



Merchant & Investment Banking Operations in Jamaica
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NON-BANKING FINANCIAL INTERMEDIARIES IN JAMAICA WITH SPECIAL
EMPHASIS ON MERCHANT BANKS - THEIR ROLE AND BEHAVIOUR IN
RECENT TIMES

A PAPER PRESENTED TO THE CONFERENCE ON FINANCING ECONOMIC
DEVELOPMENT IN THE CARIBBEAN BY HENRY A. FULLERTON,
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ECONOMIC TRENDS ARE OFTEN TRIGGERED BY ECONOMIC CRISES. I
CITE THE POPULAR STORY OF THE INDOMITABLE WALTER WRISTON,
WHO IN THE EARLY 1960s AS VICE PRESIDENT OF NEW YORK'S
CITIBANK, NOW ONE OF THE LARGEST BANKS IN THE WORLD, TOOK
THE BULL BY THE HORNS WHEN U.S. BANKS BEGAN TO LOSE DEPOSITS
FROM THEIR TRADITIONAL SOURCES.

FOR THE FIRST DECADE OR SO AFTER THE SECOND WORLD WAR,
CORPORATION TYPICALLY KEPT LARGE CHEQUING ACCOUNTS WITH
BANKS. BUT FEDERAL RESERVE BOARD REGULATIONS PROHIBITED
BANKS FROM PAYING INTEREST ON CHEQUING ACCOUNTS AND PLACE
THEM IN OTHER KINDS OF FINANCIAL INSTRUMENTS WHERE THEY
COULD EARN INTEREST, SUCH AS TREASURY SECURITIES.

THIS FORCED BANKS TO COME UP WITH NEW WAYS TO ATTRACT
CORPORATE SAVINGS AND THEREBY STOP THE DRAIN OF FUNDS. IN
1961, WRISTON FOUND THE SOLUTION. HE INVENTED THE NEGOTIABLE
CERTIFICATE OF DEPOSIT (CD). TO TAP CORPORATE SAVINGS, BANKS
SELL CDs IN DENOMINATIONS OF \$100,000.00 OR MORE FOR 30 TO

180 DAYS AT COMPETITIVE INTEREST RATES. WRISTON'S INVENTION ALLOWED BANKS TO BID COMPETITIVELY FOR CORPORATE FUNDS. THEY QUICKLY BECAME DEPENDENT ON FUNDS RAISED THROUGH THE SALE OF CDs. BEFORE FEDERAL REGULATIONS HAD A CHANCE TO DEBATE THE PROS AND CONS, THE REGULATORS ACCEPTED THE CD MARKET AS A 'FAIT ACCOMPLI'. TODAY CDs ARE A PART OF OUR FINANCIAL SYSTEM.

SIMILARLY, THE BIRTH AND GROWTH OF NON-BANKING FINANCIAL INTERMEDIARIES IN JAMAICA HAS IN FACT BEEN A RESPONSE TO MARKET DEMANDS. THE INCREASED LEVEL OF ECONOMIC ACTIVITY, INVESTMENT AND GROWTH OVER THE LAST FIVE YEARS HAS LED TO AN INCREASED DEMAND FOR LOAN FUNDS. TRUST COMPANIES, CREDIT UNIONS, FINANCE COMPANIES AND MERCHANT BANKS HAVE COLLECTIVELY RECORDED SIGNIFICANT GROWTH DURING THIS PERIOD. MERCHANT BANKS IN JAMAICA FOR INSTANCE, GREW BY A SUBSTANTIAL 63 PERCENT TO REACH \$1956.7 MILLION IN TOTAL ASSETS LIABILITIES AT THE END OF DECEMBER 1988. AT THE END OF JUNE 1989 THE FIGURE STOOD AT \$3.5 BILLION.

WHAT IS THEIR ROLE IN THE PRESENT MARKET ECONOMY?

INTERMEDIARIES NOT ONLY INCREASED THE EFFICIENCY OF THE FINANCIAL SECTOR, BUT THEY ALSO REDUCE THE RISK INVOLVED IN FINANCIAL TRANSACTIONS BY BEING MORE WILLING TO TAKE RISKS. THE HISTORY OF MERCHANT BANKS HAS BEEN PRECISELY THIS - QUICK FINANCIAL SERVICES UPON WHICH TRADE AND COMMERCE CAN

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RELY. JAMAICA'S CURRENT CREDIT SQUEEZE AND HIGH INTEREST RATES COULD CAUSE THE ECONOMY TO CONTRACT AS FLOW OF FUNDS TO THE PRODUCTIVE SECTOR IS CURTAILED, JE EVEN TEMPORARILY. THIS ECONOMIC SCENARIO HOWEVER, OPENS DOORS FOR NON-BANKING FINANCIAL INTERMEDIARIES WHO ARE STILL ABLE TO LEND TO DEVELOPMENT PROJECTS. THIS IS IMPORTANT BECAUSE THE ECONOMIC REALITY IS THAT WE STILL NEED TO ENCOURAGE INVESTMENT, PRODUCTION AND EXPORTS. MERCHANT BANKS IN PARTICULAR CAN PLAY A KEY ROLE IN MAINTAINING A CLIMATE FOR DEVELOPMENT, BUT THIS DEPENDS ON HOW LONG THE CREDIT SQUEEZE LASTS BECAUSE MERCHANT BANKS ALSO FEEL THE PRESSURE IN ANY STRINGENT FINANCIAL SITUATION.

JAMAICA'S ENTRY INTO THE MERCHANT BANKING ERA BEGAN IN THE 1960'S AT A TIME WHEN THE NEED FOR CAPITAL FORMATION AND SPECIALIZED FINANCIAL INSTITUTIONS WAS BECOMING MORE EVIDENT. TENTATIVE AT FIRST, BUT ENCOURAGED BY ECONOMIC DEVELOPMENTS IN THE LATE 1970'S AND EARLY 1980'S, THE COMMUNITY OF MERCHANT BANKS ANNOUNCED ITSELF WITH SUBSTANTIAL GROWTH IN BUSINESS.... AND IN MEMBERS.

UP TO THE END OF SEPTEMBER 1989, THERE WERE 27 NEAR BANKS IN OPERATION IN JAMAICA, 16 OF THESE BEING MERCHANT BANKS, COMPARED TO ABOUT HALF THE NUMBER A YEAR OR SO BEFORE. OTHERS ARE REPORTEDLY IN THE PIPELINE, NOT TO MENTION THE TREND TOWARDS THE CONVERSION OF TRUST COMPANIES TO MERCHANT

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BANKS, A SURE SIGN, IF ANY, THAT THE SECTOR IS PERCEIVED TO BE ONE OF SUBSTANTIAL OPPORTUNITY AND POTENTIAL.

THE MERCHANT BANK IS OFTEN REFERRED TO AS A "NEAR BANK", DISTINGUISHING IT FROM A COMMERCIAL BANK. THE ESSENTIAL DIFFERENCE BETWEEN THE TWO IS EASILY EXPLAINED BY THE FACT THAT A MERCHANT BANK CANNOT OPERATE SAVINGS AND CHEQUING ACCOUNTS WHILE COMMERCIAL BANKS CAN AND DO.

HOWEVER, MERCHANT BANKS CAN AND DO ACCEPT DEPOSITS AND GRANT LOANS. THEY WILL ALSO CONDUCT NEGOTIATIONS, ARRANGE MERGERS AND ACQUISITIONS AND FACILITATE BUY-OUTS AND EXPANSION OF COMMERCIAL ENTERPRISES BY ACQUIRING SHARES SOMETIMES TEMPORARILY AS PART OF THEIR SERVICES TO THE BUSINESS COMMUNITY.

MERCHANT BANKS OPERATE WITHIN THE FRAMEWORK OF THE "PROTECTION OF DEPOSITORS ACT" WHICH PROVIDES, AMONGST OTHER THINGS, FOR THE APPOINTMENT OF AN INSPECTOR WHOSE DUTIES INCLUDE:

1. MAINTAINING A GENERAL REVIEW OF THE BUSINESS OF ACCEPTING DEPOSITS IN ORDER TO ENSURE PROTECTION OF DEPOSITORS AND COMPLIANCE WITH THE ACT. IN THIS RESPECT, THE INSPECTOR MUST HAVE ACCESS TO SUCH BOOKS, RECORDS, VOUCHERS, DOCUMENTS, CASH AND SECURITIES OR ANY LICENSEE OR ANY OF HIS SUBSIDIARIES.

2. EXAMINING, AT LEAST ONCE A YEAR, THE AFFAIRS OF THE BUSINESS TO ENSURE THE DEPOSITORS ACT IS NOT BEING BREACHED AND REPORT TO THE MINISTER OF FINANCE. IN THIS CASE, THE INSPECTOR MAY CALL UPON ANY LICENSEE OR SUBSIDIARY FOR INFORMATION OR EXPLANATION HE MAY REASONABLY REQUIRE.

MERCHANT BANKS ARE REQUIRED BY LAW TO SUBMIT RETURNS TO THE BANK OF JAMAICA EVERY MONTH. IN RECENT MONTHS THE CENTRAL BANK HAS STARTED TO PUBLISH QUARTERLY STATISTICS OF ASSETS AND LIABILITIES FOR THE MERCHANT BANKS, AS IS DONE FOR COMMERCIAL BANKS.

SPEED AND INTIMACY

IT IS TRUE TO SAY THAT IN JAMAICA, MERCHANT BANKS HAVE TENDED TO FUNCTION SOMEWHAT IN THE CLASSIC MOLD OF THE TRADITIONAL COMMERCIAL BANK, MINUS THE SAVINGS AND CURRENT ACCOUNTS. BUT TO THE PERCEPTIVE, THERE ARE IMPORTANT DIFFERENCES IN STYLE AS WELL AS SUBSTANCE.

MERCHANT BANKS TEND TO MOVE MORE QUICKLY ON LOAN REQUESTS AND WORK MORE CLOSELY WITH CLIENTS. MANY TRANSACTIONS ARE CONDUCTED OVER THE TELEPHONE, WITH THE PARTIES NEEDING TO MEET ONLY FOR THE SIGNING OF THE SECURITY DOCUMENTS. IN THIS RESPECT, THEY ARE NOT CONSTRAINED AS THE COMMERCIAL BANKS ARE, TO BE LOCATED IN A MANNER TO FACILITATE EASY

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ACCESS BY THE PUBLIC.

SPEED OF MOVEMENT IN PROCESSING CLIENT'S REQUESTS IS FACILITATED BY THE FACT THAT THE MERCHANT BANK HANDLES A MUCH SMALLER VOLUME OF BUSINESS THAN THE COMMERCIAL BANK, AS IS FAIRLY OBVIOUS. BUT WHAT THE MERCHANT BANK LACKS IN MONEY AND BRANCH NETWORK, IT MAKES UP IN QUALITY OF CLIENT SERVICE.

MANY ARE PREPARED TO WORK WITH THE ADMINISTRATORS OF THE BUSINESS THROUGH THE DIFFICULT INAUGURAL PERIOD AND WHEN THERE IS A SLOWDOWN IN BUSINESS. SOME ARE WILLING TO TAKE EQUITY PARTICIPATION IN THE BUSINESS UNTIL IT IS UP AND RUNNING OR RESTORED TO VIABILITY. FOR THESE REASONS, MERCHANT BANKING HAS FOUND FAVOUR WITH MANY BUSINESS PEOPLE WHO APPRECIATE THE SPEED AND INFORMALITY WHICH CHARACTERISE DISCUSSIONS AND NEGOTIATIONS.

THE BROCHURE OF ONE FAST-GROWING MERCHANT BANK PUTS IT IN CAPSULE:

"SHOULD A BUSINESS PERSON HAVE UNUSUAL FINANCIAL PROBLEMS, WE HAVE THE EXPERTISE TO ADOPT A CREATIVE APPROACH TO FINANCING. WE ARE ALSO PREPARED TO LEND FUNDING SUPPORT TO JOINT VENTURES, OR DEVELOPMENT PROJECTS, AND WE ARE EQUIPPED TO ASSIST THE BUSINESS VENTURE BY PROVIDING MANAGEMENT

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SERVICES. WE WILL PREPARE THE COMPANY'S FEASIBILITY STUDIES AND, IDEALLY, MAINTAIN A CLOSE WORKING RELATIONSHIP WITH THE CLIENT THROUGHOUT THE LIFE OF THE LOAN."

IT IS WORTHY OF NOTE THAT THE COST OF MONEY IS NOT NECESSARILY ANY LESS THAN IT IS WITH A COMMERCIAL BANK, AND MERCHANT BANKS OFFER NO LESS STRINGENT REQUIREMENTS FOR GRANTING LOANS. THIS IS SO BECAUSE THE INTEGRITY OF THE DEPOSITOR'S MONEY MUST BE PROTECTED AT ALL TIMES, AND THE FACT THAT FISCAL AND MONETARY POLICIES PURSUED BY THE GOVERNMENT IMPACT GENERALLY IN THE SAME WAY ON BOTH OF THEM. THE EDGE LIES IN CLOSER KNOWLEDGE OF THE CLIENT'S BUSINESS AND THE INTIMATE TERMS OF THEIR RELATIONSHIP.

WHAT ARE THE IMPLICATIONS OF THIS FOR THE JAMAICAN ECONOMY AND THE REGIONAL ECONOMY? CAN MERCHANT BANKS SPEARHEAD A NEW DIRECTION IN FINANCING FOR GROWTH AND EXPANSION? ARE GOVERNMENTS TO LOOK TO THIS SECTOR FOR A NEW SUPPORTIVE ROLE? CLEARLY THEY CANNOT GRAPPLE WITH THE HYDRO-HEADED ECONOMY ALONE IN LIGHT OF THE FACT THAT AS ONE PROBLEM IS TACKLED, TWO MORE EMERGE.

MERCHANT BANKS CAN PLAY A BIGGER ROLE IN THE ECONOMY BY AIDING IN DEVELOPMENT AND IN ECONOMIC RESTRUCTURING PROGRAMME.

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THEIR ABILITY TO MEET CAPITAL NEEDS FOR GROWTH AND EXPANSION WILL HELP THE REGION TO REGAIN THEIR INDUSTRIAL STRENGTH, THE ONLY PATH TO TAKE IF WE ARE GOING TO CRAWL OUT OF OUR ECONOMIC MORASS. THIS MUST BE THE REAL MISSION OF MERCHANT BANKS FOR THE 1990'S - A VEHICLE CREATING INCENTIVES FOR GROWTH SO THAT COMPANIES CAN BECOME THE FOUNDATION FOR ECONOMIC STABILITY.

WHEN WE LOOK AT THE FUTURE OF OUR REGIONAL ECONOMICS, THIS MUST BE OUR COMMON GOAL TO KEEP OUR DEBTS DOWN AND OUR ECONOMICS UP AND RUNNING. THIS WE CAN ACHIEVE WITH INNOVATIVE BANKING, IMPORTANT TAKE-OVERS, CREATIVE SERVICES AND OPTIONS.

CAPITAL IS THE LIFE BLOOD OF A FREE MARKET ECONOMIC SYSTEM AND COMPANIES NEED CAPITAL TO SURVIVE. THE KIND OF LIQUIDITY THAT MERCHANT BANKS CAN PROVIDE THEREFORE CONTRIBUTE TO THE HEALTH OF OUR BANKING SYSTEM. REGIONALLY, AN ECONOMIC ANALYSIS MIGHT REVEAL THAT MERCHANT BANKS CAN IMPACT MORE SIGNIFICANTLY ON THE FINANCIAL SYSTEM BY CREATING A NEW POWER BASE TO SUPPORT OUR CARIBBEAN ECONOMIES.

I THEREFORE SEE MERCHANT BANKS COMING TOGETHER IN A COMMON DESIRE TO SOLVE OUR ECONOMIC PROBLEMS. THE KIND OF NOVEL BANKING THAT TAKES PLACE IN THEIR PORTFOLIO CAN HELP INVESTMENT

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GROW THROUGH TAKE-OVERS, MERGERS AND THE FUNDING OF PROJECTS THAT WILL CONTRIBUTE MEANINGFULLY TO THE ECONOMY.

THE FACT THAT IN JAMAICA MANY COMMERCIAL BANKS ARE DIVERSIFYING TO INCLUDE MERCHANT BANKS IN THEIR GROUP OF COMPANIES SUGGESTS THE VIABILITY OF THIS FINANCIAL SECTOR AND NEW PROFIT CENTRE. MERCHANT BANKS ALSO FINANCE MORTGAGES, LEASING AND OFFER ATTRACTIVE FIXED DEPOSITS, WHICH MAKE THEM VIRTUALLY A ONE-STOP FINANCIAL CENTRE.

AS A REGION, THIS IS ONE APPROACH TO ADDRESSING THE NEEDS OF OUR VARIOUS ECONOMIES. THE ATTRACTIVENESS OF MERCHANT BANKS TO THE BUSINESS COMMUNITY IS, IN MY VIEW, ONE OF THE STRONGEST ARGUMENTS IN FAVOUR OF THE NEED FOR A VIBRANT ASSOCIATION OF MERCHANT BANKERS TO FACILITATE A GROUP APPROACH AND DISCOURAGE FRAGMENTATION IN SO VITAL AN AREA OF BUSINESS. AT PRESENT, THERE IS AN ASSOCIATION WHICH LUMPS TOGETHER ALL THE INSTITUTIONS REGISTERED UNDER THE PROTECTION OF DEPOSITORS ACT.

BUT WHILE THIS ASSOCIATION SERVES A PURPOSE, AT BEST IT COULD NOT PROPERLY REPRESENT ENTIRELY THE INTEREST OF THE MERCHANT BANKING COMMUNITY WHOSE ACTIVITIES ARE UNIQUELY DIFFERENT FROM THOSE OF TRUST COMPANIES WHICH ARE ALSO REGISTERED UNDER THE ACT.

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A MERCHANT BANKERS ASSOCIATION IS DEFINITELY ON THE HORIZON, AS WE DRAW CLOSER TO THE END OF THE THIRD DECADE OF MERCHANT BANKING IN JAMAICA. PERHAPS WE CAN NOW TAKE IT FROM THERE AND FAVOUR A CARIBBEAN ASSOCIATION OF MERCHANT BANKERS. THE NEED TO HAVE A REGIONAL BODY TO FOCUS ON ECONOMIC MATTERS THAT WILL FOSTER DEVELOPMENT AND ALLOW FOR FLEXIBILITY IN OFFERING BANKING SERVICES, IS EVEN MORE IMPORTANT NOW AS WE FACE A UNITED EUROPE AND LATIN AMERICA. IN CONSIDERING THE FUTURE, I WOULD URGE US TO REMEMBER THAT OPPORTUNITY, WHICH MERCHANT BANKS OFFER THE BUSINESS SECTOR IS NOT OFTEN VISIBLE IN PLANNED CIRCUMSTANCES, BUT AS IN THE LABORATORY OF HISTORY, MUST BE CREATED AND SEIZED. LADIES AND GENTLEMEN, WE ARE NOT PLANNING FOR TODAY, BUT FOR CONTINUITY.
