchange regarding the report on an independent Corporate Governance audit that was recently undertaken by the Fijian Holdings Limited.

Quarter 2 2009 Trading on the South Pacific Stock Exchange

Company	Total No. of Shares Traded	Total Value of Shares Traded (\$)	No. of Trades	Last Price Traded this Qtr (\$)	Qtr 2 (09) - Qtr 1 (09) (% Change)	Earnings Per Share Traded (cents)	Price/Earning Ratio (times)	Divided Yield (%)	Market Capitalisation (\$m)	
Atlantic & Pacific Packaging	-	-	-	0.88	-	2.97	29.60	3.98	7.04	
Amalgamated Telecom Holdings	107,406	119,607	39	1.15	(0.86)	10.93	10.52	7.83	485.42	
Communications (Fiji)	7,400	12,210	4	1.65	-	24.29	6.79	4.85	5.87	
Fosters Group Pacific	3,022,570	40,081,554	6	13.70	(0.65)	96.95	14.13	1.82	142.59	
FijiCare Insurance	11,177	7,510	2	0.67	0.00	8.83	7.59	5.97	4.16	
Flour Mills of Fiji	10,100	7,619	3	0.72	(10.00)	2.58	27.88	-	108.00	
Fiji Sugar Corporation	-	-	-	0.36	-	n/a	n/a	-	15.98	
Fiji Television	7,890	26,432	7	3.35	-	26.56	12.61	5.37	34.51	
Kontiki Growth Fund	-	-	-	0.77	-	n/a	n/a	0.00	2.72	
Pleass Beverages & Packaging	3,000	2,824	5	0.95	-	6.64	14.30	3.16	5.70	
Pacific Green Industries	-	-	-	2.10	-	n/a	n/a	0.00	16.00	
R B Patel Group	7,000	12,600	4	1.84	3.37	14.26	12.90	5.98	55.20	
The Rice Company of Fiji	-	-	-	3.00	-	36.07	8.32	-	18.00	
Toyota Tsusho	-	-	-	1.96	-	9.97	19.66	5.36	27.50	
VB Holdings	-	-	-	3.00	-	9.58	31.32	1.67	4.70	
Fijian Holdings	65,452	191,906	155	2.79	(3.79)	89.34	3.12	7.17	29.20	
TOTAL	3,241,995	40,462,262	225	Market Capitalisation as at 30 June 2009						\$962.61