FINANCIAL DEVELOPMENT IN FIJI

Submitted in fulfilment of the requirements of the degree of

Doctor of Philosophy

by

Parmendra Sharma

May 2008
Abstract

Fiji, a developing island economy in the East Asia and Pacific region, has been experiencing modest growth for some time despite its ability to do better. Various strategies to boost the growth levels, including major cross-sectoral reforms, have yielded little success. Motivated by a recent and expanding finance-growth literature, this study investigates the possibility of enhancing the country’s financial development. Further financial development appears to depend importantly on designing appropriate strategies to deal with obstacles and challenges relating to enhancing both the supply of funds to the private sector and the demand for these funds. This study provides strategies for dealing with two such likely important challenges in the case of Fiji—legal institutions and alternative finance.

Prior to investigating and developing strategies in relation to these issues, the study attempts to understand the financial sector’s past development trends and its current strengths and weaknesses. This extensive analysis uses a recently available comprehensive financial structure database to assess Fiji’s situation against 20 developing and developed countries across the Asia-Pacific region over a 33-year period. Overall, it assesses Fiji’s relative banking and stock market development using relevant composite indices constructed for the purpose. Specifically, it assesses the size, activity and depth of Fiji’s sectors relative to the comparator countries. Findings suggest positive past development of the banking sector but weak development of the stock market. Further, the banking sector has become larger, deeper and more active while the stock market remains small and largely inactive.

Legal institutions—encompassing the mandating of legal rights of the suppliers of funds and the appropriate enforcement of their rights—have become widely accepted in the
literature as a major, possibly even the dominant, supply–leading determinant of financial development. The legal theory asserts that the supply of funds is likely to be better in countries with better legal institutions. The suppliers of funds include mainly banks (providers of private sector credit) and shareholders (providers of stock market equity).

Using both primary and secondary data, this study investigates the role of legal institutions for financial development in Fiji by (i) assessing their status relative to 49 other countries across the world; (ii) examining how they may have affected past banking and stock market development; and (iii) ascertaining their importance for further financial development. The primary data comes from an opinion survey of senior officers and executives of the five commercial banks in Fiji, existing and potential shareholders, and experts. The secondary data comes from Fiji’s relevant legislations and other literature on financial development.

The study finds that, from a supply perspective, further financial development in Fiji may be less critically dependent on the enhancement of legal institutions than might appear from a reading of the existing international literature. Nevertheless, noting that some enhancement would be reasonable, it recommends and outlines strategies for enhancing the law enforcement component of legal institutions.

Alternative finance is defined in this study as any source of finance not from the financial sector. While the literature appears short on the demand–following determinants of financial development, one way of understanding the challenges and demand for financial sector funds and thus developing strategies for enhancing demand
would be via investigation of the extent and nature of alternative sources, together with the reasons for their preference.

Using both primary and secondary data, this study investigates the role of alternative finance for financial development in Fiji by (i) assessing its relative importance as a category of funding for expansion and growth of private sector firms; (ii) identifying factors and examining how these factors may have influenced their preference; and (iii) ascertaining the possibility of making the financial sector funds more attractive to firms. The primary data comes from an opinion survey of private sector firms across industries, size and listing status, and experts. The secondary data is sourced from annual accounts of a number of firms over a 30 year period.

The study finds that, alternative finance accounts for majority of firms’ needs and firms find costs of funds from the formal sector higher, contrary to what theory would predict. Firms also find the disclosure, collateral and other procedural requirements of financial–sector funds too demanding and time consuming. However, making financial–sector funds more attractive to firms appears possible and this study recommends and outlines strategies for doing so, which includes the moderation of costs for bank credit to the private sector.

The study makes a number of contributions to literature, and policy formulation in the case of Fiji. It has implications for a broad group of economies, particularly in the Pacific region. It also provides reasonable scope for further research.
Statement of Originality

I, Parmendra Sharma, hereby certify that this work has not previously been submitted for a degree or diploma in any university. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

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Acknowledgements

Writing this dissertation has been extensive and trying, but also exciting, instructive, challenging and to date, the most meaningful scholarly experience of my life. Without the support, patience, guidance, and inspiration of the following people, this study would not have been completed. It is to them that I owe my deepest gratitude.

Professor Tom Nguyen, my principal supervisor, whose immense research and research higher degree supervision experience has been most valuable. Tom gave me freedom to explore on my own, and at the same time, guided me when I was not certain about issues. Tom taught me how to question thoughts and findings of existing research and to express ideas in the most meaningful and constructive ways. He provided me the opportunity to grow as an independent and thoughtful researcher.

Dr. Tarlok Singh, also a principal supervisor, provided insightful comments and constructive criticisms, which made me see issues from different perspectives and helped significantly in improving the quality of the dissertation along the way. Tarlok ensured that I did not get unnecessarily stressed and was readily available for a long or short conversation at very short notice.

Dr. Mark Brimble, an associate–supervisor, guided me in sorting out the technical details of my work. From day one, Mark encouraged me to be vigilant about grammatical and typographic pitfalls and to be consistent in the use of notations and references in my writing. Mark’s feedback was always detailed and thought–provoking, which helped me keep focussed on the bigger picture.

The supervision team has been wonderful; while all three supervisors ensured that the quality of the dissertation was not compromised in any way, that high standards were maintained at all times, they have also been very considerate, caring and understanding. The experience has been gratifying and pleasurable. Thank you very much, Tom, Tarlok and Mark.

Professor Chew Ng, the Head of Department during most of my dissertation period, provided a conducive working environment and made sure that I was not distracted from the thesis at any time. Having Chew as a supervisor during the time of the
dissertation has been valuable. Chew’s constant inspiration and encouragement has been highly motivating.

Associate Professor Eduardo Roca, the most senior staff in the banking and finance discipline that I could relate to, has also been a wonderful source of inspiration. I wish to thank him for sharing with me some of his experiences in research and research supervision.

The many respondents, companies and individuals in Fiji, who participated in the survey carried out for this research, provided me an opportunity to conduct a meaningful research. Their willingness to participate is much appreciated.

Finally, and importantly, my wife, Reshmi and two daughters, Sharol and Ashley, whose patience, understanding, love and support have been wonderful. Reshmi made sure that I was always well rested and encouraged me to keep working on the dissertation as much as I could. For Sharol and Ashley, it may not have been easy settling down in a foreign country, away from families and friends, especially when they had just started school, but their understanding and patience have been wonderful.
Chapter 1

Introduction

1.1 BACKGROUND AND SIGNIFICANCE OF THE RESEARCH AREA

A British colony from 1874 to 1970, Fiji is a developing island economy located in the East Asia and Pacific region, east of Australia and North of New Zealand. Comprising of 332 islands, with approximately one third inhabited and a total land area of 18,333 sq km—made up mainly by two islands, Viti Levu (10,249 sq km) and Vanua Levu (5,559 sq km)—the country is dependent largely on the agricultural and tourism sectors for growth. Traditionally a multiracial country, about 50% of the 0.9 million people are native Fijians, 45% descendants of the Indian contract labourers brought by the colonisers and the rest are made up of Europeans, Chinese and other Pacific Islanders.

Imposed with the English laws and political systems, the country was governed by democratically elected governments since independence in 1970 until 1987 when democratic rule was disrupted by two military coups, instigated by perceptions of insecurity among the indigenous society, resulting in a redrafting of the constitution, favouring an indigenous control of the government (Alley, 2000; Fraenkel, 2000). However, the racially–biased 1990 constitution was amended in 1997 in response to national and international calls for equity and democratic elections. The 1999 elections ushered in a government led by an Indo–Fijian, renewing the perceptions of insecurity, leading to another coup in 2000, followed by another period of political turmoil, substantial job losses, and migration of skilled and professional workers.

Expectedly, a notable consequence of the above less favourable geo–political situation has been economic decline. However, as can be seen from the discussion that follows,
the country’s economic growth performance over a long period of time, including
during times of political stability, can only be described, at best, as mediocre.

From independence (in 1970) to the mid–1980s, the average annual rate of growth in
real GDP per capita in Fiji was approximately zero. From the mid–1980s to the mid–
1990s, this growth rate increased to around 1.9% p.a. (ADB, 1999). By comparison, the
countries classified by the World Bank as ‘lower middle income’, with which Fiji has
been associated for many years\(^1\), as a group experienced on average a corresponding
growth rate of 3.5% p.a. during the 1980s and 3.3% p.a. during the period 1990–98.
From an aspirational point of view, it might be relevant to compare Fiji with the ‘East
Asia and Pacific’ region: as a group, countries in this region recorded growth rates of
8.0% and 8.1% p.a., respectively for these two periods. It is clear that, over recent
decades, not only has Fiji’s economic growth performance compared very unfavourably
with the East Asia and Pacific region as a whole, it has also been weaker than that of the
worldwide group of countries with similar income levels.

In more recent times, as table 1–1 shows, Fiji’s growth performance has remained
relatively weak in comparison with the above two groups. For example, as Panel A
shows, its average annual GDP per capita growth of 2.6% over the period 2001–2006
compared unfavourably against that of the East Asia Pacific Region (7.3%) and that of
the ‘lower middle income’ group of countries (5.7%).

\(^1\) The World Bank classifies economies into income groups according to the relevant GNI per capita.
For 2008 classification, the relevant GNI data is 2006 and the groups are: low income (LIC),
USD905 or less; lower middle income (LMC), USD906–3,595; upper middle income (UMC),
USD3,596–11,115; and high income, USD11,116 or more. (Statistics cited to here are sourced from
various issues of the World Development Reports.)
### Table 1–1: Economic growth in Fiji and other countries and regions

**Panel A: Fiji and World Bank classified world wide group of countries**

Panel A, sourced from the World Bank’s *World Development Reports* (various) compares Fiji’s annual real GDP per capita growth rates (%) with various groups of countries classified by income and region.

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**Panel B: Fiji and ADB classified Asia–Pacific Developing countries**

Panel B, sourced from ADB’s *Outlook 2007*, compares Fiji’s growth rate of per capita GDP (% per year)

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It may be argued with justification, however, that Fiji should be compared not with those groupings but rather with the group of Pacific island economies, with which Fiji shares many socio–economic characteristics. As panel B of the table shows, during the period 2002–06, Fiji’s annual GDP per capita growth averaged 1.8%, which was lower than that of Samoa (2.7%) and Tonga (2.1%) but higher than that of Papua New Guinea (0.4%) and of the ‘Pacific’ grouping as a whole (0.5%).
This last comparison suggests that Fiji’s relatively weak performance by international standards is a characteristic pertaining not only to the country but also shared by the Pacific island economies as a group. In turn, this means that any findings arising from this study that may have a bearing on Fiji’s economic growth will be potentially of interest to a broad group of economies which, despite their relatively small populations, are of considerable diplomatic, political and security significance in regional terms.

While Fiji’s economic performance has largely been mediocre by international standards (nor exceptional by comparison with the Pacific grouping) there may be real opportunities for enhancing the country’s growth rates, especially in light of its various advantages, as outlined by the Asian Development Bank (ADB). The ADB (2006) describes Fiji as ‘a country with great potential, abundant natural resources, and arguably the best human resources in the Pacific’ where ‘social indicators remain high by Asian standards, and the quality of social services delivery is considered good’ (ADB, 2006)\(^1\)\(^2\).

Moreover, even amidst political upheavals, the country’s judicial system has remained independent and strong; individuals, business entities and others have always had recourse to fair legal recourse. Further, during this period, existing legislations, regulations and procedures have been strengthened and new ones introduced to encourage continued operation of market oriented business and financial sectors. There is also increasing understanding and appreciation for the role that civil society and the media play in promoting good governance and public consultations are becoming a common part of national policy development. Further, there is increased disclosure of financial information and greater public accountability.

\(^1\)\(^2\) http://www.adb.org/Documents/CSPs/FIJ/2006/csp0200.asp
In view of the above, if the opportunity for enhancing growth does exist, a key question is: how can the prospects be improved? Historically, growth strategies in Fiji, as in many other developing countries around the world, have significantly been influenced by multilateral organisations such as the World Bank, IMF and ADB and have included ‘filling the gap’ with aid and investment, human capital development and loans linked to recommended policy changes. However, these strategies appear to have yielded little success (as summarised in ADB, 2004). In recent times, the government has also taken steps to reform the economy. The overall strategy has been to pursue a market–oriented sustainable growth which, based on the experiences of other countries, has largely included tax reforms, reduced trade barriers, civil service reforms, and corporatisation and privatisation of public utilities (Duncan et al., 1999). However, these reforms have again not had much success and vigorous, steady growth remains elusive.

A number of analysts have suggested that a key to sustainable economic growth in Fiji would be a robust and vibrant private sector (e.g. ADB, 1999, 2004). The ADB also identifies the financial sector as a crucial ingredient for the development of such a vigorous private sector. In principle, a well–developed financial sector provides many essential services. As summarised by Levine (2005a), these include: (i) the production of information; (ii) the monitoring of firms’ performance and exercise of corporate governance; (iii) risk amelioration; (iv) the pooling of savings; and (v) the facilitation of exchange of goods and services. In providing these services, financial sectors contribute, inter alia, to resource allocation, capital accumulation and technological innovation, which in turn may foster economic growth. As Levine (1997) points out, Reddy, et al (2004) provide a chronological account of sectoral and institutional reforms in Fiji.
‘...broad cross–country comparisons, individual country analyses, and firm–level investigations point in the same direction: the functioning of financial systems is vitally linked to economic growth’ (p689-70).

Thus, a better developed financial system is likely to contribute to improved economic growth performance. In any case, financial development in itself is a topic of considerable interest. For example, what metrics can be used in comparing the level of development across two or more financial systems? Similarly, how can financial development be promoted or accelerated? Intuitively, such development would require the enhancement of both the supply and the demand sides of the financial sector.

With regard to the supply of funds to organised financial channels, many researchers agree that legal protection of the suppliers or investors (creditors and minority shareholders) is a key determinant. Advanced by La Porta et al. (1998), the law–finance theory emphasises the importance of adequate legal investor protection as a pre–requisite for supply of funds and stresses that a country’s legal institutions, in turn, have prominently been shaped by the origin of its laws. Legal investor protection encompasses both the mandating of legal rights and the appropriate enforcement of these rights, referred to as legal institutions. Although proponents of competing supply–side theories, such as Rajan and Zingales (2003b), Licht et al. (2001), and Acemoglu et al. (2001), do not support the view that legal origin is the primary determinant of the adequacy of legal institutions, most tend to agree with the law–finance link in general. Thus, in exploring ways to enhance the supply of financial sector funds, it will be of interest to understand the role of the legal institutions.
With respect to the demand for funds, the literature appears far less substantial. While economic agents, especially those in the private sector, may obtain funds from many sources, only those obtained through organised channels would contribute to financial development. In this study, funding sources are classified as either financial–sector sources or others, and the latter source is also described as ‘alternative finance’. Thus, in exploring ways to enhance the demand for financial–sector funds, it is important to understand the extent and nature of the alternative channels of finance, the reasons for their preference and use, and consequently, the possibilities of making the financial–sector funds more attractive.

Existing literature (ADB, 2001b; Chand, 2002; and Waqabaca, 2004) suggests that while Fiji’s financial sector may have become more developed over the years, it still lacks depth and sophistication. Moreover, some positive trends in the past appeared to show signs of reversal in recent times. For example, while the size and depth of the banking sector may have improved over the period 1970–1990, more recent trends indicate a decline in these areas. Further, the stock market may be far less developed than the banking sector. In particular the market appears to be relatively inactive in terms of both the number of listed companies and daily trading (Chand, 2002).

While the above studies provide some indication of the level of Fiji’s financial development, knowledge remains incomplete regarding the country’s current state of financial development and historical trends. Consequently, the strengths and weaknesses of the sector and its potential for further development are not well documented. Moreover, little is known about the role of legal institutions, alternative finance channels and other determinants in the further development of Fiji’s financial sector. As financial development is likely to contribute to economic growth, these
issues are of relevance to policy-making. It is hoped that this study will assist in filling these gaps in relation to knowledge about Fiji, especially its financial development.

1.2 RESEARCH PROBLEM, OBJECTIVES AND RESEARCH QUESTIONS

The purpose of this study is to investigate past trends and the current state of financial development in Fiji, analyse the influence of legal institutions and other factors on financial development, and explore ways in which financial development can be further promoted.

Specifically, the main objectives of this study are:

(a) to assess the financial sector’s past development trends and its current strengths and weaknesses;
(b) to investigate the importance of legal institutions for financial development;
(c) to investigate the importance of demand–side factors for financial development; and
(d) to explore ways to enhance financial development in Fiji.

Accordingly, the main research questions (RQ) are as follows:

1. how well has the financial sector in Fiji developed in the past and what are its strengths and weaknesses?
2. what is the role of legal institutions in Fiji’s financial development?
3. what is the role of demand–side factors in firms’ reliance on alternative finance? and
4. on the basis of the above, how may financial development in Fiji be accelerated?

For operational purposes, each of the above main questions is broken down into smaller sub–questions. For example, RQ 1, which is about assessing the financial sector’s development, strengths and weaknesses, comprises the following specific sub–questions:
RQ 1–1: how well has the banking sector developed over the period 1970–2003?
RQ 1–2: how well has the stock market developed over the period 1970–2003?
RQ 1–3: what are the strengths and weaknesses of the banking sector with regard to size, activity and depth? and
RQ 1–4: what are the strengths and weaknesses of the stock market sector with regard to size, activity and depth?

Similarly, RQ 2, which focuses on the role of legal institutions in financial development in Fiji, is operationalised through the following sub–questions:
RQ 2–1: what has been the level of legal rights of creditors?
RQ 2–2: what has been the level of legal rights of minority shareholders?
RQ 2–3: what has been the quality of enforcement of these rights?
RQ 2–4: how may legal institutions have affected banking development?
RQ 2–5: how may legal institutions have affected stock market development?
RQ 2–6: is enhancement of legal institutions important, or even essential, for further banking development? and
RQ 2–7: is enhancement of legal institutions important, or even essential, for further stock market development?

Finally, RQ 3, which examines the role of demand–side factors in firms’ reliance on alternative finance, can be broken down into the following specific sub–questions:
RQ 3–1: what has been the relative importance of alternative channels of finance?
RQ 3–2: how have various factors influenced firms’ preference for alternative sources? and
RQ 3–3: can financial–sector funds be made more attractive to the firms?
1.3 OVERVIEW OF METHODS AND DATA

In general, answers to the above questions are obtained through the use of a variety of techniques, as outlined below. The data comes from both secondary and primary sources. The source of the primary data is an opinion survey of respondents in Fiji conducted specifically for this study in 2006. The sources of the secondary data include ‘The Financial Structure Database’ compiled by Beck et al. (2003), the relevant Fiji legislations and annual reports of firms in Fiji.

The Beck et al. (2003) database, used mainly to answer RQ 1, is by far the most comprehensive set of cross–country data for financial development related analysis. It covers up to 175 developed and developing countries around the world, including Fiji, over the period 1960–2003. In this study, a number of composite indices are constructed on the basis of such data, to measure overall levels of banking and stock market development in Fiji relative to other countries. Fiji’s level of financial development is then compared to 20 developed and developing economies across Asia Pacific, including the South Pacific Island economies and Australia and New Zealand. A sensitivity analysis is also conducted to test the robustness of the findings.

The opinion survey involved personal interviews of individuals associated with the main suppliers of credit (commercial banks) and equity funds (minority shareholders) in Fiji and the main users of these funds, the private sector firms. Opinions of independent individuals who are knowledgeable with respect to the relevant issues were also obtained. The survey used a pre–tested structured questionnaire to obtain the views of these respondents on various issues in relation to research questions 2 and 3.

\footnote{\textsuperscript{1-4} All data used for this research was analysed using SPSS (version 15.0).}
1.4 MAIN CONTRIBUTIONS OF THE RESEARCH

This study aims to contribute, in the first instance, to knowledge about financial development in Fiji. In so doing, however, it hopes also to make contributions to knowledge about the process of financial development in developing economies, especially those in the Pacific region and especially with regard to alternative, informal channels of finance. More generally, the study makes a number of innovations and contributions which apply broadly to the growing literature on financial development, especially its measurement and its relationship with legal institutions.

First, this is (to the author’s knowledge) one of the very few attempts made to date (if not the very first attempt) to assemble a comprehensive body of information and data about Fiji’s financial development from various sources, to reconcile and organise such information in a consistent manner, and to systematically analyse the data in order to gain insights into past trends, current state and prospective developments.

Second, the study proposes a set of composite indices to combine a variety of financial indicators into broad measures of the level of financial development in a given country, in a form that is suited for international and inter-temporal comparisons. To guard against the risk that the results of such comparison may be sensitive to the particular methods of construction, sensitivity analysis is carried out with respect to the particular weights attached to individual indicators.

Third, in view of the prominence of the law-financial development school in the recent literature, it is timely to provide another perspective on the importance of legal institutions in the process of financial development, especially in the context of developing countries. In particular, if the view held by many of the school’s proponents is valid, that is if legal institutions are an essential prerequisite for financial
development, then further financial development in Fiji can only be achieved if legal institutions are strengthened noticeably. In this study, both primary and secondary data are used to assess the validity of this proposition. Interestingly, the data for Fiji suggests that legal institutions probably play an important, but not necessarily essential, role in the financial development process. The results, whilst pertaining only to Fiji, suggest that the view described above may require some qualification or modification to be applicable universally, including in “transplant” and other developing economies.

Fourth, the study highlights the importance of alternative (often informal) channels of finance, and explores factors that make them attractive relative to organised sources of funds such as banks and the stock market. This is an area that has received relatively little attention in the literature to date. Yet for developing countries such as Fiji and other Pacific island economies (indeed, even for large and now-rapidly developing economies such as China and India) alternatives to the formal financial sector remain highly important as a major source of funding for private businesses.

Fifth, to address the study’s various research questions properly, a questionnaire survey of opinions was conducted in 2006 covering both suppliers and users of funds, as well as knowledgeable observers. The responses collected from this survey provide an important source of primary data which add to the rather limited information available to date with regard to Fiji’s financial development.

1.5 ORGANISATION OF THE STUDY

The rest of the study is organised as follows. Chapter 2 describes the conceptual framework underpinning the study. It provides a definition of financial development and a discussion of its benefits and how it is measured. It also develops a framework, which stresses the importance of both supply and demand for funds for financial
development. Chapter 3 describes the methods and data employed in investigating the answers to the research questions of this study.

Chapter 4 investigates RQ 1. Based on worldwide secondary data and composite indices developed for this research, the chapter provides an assessment of how Fiji’s banking and stock markets may have developed over a 33 year period compared to 20 East Asia and Pacific countries. Chapter 5 addresses RQ 2. Based on primary data collected for this research together with secondary data, the chapter examines the adequacy of legal investor protection in Fiji, how legal institutions (legal rights and enforcement quality) may have influenced past financial development and the importance of its role for further development. Results do not strongly support the usual law–finance view and experiences elsewhere.

Chapter 6 investigates RQ 3. It provides a framework for conceptualising and measuring alternative finance. Based on primary data collected for this research and on secondary data also collected and compiled specifically for this research, the chapter assesses the possible extent of alternative finance in Fiji, the nature and trends of these financing sources, the barriers to financial sector sources, and how financial sector funds may be made more attractive to the firms.

Chapter 7 addresses RQ 4. Based on findings per RQ 1, 2 and 3, this chapter provides strategies for enhancing the supply and the demand for financial sector funds in Fiji. Finally, Chapter 8 presents a summary of the study’s main findings, discusses its limitations and outlines directions for future research.
Chapter 2

Conceptual Framework

2.1 OVERVIEW

This chapter describes the conceptual framework underpinning this study. It begins by firstly adopting a definition of financial development for the study followed by discussions on its benefits and measures. The foregoing set an appropriate background for the framework, which entails investigating both supply and demand side determinants of financial development in the case of Fiji with the objective of exploring ways to enhance development.

Briefly, the framework is as depicted in figure 2–1. Increased supply of funds is a major component of further financial development; thus it is important to investigate and explore ways to enhance the determinants of supply. Increased demand for funds appears equally important for financial development; thus it is important to investigate and explore ways to enhance the determinants of demand as well. In case of the latter, suppressed demand for financial sector funds is likely to result in companies and entrepreneurs turning to non–financial sector channels, referred to as alternative finance in this study.

Figure 2–1: The supply and demand for funds and financial development

Financial development is driven by both supply and demand determinants, requiring thus an investigation of both for exploring ways to enhance development. In case of discouraged supply or suppressed demand for financial sector funds, suppliers, firms and entrepreneurs may turn to alternative channels of finance.
The rest of the chapter is organised as follows. The next section provides a definition for financial development used in this study. Section 2.3 discusses the benefits of financial development. Section 2.4 provides an overview of issues in relation to measuring financial development. Section 2.5 provides the overview of the framework for the study. Section 2.6 discusses in more detail one component of the framework—supply–side determinants and section 2.7 details the determinants the second component—demand–side determinants. Section 2.8 summarises the chapter.

2.2 WHAT IS FINANCIAL DEVELOPMENT?

Remarkable advances in the design of market securities, computer and telecommunications technology and in the theory of finance have in recent years dramatically altered the international design and delivery of services in the financial sector. For instance, home banking has today become commonplace even in developing small island economies such as Fiji (Sharma and Reddy, 2003). Despite these colossal innovations and the accompanying structural changes, the basic functions of financial systems remain traditionally embedded; at the most basic level, a financial system remains a conduit for relocating surplus funds across economic agents, allowing thereby household savings to be used by firms and households (e.g. Allen and Gale, 2001).

Notwithstanding any differences that might exist in the conceptual definition, in practice, a financial system is commonly regarded as well developed if (i) the bulk of the flows of funds between savers and users of funds pass through institutions and markets in the formal financial sector; and (ii) such financial institutions and markets operate with a high degree of efficiency and soundness. The likelihood of these characteristics increases where circumstances favour ‘the ease with which any
entrepreneur or company with a sound project can obtain finance and the confidence with which investors anticipate an adequate return’ (Rajan and Zingales, 2003b, p.9). In defining financial development, the authors stress the word ‘any’, indicating that access to finance should be determined by the quality of underlying assets or ideas and not the identity of the owner. In addition to ease of access, as Guiso et al. (2004) observe, financial development is also expected to have a positive impact on the premiums paid on borrowed funds, such that the rates should fall as a financial system develops.

Financial institutions, as defined in the IMF’s International Financial Statistics (IFS), are distinguished between three groups—central banks (CENTRAL), deposit money banks (BANK) and other financial institutions (OFIs) where, CENTRAL represents functions of monetary authorities, BANK is an institution with ‘liabilities in the form of deposits transferable by cheque or otherwise usable in making payments’ and OFIs are institutions other than a BANK. OFIs include: (a) institutions that accept deposits but do not provide transferable deposit facilities (e.g. savings banks, cooperative banks, mortgage banks and building societies); (b) institutions whose main source of funds is through issuance of negotiable bonds (e.g. finance companies); (c) insurance companies; (d) development banks; (e) pooled investment schemes (e.g. real estate investment schemes, mutual funds); (f) private pension and provident funds; and (d) offshore units. Financial markets include money and capital markets; the latter includes stock and debt markets. Studies on financial development usually focus on the development of banks and stock markets.

While private individuals (non-entrepreneurs and companies) also need external finance, fulfilling such needs is less important than those of entrepreneurs and companies for a country’s economic growth.
2.3 BENEFITS OF FINANCIAL DEVELOPMENT

The likelihood of ease of obtaining finance and confidence of return increases with improvements in (Levine, 2005a): (a) information production and capital allocation; (b) monitoring and corporate governance mechanisms; (c) facilitation of trading, diversification and management of risks; (d) mobilisation and pooling of savings; and (e) ease of exchange of goods and services. Consequently, these benefits are likely to enhance capital formation and economic growth. Each of these benefits is discussed below.

2.3.1 Advantages of a Developed Financial System

Information production and capital allocation

Financial development fosters information production on potential and existing investments and thereby improves capital allocation. Financial intermediaries arise to produce information and sell this information to investors (Ramakrishnan and Thakor, 1984; Allen, 1990). By reducing the costs of acquiring and processing such information, intermediaries may improve resource allocation (Boyd and Prescott, 1986) and encourage funding of less established but likely highly productive firms (Diamond and Dybvig, 1983). Financial development enhances improvements in the gathering and processing of information on firms, managers and market conditions (Levine, 2005a). Greenwood and Jovanovic (1990) present a model in which both financial intermediation and growth are endogenous. Using this model, the authors demonstrate that financial institutions which produce better information on firms are capable of funding more promising firms and thereby induce more efficient capital allocation and growth.
Intermediaries may also boost the rate of technological innovation by identifying entrepreneurs with relatively greater success rates at initiating new goods and production processes (King and Levine, 1993c). Thus, improvement in information production accelerates technological innovation, investment and growth. Information production may also be stimulated by stock markets; larger and more liquid markets may have greater incentives to increase and improve information production (Grossman and Stiglitz, 1980; Kyle, 1984; Holmstrom and Tirole, 1993).

**Corporate governance**

Financial development enhances investment monitoring and corporate governance of externally financed firms. Diamond (1984) develops a model in which financial intermediaries improve the corporate governance of firms that receive external funds. An intermediary acting as a ‘delegated monitor’ for all investors, is able to economise on aggregate monitoring costs and eliminate free-rider problems. In the long run, such monitoring is enhanced as the intermediary–firm relationship develops. Bencivenga and Smith (1993) develop a model in which intermediaries that improve corporate governance of firms reduce credit rationing, which stimulates productivity, capital accumulation and growth. Similarly, the De La Fuente and Marin (1996) model shows that by undertaking the costly process of monitoring innovative activities, intermediaries improve credit allocation among competing technology producers which stimulates economic growth.

**Risk amelioration and liquidity**

Financial development enhances the facilitation of trading, diversification and management of risks. Financial institutions and markets arise to mitigate risks associated with individual projects, firms, industries, countries and regions; banks,
mutual funds, debt and equity markets all provide vehicles for trading, pooling and diversifying risks, which may improve resource allocation and savings rates. Intuitively, investors prefer low risks (tied with low return projects) but high returns (tied with high risk projects). By diversifying the inherent risks, financial systems allow savers to take on high risk–return investments (Gurley and Shaw, 1955; Greenwood and Jovanovic, 1990; Saint–Paul, 1992).

Diamond and Dybvig (1983), note that an important role of financial intermediaries is to provide liquidity. Bencivenga and Smith (1991) present a model in which individuals face uncertainty about their future liquidity requirements; their choices involve investing in safe but low productivity liquid assets and/or riskier but higher productivity illiquid assets. The authors demonstrate that financial intermediaries induce economic growth by channelling savings into high productivity activities while allowing individuals to reduce the risk associated with their liquidity needs. In the absence of financial intermediaries, individuals may be compelled to liquidate their investment in illiquid assets when liquidity needs arise.

Levine (1991) also finds that financial institutions raise the fraction of total savings devoted to investment and avoid premature liquidation of capital. Developed stock markets enhance liquidity which reduces the disincentives associated with long–duration projects since investors can easily sell their stake before maturity (Levine, 1991; Bencivenga et al., 1995). Thus, financial development improves risk diversification mechanisms and helps in further eliminating unnecessary liquidations, which accelerate economic growth. Bencivenga and Smith (1991) show that even if financial development leads to reduced aggregate savings, economic growth is still
enhanced due to the dominant effect of financial development on the efficiency of investment.

Acemoglu and Ziliboti (1997) develop a model that shows financial systems allow savers to hold a diversified portfolio of risky assets, which stimulates a reallocation of savings toward high–return projects with positive effects on economic growth. Saint Paul (1992) presents a model where financial markets affect technological choice. In this framework, agents have two choices: a highly flexible technology that allows productive diversification but has low productivity; and a more rigid, more specialised but more productive technology. The economy being potentially exposed to shocks to consumer preferences may result in lack of demand for some products. In the absence of financial markets, risk–averse individuals (consumer–producers) may prefer flexibility to productivity with respect to technology. Financial markets allow individuals to hold a diversified portfolio as assurance against negative demand shocks, and at the same time, to choose more productive technology. King and Levine (1993b) also show that financial systems that improve risk diversification stimulate innovation, accelerate technological change and economic growth. Financial systems also promote accumulation of human capital (Jacoby, 1994) and those that facilitate borrowing for skill accumulation and human capital creation help stimulate economic growth (DeGregorio, 1996; Galor and Zeira, 1993).

Savings mobilisation

The ability of financial systems to offer profitable investment opportunities enhances savers’ confidence and attracts additional savings. Financial development improves pooling and mobilisation of savings. Mobilisation, the costly process of agglomerating capital from disparate savers for investment, involves overcoming transaction costs of
collecting savings from numerous savers and informational asymmetries associated with making savers feel comfortable in relinquishing control of their savings (Levine, 2005a). Savings mobilisation may occur through financial markets (e.g. joint stock company) and/or intermediaries. Moreover, mobilisation usually involves creation of small denomination instruments, which provide opportunities for individuals to hold diversified portfolios (Sirri and Tufano, 1995), thereby augmenting liquidity relief.

Better savings mobilisation enhances capital accumulation, improves resource allocation, boosts technological innovation and accelerates economic growth (Levine, 2004). In the absence of pooling and mobilisation of savings, many production processes would be constrained to economically inefficient scales (Sirri and Tufano, 1995a) and many investments which require enormous external funds beyond the capability of any single investor, would never commence. The financial system’s better mobilisation and the capital allocation capabilities enabled England to make better and larger investments which induced faster growth compared to some other countries (Bagehot, 1873).

*Exchange facilitation*

Financial development further eases the exchange of goods and services and thus fosters economic growth. Greenwood and Smith (1996) present a model that provides a connection between exchange, specialisation and innovation. Since more specialisation requires more transactions and each transaction is costly, financial arrangements that lower transaction costs facilitate greater specialisation, which promotes exchange and encourages productivity gains. Higher growth in turn may spur further development of financial markets—if there are fixed costs in establishing markets, higher per capita income make these costs less burdensome as a share of per capita income.
Summary

Thus, financial development leads to, *inter alia*, improvements in information production and capital allocation, monitoring and corporate governance mechanisms, facilitation of trading, diversification and management of risks, mobilisation and pooling of savings; and ease of exchange of goods and services. In practice, these benefits result in lower transaction costs, lower margins, wider choices, greater transparency, etc. which enhance ease of borrowing and confidence in return on investment.

2.3.2 Financial Development and Economic Growth

An important consequential benefit of the above is enhanced capacity for economic growth. Levine (1997, 2004a) provide comprehensive reviews of the finance–growth literature, concluding that ‘…broad cross–country comparisons, individual country analyses, and firm–level investigations point in the same direction: the functioning of financial systems is vitally linked to economic growth’ (Levine, 1997: p689-70). An account of the expanding literature on finance–growth is provided in appendix 2–1. (Levine, 1997: p691) also maps out a theoretical framework illustrating how certain factors drive the formation of financial intermediaries and markets and how these in turn affect economic growth (figure 2-2).

Figure 2–2 proposes that information and transaction costs create incentives for formation of financial intermediaries and markets. In ameliorating these costs, financial systems serve several functions, including mobilising savings, allocating resources and exerting corporate control. The performance of these functions contributes to capital

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2-2 This thesis does not suggest and/or assume that the finance—growth causality runs only one way; as noted latter in this section (p24), that the direction of causality may co-exist, is recognised.
accumulation and technological innovation, which in turn has a positive impact on the rate of economic growth.

**Figure 2–2: A theoretical approach to finance and growth**

Figure 2–2 proposes that information and transaction costs create incentives for formation of financial intermediaries and markets, which via provision of various services, contribute to many essential benefits, including economic growth.

Source: Levine (1997), p691

The underlying assumption here is that financial systems that allocate more credit to the private sector are more engaged in researching firms, exerting corporate control, managing risks, mobilising savings and facilitating transactions than those that lend more to government or public enterprises. A financial system which simply funnels resources to the public sector and/or state–owned enterprises is less likely to contribute to financial development. Similarly, directed credit initiatives and government subsidy
programs may affect development. Greater redistribution of credit from government and public enterprises to the private sector enhances financial development. Thus, as illustrated in figure 2–3, the private sector is a crucial link between the financial sector and economic growth. This point needs to be made in view of the framework developed in section 2.5 below.

**Figure 2–3: The importance of the private sector for financial development and economic growth**

As figure 2–3 illustrates, the private sector plays an important role in the financial development—economic growth link. The funds provided by the financial sector are used, among other things, by the private sector for capital accumulation and technological innovation, important ingredients for economic growth.

Empirically, Levine and Zervos (1998a), using data of 42 developed and developing countries over 1976–1993, show that in some cases a one standard deviation increase in initial stock market liquidity increased a country’s per capita GDP by 15%; one standard deviation increase in bank credit increased per capita GDP by 14%; together, per capita GDP increased by 30%, productivity by 25%; in some cases, increasing the private sector credit to GDP from 19% to 25%, increased per capita GDP by 1% pa. Similarly, Demirguc–Kunt and Maksimovic (1998), show that firms grow relatively faster in countries with active stock markets and banking sectors than otherwise. Others (e.g. King and Levine, 1993a, b, c; Jayaratne and Strahan, 1996; Rajan and Zingales, 1998; Wurgler, 2000; Beck et al., 2001; Guiso et al., 2002) also demonstrate a positive and strong finance–growth correlation. Financial development is also shown to be a good predictor of future growth. King and Levine (1993a) demonstrate the level of financial development in 1960 to be a good predictor of growth for the next thirty years. Time series studies confirm the prediction claim (Neusser and Kugler, 1998; Rousseau and Wachtel, 1998).
Advocates maintain that the observed strong finance–growth link is not due to simultaneity bias; there is a strong correlation between exogenous components of financial development and long–run economic growth. While the direction of causality may co–exist, there is strong evidence that financial development causes economic growth (e.g. Neusser and Kugler, 1998; Rousseau and Wachtel, 1998; Beck et al., 1999; Levine et al., 1999; and Calderon and Liu, 2002). For instance, Levine et al’s (1999) GMM dynamic panel estimator and pure cross–sectional regression on 71 developing and developed countries, including Fiji, over 1960–1995, consistently show a positive and robust link between the exogenous components of financial development and economic growth, with an economically large impact. Similarly, Calderon and Liu’s (2002), panel analysis and Geweke decomposition test on 109 developing and developed countries, over 1960–94, show inter alia, that financial development generally leads to economic growth with a relatively more pronounced finance–growth link in developing countries.

Finance and growth: A counter–example

If economic growth is indeed an important consequential benefit of financial development, one may be inclined to question the case of a country such as China, where remarkable economic growth has been possible without comparable financial development (Allen et al., 2005). China’s strong economic growth appears to be financed substantially by funds from sources other than the financial sector. In fact, non–financial sources appear to feature prominently in the remarkable consistent growth of the greater Asian Region, particularly East Asia (Waldron, 1995)
In view of the above one may also be inclined to ask, should financial development matter if economic growth can be achieved without corresponding financial development? The counter question is, as Allen et al. (2005) appropriately raise—how long can the alternative sources sustain the growth of firms and thereby, the economy—growth would appear to be more sustainable with the financial sector as a substantial source of external funds. This question is similar to one asked by Guiso et al. (2004)—does local financial development matter in light of increasing international access to finance? More generally, does local financial development matter if alternative channels are accessible? That is, what is the relevance of local financial development for a country’s economic growth when finance is accessible from alternative sources? Thus, in case of China (Fiji), the question is: what would be the importance of developing the banking sector and stock markets when (if) finance is readily accessible from alternative sources and perhaps in future, also (if) significantly from foreign markets?

All evidence in the Guiso et al. (2004) study suggests that local financial development plays an important role even in perfectly integrated financial markets and such role is not likely to disappear as the world becomes more integrated. Thus, even as China becomes more integrated with world financial markets, local financial development would still be important. Moreover, the Guiso et al. (2004) study demonstrates that financial development is differentially important for large and small firms; the real beneficiaries of financial development being small firms and potential entrepreneurs. While the Allen et al. (2005) study highlights the importance of alternative finance for firms, it does not provide data on entrepreneurs, potential and existing, who need or needed external funds but have been unsuccessful and the reason(s) for this (e.g. discouraged, turned down). Potential and existing entrepreneurs with none or limited
access to informal sources would have to rely on the financial sector, which with development would, as literature predicts and demonstrates, become more accessible. Thus, while China is growing relatively fast, the country’s growth rate could be much higher and sustainable with corresponding financial development.

Further, while peer monitoring (e.g. Stiglitz, 1989) and enforcement capacity provide comparative advantages of alternative channels and thus a powerful substitute to formal institutions in mainly low income countries, these monitoring and enforcement mechanisms are ill-equipped to be upgraded to meet the needs of the a wider market. Moreover, Ayyagari et al. (2008) find that even in China, firms using formal bank finance grow faster than those financed by alternative sources. These results hold even when registered publicly trading and state owned companies are excluded and only private sector firms—the fastest growing firms in the Chinese economy are included. Further, formal bank financed firms have higher reinvestment rates and at least the same productivity growth. These results are not surprising in view of the advantages offered by a developed financial system, as outlined in section 2.3.1.

The key question, therefore, for fast–growing economies (like China) as well as for economies with more modest growth rates (like Fiji) is, what factors determine a firm or an entrepreneur’s decision to obtain funds from a financial sector or an alternative source? A related question is, how can financial sector funds be made more attractive than alternative sources so that further financial development may occur? These questions have been explored in literature but not with the objective of accelerating financial development. Moreover, these questions remain unanswered in the case of Fiji.
2.4 MEASURING FINANCIAL DEVELOPMENT: AN OVERVIEW

This section provides an overview of issues in relation to measuring financial development. It highlights the concurrent importance of a number of aspects of a financial sector—such as size, activity and efficiency—in measuring financial development. Details of the measures are provided in appendix 2–2.

Given that financial systems comprise of a variety of institutions, markets and products, it is difficult to conceive of just a few measures that could adequately capture the different and rapidly changing structural and institutional details of what broadly constitutes financial development. Moreover, as has traditionally been the case, size measures *per se* may not be able to fully determine a country’s level of financial development. For instance, a country may have a large stock market (e.g. large MCAPY—market capitalisation to GDP—value) but not necessarily an active one and activity or liquidity is an important measure of stock market development. That is, simply listing on stock exchange does not necessarily foster resource allocation; volume and frequency of trade are equally important, if not more (e.g. Levine and Zervos, 1998a). A comprehensive financial development analysis should then cover the depth, breadth and resilience of the system. To adequately capture the essence of financial development then, it appears important not only to employ a wider range of measures but also to ensure that these cover not only the size but also a system’s activities and efficiency in accomplishing its objectives.

The *size* of a financial system may be measured in various ways, including the amount of funds it intermediates and processes, the number and range of institutions and services it provides and/or the economic resources it employs. *Activity* measures distinguish between claims on the private versus public sectors. Since economic growth
is spurred more by the private sector, these measures, by indicating the proportion of a financial system’s credit to the private sector, help in understanding growth performances. The activity measures indicate the effectiveness of one of the main functions of intermediaries: resource allocation. These measures also indicate the relative importance of different types of institutions in the resource allocation process, the focus being on banks and OFIs rather than on central banks. Activity measures (e.g. PRVY—private sector credit to GDP) have a clear advantage over measures of traditional monetary aggregates (e.g. LLY—liquid liabilities to GDP) and other size measures in that they more accurately account for the volume of funds channelled to the private sector (De Gregorio and Guidotti, 1995).

Measures of efficiency reflect the competence of institutions in accomplishing the above functions. If size measures the amount of funds intermediated, then efficiency measures how they are intermediated; efficiency is associated with waste of resources in the intermediation process; the less the waste, the more efficient the system. Efficiency measures reflect transaction costs, information asymmetries and competition issues. For instance, a highly concentrated banking sector or banks with high operating costs may reflect lack of competition and/or inefficient savings mobilisation and capital allocation. Measures of efficiency primarily include ratios involving margins, overhead costs, turnover and the volume of trade in the stock market and financial structure; the latter measuring concentration and penetration aspects.

In view of the above, researchers (e.g. Goldsmith, 1969; McKinnon, 1973; King and Levine, 1993a, b, c; Levine and Zervos, 1998a; Beck, Demirguc–Kunt and Levine, 2000; Beck and Levine, 2002; Beck, Levine and Loayza, 2000; Demirguc–Kunt and Levine 1996, 2001a, b; Demirguc–Kunt and Maksimovic, 2002; Rajan and Zingales,
1998, 2003a) have over the decades, developed various alternative measures of financial development, which enable time series, cross-country and panel data analysis. These measures of size, activity and efficiency of financial intermediaries and markets have been developed bearing in mind that:

(a) different measures capture different aspects of financial development e.g. BANKY (bank assets to GDP) measures size of intermediaries, BPRVY (bank private sector credit to GDP) measures activity and OVERH (bank overheads to bank assets) measures efficiency. Similarly, while MCAPY measures the size of stock markets, TRADE (total value traded to GDP) measures liquidity in the market;

(b) each measure (including the common) has particular positive features and shortcomings, so that a combination of different measures mitigates overall weaknesses and strengthens the analysis;

(c) depending on the availability of data and/or preference, researchers tend to use different combinations (sometimes not even the more common measures), thus the list provides a good reference point, allowing minimum subsequent detailed discussion; and

(d) for cross-sectional and time-series analysis, some generally less important measures may sometimes become relatively meaningful e.g. while the relative role and size of central banks are generally deemed to have significantly reduced across countries and thus generally not important for financial development analysis, measures involving central banks (e.g. CENTRALY—central bank assets to GDP) may still be important for countries which are in their initial stages of development.
2.5 DETERMINANTS OF FINANCIAL DEVELOPMENT: THE FRAMEWORK

2.5.1 Overview

In view of the foregoing important benefits of financial development, an obvious question that arises is how can financial sectors be developed i.e. what determines financial development. Per earlier discussion, a basic function of a financial sector is to transfer funds across economic agents. For this transfer to take place, there ought to be supply and demand for financial sector funds. Accordingly, there ought also to be factors that determine the supply and the demand for such funds, i.e. there ought to be supply–side and demand–side determinants of financial sector funds. Combining this philosophy with the definition of financial development adopted in this study—the ease with which any entrepreneur or company with a sound project can obtain finance and the confidence with which investors anticipate an adequate return—suggests, *inter alia*, that the ‘confidence of anticipated return’ determines the supply of such funds and the ‘ease’ of obtaining the funds determines its demand (see figure 2–4).

**Figure 2–4: Financial development: the supply and demand perspectives**

Figure 2–4 illustrate, using the definition of financial development used in this study, that an increase in the confidence of anticipated return on investment is likely to result in an increase in the supply of financial sector funds; similarly, enhanced ease of obtaining these funds is likely to result in an increase in the demand for these funds. Both supply and demand appear equally important for enhancing financial development.

As figure 2–4 shows, an increase in the confidence of anticipated return on investment is likely to result in an increase in the supply of financial sector funds; similarly, enhanced ease of obtaining these funds is likely to result in an increase in the demand
for these funds. Both supply and demand appear equally important for enhancing financial development. For example, while a high level of confidence may result in increased supply, this *per se* may not necessarily lead to further financial development—the demand for such funds, determined by the ease of obtaining it, appears equally important for the purpose. Thus, exploring ways to accelerate financial development in a country, such as Fiji, appears to require simultaneous investigation of both the supply–side and demand–side determinants.

This study, for reasons explained in sections 2.5.2 and 2.6, focuses on the legal protection of investors (suppliers of funds) as the supply–side determinant of financial development. Essentially, the law–finance argument is that adequate legal protection, in the form of legal rights and quality of law enforcement, (together referred to as legal institutions) enhances supply of funds via strengthened investor confidence in anticipated returns. Literature appears rather silent on demand–side determinants versus financial development. However, as identified in section 2.7, the level and extent of paperwork and bureaucracy, collateral, disclosure and costs associated with various funding sources, appear to be important demand–side determinants of financial development, especially in developing economies.

With the above in mind, figure 2–5, an extension of figure 2–4, captures the essence of this study. Among others, two important questions of this study are: (i) what is the role of legal institutions in Fiji’s financial development; and (ii) what is the role of demand–side factors in firms’ reliance on alternative finance.

In relation to the first question, this study attempts to investigate the adequacy of legal investor protection in Fiji, keeping in mind that adequate or enhanced legal protection
of investors is likely to increase the confidence of anticipated return on investment resulting in a likely increase in the supply of financial sector funds. In relation to the second question, paperwork, collateral, disclosure and costs are used as factors that determine the ease of obtaining financial sector funds. Favourable paperwork, collateral, disclosure and costs are expected to enhance the ease of obtaining these funds resulting in a likely increase in the demand for these funds. Similarly, unfavourable attributes are expected to reduce the ease of obtaining these funds resulting in a likely fall in the demand for these funds. In the latter case, companies and entrepreneurs are likely to turn to alternative channels. Similarly, discouraged suppliers may supply their funds via alternative channels.

**Figure 2–5: Financial development: the supply and demand determinants of this study**

Figure 2–5, an extension of figure 2–4 above, illustrates that adequate or enhanced legal protection of investors is likely to increase the confidence of anticipated return on investment resulting in a likely increase in the supply of financial sector funds. Similarly, favourable paperwork, collateral, disclosure and costs are expected to enhance the ease of obtaining these funds resulting in a likely increase in the demand for these funds. Both processes are likely to lead to financial development. In case of suppressed demand for financial sector funds, firms and entrepreneurs may turn to alternative finance channels. Similarly, discouraged suppliers may supply their funds via alternative channels.

**2.5.2 Supply–Side Determinants And Financial Development**

While it is likely that most ultimate suppliers will supply at least some of their funds to the demanders, it is not necessarily the case that they would supply their entire savings via the financial system. Moreover, they may not supply any funds at all to the private sector. Thus, it becomes important to understand and address the factors that would
entice the suppliers to supply funds to the private sector via the financial sector. As depicted by figure 2–6, funds may flow from the savers to the private sector indirectly i.e. via financial intermediaries (such as commercial banks) or directly (e.g. facilitated by financial markets such as stock markets).

Figure 2–6: Financial development: A supply–side perspective

The volume and extent of the flow of funds from the ultimate suppliers to the ultimate demanders importantly determines the level of a country’s financial development. Such funds may be transferred across agents via financial intermediaries and/or markets. The former process involves supply of credit and the latter, supply of equity funds, at the discretion of intermediaries and ultimate suppliers, respectively. Suppliers discouraged by financial sector conditions may supply their funds to firms via alternative channels.

Funds that flow from the suppliers via financial intermediaries would be at the discretion of the intermediary; that which is facilitated by markets is at the discretion of the ultimate savers themselves. The former process involves supply of credit funds to the private sector and the latter equity funds; thus, intermediaries become creditors and savers become shareholders. The question that arises now is what determines the volume and extent of supply of credit and equity funds to the demanders? Traditionally, issues relating to information asymmetries, adverse selection and moral hazard have been important concerns for suppliers. In more recent times, a number of new theories have emerged to answer this question, including law (e.g. La Porta et al., 1997, 1998, 1999, 2000), politics (e.g. Pagano and Volpin, 2001; Rajan and Zingales, 2003a), culture (Guiso et al. 2004; Licht, 2001; Licht et al. 2007; Stulz and Williamson, 2003;
Garretsen et al. 2004) and *endowments* (e.g. Engerman and Sokoloff, 1997; 2002; Acemoglu et al., 2001).

The law–finance view asserts that adequate legal investor protection,\(^2\) which strengthens investor confidence in returns, is a pre–requisite for supply of funds and that a country’s legal institutions in turn have been prominently shaped by the origin of its laws. The political and cultural theories confirm the law–finance view in principle, however, they disagree with the notion that legal origin determines legal institutions; the political view stresses the importance of political influence and the cultural view on cultural beliefs and attitudes in shaping legal institutions. The endowment view is a historical account of the cross–country development processes and appears less important for accelerating development.

Of these, *law* appears to be more important for assessing a country’s financial development and determining a practical approach for further development. It also appears to be the most manageable and achievable given time and resource constraints of this study. While past endowments appear important in understanding the history of a country’s financial development, it does not appear to offer measures for further development. The cultural and political theories appear to be largely motivated by an observation that the legal explanation might take too narrow a view of the role of institutions, that other formal and informal institutions\(^2\) are perhaps unduly neglected. Thus, cultural and political theories challenge as well as enrich the legal explanation of

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\(^2\) It must be noted here that investors include creditors and shareholders. With respect to creditors, this study focuses on commercial banks. While depositors (households and others) may supply funds to commercial banks, their legal protection is usually well defined in legislature across countries.

\(^2\) These may include a clearly defined system of property rights; a regulatory system to minimise fraudulent activities, anti–competitive behaviour, and moral hazard; institutions for encouraging trust and social cooperation; social and political institutions that mitigate risk and manage social conflicts; and the rule of law and clean government (e.g. Rodrik, 2000).
financial development. For these reasons, law has been selected as the supply–side factor to be investigated in exploring ways to accelerate financial development in Fiji.

Thus, for the supply of credit funds, it would be the legal protection of banks that would matter for development of the banking sector and therefore financial development; for supply of equity funds, it would be the legal protection of the shareholders that would matter for development of stock markets and financial development.

2.5.3 Demand–Side Determinants And Financial Development

While the demand for funds appears as important as the supply of funds for financial development, research on this perspective does not appear to be as well researched as the former. The demand perspective of financial development may be explained using figure 2–7 below. Firms and entrepreneurs may obtain funds from various sources. Broadly, all of these sources may be categorised as internal or external. The internal sources may include founder’s equity, family/friend equity/loan and retained earnings. The external sources can be further categorised into that from financial and/or non–financial sectors. The financial sector sources include financial institutions (e.g. bank credit) and financial markets (e.g. stock market equity). The non–financial sector sources include trade and other credit, inter–company/shareholder/director loans, money lenders and others. Thus, financial sector funds may be but only one of the many funding options for firms and entrepreneurs.

Finance from any source that is not from the financial sector—alternative finance—is likely to be inversely related to financial development. Arguably, regardless of the extent and magnitude of supply, if firms had significant preference for alternative sources, development of the financial sector could be affected. In the extreme case, a
firm may have no funding at all from the financial sector. Such a firm may rely extensively on founder and/or family/friend equity or borrowing, retained earnings, reserves, inter–company loans, shareholder loans, private credit/lending agencies and other relationship– and reputation–based financing channels such as other entrepreneurs, business partners including retailers, suppliers, etc. (e.g. Allen et al., 2005).

Figure 2–7: Financial sector versus alternative channels of finance for firms

Firms may obtain finance for formation, growth and expansion from various sources, which may broadly be categorised into internal and external. The internal sources immediately become part of alternative sources. The external source may be from financial or non–financial sectors; the latter, which may be classed as formal/semi–formal or informal also become part of the alternative sources. Thus, the financial sector (institutions and markets) is but only one of the many sources available to firms for funding needs; the extent and magnitude of alternative channels is likely to be inversely related to financial development.

From the demand perspective then, it becomes important to identify and understand the factors and/or their attributes that determine the preference for, and use of various funding sources. Such understanding appears important for exploring ways to enhance
demand for financial sector funds. Unfortunately, literature in the area of demand–side determinants versus financial development appears scant. This study attempts to fill that gap. The determinants are identified in section 2.7.

2.6 SUPPLY–SIDE DETERMINANTS: A REVIEW OF LITERATURE

This section reviews the literature on supply–side determinants of financial development; a summary of which is provided in appendix 2–3.

2.6.1 Law And Finance

The legal theory

The basic contention of the law–finance theory is that legal institutions (legal rules and enforcement mechanisms) influence corporate finance and thus financial development; financiers (suppliers of funds) are inclined to participate more freely in the financing process in an environment that provides adequate legal protection against potential expropriation by financees (borrowers/users of funds). The demonstrated arguments of the theory are as follows: (i) adequate legal protection and enforcement of private property and investor rights encourage greater corporate financing and consequently financial development. Conversely, inadequate legal protection and enforcement hinder corporate financing and thus financial development; (ii) cross–country differences in property and investor rights and thus in financial development is due to differences in legal systems, which in turn is due to legal heritage; laws in different countries were not written from scratch but emerged in Europe and were imposed on the rest of the world through occupation or colonisation or merely borrowed or imitated by others. The legal origins are only four families: English, French, German and Scandinavian.
The second part of the law–finance theory—legal origins—affects financial development via two channels: (i) the ‘political’ channel, which stresses the state versus private priority of legal traditions, holds that private rights form the basis of financial development (La Porta et al., 1999a); and (ii) the ‘adaptability’ channel, which stresses the rigidity versus flexibility aspects of legal traditions, holds that flexibility or ability of the legal system to change with changing conditions forms the basis of financial development (Beck et al., 2001a; 2003b). Thus, legal systems that adequately protect and enforce the rights of investors, are non-state-oriented and adapt efficiently to changing economic and commercial conditions, facilitate financial development. The main findings of the pioneer, and subsequently widely accepted, law–finance studies are as follows.

*La Porta et al. (1998) study*

Using relevant data of 49 countries (18 English; 21 French; 6 German; and 4 Scandinavian) across Europe, North and South America, Asia and Australia, this seminal law–finance study demonstrates that,

(a) *Shareholder protection*: along a broad range of dimensions, results show that common–law countries afford the best legal protection to shareholders; French civil–law countries afford the worst.

(b) *Creditor protection*: results show that common–law countries afford the best legal protection to creditors; French civil–law countries afford the worst.

(c) *Law enforcement*: French civil law countries have poorer enforcement than common law countries; German civil law countries tend to have poorer enforcement than common law countries but better than French; and enforcement in Scandinavian regimes are similar to common law countries.
(d) **Investor protection:** thus, investors are best protected in countries with common law heritage and worst in countries with French civil law heritage;

(e) **Ownership concentration:** results suggest that concentration of ownership is an adaptation to poor legal protection of investors.

*La Porta et al. (1997) study*

The study uses three measures of equity finance to represent capital market size: stock market capitalisation/GNP, scaled by a rough measure of the fraction of equity shares held by outside shareholders; number of listed firms/population; and IPOs/population. The selected firms are the 10 largest in the respective countries and are publicly traded, non–state firms. The average of the 10 is then taken to measure the extent of equity finance in a country. To measure debt finance, the aggregate of each country’s total private sector bank debt and total face value of corporate bonds/GNP is used. This is done to overcome problems relating to unavailability of bank financing information on largest firms.

The authors demonstrate that legal institutions significantly influence external financing of firms and matters for the size and extent of a country’s capital markets; countries with better legal protection for investors have broader and deeper capital markets. Thus, common law countries tend to have better developed financial markets and French civil law countries have least developed markets, even after controlling for the overall level of economic development.

### 2.6.2 Politics And Finance

The contention of the political theory of financial development is that it is not legal origin but politics which determines development of relevant legal institutions which in
The proponents accept that while legal institutions are important determinants of financial development, they reject the notion that legal origins determine cross–country variations in institutions. The Rajan and Zingales (2003a) work is an important contribution in the politics–finance literature. The authors argue that most countries, regardless of the legal origins, were financially more developed in 1913 than in 1980 and only recently did they surpass the 1913 levels. Further, common law countries were not relatively more financially developed in 1913. Rajan and Zingales (2003b) point out that while financial development had not followed a monotonic path over 1913–1999, a country’s ‘legal origin’ had remained constant over time and thus may not fully explain the changing nature of the financial development process. Time series variations and cross–sectional differences in financial development, they argue, are determined by politics rather than legal traditions.

Using data from 24 countries, Rajan and Zingales (2003) show that the average level of financial development in 1913 was relatively higher than 1980 or 1990; only by end of 1990s did they equal or surpass the 1913 levels. Further, countries financially more developed in 1913 did not continue to be so in the 1990s and contrary to findings of the legal studies, some French civil law countries may have been more developed in 1913 than some common law countries. For instance, in 1913, France (French civil law, MCAP = 0.78) had a much larger stock market than the US (English common law, MCAP = 0.39), the positions reversed by 1980 (0.09 and 0.46, respectively) and in 1999 the two countries seemed to be converging (1.17 and 1.52, respectively). In 1913, France (French civil law), Belgium (French civil law) and Russia had more equity issues than the US (common law) but by 1999 the US had surpassed these countries. Similarly, in 1913, Belgium (French civil law), France (French civil law), Germany and
Sweden had more MCAP than the US but by 1999 the US (common law) had surpassed the first three.

*Interest groups*

Rajan and Zingales (2003b) propose a ‘political’ explanation of financial development, based on an interest group theory where incumbents, both firms and financiers, oppose financial development because it breeds competition and impairs their positional rents. The authors argue that these interest groups have been primary drivers of a country’s financial development over the last century. They reject the view that cross–country differences in financial development are correlated with a country’s legal heritage.

Rajan and Zingales (2003b) argue that industrial incumbents (established large industrial firms) have the ability to finance new projects out of earnings and/or borrow on collateral and reputation. Such privileged access to finance endows the incumbents with positional rents, which is likely to be impaired with financial development, thus the interest of industrial incumbents to oppose financial development. Similarly, financial development may compete away the powers and positional rents of incumbent financiers and thus the interest of incumbent financiers to oppose financial development. The mutual ‘rent protection’ objectives enable financiers to solicit the support of firms in return for privileged access to finance and protection of confidentiality. These incumbents have large economic power to collectively determine the development of the financial sector through political influence.

Rajan and Zingales (2003b) argue that those in power are able to influence policies and institutions to their own advantage, thus, if development of financial markets is in the interest of the elite, they will influence laws and institutions that support development
and vice versa. This argument is echoed by Roe (1994), who uses case studies of the United States, Germany and Japan to show that political factors do play a crucial role in the development of regulatory systems and thus the structure of corporate governance in different countries. The author notes that the absence of a controlling shareholder in the US allows managers to have increased powers and thus private benefits, which they can protect via political lobbying. Roe (1994) suggests that the twentieth century US regulatory efforts to prevent the emergence of controlling shareholders may have been a consequence of such lobbying. Moreover, such regulations could not be introduced in Continental Europe because here managers have historically been less powerful due to a large and significant presence of controlling shareholders.

Pagano and Volpin (2001) describe the interest group influence using the example where managers and workers cut a political deal against shareholders to protect respective interests from corporate raiders. The managers being hired to maximise shareholder wealth are expected to cut costs, including wages, among other things, to pursue this goal at the expense of manager–worker conflicts. On the other hand, managers have potential private benefits of control which they endeavour to protect from shareholders by limiting shareholder rights and avoiding takeovers. The managers thus solicit the support of workers in minimising shareholder rights and takeovers in return for higher wages and protection against dismissals. Such mutual rent protection inducements result in formation of a manager–worker interest group, which works against the interest of shareholders.

The ‘politics–finance’ view has two important features. First, the political process is dictated by coalitions between different interest groups—such as banks and firms, managers and workers—in pursuit of mutual personal benefits. Second, laws and
regulations—for example, those relating to investor protection—are a result of the bargaining and alliance between different interest groups. Politics is thus not an exogenous factor in the financial development processes. The theory does not reject the view that legal institutions are important for financial development, rather it disagrees with the explanation that legal origin predetermines financial development. However, the theory lacks empirical evidence. Moreover, the political view is challenged by Pistor, et al. (2002) who argue, citing the cases of Germany, France and England during the 20th century that even severe political changes did not always lead to substantive transformation of corporate law. Similarly, Allen and Gale (1995), citing the cases of United States and United Kingdom, argue that while politics is an important factor, the extent of its importance may be uncertain.

2.6.3 Culture And Finance

The argument of the cultural theory of financial development is similar to that of the politics–finance theory. The proponents of the culture–finance theory argue that sole reliance on legal institutions as a determinant of financial development and/or legal origin as the determinant of variations in legal institutions may be misleading. They argue that informal institutions such as culture are also important determinants of financial development and/or legal institutions.

Culture encapsulates an inter–generational transmission of values, knowledge, orientations, underlying assumptions and other factors that influence societal behaviour via teaching, imitation, customs, laws, norms, scripts and practices. The deepest manifestation of cultural differences seems to lie in the set of values (Licht, 2001; Licht et al., 2007; Stulz and Williamson, 2003; Garretsen et al., 2004), which constitute the ‘implicitly and explicitly shared, abstract ideas about what is good, right and desirable
in a society’, which in turn influence how social actors (e.g. organisational leaders, policy–makers, individual persons) select, evaluate and explain or justify behaviour, policies and events and which generally influence preference for certain states of affairs over others.

The values specify desirable or legitimate behaviour or norms, which guide and/or constrain the functioning and performance of societal institutions, such as the family, education, economic, political and religious systems (Licht et al, 2007). These norms or ‘ought statements’ as the legal economist call, also appear to significantly influence implementation of formal rules and/or constitutions resulting in different outcomes for different societies. Thus, cultural values and norms may compliment or even substitute financial development theories based on legal institutions, which have become a central issue in the debate on determinants of financial development.

Cultural variables
Researchers commonly use the four Hofstede– and three Schwartz–derived proxies to empirically test hypothesis relating to culture and economics. Table 2–1 summarises and compares the Hofstede and Schwartz cultural variables. The two cross–cultural psychology–based theories propose that all societies confront similar basic issues or problems in regulating human activity. Societies recognise these problems, plan responses to them and motivate members to cooperate in coping with them, which in essence become societal values.
Table 2–1 summarises and compares the Hofstede and Schwartz cultural variables.

<table>
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<tr>
<th>Cultural dimensions</th>
<th>Hofstede variables</th>
<th>Schwartz variables</th>
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<tr>
<td>Societal equality</td>
<td>Power distance (PDI)</td>
<td>Hierarchy (HRC)</td>
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<td></td>
<td></td>
<td>Egalitarianism (EGL)</td>
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<tr>
<td>Individual and group relationships</td>
<td>Individualism/Collectivism (IND)</td>
<td>Embeddedness (EMB)</td>
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<td>Affective Autonomy (AATN)</td>
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<td>Intellectual Autonomy (IATN)</td>
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<td>Desirable behaviour</td>
<td>Masculinity/Femininity (MAS)</td>
<td>Mastery (MAST)</td>
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<td>Harmony (HAM)</td>
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<tr>
<td>Dealing with uncertainty</td>
<td>Uncertainty Avoidance (UAI)</td>
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**Garretsen 2004 study**

Garretsen et al. (2004) demonstrate that societal norms are important in explaining stock market capitalisation and largely coincide with legal institution explanation of financial development. Taking the example of The Netherlands, Garretsen et al (2004) observe that while the country had weak investor protection according to legal origin country classification (French) and corresponding index computations ($ADRI$ and $CRI = 2$), its financial system, on the contrary, was well developed, with above average economic growth in the 1990s. They argue that societal norm was the reason for this. Indeed, Inglehart et al. (1998) find that ‘trust’ in The Netherlands was relatively higher (56%) than in other French legal origin countries (average 24%). La Porta et al. (1997) also suggest that ‘trust’ may be a surrogate for legal institutions. Guiso et al. (2004) find ‘trust’ to be a major determinant for financial development in Italy. Differences in societal norms also explain the differences in legal institutions of some Asian and the big–5 common law countries (Licht, 2001).

The legal family country classification is retained to enable comparison between societal norm scores and legal origin scores. Additionally, countries were clustered according to their scores on some common factor of the four Hofstede (1980) variables to enable comparison with the La Porta et al. (1998) scores. Countries were clustered

The authors use the Hofstede (1980) societal indicators ($PDI$, $IND$, $MAS$ and $UAI$) in their study because these relate to general cultural features, appropriate for emphasising the role of societal norms that are more general to certain financial markets or transactions; the objective was not to analyse norms that were specific to markets in general or stock markets in particular. The authors then proceed to examine the association, if any, between societal norms and investor protection/rights (shareholder and creditor rights). For comparability, they use the La Porta et al. (1998) shareholder and creditor rights variables and scoring methods; for stock market development the variable is MCAP (market capitalisation) and for banking development it is BPRVY (bank private sector credit to GDP).

The main findings of this study are as follows.

(a) **Shareholder protection**: in addition to legal heritage, societal norms also contribute to legal institutions explanation of significant cross–country differences in shareholder rights;

(b) **Creditor protection**: the study finds little difference in creditor rights based on their classification of countries using societal origin, which coincides with La Porta et al. (1998) finding of little difference between English and German or Scandinavian legal origin countries; the study does find a significant difference between English and French countries. Garretsen et al. (2004) also find that the Asian group had relatively higher creditor rights scores than other groups;

(c) **Financial development**: the study finds a strong positive correlation between Hofstede variables and MCAP i.e. societal norms are shown to be significant
determinants of stock market development. For instance, given that stocks are perceived to be relatively riskier investment and thus UAI (uncertainty avoidance, see table 2–1) might be thought to be negatively correlated with stock market development, the results show that indeed a higher degree of UAI is correlated with a lower degree of stock market capitalisation. For banking development then, societal norms do not seem to be significant; legal institutions also appear to be relatively less important for banking development.

*Licht 2001 study*

Licht et al. (2001) find that cultural values strongly determined legal institutions such as shareholder and creditor rights; legal origin could not fully explain the development process. Moreover, their findings cast a doubt on the alleged supremacy of the English legal institutions in protecting investors in general. The sample for this study is 54 of the 65 Schwartz countries across Europe, North and South America and Australasia. The respondents are urban school teachers who teach the full range of subjects in grades 3–12 of the most common type of school system. The respondent selection is based on the assumption that teachers play an explicit role in value socialisation, are key carriers of culture and reflect the mid–range of prevailing value priorities in most societies. The legal family country classification is retained to enable comparison between cultural scores and legal origin scores. For cultural classification, the Schwartz and Hofstede approaches are used, except in the case of the latter, Asian regions are consolidated. The concept of values is used to represent culture and the Schwartz (1988, 1999) and Hofstede (1980, 1991) bi–polar variables are used to denote values. The 45 equivalent–meaning Schwartz values are included in the study.
The main findings of this study are as follows.

(a) **Shareholder protection:** with regard to English speaking countries, Licht et al. (2001) findings compliment La Porta et al. (1998) finding that common law regimes provide better shareholder rights. That is, cultural values and legal institutions appear to be well matched in English speaking common law countries. However, the results cast a doubt on the law–finance assertion that common law countries generally provide better shareholder rights. By the law–finance implication, Asian countries with common law heritage should generally have better shareholder rights than countries with other law traditions, which is found to be in contradiction;

(b) **Creditor protection:** the doubts are stronger for creditor protection; Licht et al. (2001) doubt that common law countries generally provide better creditor rights. They argue that statues in English speaking regions provide similar creditor rights protection to statutes in countries with civil law origins in Western Europe, Latin America, and Asia. In the La Porta et al. (1998) sample, the average creditor rights index is highest for the common law group, depicting best creditor rights protection in these countries generally. Licht et al. (2001) find that this relatively high average score is due to the relatively high scores of Far Eastern and African cultural countries (Schwartz grouping; average) or Asian countries (Hofstede grouping). Within the common law countries, the Far Eastern/African average creditor rights index is 4.0, the Asian average is 3.8 and the Anglo average is 1.9. Thus, the Far Eastern/African/Asian country scores elevate the common law average;

(c) **Investor protection:** the Far Eastern countries appear to be relatively superior in protecting both the shareholders and creditors; however, the authors doubt the effectiveness of statutory law in these countries. English speaking countries
appear to be superior only in protecting shareholders. Thus, sole reliance on the advocated ‘legal approach’ for investor protection and financial development may result in inappropriate policy formulation.

_Guiso 2004 study_

Guiso et al. (2004) examine the role of trust or ‘social capital’ in financial development and find, in the case of different parts of Italy, that households’ investment in stock is much larger than their cash holdings in areas with higher levels of trust; the results are statistically significant. Here, cash holdings resemble less trust in others and willingness to invest in stock resembles a trust in the firm being financed. The analysis also shows that trust is positively and significantly associated with the use of cheques and formal credit and negatively associated with informal credit. Similarly, firms are shown to have increased access to formal credit in areas with higher levels of trust. Thus, financial development is shown to be associated with trust. However, Guiso et al. (2000) do not critique the law–finance theory. In fact, they find that the importance of trust increases in situations where legal enforcement is weak, indicating that while law matters, trust may substitute for weak legal enforcement of contracts.

Household data was gathered from the Survey of Households Income and Wealth (SHIW), which is conducted by the Bank of Italy every two years on a representative sample of 8,000 households. Guiso et al (2004) pool household data for four surveys (1989–1995) to obtain a sample of 32,617 observations. The surveys collect data on household income, consumption and wealth as well as their portfolio allocation across financial instruments and their access to formal and informal credit. Demographic information on the household’s head is also collected. Among other things, the survey distinctly reveals information on households not applying for a loan and those not
successful in applying; the latter being for reasons of being turned down or expecting to be turned down. The survey also reveals information on the extent of credit obtained from informal sources such as families and friends.

Firm data was gathered from the 1994 Survey of Manufacturing Firms (SMF) conducted by an investment bank on a random sample of over 4,000 small and medium (mostly private) manufacturing firms with at least 10 employees. Among other things, the survey collects data on firms’ access to credit.

2.6.4 Endowment And Finance

The law–finance theory argues that Europeans either imposed their laws on the countries they colonised or conquered and these laws then shaped the development of financial sectors in the respective countries; the endowment theory also bases its argument on European colonisation but in contrast to the former, the identity of the coloniser is irrelevant (Acemoglu et al., 2001). While the former focuses on law for institution creation, the later focuses on the different disease and geography endowments for institution creation.

The Acemoglu et al., (2001) endowment theory is based on three principles: (1) the colonisers adopted different colonisation strategies; (2) the strategies and thus institution creation were significantly influenced by the feasibility of settlement; and (3) the institutions created by colonisers remained after independence. The strategies were to either, settle and create institutions to support private property rights or to extract (e.g. gold, silver) as much from the colony as possible without any consideration for private property rights; rather establish institutions that empowered the colonisers (the elite) to extract resources.
The settler colonies included the US, Australia and New Zealand, where endowments favoured settlement and the ‘extractive’ colonies included countries such as Congo, Ivory Coast and much of Latin America where endowments were unfavourable. For instance, high mortality rates made the ‘extractive’ countries inhospitable for settlement. Thus, the disease environment influenced colonisation strategies and creation of institutions, which endured after independence, such that post–colonial rulers in settler colonies continued to protect private property rights while the elite in extractive colonies used the existing extractive institutions to continue exploiting the respective countries. Engerman et al. (1997, 2002) provide further evidence of this.

The implication of the endowment theory for financial development is as follows: private property rights being crucial for finance, financial development occurred in settler colonies where institutions protected the rights; in extractive colonies, absence of such institutions resulted in less or underdevelopment of financial sectors. Acemoglu et al. (2002), Beck et al. (2003a) and Easterly and Levine, (2003) provide empirical support for the endowment theory’s explanation of financial development. However, neither the theory nor the supporting empirical research argues that law or legal origin is irrelevant for financial development.

2.7 DEMAND–SIDE DETERMINANTS

2.7.1 Overview

Unlike the supply–side determinants, research on the influence of demand–side determinants on financial development appears rather scarce. This section attempts to identify the factors that may determine a firm or an entrepreneur’s choice between a financial sector and an alternative funding source. This is done keeping in mind the
relevant part of the definition of financial development used in this study, i.e. ‘the ease with which any entrepreneur or company with a sound project can obtain finance.’ The emphases here are particularly on two words: ‘any’ and ‘ease’; not only should any company or entrepreneur, notwithstanding the identity of the owner, be able to obtain finance but also where there is a choice, they should find financial sector funds easy to opt for in lieu of alternative sources. The ‘ease’ and ‘any’ aspects then are expected to primarily drive the search for the factors. First, though, further explanation on the constituents of alternative finance, as defined in this study, is provided.

2.7.2 Alternative Finance: A Detailed Description

Alternative finance, as used in this study, includes informal finance plus many other forms as explained below. Informal finance, a phrase synonymous with ‘parallel’, ‘black’, ‘underground’, ‘fragmented’, ‘unorganised’, ‘segmented’ and ‘curb’ markets, as is commonly understood describes various forms of ‘unregulated’ and/or ‘unmonitored’ economic activity. Informal finance may be distinguished between credit extended (i) within a group of entities or (ii) outside the group (ADB, 1992; Montiel et al., 1993). In the latter case, lending may be occasional/intermittent or on a regular basis. Regular lenders may lend on the basis of tied or untied credit.

Group finance is a traditional form where individuals voluntarily pool their savings on a regular basis to generate loanable funds exclusively for their membership, such as the highly popular rotating savings and credit associations or ROSCAs, as they are commonly known, in Asia and Africa. Intermittent lenders include families and friends as well as the inter–company loans, both being important sources of firm–financing. For instance, loans from families and friends are, in many cases, crucial for start–up and/or working capital finance. Loans from families and friends are based on social and
economic relationships and therefore are normally free of interest, collateral and formal enforcement, with reciprocity being a common practice. Similarly, inter–company loans, such as the inter–corporate funds market in India, frequently provide funds to alleviate short term cash flow problems as well as longer term credit constraints.

The regular lenders, moneylenders, pawnbrokers and indigenous bankers—examples of ‘untied credit’—often have intimate knowledge of the borrower and lend primarily on the basis of information and/or collateral. Trade credit is a common form of ‘tied credit’, where traders supply either inputs or cash advances to firms and the credit is tied to purchases of some product at a highly discounted price.

In addition to the above ‘informal’ sources, firms may have access to and obtain funds from, other ‘alternative’ sources, such as those identified in China’s case (Allen et al., 2005). These may include fundraising; state budget; foreign direct investment; coalitions among producers and retailers; and cross–listed accounts. Fundraising includes capital (not in the form of equity or bonds) raised from local governments, communities and other investors; internal financing such as retained earnings, reserves, shareholder, director and inter–company loans; and all other funds raised domestically not included elsewhere. Together, these funding sources are ‘alternatives’ to funds from the formal financial sector. Thus, the definition of ‘alternative’ finance in this study is not confined to ‘informal’ finance; it embraces informal finance as well as all other forms of financial transactions that take place beyond the financial scope of the formal financial sector. Figure 2–7 provides a summary of the many alternative finance channels.
2.7.3 **Alternative Finance: Country Examples**

While known to be prevalent in developing economies (Germidis, 1990; Germidis et al., 1991; ADB, 1992; Montiel et al., 1993; Steel et al., 1997; Isaksson, 2002), the very nature of many alternative finance channels make it indeed very difficult to quantify the significance of these for firm–financing. Nevertheless, table 2–2 highlights the possible extent of alternative finance in selected developing countries and regions. Sourced from Allen et al. (2005), this table shows that use of alternative finance may be quite extensive in developing economies. For example, in Bangladesh, up to 70% of firm assets may be financed from alternative sources.

**Table 2-2: Alternative finance in selected developing countries and regions**

This table shows the proportion of firm assets financed from alternative sources in selected developing countries and regions and across various income groups. E.g. in Bangladesh, up to 70% of firm assets may be financed from alternative sources.

<table>
<thead>
<tr>
<th>Across Countries</th>
<th>Alternative Finance (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>70</td>
</tr>
<tr>
<td>Brazil</td>
<td>86</td>
</tr>
<tr>
<td>China</td>
<td>79</td>
</tr>
<tr>
<td>India</td>
<td>67</td>
</tr>
<tr>
<td>Indonesia</td>
<td>84</td>
</tr>
<tr>
<td>Nigeria</td>
<td>70</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>94</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Across Regions</th>
<th>Alternative Finance (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>81</td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td>68</td>
</tr>
<tr>
<td>(excluding China)</td>
<td></td>
</tr>
<tr>
<td>East Europe and Central Asia</td>
<td>87</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>79</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>87</td>
</tr>
<tr>
<td>South Asia</td>
<td>77</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Across Income Groups</th>
<th>Alternative Finance (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low Income</td>
<td>83</td>
</tr>
<tr>
<td>Middle Income</td>
<td>83</td>
</tr>
<tr>
<td>High Income OECD</td>
<td>79</td>
</tr>
</tbody>
</table>

Source: Allen et al., 2005

In examining the extent and magnitude of alternative finance, the case of China, a country which is not only one of the fastest growing economies but, using Purchasing Power Parity (PPP), is already the second largest economy and is expected to overtake the United States in the next decade, can not be ignored. The country’s rapid economic growth is contributed significantly by the country’s informal sector, which is financed
substantially by sources other than the country’s formal financial sector (Allen et al., 2005). Tsai’s (2002) survey, conducted between 1994 and 2001, finds that 88% of 374 private entrepreneurs had never borrowed from the formal financial system; only 0.4% of the official bank credit was lent to the private sector in 1998. Further, most of the over 30 million private businesses established in China between 1978 and 2001 were excluded from the formal financial system.

The four most important financing sources for all firms in China include bank loans (domestic); self–fundraising; state budget; and foreign direct investment, of which bank loans and fundraising are the most important (Allen et al., 2005). Fundraising includes capital (not in the form of equity or bonds) raised from local governments, communities and other investors; internal financing such as retained earnings; and all other funds raised domestically not included in the other three sources. Relationship– and reputation–based financing channels include funds from other entrepreneurs, business partners including retailers and suppliers, and families and friends. Private credit/lending agencies include moneylenders. Cross–listed accounts are debits and credits with business partners and other companies. Due to the absence of formal contracts and frequently renegotiated clearing dates and methods, these informal accounts are different from normal trade credit transactions.

Fundraising is the most important financing source for most firms; about 60% of total financing for firms in the informal sector (90% for privately owned firms); 45%–65% for state–and quasi–state–owned companies; 45% for publicly traded firms (for publicly traded firms, fundraising includes equity and bond issuance but these constitute only a small fraction of total fundraising compared to internal and other forms).
China’s rapid growth has been dominated by the informal sector. Firms in the informal sector are ‘quasi–state–owned’ companies (collectively– and jointly–owned companies with forged ownership between the state and local communities and institutions); and privately owned companies (excludes privately owned but publicly traded companies). The controlling owners of these companies can be Chinese citizens, investors (or companies) from Taiwan, or Hong Kong or foreign investors or companies. Firms in the formal sector include state owned and controlled enterprises (SOEs) and publicly–traded firms.

Formal external financing for firms in the informal sector is almost nil in their early stages of growth. At this stage, funds come from relationship– and reputation–based financing channels, including other entrepreneurs, business partners including retailers, suppliers, family and friends. Funds may also come from private credit/lending agencies, who charge excessive interest rates and/or require large amounts of collateral and have powers to force liquidation, which substitute for formal loan contracts. Even after the start–up phase, these firms do not receive loans from banks; the firms gradually form coalitions among producers and retailers and finance each other’s growth or borrow from the entrepreneurs who can raise extra capital. Additionally, firms have cross–listed accounts of debits and credits with their business partners and other companies. These informal accounts replace cash transactions and are cleared periodically, thus are similar to trade credits but the absence of formal contracts and frequently renegotiated clearing dates and methods make them different from normal trade credits transactions. Finance from outside the formal financial sector is thus a relatively important source of funding for firms in China, especially for those in the informal sector.
Aryeetey (2005) provides an analysis of firm financing in Africa. Alternative sources dominate firm financing across various stages of growth, from start-up to established large scale operations. In Zimbabwe, for instance, alternative sources constituted up to 90% of start-up capital for different sized firms in 1993. Moreover, only 12% of SMEs used bank loans for working capital in that year. Such trends appear common across Africa. While bank loans appear to increase as a source of funds as firms grow, a large number of growing firms continue to have little access to bank credit. The more common use of bank loans is by larger firms and mainly for large investments.

2.7.4 Why Do Borrowers Prefer Alternative Channels?

While the financial sector does provide many essential services and benefits to economies, including the consequential long-term growth (see section 2.3), providers (e.g. banks) and facilitators (e.g. stock markets) of the financial sector funds are commonly subject to high levels of government regulation and supervision. Essentially, such regulation and supervision are required and designed, *inter alia*, to enhance the safety and soundness of financial systems and to minimise detriment to investors and borrowers, i.e. suppliers and demanders of the financial sector funds. For these reasons, the providers and facilitators of funds themselves often take precautions even without formal regulation and supervision.

Safety, soundness and welfare considerations require that banks and stock markets adopt and employ appropriate policies and procedures. Among other things, these policies and procedures usually result in extensive paperwork and bureaucracy, require high levels of disclosure of borrowers’ financial and other records and necessitate collateralisation of borrowed funds. There are also costs associated with providing or
facilitating fund transfer, which particularly, in case of providers, need to be recovered with a profit.

Table 2–3: Formal versus alternative financing processes—pros and cons

Table 2–3 summarises the possible deemed pros and cons of formal financial sector and alternative funding processes from a borrower’s perspective. E.g. in terms of paperwork and bureaucracy, bank lending processes are deemed to be cumbersome and bureaucratic while an alternative funding process, such as that involving a money lender, may require minimum paperwork and deemed simple and flexible.

<table>
<thead>
<tr>
<th>Loan characteristic</th>
<th>Formal financial sector</th>
<th>Alternative sources</th>
</tr>
</thead>
<tbody>
<tr>
<td>Paperwork and bureaucracy</td>
<td>Cumbersome, bureaucratic</td>
<td>Minimum, simple, flexible</td>
</tr>
<tr>
<td>Loan approval</td>
<td>Refusal possible</td>
<td>Almost always certain</td>
</tr>
<tr>
<td>Loan disbursement</td>
<td>Time-consuming</td>
<td>Expeditious</td>
</tr>
<tr>
<td>Loan amounts and term</td>
<td>Large and long preferred</td>
<td>Flexible</td>
</tr>
<tr>
<td>Interest costs</td>
<td>Relatively low</td>
<td>Relatively high if applicable; otherwise nil or low</td>
</tr>
<tr>
<td>Transaction costs</td>
<td>High</td>
<td>Nil/low</td>
</tr>
<tr>
<td>Collateral requirement</td>
<td>Usually required; tangible,</td>
<td>Nil, substituted by past record, personal good faith, social pressures</td>
</tr>
<tr>
<td></td>
<td>appropriate and adequate</td>
<td></td>
</tr>
<tr>
<td>Own contribution</td>
<td>Usually required</td>
<td>Nil</td>
</tr>
<tr>
<td>Rules and regulations</td>
<td>Difficult to understand</td>
<td>Easy to understand</td>
</tr>
<tr>
<td>Disclosure to third party</td>
<td>Required</td>
<td>Nil</td>
</tr>
<tr>
<td>Tax evasion</td>
<td>Low</td>
<td>High</td>
</tr>
</tbody>
</table>

Unfortunately, these safety and welfare enhancing attributes of financial sector funds may ironically reduce the ‘ease’ of obtaining such funds and thereby its demand. The usual profit–orientation of the providers is likely to exacerbate the difficulties. Moreover, these attributes may also result in intentional or unintentional exclusion of certain firms and entrepreneurs from the formal financial sector. How these attributes may reduce the ‘ease’ of obtaining financial sector funds and thereby encourage borrowers to turn to alternative channels is discussed below. While the identified factors may apply generally, they are perceived to be more suitable to developing countries such as Fiji. Table 2–3 attempts to summarise the possible deemed pros and cons of the formal financial sector versus alternative funding processes from a borrower’s perspective.
Bank credit and stock market facilitated equity normally entail extensive paperwork and bureaucracy; the extent being usually greater in case of the former. For example, bank credit normally requires a potential borrower (firm or entrepreneur) to submit an application, which, in addition to completing forms may require collating and attaching various other documents such as collateral valuation, past financial records, pro forma financials, projected cash flows, feasibility assessment, etc. Subsequent vetting of these documents and decision making may proceed through various stages. In addition to this initial assessment of credit worthiness and default risk, once advanced, credit needs to be monitored to minimise risks, requiring thus further paperwork, documentation and analysis.

Expectedly, these processes may not only be seen to be rigid and cumbersome but they could also make the procedures relatively difficult to comprehend and slow down approval and disbursement of funds. Moreover, credit can not be guaranteed and where approved, it may not correspond desirably with requirements and capacity of borrowers.

Such processes and outcomes are likely to be less attractive than those which, among others, are more flexible and amorphous, involve minimal paperwork, enable faster processing and delivery of credit, have greater approval ratings, allow credit terms to meet specific needs and access amounts corresponding to requirements and capacity of borrowers, and have easily understood rules and regulations. Such attributes are associated more with alternative sources of funds discussed earlier (Germidis, 1990; Germidis et al., 1991; Baydas et al., 1995; Waldron, 1995).
With many alternative sources, default risk is minimal as information on the creditworthiness of potential borrowers is obtained easily and at minimum cost. Further, follow-ups on outstanding loans are unproblematic. These are made possible by the limited geographical operations, regularity of transactions and personal connections and contact, which enable personal knowledge of clients’ financial condition. Such ‘closed-circuit’ operations allow effective assessment of creditworthiness and close monitoring of outstanding loans (Besley and Coate, 1991; Baydas et al., 1995). Moreover, in some cases, such as family/friend and other related party transactions, the issue of default risk may be completely absent.

**Collateral**

In addition to the paperwork and bureaucracy, collateral is also usually a pre-requisite for obtaining a bank credit. From a lender’s perspective, collateral helps in mitigating the adverse selection and moral hazard problems in credit markets (e.g. Stiglitz and Weiss, 1981). A lender’s ability to effectively repossess and sell collateral are important determinants of availability and terms of credit.

However, from the borrower’s perspective, meeting adequate collateral requirements, usually stringent, may not always be feasible. Moreover, a technically creditworthy borrower, who has reasonably passed the paperwork test, may still not qualify for credit if collateral requirements are not reasonably satisfied (e.g. Waldron, 1995). For instance, while China constantly emerges as an important example in discussions relating to economic growth, collateral requirements continue to be a major deterrent to formal financial sector funds (Allen et al., 2005). To overcome difficulties associated with collateral requirements of financial sector funds, borrowers may prefer alternative
sources, where collateral may be substituted by personal relationships, credit history and social norms, if required.

Disclosure

The documentation requirements of bank credit results, *inter alia*, in written records of borrowers’ savings, lending activities and assets and thereby their wealth. Thus, paperwork leads to financial disclosure, which may be seen as an impediment to a borrower intending to evade taxes and/or where expected, sharing wealth with extended family members (Germidis, 1990; Germidis et al., 1991). Further, disclosure may be seen by distrusting borrowers as an intrusion into their financial and productive activities. Disclosure requirements are usually greater for stock market finance and therefore expected to feature more prominently as an obstacle to listing.

Disclosure–related concerns and consequences arise particularly where firm ownership structures have strong family base, which appears to be prevalent in developing economies but may also be a concern even in developed countries (Ali et al., 2007). Using the S&P 500 US firm data, Ali et al. (2007) find, *inter alia*, that the Type I agency problem—conflicts between controlling and non–controlling shareholders—results in family firms making relatively less voluntary disclosure about corporate governance practices in their regulatory filings.

For the above reasons, a borrower may prefer a source of financing, which promotes non–disclosure and thus tax, wealth–sharing and other evasions; alternative sources may well provide this opportunity.
Costs

The cost of funds is naturally an important determinant in making funding decisions. Cost of banking funds normally includes interest and fees and charges (transaction costs); the latter being usually for legal matters, appraisal, documentation, administration and monitoring of credit, which constitute crucial components of the formal bank lending processes. While these (appraisal etc.) help mitigate risks, they also constitute transaction costs and are charged in addition to the interest cost of borrowing.

In addition, transaction costs also include apportioned overhead costs. Unlike the interest cost, transaction costs are usually not readily available and comparable, usually leaving the borrower in the dark in relation to this aspect of costs. Due to the nature of financing, transaction costs are either non–existent or infinitesimal in most alternative financing channels. Moreover, borrowers may prefer a single and explicit cost of funds, which is commonly the case with most alternative sources.

With respect to public equity financing, the cost of new share issues, including registration fees and taxes, marketing and administrative expenses, underwriting fees, etc. could be large and may vary by size of offering, such that costs for smaller offerings could be considerably high (e.g. Fazzari et al., 1988). In addition, the direct and indirect costs of initial public offerings are usually higher than other issues. In these circumstances, alternative (including internal) sources of funding may have a cost advantage compared to formal financial sector financing and may well be an important barrier to financial sector funds (e.g. Beck et al., 2006, Beck and de la Torre, 2007).
2.8 CHAPTER SUMMARY

This chapter provides a conceptual framework for the study, which essentially explores ways to enhance financial development in Fiji so that the country may experience its various benefits, including economic growth. The essence of the framework is that financial development is driven by both supply-side and demand-side determinants, requiring thus an investigation of both for exploring ways to enhance financial development.

In this study, the definition of financial development is adopted from (Rajan and Zingales, 2003b, p.9): ‘the ease with which any entrepreneur or company with a sound project can obtain finance and the confidence with which investors anticipate an adequate return’. Thus, an increase in the confidence of anticipated return on investment is likely to result in an increase in the supply of financial sector funds; similarly, enhanced ease of obtaining these funds is likely to result in an increase in the demand for these funds. Conversely, suppliers may turn to alternative channels when the confidence associated with anticipated return on investment becomes questionable; firms and entrepreneurs may do so when the ‘ease’ associated with obtaining financial sector funds becomes questionable.

The study focuses on the legal protection of investors (suppliers of funds) as the supply-side determinant of financial development. Essentially, the law–finance argument is that adequate legal protection, in the form of legal rights and quality of law enforcement, (together referred to as legal institutions) enhances supply of funds via strengthened investor confidence in anticipated returns. Literature appears rather silent on demand–side determinants versus financial development. However, the level and extent of paperwork and bureaucracy, collateral, disclosure and costs associated with
various funding sources, have been identified to be important demand–side determinants of financial development, especially in developing economies.

With the above in mind, in exploring ways to enhance financial development in Fiji, the study proceeds to answer two key questions of this research: (i) what is the role of legal institutions in Fiji’s financial development; and (ii) what is the role of demand–side factors in firms’ reliance on alternative finance. These are the subjects of discussion in chapters five and six, respectively, with chapter four providing an important background for answering these questions by investigating the sector’s past development, strengths and weaknesses. The next chapter discusses the research methods and data.
Chapter 3
Research Methods And Data

3.1 OVERVIEW

This chapter discusses the methods and data employed in investigating the answers to three research questions of this study, which are:

1. how well has the financial sector in Fiji developed in the past and what are its strengths and weaknesses?
2. what is the role of legal institutions in Fiji’s financial development? and
3. what is the role of demand–side factors in firms’ reliance on alternative finance?

The ultimate objective of this study is to explore ways to accelerate financial development in Fiji. To arrive at and accomplish that objective, the study proceeds through various stages, beginning with an investigation of the financial sector’s past development, strengths and weaknesses, i.e. an attempt to answer Research Question No. 1, (hereafter, RQ 1) which provides a critical background for the rest of the research.

Subsequently, the study investigates: (i) the level of a legal investor protection in Fiji and expecting these to be relatively weak, explores the need for enhancing these for further financial development—RQ 2; and (ii) the extent of alternative finance and expecting this to be significant, explores the reasons for its greater preference compared to financial sector funds—RQ 3.

Secondary data was utilised to examine RQ 1 and mainly primary data to examine RQ 2 and RQ 3. All data used for this research was analysed using SPSS (version 15.0).

3–1 Answers to the fourth and final question (RQ 4) are formed on the basis of the findings per these three questions.
Primary data was collected via a structured interview schedule, appropriately separated into various forms to examine the relevant main and related sub-questions. While the approach for data collection was common, the questions and analyses were different, requiring some common and some different methods/approaches. With the foregoing in mind, the discussion of the methodology proceeds as follows. The method and data for RQ 1 is provided first (section 3.2), followed by a discussion of the research design for collection of primary data for RQ 2 and 3 (section 3.3). However, the questions and analysis being different for these, discussion then turns to the method for RQ 2 (section 3.4) followed by that for RQ 3 (section 3.5).

3.2 METHODS AND DATA FOR RESEARCH QUESTION NO 1—FINANCIAL DEVELOPMENT

RQ 1, which investigates the financial sector’s past development, strengths and weaknesses, focuses on the banking and stock market segment. Accordingly, it was appropriate to expand RQ 1 into the following, more meaningful and manageable related questions: (i) how well have the banking and stock market sectors developed over a period of time? and (ii) what are the strengths and weaknesses of these sectors?

3.2.1 The Beck et al. (2003) Database

The data for assessing Fiji’s historical financial development and ascertaining potential for further development is sourced from ‘The Financial Structure Database’ compiled by Beck et al. (2003). The database is by far the most unique and comprehensive cross-country data for financial development related analysis. It covers up to 175 developed and developing countries around the world, including Fiji, over the 1960–2003 period. The database allows analysts and researchers for the first time, to compare the level of any country’s financial development with that of others at various levels. It allows comparative financial development analysis for a given year and over a period of time.
The database includes data on the size, efficiency, and activity of a broad set of financial institutions and markets (including banks, various non–bank financial institutions, stock markets and bond markets), drawn from a wide array of sources. Previous financial development related research has relied on limited indicators of the banking and the stock market sectors using data from limited sources, such as the International Monetary Fund’s (IMF’s) International Financial Statistics (IFS) and the International Finance Corporation’s (IFC’s) Emerging Market Database.

Description and primary source(s) of the data are provided in appendix 3-1 (A & B), respectively. As the appendices show, the measures have been carefully determined, including consistently deflating the ratios where and as required. Raw data has been sourced mainly from the IMF’s International Financial Statistics, Fitch’s Bankscope Database, various issues of Sigma, Standard and Poor’s Emerging Market Database and Emerging Stock Markets Factbook. Data also comes from various other sources including individual country’s central bank annual reports and bureau of statistics. Further details on the variables are provided in appendix 2–2.

3.2.2 Methods of Analysis: Composite and Component Indices

The analysis is conducted in two steps. The first step involves measuring historical financial development in Fiji. In doing so, appropriate composite indices have been constructed for measuring overall banking and stock market development in Fiji compared to other countries. The second step involves ascertaining the potential for further banking and stock market development in Fiji. This has been accomplished by disaggregating the composite indices into their basic components so that the strengths and weaknesses of the size, activity and efficiency aspects of Fiji’s financial sector may
be assessed. Such analysis is expected to highlight, among other things, area(s) in which improvement(s) may be required for further development of Fiji’s financial sector.

3.2.3 Variables For The Indices

As chapter 2 (section 2.4) highlights, various variables have been developed over the years to measure a country’s banking and stock market development. Among other things, these variables have been developed keeping in mind the importance of various aspects of financial sectors, such as the depth, breadth and resilience, i.e. the size, activity and efficiency, of financial sectors. Limitations and strengths of individual variables, such as that of the traditional monetary variables, have also been a moot point. Moreover, data limitations have been a problem in itself. The Beck et al. (2003) database, however, makes it increasingly possible to measure all of size, activity and efficiency aspects of financial sectors. Moreover, in some cases, the database allows an analyst to choose variables from among a number of similar ones. For example, there is data on a number of variables for measuring the size of the banking sector.

While the most comprehensive yet, the Beck et al. (2003) database is not all–inclusive i.e. not all financial development ratios for all countries over the 1960–2003 period is available. Consequently, the period of analysis is confined to 1970–2003 and measures selected on the basis of completeness i.e. I use those measures for which more complete data is available for most comparator countries. In addition to completeness of data, popularity and tradition have also been considered in the selection criteria. Other considerations include incorporating, as much as possible, all of size, activity and efficiency aspects and identifying the relevant variables on the basis of their strengths and weaknesses. It should also be noted that the BDL data, which is available in ratio
form, was converted to percentage for the purposes of this research and tables, graphs and averages constructed and computed on this basis.

Data limitation has not allowed meaningful assessment of the efficiency of Fiji’s banking industry. Thus, the measures of banking development have centred on size, depth and activity. Banking development measures used in this study then include: BANKY (bank assets to GDP—size measure); LLY (liquid liabilities to GDP—depth measure); and BPRVY (bank private sector credit to GDP—activity measure). The measures of stock market development include: MCAPY (market capitalisation to GDP—size measure); TRADE (total value of shares traded to GDP—activity measure); and TURN (TRADE to MCAPY—efficiency measure). (See appendix 2–2 for details.)

*A note on deflating*

Ratios where the numerator and denominator are stock and flow values—such that stock variables are measured at the end of a period and flow variables defined relative to a period—present problems in terms of correct timing and in terms of deflating correctly. To alleviate this problem Beck et al. (2003) deflate the end–of–year financial balance sheet items by end–of–year consumer price index (CPI) and the GDP series by the annual CPI. Subsequently, the authors compute the average of the real financial balance sheet item in year \( t \) and \( t – 1 \) and divide this average by real GDP measured in year \( t \). The end–of–year CPI is either the value for December or the value for the last quarter.

3.2.4 **A Composite Index For Banking Development**

Some attempts have been made in the past to construct composite indices for measuring a country’s banking and stock market development. However, data limitations have
usually been a primary drawback; even if sound indices could be developed, data limitations diminished their usefulness. Thus, extant literature has not been able to determine how a country’s overall banking and/or stock market may have developed over either a restricted or extended period of time. The Beck et al. (2003) database helps alleviate these problems significantly. Keeping the usefulness aspect in mind, I attempt to develop some indices approaching the issue from the data availability perspective. Such an approach is likely to have methodological concerns, however, it is a useful starting point.

Selection of measures

One of the concerns may be in relation to the selection of the measures. An important intention of the index is to compare the development of Fiji’s banking sector to other countries over the longest possible period of time. Data limitations then require efficiency measures to be dropped from the composite banking index, leaving size, activity and depth measures to be included, of which BANKY, BPRVY and LLY, respectively, are used.

Selection of weights

Another concern may be in relation to assigning weights to the above selected measures. Should the measures be assigned similar or different weights? In case of the latter, which measure(s) should get greater weight(s) and how much greater? Literature asserts that in analysing a country’s financial development, activity should be given relatively more prominence than others. For instance, a country may have a large stock market (e.g. large MCAPY value) but not necessarily an active one and activity or liquidity is shown to be a more important measure of stock market development. That is, simply listing on a stock exchange does not necessarily foster resource allocation;
volume and frequency of trade are more important (e.g. Levine and Zervos, 1998). Similarly, a large banking sector—indicated by large BANKY—does not necessarily imply correspondingly large lending to the private sector; in fact, a smaller sector with more private sector credit would be preferred to the contrary. (See section 2.4 for further details on the relative importance of various measures.) On the basis of this argument, in constructing the banking development index, this study assigns a 50% weight to BPRVY, with the other two getting equal weights of the remaining 50%.

A composite index for banking development is thus constructed as follows:

\[
B\text{–Index} = 0.25(\text{LLY}) + 0.25(\text{BANKY}) + 0.5(\text{BPRVY}) \quad (3–1)^{3–2}
\]

where,

- \(B\text{–Index}\) = composite index for banking development;
- \(\text{BANKY}\) = bank assets to GDP—a size measure of banking development;
- \(\text{LLY}\) = liquid liabilities to GDP—a depth measure of banking development; and
- \(\text{BPRVY}\) = bank private sector credit to GDP—an activity measure banking of development.

3.2.5 **A Composite Index For Stock Market Development**

Construction of a composite index that could be used to examine trends in Fiji’s stock market development against other countries appears rather difficult; Fiji’s size, activity and efficiency data are available for only 4 years—1997–99 and 2003. While a ‘trading post’ has existed in Fiji since 1979, a call market was established only in 1996, hence, it is expected that market activity in the 1979–1996 period may have been rather insignificant. A quick examination of the available data confirms this; market activity has indeed been extremely low even over 1997–99. Further, the pre–1997 market size
also appears relatively insignificant. Thus, despite data limitations, an insight into Fiji’s stock market development over only 1997–1999 and 2003 may give an indication of the status of development over a much longer period of time.

In constructing a meaningful composite index for measuring stock market development in Fiji, for consistency with B–Index, it appears logical that efficiency ratios be excluded from the SM–Index as well. Available size and activity measures are only MCAPY and TRADE, respectively. Again, for reasons outlined above, TRADE representing activity, gets 50% weighting.

A composite index for stock market development is thus constructed as follows:

\[
\text{SM–Index} = 0.5(\text{MCAPY}) + 0.5(\text{TRADE}) \tag{3–2}
\]

where,

- \(\text{SM–Index}\) = composite index for stock market development;
- \(\text{MCAPY}\) = market capitalisation to GDP—a size measure of stock market development; and
- \(\text{TRADE}\) = total value of shares traded to GDP—an activity measure of stock market development.

3.2.6 **Sensitivity Analysis**

A few questions may still arise on the above method of assigning weights. For example, even if the above argument was acceptable, it may still be asked, why not increase the weights for activity measures? While activity may be the more important measure, the importance of size measure should not be undermined. Despite its relative less importance, size ratios, among others, provide an indication of a banking sector’s capacity to develop, which is perhaps a more important issue for developing countries, such as Fiji than for a developed one like Australia. Thus, the current approach is likely to provide a more levelled playing field; assigning more weight to activity is likely to
make Fiji’s comparison with more financially developed countries like Australia, less meaningful. Fiji is likely to be more developed in size than in activity.

In any case, a series of sensitivity analysis runs were carried out, using alternative sets of weights, to see if results were greatly affected by variations in weights. Further details of this are provided in section 4.5. Overall, the results suggest that the B–Index may not be too sensitive to alternative weight allocations. However, the SM–Index does seem sensitive to the different weight combinations. Nonetheless, as explained in section 4.5, this is not of much concern as Fiji’s level of stock market development does not appear to change in any important, big–picture way relative to comparator countries.

3.2.7 **Selection of Countries for Comparative Analysis**

In view of Fiji’s historical foreign dominance of the financial system, the worldwide influence of international practices and trends and the increasing explosion of international capital mobility, a cross–country comparative analysis appears important. Further, information regarding the development of banking and stock markets in a particular country as compared with their counterparts in other countries would enable policy-makers to make better decisions regarding the direction of their financial development. Hence, this study investigates differences in banking and stock market development of Fiji across select countries in the Asia Pacific region.

The reasons for this comparison is that Fiji falls in this region and the country’s socio–economic conditions are likely to be similar to many of the region’s developing economies. It also appears reasonable to compare financial development in Fiji, a developing country, with that in developed countries (e.g. Australia) for at least the following reasons: (i) Fiji appears to have a banking history that may be comparable to developed countries; (ii) Fiji’s banking industry has, for most part of 1970–2003, almost
exclusively been controlled and influenced by institutions and practices of developed countries (e.g. Australia); (iii) it is possible that in view of the relatively stronger ‘market’ focus of some developed countries, Fiji’s banking development may at least be comparable to those in developed countries over some periods; (iv) it is possible that despite its developing economic status, Fiji may be doing well in terms of financial development; and (iv) to get some insight into how Fiji has performed against the better economies.

The developing countries are categorised into three groups: the Small Island Developing States (SIDS); countries with GDP per capita less than USD1000 (low GDP/capita); and those with GDP per capita more than USD1000 (high GDP/capita) in 2003. The year 2003 has been selected as this is the end and hence most recent within the period of analysis. GDP per capita data is obtained from the World Bank statistics database. In 2003, GDP per capita of almost half of the developing countries in the Asia–Pacific region was below USD1000, while that of the rest varied between USD1000 and USD13000.

The SIDS include Papua New Guinea (PNG), Samoa (WSM), Solomon Islands (SLB), Tonga (TON), Vanuatu (VUT) and Mauritius (MUS. The developing Asia–Pacific countries with low GDP/capita (LGDP) include Cambodia (KHM), Lao PDR (LAO), Myanmar (MMR), Mongolia (MNG), Philippines (PHL), and Vietnam (VNM); those with high GDP/capita (HGDP) include Macao–China (MAC), Indonesia (IDN), Korea (KOR), Malaysia (MYS) and Thailand (THA). The developed countries (DEV) include Australia (AUS), Japan (JPN), New Zealand (NZL) and Singapore (SGP). That is, there are six SIDS, six LGDP, five HGDP and four DEV comparator countries; a total of 21.
3.3 A SURVEY OF OPINIONS FOR RESEARCH QUESTIONS 2 AND 3—LEGAL INSTITUTIONS AND ALTERNATIVE FINANCE

3.3.1 Overview

Both primary and secondary data are used to answer RQ 2 and 3. Primary data for both come from a survey of opinion, which is the subject of this section; secondary data is described later. Legal institutions (RQ2) being a supply–side determinant of financial development, opinions of suppliers of funds was considered to be most appropriate in understanding the relevant issues. This group included creditors (suppliers of credit) and shareholders (suppliers of equity). Alternative finance (RQ 3) is the substitute for financial sector funds and the respective extents are determined importantly by the private sector on the basis of various factors identified in section 2.7. Thus, the opinions of private sector firms appeared most appropriate in understanding issues on these. In addition, opinions of experts on all of these issues were also obtained; the intention being to obtain independent views on issues of concern and to compare these with those of the suppliers and demanders of funds.

3.3.2 The Survey Instrument

Data was collected by contracted interviewers across sub–groups of respondents. There was no particular need for probing or deviating from the specified agenda. The questions for each group of respondent were exactly the same to allow aggregation of results and comparison across sub–groups. Accordingly, a structured interview schedule was the most appropriate instrument to use for data collection.

Further, bearing in mind the divergence in some questions to be asked of different sub–groups in relation to the two RQs, the main questionnaire was separated into four sub–questionnaires as follows: Form I—survey of borrowers; Form II—survey of banks; Form III—survey of households (shareholders); and Form IV—survey of experts.
Further information is provided in appendix 3–2. Appropriate ethical clearance from Griffith University was obtained as required (appendix 3–3). The relevant research questions (RQ 2 & 3) required understanding respondents’ views on the level of importance of legal institutions and alternative finance. Related issues also required an understanding of the strength of respondents’ feelings about a particular issue e.g. the degree of difficulty in relation to obtaining funds from the formal financial sector (firm/demand perspective) or in liquidating a debt (bank/supply perspective).

In view of the nature of responses required, it appeared most appropriate to use a Likert scale to obtain opinions; details provided in relevant sections below. The use of the Likert scale significantly reduced the non–response and measurement errors (Mitchell, 1992) likely to occur with opinion surveys. Further, questions were purposely kept as short as possible to maximise respondent interest.

3.3.3 Selecting Potential Participants

Opinion surveys may also be subject to frame, sampling and selection errors (Mitchell, 1992; Tull and Hawkins, 1990). Keeping in mind the importance of minimising variations between the sample and the population, potential participants were selected as follows. The creditor group was confined to the most important secured creditor group in Fiji—commercial banks. There are five commercial banks operating in Fiji. However, they differ in size; two of these (the majors) control over 70% of the total banking assets. While the intention was to cover all the banks, it was also important to cover more of the major banks. Given that it is the credit to the private sector that matters for financial development, it was important to confine the creditor respondents

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3–3 The project required only an ‘expedited’ review by Griffith’s Ethical Review Committee since it involved no risks to participants and minimum ethical concerns.

3–4 A scale information sheet showing the corresponding meaning of each set of scale was made available to respondents during the interviews (see last page of appendix 3–2).
to senior officers/managers and other executives of a bank’s commercial lending department. The intention was to obtain views and opinions of the most qualified representatives. These individuals were expected to have a sound knowledge of the legal and non–legal issues and consequences relating to advancing credit to the private sector and would also be important decision–makers.

All five commercial banks have their head offices and largest branch operations in Suva; for the majors, lending decisions on commercial applications received by branches outside Suva are also made in Suva. Therefore, it was reasonable to confine this part of the survey to Suva. The names of appropriate participants were identified by contacting the appropriate sections of the head offices and branches of all banks.

With respect to the shareholder respondents, keeping in mind the importance of ‘local knowledge’, it appeared reasonable to confine the group to knowledgeable, educated, better informed and above average income–earning individuals. That is, respondents were confined to the above average socio–economic group. The rationale for this criterion was that individuals should at least be aware and have some understanding of stock market investment opportunities plus have adequate savings for the purpose. This strategy also helped in maximising the validity of the results.

Moreover, it is this group of individuals who are more likely to be aware and understand the implications of legal rights for minority shareholders. Such criteria appear particularly important in the case of a country such as Fiji in view of its less favourable socio–economic conditions and expected low stock market investment awareness levels. These individuals were more likely to be employees, officers, managers and employers of educational institutions, financial services industry,
professional firms, government organisations and the private sector. Thus, the strategy was to target school teachers, university lecturers, bank officers, public servants, lawyers, managers of business firms, among others.

From a supply perspective, the participation of both existing and potential shareholders appeared equally important for stock market development. In fact, to enhance stock market activity in Fiji, the number of shareholders may have to be increased significantly; potential shareholders then become important for the purpose.

The highest proportion of the identified shareholder group was most likely to reside in Suva, the capital and the hub of business, educational and government activity in Fiji. Moreover, the stock exchange is also situated in Suva. The brokers too are found only in Suva since the current trading system involves open–outcry, automated trading is yet to commence. Thus, this part of the survey was confined to the wider Suva area.

The borrower group was confined to the private sector business entities. To ensure the widest possible cross–sectional coverage, the Fiji business listing—The Yellow Pages—was consulted. The business firms were then categorised into various sectors/categories such as airlines and air services, textile and fabric, hardware, etc. In addition to business type/sector, a number of other issues was also considered, including size, date and place of incorporation, listing status, and ownership type. A reasonable representation of the firms covering the above criteria can be found operating in the wider Suva area. Further, relevant information on the listed companies could easily be obtained in Suva. Thus, the survey of borrowers was also confined to the wider Suva area.
For the purposes of this study, experts included individuals deemed to have a sound knowledge of local socio–economic and political conditions, financial intermediary and market operations and the country’s legal investor protection rights and quality of law enforcement. Accordingly, it was decided to include academics, financial regulators, and accounting firms in this group.

The academics were recruited from the main, and by far the largest, university in Fiji, the University of the South Pacific (USP), and confined to those involved in teaching and researching in the banking, finance and economic areas. The financial regulators in Fiji include the Reserve Bank of Fiji (RBF) and the Capital Markets Development Authority (CMDA); RBF is responsible for central bank functions and regulation and supervision of financial institutions, and CMDA is responsible for development and regulation of the capital markets, including the stock exchange. Accounting firms in Fiji include world renowned KPMG and PricewaterhouseCoopers plus other established local firms.

3.3.4 First Contact With Potential Participants

Once identified, the creditor respondents were contacted by phone and appropriately informed about the purpose of the call, using a pre–written ‘telephone contact script’ (appendix 3–4A). Among other things, the script noted how the respondent had been identified and the importance of the respondent’s participation in the survey, highlighting the anonymity and confidentiality of the responses. A convenient appointment time was requested for the interview.

The shareholder, borrower and expert participants were approached ‘cold’ via a ‘face–to–face contact’. Given the anonymity of response, lack of sensitivity and absence of
potential risk to the participant, it appeared appropriate to seek a participant’s consent at
the point of first approach. There was no need to access or evaluate a potential
participant’s personal information prior to an interview, thus no need for prior consent
for participation. There was also no need to provide participants advance information
about the project and request for their participation by letting them contact the research
team.

In the case of shareholders, a number of elite Suva suburbs were randomly selected and
participants recruited via random sampling; every third household in the selected suburb
was approached. Only one person per household was interviewed, this being the most
willing and available member.

Respondents were personally interviewed at a time and place convenient to them. None
of the approached respondents refused to participate. Interviewers were required to
introduce themselves via a letter of authenticity (appendix 3–4B) and a picture identity.
They were cautioned not to be intrusive, threatening or persistent; it was acceptable for
a participant not to answer all questions—the questionnaire specifically noted: ‘leave
blank if not relevant/don’t know/ not sure’ where and as required. Interviewers were
also cautioned not to influence a response.

3.3.5 Data Collection

Interviews of creditor, shareholder and borrower respondents, confined to structured,
pre–tested questionnaires were conducted by students of the University of the South
Pacific\textsuperscript{3–5}. The various forms of the questionnaire were pilot–tested two months before
the main survey. The pilot survey found minimal problems with readability or other

\textsuperscript{3–5} The expert and most bank respondents were personally interviewed by the researcher.
difficulties with the various forms. Respondents identified for each sub–questionnaire were able to understand the language and terminology used in the forms.

Keeping in mind the likely interviewer effects problem of opinion surveys (Mitchell, 1992), a number of steps were taken to carefully minimise such problems. For instance, interviewers, preferably with relevant prior experience, were recruited through an advertisement and appropriately trained for the purpose. A workshop was organised for such training where it was discovered that all 30 attendees had previously been involved in a similar survey and/or had undertaken a course at the University dealing with basic level research methods, including conducting surveys involving interview schedules. The workshop covered issues stated on the Griffith University required coversheet and details of questions per the various sub–questionnaires. Reasonable time was spent in explaining the objectives and benefits of the survey, which attendees appeared to appreciate. Attendees were allowed and took the opportunity to ask questions to clarify issues. They were allowed to leave the room at any time if they felt they would have difficulty in collecting the required data; none left.

To determine the genuineness of the potential interviewers, at the end of the workshop, they were asked to provide a list of firms, banks and suburbs they would be able to approach, keeping in mind the pre–determined selection criteria for each respondent type. Those who could not provide a list were asked to leave. Attendees able to provide a list, in consonance with the selection criteria, were asked to re–think their involvement in the survey and report back later in the day; all reported back.

The potential participant list provided by the interviewers adequately covered the identified list of potential respondents. The interviewers were issued the forms per their
preferred lists and requested to report back after 2 days to show and explain their progress; the intention being to ensure that they were completing the questionnaires as required. All appeared to be progressing well. The survey was concluded in two weeks with 14 bank, 230 shareholder, 75 borrower and 15 expert responses obtained; details can be found in relevant subsequent chapters.

3.4 METHODS AND DATA FOR RESEARCH QUESTION NO. 2—LEGAL INSTITUTIONS

The main question here was: what is the role of legal institutions for financial development in Fiji? This question was expanded into the following, more meaningful and manageable sub-questions: historically, (i) what has been the level of legal rights of creditors and minority shareholders? (ii) how may legal institutions have affected past banking and stock market development? and, potentially, (iii) is enhancement of legal institutions essential for further banking and stock market development? To investigate these, both primary data from the survey and secondary data compiled into comparable format were used.

3.4.1 Legal Variables

In investigating the above issues, it was important to first identify appropriate investor legal variables. Since an intention was to compare Fiji’s situation with other countries (and otherwise), it seemed reasonable to use the seminal and most widely used investor legal variables in the financial development literature—the La Porta et al., (1998) variables; the importance of this study is discussed in detail in section 2.6.

In identifying the legal variables for investor—shareholder and creditor—protection the source is confined to a country’s company and bankruptcy/reorganisation laws. (Company laws define the legal relations of the corporation with insiders and outsiders
and bankruptcy/reorganisation laws deal with procedures relating to non-repayment of debt.) The authors note that their data set largely omits merger and takeover rules, disclosure rules, security exchange regulations, and banking and financial institutions regulations. However, the variables included to measure investor rights were among ‘the most basic rules that observers of corporate governance around the world believe to be critical to the quality of shareholder and creditor legal rights’ (La Porta et al., 1998: p. 1117). Additionally, these variables are considered to adequately capture the pro-investor/pro-management dimensions, which is a critical aspect of the study and disclosure rules are covered in the form of accounting standards.

Eight variables (summarised in table 3–1, below) are used to assess shareholder rights (SHR) in Fiji: proxy voting by mail (PROXY); share blocking before meetings (BLOCK); cumulative voting/proportional representation on board of directors (VOTE); legal protection against perceived oppression (OPP); pre-emptive rights to new issues (PRE); percentage of share capital needed to call an extraordinary shareholders’ meeting (PERC); one–share–one–vote (ONE); and mandatory dividend (MAND). Details are provided in chapter 5.

In determining creditor rights, the focus is on the rights of senior secured creditors to correct for complexities arising from different kinds of creditors and because most of the debt worldwide is commonly held by these creditors. Five variables are used: automatic stay on assets (STAY); ranking in distribution of profits (RANK); procedures for going into liquidation (CONSENT); management’s power in reorganisation (MANAGE); and legal capital reserve requirement (RESERVE).
Table 3–1: Variables used in this study to assess investor legal protection in Fiji

Eight shareholder rights, five creditor rights and five enforcement quality variables were used to assess investor legal protection in Fiji. E.g. one of the shareholder rights variables is PROXY, which stands for proxy voting by mail.

<table>
<thead>
<tr>
<th>Variable category</th>
<th>Abbreviated form</th>
<th>Variable–Extended form</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Shareholder rights</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(SHR)</td>
<td>PROXY</td>
<td>Proxy voting by mail</td>
</tr>
<tr>
<td></td>
<td>BLOCK</td>
<td>Share blocking before meetings</td>
</tr>
<tr>
<td></td>
<td>VOTE</td>
<td>Voting for representative on BOD</td>
</tr>
<tr>
<td></td>
<td>OPP</td>
<td>Protection against oppression</td>
</tr>
<tr>
<td></td>
<td>PRE</td>
<td>Pre–emptive rights</td>
</tr>
<tr>
<td></td>
<td>PERC</td>
<td>Percent of share capital required to call a meeting</td>
</tr>
<tr>
<td></td>
<td>ONE</td>
<td>One–share–one–vote</td>
</tr>
<tr>
<td></td>
<td>MAND</td>
<td>Mandatory dividend</td>
</tr>
<tr>
<td><strong>Creditor rights</strong></td>
<td>STAY</td>
<td>Stay on assets</td>
</tr>
<tr>
<td>(CR)</td>
<td>RANK</td>
<td>Ranking in profit sharing</td>
</tr>
<tr>
<td></td>
<td>CONSENT</td>
<td>Consent before liquidation</td>
</tr>
<tr>
<td></td>
<td>MANAGE</td>
<td>Management’s power after liquidation</td>
</tr>
<tr>
<td></td>
<td>RESERVE</td>
<td>Reserve capital requirement</td>
</tr>
<tr>
<td><strong>Enforcement quality</strong></td>
<td>EFJS</td>
<td>Efficiency of the judicial system</td>
</tr>
<tr>
<td>(ENF)</td>
<td>RoL</td>
<td>Rule of law</td>
</tr>
<tr>
<td></td>
<td>COR</td>
<td>Corruption</td>
</tr>
<tr>
<td></td>
<td>EXP</td>
<td>Risk of expropriation</td>
</tr>
<tr>
<td></td>
<td>REP</td>
<td>Repudiation risk</td>
</tr>
<tr>
<td></td>
<td>ACT</td>
<td>Accounting standards</td>
</tr>
</tbody>
</table>

To measure the quality of enforcement (ENF) mechanisms, LLSV (1998) use estimates of law and order in different countries compiled by private credit risk agencies for use of foreign investors contemplating investment opportunities in these countries. Five such measures are used: efficiency of the judicial system (EFJS); rule of law (RoL); corruption (COR); risk of expropriation (EXP) i.e. outright confiscation or forced nationalisation by the government; and the likelihood of repudiation by government (REP). As with SHR and CR, ACT is used as a remedial measure for ENF.

3.4.2 Quantifying The Variables

To operationalise the above legal rules, quantitative values or scores were assigned to each variable. For each of the first five SHR variables, a country gets a score of 1 if the law favours minorities, 0 otherwise. In the case of the sixth SHR, a lower percentage is
deemed to favour minorities; thus, a country gets a score of 1 if the required percentage is at or below the world median of 10 and 0 otherwise. The scores of these six variables are then aggregated to obtain an ‘anti–director’ index (ADRI). The ADRI could have values ranging from 0 to 6, with higher scores indicating stronger legal protection of minority shareholders from managers and controlling shareholders.

ONE is also deemed to provide strong protection for minorities; a country gets a score of 1 if it has ONE rule only, i.e. in the absence of all of the other rules/practices; 0 otherwise. The mandatory dividend measure of SHR is treated differently from others. The authors presume this to be a legal substitute for weaknesses in other measures.

Similarly, a country gets a score of 1 if legal rules relating to CR variables are in favour of creditors and 0 otherwise. Scores of the first four are then aggregated to obtain a ‘creditor rights’ index (CRI) where the values range from 0 to 4; with higher scores indicating stronger legal protection of creditors from managers.

Each ENF variable is ranked on a scale of 1 to 10; higher scores indicate better enforcement quality. In addition to law enforcement quality, the quality of a country’s accounting standards is also examined. Accounting systems become important tools for verifiability in court for contractual disagreements between managers and investors. As with the rule of law, the measure of accounting standards is a privately constructed index based on examination of company reports from different countries.

3.4.3 Compiling Indices For Historical Investor Rights

Secondary data is used to assess the past and current level of investor rights in Fiji. The eight shareholder rights and the four creditor rights variables for Fiji are sourced mainly
from the Fiji Companies and the Bankruptcy Acts; expert academics at the University of the South Pacific were also consulted. Fiji’s results are subsequently compared to that of other countries; these being the La Porta et al. (1998) sample countries.

Data for comparative countries

The La Porta et al. (1998) sample, which is used to compare Fiji’s situation with the rest of the world, includes 49 countries across Europe, North and South America, Asia and Australia. The countries were classified according to their legal origin. Of the selected countries, 18 had English common law origin; 21 French civil law origin; 6 German civil law origin; and 4 Scandinavian civil law origin; the sample included the countries of law origins, i.e. England, France, Germany and Scandinavia. Appendix 2-3 provides comparative country classifications of studies on determinants of financial development to date.

3.4.4 Ascertaining The Importance Of Legal Institutions For Further Financial Development

Primary data collected via the survey was used to determine if enhancement of legal institutions is critical for further financial development in Fiji. While both legal rules and enforcement quality make up legal institutions, it is possible that enhancement of only one or both or neither may be critical for further development. Moreover, rules are

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3-6 The La Porta sample did not include socialist or ‘transition’ economies. The countries were selected from the WorldScope sample which covered 15,900 firms across 33 countries and the Moody’s International sample which covered 15,100 firms across 92 countries. Since a key focus of the study was investor protection rights, a country was included if it had at least five domestic, non-financial, publicly traded firms with no government ownership in 1993; at least five firms were essential for construction of ownership data.

3-7 In doing this, La Porta et al (1998) starting point was Watson’s (1974) observation that laws emerged from only a few legal families in Europe, namely, English, French, German and Scandinavian families and were either imposed on the rest of the world through conquest or colonisation or otherwise merely emulated by the rest. Further, David and Brierley (1985), point out that a given country’s commercial laws have been sourced from one of these legal families. LLSV (1998) rely principally on the work of Reynolds and Flores (1989) for country classification.
usually different for shareholders and creditors but enforcement quality similar. Thus, discussion proceeds as follows: (i) shareholder view on legal rules for further stock market development; (ii) creditor view on legal rules for further banking development; (iii) expert view on legal rules for further financial development; and (iv) all respondent views on enforcement quality for further financial development.

**Shareholder view on legal rules for further stock market development**

In determining the importance of legal rights for stock market development, it seemed that a direct question on the importance of each of the eight variables—which would most likely return affirmative responses—would fail to reveal the real importance of the rights. Therefore, it was resolved that a test of shareholders’ awareness would be a stronger and a more reasonable indication of their views on the importance of the rights. For instance, simply seeking a shareholder’s view on say, the importance of PROXY for stock market investment would most likely return a strong affirmative opinion. However, such response does little to indicate, from a respondent’s perspective, the real value for PROXY in relation to stock market investment; the respondent may see PROXY as an important right but it tells us little about their awareness of this basic legal right. Further, it does not convey their awareness of the existence or absence of such a right; it does not indicate how PROXY may have influenced their decision to trade shares.

For a concerned shareholder, the above issues may have participatory implications. For instance, if a shareholder were aware of his/her basic legal rights and aware that these were absent in Fiji’s case, he/she would be less likely to participate in stock market activities, which may obviously seem riskier than say, bank deposits. On the other hand, ignorance of these basic rights may not matter for participation and therefore legal rights would be less important for stock market development. Hence, the objective was
to determine if shareholders were aware of their basic legal rights by determining if they were aware of the existence or absence of these rights.

Accordingly, respondents were asked if they knew [1 (Yes), 2 (No) or 3 (Don’t know)] whether or not the legislation in Fiji mandated each of PROXY, VOTE, PRE, BLOCK, PERC, OPP, ONE and MAND. Incorrect or ‘don’t know’ responses were deemed to indicate that respondents’ were less informed of their basic legal rights and/or of their existence or absence and hence an indication that investor legal protection may be less important for stock market development in Fiji. In any case, to confirm, the survey followed–up with a question seeking a direct response on how important legal issues were for stock market investment.

There were two categories of respondents; current and potential shareholders. Within each category, it was decided to determine the level of awareness/ignorance and their response to the above follow–up question. Where a respondent was ignorant of his/her basic legal rights but indicated that legal issues were important, a reasonable conclusion would be that the respondent was either mislead or not really concerned about his/her rights, suggesting that enhancement of legal shareholders rules may not be a critical priority for further stock market development in Fiji.

The level of awareness of legal rights of each shareholder respondent was determined as follows:

\[ A_L = \sum_{i=1}^{6} SLR_i \]

where,

- \( A_L \) = awareness level
- \( SLR_i \) = shareholder legal right
  - \( i = 1 \): awareness score on PROXY right;
  - \( i = 2 \): awareness score on BLOCK right;
  - \( i = 3 \): awareness score on VOTE right;
  - \( i = 4 \): awareness score on OPP right;
In each of the above cases, a score of 1 was assigned for a correct response and 0 for an incorrect or ‘don’t know’ response. For example, say that minority shareholders in Fiji did not have a legal right to mail their votes (PROXY); accordingly, a value of 1 would be assigned for a ‘no’ (correct) response to PROXY and 0 for a ‘yes’ (incorrect) or ‘don’t know’ response. The awareness level could thus range from 0 to 6, with 0 indicating total ignorance, 3 moderately informed and 6 fully informed. The overall awareness level was determined by averaging the aggregate of individual scores.

_Creditor view on legal rules for further banking development_

Since the identified respondents were expected to be well acquainted with their bank’s lending related activities, the importance of legal rules for creditors could reasonably be obtained by asking respondents to rate, on a scale of 1 (major obstacle) to 7 (no obstacle), problems associated with each of the identified variables. Regardless of the actual situation, a score of 1 was expected to indicate that a bank had major legal problems while a score of 7 would indicate that legal problems were insignificant; the rest of the scores represented the following obstacles: 2 = high; 3 = high to moderate; 4 = moderate; 5 = moderate to low; and 6 = low. For instance, if say, STAY was not legally mandated in Fiji, a 7 response would indicate that a bank did not have problems in repossessing collateral despite the absence of this particular legal right. Thus, it would appear that STAY may not have to be legally mandated in Fiji as it would not be an important legal right for creditors in Fiji.

The overall importance of legal rights for each respondent was determined as follows:

\[
C_L = \sum_{i=1}^{4} CLR_i
\]
where, 
\[ \text{CL} = \text{importance of creditor legal rights} \]
\[ \text{CLR}_i = \text{creditor legal right} \]
\[ i = 1: \text{score on STAY right;} \]
\[ i = 2: \text{score on RANK right;} \]
\[ i = 3: \text{score on CONSENT right;} \]
\[ i = 4: \text{score on MANAGE right.} \]

The aggregated scores of each respondent were then averaged to determine their mean scores, which reverted to the 1 to 7 range, with 1 indicating overall major obstacle and 7 no obstacle. Thus, a mean score of 1 would indicate that the respective bank, from the respective respondent’s point of view, experienced serious legal problems in granting and/or liquidating debts. Hence, from this perspective, legal rules would be important for further banking development. Similarly, a mean score of 7 would indicate that legal rules were not important for further banking development. Further, respondents were separated into large and small bank groups to understand the importance of legal rules from the two different perspectives. The large banks (big two) appear to be the dominant drivers of banking development in Fiji, therefore, the views of these banks would have to be relatively more important.

*Expert view on legal rules for further financial development*

As with shareholders, it appeared that a test of experts’ awareness would also be a stronger and a more reasonable indication of their views on the importance of legal rights for further financial development. In view of the expectation that investor rights in Fiji was inadequate and had not changed in a long time, an understanding of the awareness of individuals and institutions deemed to be aware of investor laws was expected to help understand the likely future situation. If experts are adequately aware and understand the importance of investor laws for financial development, there could be a likelihood of future positive outcomes (especially for shareholders) and vice versa.
Accordingly, experts were asked if they knew [1 (Yes), 2 (No) or 3 (Don’t know)] whether or not the legislation in Fiji mandated each of the eight shareholder and the five creditor rights. Incorrect or ‘don’t know’ responses were deemed to indicate that experts’ were less informed of these basic legal rights and/or of their existence or absence and hence an indication that future positive changes to investor legal protection in Fiji may not be forthcoming.

Importance of law enforcement for further financial development

It is possible that investors may not be too concerned about legal rules if they believed that a country’s quality of law enforcement was adequate. Questions on the quality of law enforcement were the same for both creditors and shareholders. Respondents were asked to indicate their assessment on each variable on a scale of 1 (worst) to 10 (best). The quality of Fiji’s accounting standards was also assessed. Specifically, respondents were asked to assess each aspect using the following scales: for EFJS, 1 = least efficient, 10 = most efficient; for RoL, 1 = less tradition, 10 = high tradition; for COR, 1 = highest levels, 10 = lowest levels; for EXP, 1 = highest risk, 10 = lowest risk; for REP, 1 = highest risk, 10 = lowest risk; and for ACT, 1 = lowest standard, 10 = highest standard.

Subsequently, each respondent’s score for the enforcement quality was determined as follows:

\[
\text{ENFI} = \sum_{j=1}^{5} \text{LE}_j
\]

where,

- \( \text{ENFI} \) = enforcement quality index;
- \( \text{LE}_j \) = law enforcement
  - \( j = 1 \) = score on EFJS;
  - \( j = 2 \) = score on RoL;
  - \( j = 3 \) = score on COR;
  - \( j = 4 \) = score on EXP; and
  - \( j = 5 \) = score on REP.
The five scores were then aggregated and averaged to find an individual’s overall view on quality of enforcement, with 1 indicating highest level of quality and 10 lowest level. Mean scores of the different sub-groups—creditors, shareholders, borrowers and experts—were also determined plus an overall score for all respondents across groups, these representing respective views, with lower scores indicating expedited attention to enhancement of the enforcement quality.

Validation question regarding the importance of overall legal protection

It was noted earlier that a direct question on the importance of each of the legal shareholder rights may not reveal the real importance of the rights. A test of shareholders’ awareness level was considered to be a stronger and a more reasonable indication of their views on the importance of the rights. However, it is possible that while the shareholders may not be aware of their legal rights, they may still deem legal protection (rights plus enforcement) to be important for purposes of participating in the stock market. In such circumstances, on one hand, an implication would be that shareholders are not really concerned about their rights, on the other, shareholders may be mislead about their legal protection status—are not aware of the basic rights they are entitled to as a shareholder. It is also possible that it is not the legal rules component of legal institutions but perhaps the quality of the law enforcement component that they are more concerned about.

Similarly, while creditors may not be experiencing legal problems in relation to collateral repossession and other issues—indicating thus that mandatory legislation of these rights may not be warranted—it is possible that they too may deem legal protection to be important. This belief may have implications for further development of the banking industry. Further, for both the creditors and shareholders, a subsequent
awareness that they are not adequately legally protected may have adverse implications for further banking and stock market development.

In view of the above, it appeared important to confirm/validation the overall importance of legal protection for investors in Fiji. To accomplish this objective, respondents were asked to rate, on a scale of 1 (not important) to 7 (very important), the importance of legal protection to them in terms of making a decision to lend (for banks) or to buy shares in a company (shareholders).

Having described the methods and data employed for answering RQ 2; discussion now turns to RQ 3, the subject of the next section.

3.5 METHODOLOGY FOR RESEARCH QUESTION NO. 3—ALTERNATIVE FINANCE

With the expectation that alternative finance channels would be extensive in Fiji, the relevant issues to explore appeared to be in relation to: (i) the extent of alternative finance in Fiji; (ii) the nature of these sources; and (iii) the reasons for high preference for these and simultaneous low preference for financial sector funds, so that appropriate strategies may be explored and developed to enhance the attractiveness of the latter relative to the former. Two types of data are used to investigate this question: (i) primary data collected from the survey; and (ii) secondary data in the form of annual reports.

3.5.1 Extent of Alternative Finance in Fiji

To gain an initial understanding of the importance and extent of various sources of funds, from the borrowers’ perspective, interviewed participants were asked to rate the importance of a list of sources of funds for the operation and growth of their business.
Responses were obtained on a scale of 1 (not important) to 7 (very important). The list was prepared on the basis of firms’ annual reports and literature, and included self–fundraising, family/friends, trade creditors, banks, stock market, etc. Self–fundraising includes own capital, retained earnings, inter–company loans, director loans and shareholder loans (see section 2.7 for details). For the purposes of this study, only bank loans and stock market equity are associated with financial development; the greater the preference for these, the better the opportunity for financial development. Conversely, a greater preference for all other sources would imply greater use of alternative sources.

To verify the views of borrowers and gain a deeper understanding of the situation, annual reports of firms were also examined. Unlisted firms in Fiji are not legally required to prepare audited financial statements and in view of the relatively short existence of a proper stock market, historical audited statements of even the listed firms was expected to be difficult to obtain. However, the Registrar of Companies requires all registered businesses in Fiji to file with it financial statements at least annually. While not legally required to be audited, a quick perusal showed that some were actually audited and others appeared reasonably authentic, the case being more bona fide for larger and/or well-established firms. Since the interest of the study was in long–term (25–30 year) trends, in view of the foregoing, the validity of the financial accounts appeared not too questionable. In addition, the stock exchange and firms themselves also proved to be valuable sources of information.

Data was then entered into appropriately designed Microsoft Office Excel (2003 version) spreadsheets created for each firm. Each spreadsheet contained information on a firm’s total assets available over the 1970–2003 period. Financing sources were grouped into domestic bank, capital and other liabilities. To better understand the
nature of bank financing, the bank category was separated into overdraft, short–term (STL) and long–term (LTL) loans. Similarly, the capital category was separated into equity, retained earnings and reserves. Given that equity shares could be held by insiders (non–tradeable) and outsiders (tradeable)\(^{3–8}\), equity was further separated into the respective strands. To determine the proportions of the tradeable and non–tradeable equities, additional worksheets were created, which included information on distribution of equity by different categories of holders and their shareholding percentages, as required by SPSE and reported in annual financial statements. The annual reports also provided information on shares held by insiders.

On the basis of the information presented in the balance sheets, the ‘other’ liability category included the following components: creditors and accruals, provisions, related party loans, foreign loans and others. Of the above, only domestic bank and tradeable equity formed financial sector funds; all other sources were considered as alternative finance. The spreadsheets enabled analysis of each category’s funding to total asset ratios, thereby illustrating the extent and importance of funding sourced from the financial sector relative to alternative sources.

### 3.5.2 Nature Of Alternative Finance

Having determined the extent of alternative finance, it was important to understand the nature of these sources for subsequent better understanding of the reasons for their use. That is, it was important to understand the importance of various alternative sources generally and across firm type, size, listing status, etc over a period of time. The objective was to understand trends and patterns so as to ascertain the possibility of discouraging the use of alternative sources and simultaneously encouraging the use of a financial sector source. Secondary data was used for this analysis.

\(^{3–8}\) It is the ‘tradeable’ component of equity that determines the likely level of TRADE, a critical measure of stock market development; for details see section 2.4.
For this purpose, all alternative sources were initially grouped into broad balance sheet components—liability (debt) and capital. Since the tradeable equity component would be part of the capital category and bank finance part of the liability, these were excluded from the two categories, such that the remaining respective categories became non–bank liabilities (NBL) and non–public equity capital (NPEC), with NBL sources including loans from related parties (shareholders, directors, and related companies), trade and other creditors, provisions, foreign loans, etc. and NPEC including mainly non–tradeable equity, reserves and retained earnings. For unlisted firms NPEC would be the total capital and for listed firms, shares held by the ultimate owners, their subsidiary companies and/or families and friends. Consequently, alternative finance (ALT) equalled the sum of NBL and NPEC. Thus, to understand the nature of ALT, its components—NBL and NPEC—had to be examined. Analysis focused on the importance, patterns and trends of the broad categories and their respective components.

3.5.3 Preference For Alternative Versus Financial Sector Funds

Data for this was obtained via the primary survey. The objective here was to understand how various factors had influenced the preference for alternative sources; these would also explain possible barriers to financial sector funds. The factors were identified on the basis of existing literature and common knowledge, which indicate that issues relating to cost, paperwork and bureaucracy, collateral and disclosure requirements, *inter alia*, may influence a firm’s decision to borrow from the financial sector or alternative sources; see section 2.7 for details. Respondents were asked to rate, on a scale of 1 (major obstacle) to 7 (no obstacle), the difficulties they experienced in relation to each of the above factors in obtaining funds from the formal financial sector.
It was possible that these factors may have dissimilar degrees of effect on the banking sector versus stock market funds; e.g. while cost issues may generally influence a firm’s decision to borrow more from alternative sources, it may have greater consequences for banking versus stock market funds, e.g. the nature and level of banking costs may be viewed differently from stock market costs, such that while borrowing from the financial sector may generally be less preferred to alternative sources, stock market funds may be more preferred to banking funds. Thus, the objectives were two-fold; to understand the preference for alternative versus financial sector funds and the preference between banking and stock market funds within the financial sector.

In addition, understanding of both the past/current and future situations was equally important. Thus, questions were designed to obtain responses on both. Further, while firm views were important in relation to the identified issues, that of the financial sector, particularly banks, also seemed important. To give an example, say if borrowers indicated that high cost discouraged borrowing from the banking sector, if banks did not believe costs were high, the likelihood of any bank-driven positive change to this aspect was going to be minimum, if any. In this case, strategies for positive change would have to be policy-driven, perhaps, regulated. Similarly, if collateral was also a major impediment, but say, in this case, banks sympathised with borrowers, strategies may not have to be policy-driven. Further, the independent view of experts was also important for strategy formulation.

3.6 CHAPTER SUMMARY

This chapter discusses the methods and data for investigating the research questions of this study, which are: (RQ 1) how well has the financial sector in Fiji developed in the past and what are its strengths and weaknesses?; (RQ 2) what is the role of legal
institutions in Fiji’s financial development?; and (RQ 3) what is the role of demand–side factors in firms’ reliance on alternative finance? Answers to these questions are expected to help find ways to accelerate financial development in Fiji, which is the ultimate objective of this study.

The first question is investigated using secondary data sourced from ‘The Financial Structure Database’ compiled by Beck et al. (2003). Composite banking and stock market indices are developed for the purpose and Asia–Pacific countries used for comparative analysis.

The composite indices measure Fiji’s overall banking and stock market development relative to Asia–Pacific countries. In constructing the composite indices, care has been taken to include size, activity and efficiency aspects of the respective sectors. However, activity, being relatively the more important component, attracts a relatively higher weighting. The composite indices are subsequently disaggregated into their respective basic components to assess the strengths and weaknesses in relation to each of size, activity and efficiency of the respective sectors, which highlights, among other things, area(s) in which improvement(s) may be required for further development of Fiji’s financial sector.

Questions 2 and 3 are investigated using both primary and secondary data. Primary data was collected via a structured interview schedule, appropriately separated into various forms to examine the relevant main and related sub–questions. Legal institutions (RQ2) being a supply–side determinant of financial development, opinions of suppliers of fund—banks (suppliers of credit) and shareholders (suppliers of equity)—were obtained on issues relating to legal protection of investors. Alternative finance (RQ 3) is the
substitute for financial sector funds and the respective extents are determined importantly by the private sector. Thus, the opinions of private sector firms appeared most appropriate in understanding issues on these. In addition, opinions of experts on these issues were also obtained. LLSV (1998) legal variables are used to understand issues in relation to RQ 2. Literature and common knowledge was the basis for identifying factors to be used to understand firm views on barriers to financial sector funds.

Other than for the bank participants, a cold, face to face approach was used to recruit respondents. This was reasonable in light of anonymity of response, lack of sensitivity and absence of potential risk to participant. Bank respondents were initially contacted by phone and subsequently interviewed at their convenience. In addition to primary data, secondary data sourced from relevant legislation and annual reports, were also used to explore issues relating to legal institutions and alternative finance, respectively. All collected data—primary and secondary—was analysed using SSPS (version 15.0) to answer the various questions of this study.

The next chapters investigate, analyse and present results on the research questions of this study, beginning with Chapter 4 in relation to RQ 1; Chapter 5 in relation to RQ 2; and Chapter 6 in relation to RQ 3.
Chapter 4

Financial Development in Fiji, 1970–2003:
A Comparative Analysis

4.1 OVERVIEW

A recent ADB report describes Fiji’s financial sector as ‘the most developed and extensive financial market in the Pacific region’ (ADB, 2005, p75), where the Pacific region includes 14 countries, namely, Cook Islands, Fiji Islands, Kiribati, Marshall Islands, Federated States of Micronesia, Nauru, Palau, Papua New Guinea, Samoa, Solomon Islands, Timor-Leste, Tonga, Tuvalu and Vanuatu. While Fiji’s financial sector may be more developed than others in the Pacific region, its development trends, strengths and weaknesses are not well documented.

For example, ADB’s own analysis appears inadequate for the purposes described above. Similarly, while Chand (2002) makes some interesting observations, the results are based on extremely limited available data at the time. Waqabaca (2004) also attempts to analyse Fiji’s historical financial development, however, the author acknowledges that the results have been obtained using a specific set of variables; that other variables could yield different results and that data limitations prevented meaningful analysis of even the selected measures over the desirable period, in some cases much shorter period trends are analysed. Moreover, the limited ratio analysis is not substantiated by data; trends are illustrated graphically only. Further, comparative analysis is lacking, thus the study is unable to compare Fiji’s financial development relative to other countries around the world, e.g. relative to similar socio–economic, developing and developed countries.
Consequently, there is relatively little that can be regarded as a firm basis for an assessment of prospects for further development or the degree to which the country’s financial development could be enhanced in a given time period. Absence of such understanding inhibits meaningful investigation of obstacle(s), if any, to the development process and subsequent determination of strategies for enhancing financial development. Satisfactory understanding of the financial sector’s past development trends and its strengths and weaknesses is thus the issue pursued in this chapter.

That is, this chapter attempts to gain a better understanding of Fiji’s financial development over the 1970—2003 period by answering RQ 1: how well has the financial sector in Fiji developed in the past and what are its strengths and weaknesses? Such analysis is now possible as data difficulties have been resolved in more recent times with the availability of the Beck et al. (2003) database (see section 3.2.1 for details), which enables a comprehensive analysis of the issues pursued in this chapter.

The analysis focuses on bank and stock market components of the financial sector for the following reasons: (i) within the intermediary sector, it is the banks and within the markets, it is the stock markets, which dominate lending to the private sector in Fiji; collective private lending by other financial institutions (OFIs) is insignificant, if any, and borrowers in the debt markets include government, quasi—government and financial institutions; corporate participation is non—existent (e.g. ADB, 2001a). Lending to the private sector is a crucial criterion because it is not only a key factor for accelerating financial development but it also forms a fundamental link between financial development and economic growth (see section 2.3.2); (ii) in this study, financial development by definition focuses on credit obtained by an entrepreneur or a company
and (iii) data availability necessitates financial development analysis to be confined to banking and stock market development.

4.2 SPECIFIC QUESTION AND PRIOR EXPECTATIONS

In light of the bank and stock market focus, RQ 1—how well has the financial sector in Fiji developed in the past and what are its strengths and weaknesses—may be investigated more effectively by examining the following, related sub–questions:

RQ 1–1: how well has the banking sector developed over the period 1970–2003?
RQ 1–2: how well has the stock market developed over the period 1970–2003?
RQ 1–3: what are the strengths and weaknesses of the banking sector with regard to size, activity and depth? and
RQ 1–4: what are the strengths and weaknesses of the stock market sector with regard to size, activity and depth?

Prior expectations or ‘working hypotheses’ have been formed regarding each of these sub–questions based on:

(i) the available literature; and
(ii) a perusal of information provided by Fiji’s regulatory authorities.

Despite their limitations, the conclusions of the rather limited extant literature that Fiji’s financial sector has developed over the years, albeit insufficiently, and lacks depth and sophistication (Chand, 2002; Waqabaca, 2004) are reasonable starting points for developing prior expectations for the above research questions. Further, the stock market is expected to be far less developed than the banking sector as, inter alia, it appears to be relatively inactive in terms of both the number of listed companies and daily trading (Chand, 2002). In view of the country’s developing economic status, it is
expected that the banking industry would indeed be more developed than the stock market. As Gerschenkron (1962) argues, less developed countries usually have weaker legal and accounting systems, which make banking operations more effective than markets. Rajan and Zingales (1999) concur, arguing that powerful banks may be able to better persuade firms to divulge information and pay debts even in the absence of proper legal and accounting systems relative to markets which are dependent on these for proper functioning. Thus, banks are expected to be better developed than markets.

Reddy et al. (2004) also provide interesting observations for forming expectations. The authors note that over the decades, the financial sector has undergone significant reforms, resulting in a relatively deregulated market and a strong prudential regulation system. Most direct and indirect government influence has been removed. Major reforms have included removal of quantitative regulatory restrictions such as directed lending, interest rate ceilings and liquidity requirements. The prudential regulation system has been significantly strengthened over time and has over the past two decades been largely in consonance with international practices and the Basel recommended policies and guidelines; for instance, the prominent capital adequacy regulations are in place. These examples of reforms are likely to have resulted in some development of the financial sector, particularly of banks. Moreover, technological innovations may also have influenced financial development in Fiji. For example, ATMs and phone and home banking are increasingly becoming a commonplace.

In light of the limited literature on Fiji’s financial development, a perusal of the information provided by the Reserve Bank of Fiji, the Capital Markets Development Authority and the South Pacific Stock Exchange provides additional insight for developing prior expectations. At the outset, market trends (figs. 4–1 and 4–2) are
indicative of positive past financial development and scope for further development.

Figure 4–1 shows, using simple annual asset growth that banks and other financial institutions have expanded over the 1996–2004 period.

**Figure 4–1: Intermediary development in Fiji—1996-2004**

This graph, using simple growth ratios, shows that banks, other financial institutions (OFIs), bank deposits (B/Dep) and bank loans (B/Loan) have increased over the 1996–2004 period, suggesting a positive development of Fiji’s financial institutions in the past.

![Graph showing intermediary development in Fiji, 1996-2004](image)

*Source: Reserve Bank of Fiji Quarterly Reports (various); the FJD is in current prices.*

Similarly, financial intermediation, indicated by the deposit mobilisation and lending activities of banks’, appears to have expanded over the years. Moreover, the trends suggest and ADB (1999a) notes, that domestic liquidity has been constantly high since the mid 1980s, indicating potential for further expansion. Service provision of banks have also improved substantially over time; banks today provide most of the services provided in developed economies, including home banking services (Sharma and Reddy, 2003). These trends and changes indicate that the banking sector may have developed in the past.

The stock market appears to have undergone some transformation and expansion as well. The stock exchange has transformed from a simple trading post in 1979 to a more functional stock exchange. The number of listed companies (from 3 in 1979 to 16 in
2005) and market capitalisation (figure 4–2) have also increased over the years. As with the banking sector, stock market trends and the scope for more listing indicate some development of the market in the past. However, a quick perusal of the daily trading activities on the South Pacific Stock Exchange shows that daily trading trends may have constantly been low, suggesting that past development may have been weaker than that of banks and future development may not be as promising.

Figure 4–2: Market capitalisation in Fiji—1998–2004

This graph shows an increase in the market capitalisation of listed firms in Fiji, suggesting a development of the stock market in the past.

On the basis of the (admittedly limited) information available, the following prior expectations can be formed: (i) Fiji’s banking sector has developed positively over 1970-2003; (ii) development of the stock market has been less positive, perhaps, even weak, over this period; (iii) the banking sector has expanded across size, activity and depth; and (iv) stock market has expanded in size but activity and depth remain weak.

The rest of the chapter is organised as follows. Sections 4.3 provides an appropriate background for investigating the specific research questions listed earlier by tracing the historical evolution of the banking industry and stock market activities in Fiji, concluding with a discussion on the present system. Section 4.4 summarises the
methods and data used to investigate the main and the sub–questions of this chapter, details of which are presented in section 3.2. Sections 4.5 and 4.6 investigate RQ 1–1 and RQ 1–2, respectively i.e. Fiji’s banking and stock market development over 1970–2003. Sections 4.7 and 4.8 investigate RQ 1–3 and RQ 1–4, respectively, i.e. the strengths and weaknesses in the banking and stock market sectors. Section 4.9 summarises and concludes.

4.3 A CHRONOLOGICAL EVOLUTION

For purposes of tracing the evolution of banks and stock markets in Fiji, the temporal division follows Robinson’s (1964) Exploitative (1850–1914), Concessionary (1914–1945), National (1945–1975) and the International Era (1975–date). This classification provides a useful description of the co–evolution of international business and environment.

The Exploitative Era is one of colonisation. This is the period when powerful nations, such as Britain, France, Germany, and the United States contested in laying claims on or colonising the islands of the Pacific. In terms of establishing financial institutions, while penetration in the Pacific in this Era seems to be limited, banks from Australia and New Zealand appear to be the major influence in the region. The Concessionary Era was essentially a transitional period with banking expansion basically stalled after World War I. Then followed a period of de–colonisation—the National Era—which witnessed an upsurge of private firms and multinational corporations. Nationalism and state–led industrialisation resulted in many governments nationalising foreign as well as domestic banks. The International Era has been characterised as being increasingly open to international business.
In tracing the evolution of Fiji’s banking and stock market sector, various sources have been referred to, including Skully (1985), Tschoegl (2003), ADB (2001a) and Reserve Bank of Fiji Articles (various). A summary is provided in table 4–1 below.

**Table 4–1: A chronological evolution of Fiji’s banking and stock market sectors**

This table attempts to summarise the chronological evolution of Fiji’s banking and stock market sectors. The temporal division follows Robinson’s (1964) eras.

<table>
<thead>
<tr>
<th>Entry</th>
<th>Institution name</th>
<th>Ownership</th>
<th>Head office</th>
<th>Exit</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exploitative Era (1850–1914)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1873</td>
<td>Fiji Banking and Commercial Trading Limited (FBCT)</td>
<td>Foreign</td>
<td>New Zealand</td>
<td>1876</td>
<td>Acquired by BNZ</td>
</tr>
<tr>
<td>1876</td>
<td>Bank of New Zealand (BNZ)</td>
<td>Foreign</td>
<td>New Zealand</td>
<td>1990</td>
<td>Acquired by ANZ</td>
</tr>
<tr>
<td>1880</td>
<td>Union Bank of Australasia (UBA)</td>
<td>Foreign</td>
<td>Australia</td>
<td>1895</td>
<td>Closed operations</td>
</tr>
<tr>
<td>1901</td>
<td>Bank of New South Wales (now Westpac Banking Corporation Limited, Westpac)</td>
<td>Foreign</td>
<td>Australia</td>
<td></td>
<td>Currently operating</td>
</tr>
<tr>
<td>1908</td>
<td>Government Savings Bank</td>
<td>State</td>
<td>Fiji</td>
<td>1961</td>
<td>Subsumed into POSB</td>
</tr>
<tr>
<td><strong>Concessionary Era (1915–1945)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>No major event</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>National Era (1946–1975)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1951</td>
<td>Bank of Australasia (BOA)</td>
<td>Foreign</td>
<td>Australia</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1952</td>
<td>Australia and New Zealand Banking Group Limited (ANZ)</td>
<td>Foreign</td>
<td>Australia</td>
<td></td>
<td>Merger bet BOA &amp; UBA. Currently operating</td>
</tr>
<tr>
<td>1961</td>
<td>Bank of Baroda</td>
<td>Foreign</td>
<td>India</td>
<td></td>
<td>Currently operating</td>
</tr>
<tr>
<td>1961</td>
<td>Post Office Savings Bank</td>
<td>State</td>
<td>Fiji</td>
<td>1974</td>
<td>Subsumed into NBF</td>
</tr>
<tr>
<td>1970</td>
<td>Citibank</td>
<td>Foreign</td>
<td>USA</td>
<td>1978</td>
<td>Acquired by ANZ</td>
</tr>
<tr>
<td>1972</td>
<td>Barclays Bank International</td>
<td>Foreign</td>
<td>UK</td>
<td>1985</td>
<td>Acquired by ANZ</td>
</tr>
<tr>
<td></td>
<td>Hong Kong Shanghai Banking Corporation (HSBC)</td>
<td>Foreign</td>
<td>Honk Kong</td>
<td>1988</td>
<td>Acquired by Westpac</td>
</tr>
<tr>
<td>1979</td>
<td>Suva Stock Exchange</td>
<td>State</td>
<td>Fiji</td>
<td>2000</td>
<td>Subsumed into SPSE</td>
</tr>
<tr>
<td>1982</td>
<td>Westpac Banking Corporation</td>
<td>Foreign</td>
<td>Australia</td>
<td></td>
<td>Merger bet BNSW &amp; Commercial Bank Australia</td>
</tr>
<tr>
<td>1991</td>
<td>Habib Bank Limited (HBL)</td>
<td>Foreign</td>
<td>Pakistan</td>
<td></td>
<td>Currently operating</td>
</tr>
<tr>
<td>1993</td>
<td>Bank of Hawaii (BOH)</td>
<td>Foreign</td>
<td>United States</td>
<td>2001</td>
<td>Acquired by ANZ</td>
</tr>
<tr>
<td>1996</td>
<td>SSE call market begins</td>
<td>Local</td>
<td>Fiji</td>
<td></td>
<td>Currently operating</td>
</tr>
<tr>
<td>2000</td>
<td>South Pacific Stock Exchange (SPSE, formerly SSE)</td>
<td>Local</td>
<td>Fiji</td>
<td></td>
<td>Currently operating</td>
</tr>
</tbody>
</table>
4.3.1 The Exploitative Era (1850–1914)

The need for a bank in Fiji surfaced as early as 1868, however, it was not until 1873 that the first bank appeared on the scene. The Polynesia Company (an Australian–owned venture) was granted monopoly banking rights in Fiji in May 1868. The deal was for the bank to pay off some of King Cakobau’s foreign obligations (Skully, 1985). However, Polynesia Company failed to exploit the advantage and instead concentrated on land development and sugar production. Other unsuccessful attempts were also made to get a bank to operate in Fiji until the New Zealand owned Fiji Banking and Commercial Company opened its doors for business on 3 December 1873.

However, financial difficulties arising mainly from government loans, forced the bank to discontinue operations, and on 17 July 1876 it was taken over by Bank of New Zealand. Three years later, in December 1880, the Union Bank of Australasia (established as an Anglo–Australian bank in 1837) joined the industry but was compelled to withdraw its operations in 1895 as a result of the banking crisis of 1893. Next to enter the market was the Bank of New South Wales (BNSW, renamed Westpac in 1982) on 12 August 1901, followed by the government–owned Savings Bank in 1908 (renamed National Bank of Fiji—NBF—in 1974).

Thus, at the end of the Exploitative Era, a local savings and two foreign commercial banks constituted Fiji’s banking sector. While the banking sector seems to have been captured by Australasian institutions from inception, domestic presence, albeit modest, had been established from early days. Moreover, total banking penetration in the Exploitative Era appears significant for a relatively small island economy. There was no sign of a stock market yet.
4.3.2 **The Concessionary Era (1915–1945)**

No major banking or any stock market event appears to have taken place in this Era. Thus, a savings and two commercial banks continued to control Fiji’s banking sector with stock markets still not in sight.

4.3.3 **The National Era (1946–1975)**

The first new bank of the National Era was Bank of Australasia (established in 1835), which commenced business in Fiji on 12 April 1951. A year later, in 1952, the Bank of Australasia merged with the Union Bank of Australasia (one of the first banks to enter and subsequently exit Fiji’s financial sector) to form the Australia and New Zealand Banking Group Limited (ANZ); this was the beginning of ANZ’s momentous presence in Fiji. 5 July 1961 saw the entry of the first non–Australasian institution—Bank of Baroda (BOB), from the Gujrat state of India. In the same year, the Government Savings Bank (established in 1908) evolved into, and became known as, the Post Office Savings Bank. The entry of non–Australasian institutions continued in the new decade; first came an American bank—Citibank—in 1970, followed by a British bank—Barclays Bank International—in 1972. As the National Era came to an end, in September of 1974, the government–owned Post Office Saving Bank was converted to a full commercial bank and renamed the National Bank of Fiji (NBF).

During the National Era, four banks—all foreign—(ANZ, BOB, Citibank and Barclays) entered Fiji’s financial sector. In addition, a state–owned bank (NBF), which was established in the Exploitative Era as a Savings Bank and operated by the national post office, emerged as the only locally incorporated commercial bank. Thus, at the end of the National Era, a local commercial and 6 foreign branch banks constituted Fiji’s banking sector. A stock market was yet to emerge.
4.3.4 The International Era (1975–date)

Mergers and acquisitions appear to have been an important characteristic of this Era. In 1978, the only American presence in Fiji’s financial sector, Citibank, closed its operations by selling its business to ANZ. In 1985, ANZ acquired the business operations of Barclays Bank, the only British presence in Fiji. Three year later, in 1988, the Hong King Shanghai Banking Corporation (HSBC) also decided to cease its operations in Fiji. HSBC’s business was bought by Westpac. In 1990, financial difficulties compelled BNZ, the oldest bank in Fiji, having served Fiji for 114 years, to sell its Fiji operations. BNZ’s business operations were acquired by ANZ. However, new banks continued to enter the financial sector; Habib Bank Limited (HBL)4–1 in 1991 and Bank of Hawaii (BOH) in 1993.

Then in 1995 the state–owned NBF was declared insolvent and placed in a rehabilitation program, which inter alia, created an Asset Management Bank (AMB) with the sole purpose of recovering NBF debts. NBF’s insolvency was largely due to severe loan problems. The ‘bad’ loans of NBF were transferred to AMB (‘bad’ bank) while the ‘good’ loans remained with NBF (‘good’ bank). The bank’s rehabilitation program continued in 1996/97. In 1998, the government offered to sell off 51% of NBF (‘good’ bank). Colonial National Bank (now, Commonwealth Bank Australia—CBA) won the bid and henceforth the bank’s name changed to Colonial National Bank (CNB). The entry of CNB meant that as of 2008, three Australian banks operated in Fiji. In 2001, the supremacy of Australian banks in Fiji took another significant step with Bank of Hawaii, after over seven years in Fiji, deciding to exit the market; its business operations were acquired by ANZ. Further, in 2006, Fiji Government sold its remaining

4–1 Although from Pakistan, HBL offered western style banking products and services, not Islamic.
49% share in CNB to CBA, making CNB yet another entirely foreign (Australian) owned bank.

The International Era also saw the emergence and growth of a stock market in Fiji; a stock exchange (the Suva Stock Exchange, SSE) was finally established in 1979. Despite being called a stock exchange, it was but only a ‘trading post’ where buyers and sellers occasionally met and transacted directly; there were no brokers and listing requirements. However, a call market was established in 1996, resulting in commencement of active trading with the participation of dealers and brokers. The SSE changed its name to South Pacific Stock Exchange (SPSE) in 2000 with the intention of becoming a regional stock exchange; update on this was not available at the time of writing the dissertation.

For Fiji’s banking sector, the International Era appears to be one of consolidation. New entrants had been few but takeovers and mergers had been many more. Two new banks (HBL and BOH) entered Fiji’s financial sector. However, one of them, BOH, exited seven year later, selling its business to ANZ, which also acquired the businesses of several other banks. This has indeed been an Era when two Australian banks, ANZ and Westpac, appear to have established their dominance in the market by acquiring the businesses of a number of banks wishing to cease operations in Fiji. Moreover, the operations of the only locally incorporated bank, NBF, also came to an end with the gradual sale of its entire shares to yet another Australian Bank. Thus, in 2006, five foreign commercial banks constituted Fiji’s banking sector. For the stock markets, though, the Era has been one of emergence and gradual growth.
4.3.5 The Current Financial System

In addition to the five commercial banks and the stock market, albeit their relatively small collective impact on the private sector, several insurance companies, two finance companies, two residential mortgage providers, several unit trusts (similar to mutual funds), a development bank, a superannuation fund, other non–bank financial institutions, a money market, a bond market and a venture capital company make up Fiji’s financial sector. Further, a central bank and a capital markets regulator are also present.

As noted earlier, most of the current commercial banks are branches of foreign banks; while CNB is locally incorporated, it is also 100% foreign owned (table 4–2). Three of the banks are Australian (ANZ, Westpac and CNB) and two from the Subcontinent (Bank of Baroda—BOB from India and Habib Bank Limited—HBL from Pakistan). ANZ is the largest bank followed by WBC, CNB, BOB and HBL; the three Australian banks controlled 91.4% of total assets and 95.6% of total loans in 2006; the two majors controlled 72.5% of total assets and 75% of total loans.

Table 4–2: Incorporation, ownership and size of commercial banks in Fiji, 2006

This table shows the place of incorporation and ownership of commercial banks in Fiji. As can be seen, in 2006, all were foreign–owned and most foreign–incorporated. Moreover, the sector was highly concentrated; two banks controlled up to 75% of the industry, three controlled up to 95%.

<table>
<thead>
<tr>
<th>Bank</th>
<th>Incorporation</th>
<th>Ownership</th>
<th>Percent Assets</th>
<th>Percent Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>ANZ</td>
<td>Australia</td>
<td>Foreign (100%)</td>
<td>44.3%</td>
<td>44.1%</td>
</tr>
<tr>
<td>BOB</td>
<td>India</td>
<td>Foreign (100%)</td>
<td>9.8%</td>
<td>4.1%</td>
</tr>
<tr>
<td>CNB</td>
<td>Fiji</td>
<td>Foreign (100%)</td>
<td>18.9%</td>
<td>20.6%</td>
</tr>
<tr>
<td>HBL</td>
<td>Pakistan</td>
<td>Foreign (100%)</td>
<td>0.8%</td>
<td>0.4%</td>
</tr>
<tr>
<td>WBC</td>
<td>Australia</td>
<td>Foreign (100%)</td>
<td>28.2%</td>
<td>30.9%</td>
</tr>
</tbody>
</table>

Source: RBF Annual Reports (various).
Note: Assets and loans are percentage of the total banking sector.

4-2 Towards the end of 2006, HBL’s Fiji operations were acquired by Bank of South Pacific Ltd., a PNG owned and incorporated company.
The superannuation fund (Fiji National Provident Fund—FNPF), the development bank (Fiji Development Bank—FDB) and one residential mortgage provider (Housing Authority of Fiji—HA) are state–owned. FNPF has recently been subjected to RBF supervision. Other OFIs supervised by RBF include insurance companies, the non–state residential mortgage provider, the credit corporation, and the merchant bank; the last three are deposit–taking OFIs, also called credit institutions. Other OFIs, including FDB and HA are not subject to external/independent supervision/regulation.

The central bank—Reserve Bank of Fiji (RBF)—in addition to performing regular central banking functions, supervises and regulates deposit–taking financial institutions (DTFI) and some OFIs. DTFIs include commercial banks and some OFIs, which are licensed to accept non–transferable public deposits; in 2006 there were three such deposit–taking OFIs. RBF’s supervisory and regulatory framework is aligned to international practices and is largely based on the guidelines of the Basle Committee, the IMF and other such multilateral organisations.

The stock market, conceived in 1979 with a call market established in 1996, had 16 listed companies in 2006 with a total market capitalisation of FJD838.0m. Only three companies were listed on the exchange within the first decade since inception. Six more companies listed in the second decade and the rest (7) since 2000. The largest listed company is Amalgamated Telecom Holding Limited, holding 37.5% of total market capitalisation. Add to this two more companies—Foster’s Group Ltd and Flour Mills of Fiji Ltd—and their proportion of market capitalisation would be around 76%. The rest of the companies (13) make up the rest of the capitalisation (24%), with some having a capitalisation of as little as FJD5m or 0.5% of the total.
4.4 THE ANALYTICAL APPROACH: A RECAPITULATION

Details are provided in section 3.2. For convenience, a summary of the key points relating to the main question (RQ 1) is included here. Similarly, key points relating to specific questions are summarised in relevant sections below.

The data for the analysis is sourced from ‘The Financial Structure Database’ compiled by Beck et al. (2003). The analysis involves: (i) measuring overall banking and stock market development; (ii) ascertaining the strengths and weaknesses of the banking and stock market sectors with regard to size, activity and depth; and (iii) comparing Fiji’s situation with selected developing and developed countries in the Asia–Pacific region, with the former further categorised into Small Island Developing States (SIDS); countries with GDP per capita less than USD1000 (low GDP/capita); and those with GDP per capita more than USD1000 (high GDP/capita) in 2003. There are six SIDS, six LGDP, five HGDP and four DEV comparator countries; a total of 21.

4.5 COMPOSITE INDICES AND SENSITIVITY ANALYSIS

The historical banking and stock market development analysis uses composite indices developed specifically for this research. For banking development, the index is:

\[ B\text{–Index} = 0.25(LLY) + 0.25(BANKY) + 0.5(BPRVY), \]

where,

- \( B\text{–Index} \) = composite index for banking development and where, a rising \( B\text{–Index} \) denotes an expansion of the banking sector; a falling index denotes a contraction of the sector;
- \( BANKY \) = bank assets to GDP—a size measure of banking development;
- \( LLY \) = liquid liabilities to GDP—a depth measure of banking development; and
- \( BPRVY \) = bank private sector credit to GDP—an activity measure of banking development.

\[ \text{This classification is similar to World Bank’s Income classifications.} \]
As noted in section 3.2.6, in response to questions that may arise on the above method of assigning weights, a series of sensitivity analysis runs was carried out. The alternative weight combinations for B–Index included the following:

(i) \(0.25(\text{LLY}) + 0.25(\text{BANKY}) + 0.5(\text{BPRVY})\);
(ii) \(0.25(\text{LLY}) + 0.5(\text{BANKY}) + 0.25(\text{BPRVY})\);
(iii) \(0.5(\text{LLY}) + 0.25(\text{BANKY}) + 0.25(\text{BPRVY})\); and
(iv) \(0.333(\text{LLY}) + 0.333(\text{BANKY}) + 0.333(\text{BPRVY})\).

Table 4–3: Sensitivity analysis of B–Index—Fiji and selected Asia Pacific Countries

This table shows selected results of the sensitivity analysis on B–Index, using the following weight combinations, details are provided in appendix 4–1:

(i) \(0.25(\text{LLY}) + 0.25(\text{BANKY}) + 0.5(\text{BPRVY})\) (column 3);
(ii) \(0.25(\text{LLY}) + 0.5(\text{BANKY}) + 0.25(\text{BPRVY})\) (column 4);
(iii) \(0.5(\text{LLY}) + 0.25(\text{BANKY}) + 0.25(\text{BPRVY})\) (column 5); and
(iv) \(0.333(\text{LLY}) + 0.333(\text{BANKY}) + 0.333(\text{BPRVY})\) (column 6).

The selected AP countries include PNG and VUT from SIDS; PHL and MNG from LGDP; IDN and THA from high GDP; and NZL and AUS from the DEV group. (See section 4.4 for full names of countries.)

Columns 7–10 show Fiji's banking development relative to comparator countries, with the colours reflecting the respective weight combinations. As the results show, various weight combinations produce minimum differences in Fiji's banking development relative to comparator countries. For instance, in 1970, using any weight combination, New Zealand's level of banking development was around 1.3 times that of Fiji's.

<table>
<thead>
<tr>
<th>Year</th>
<th>Country</th>
<th>B-Index</th>
<th>B-Index</th>
<th>B-Index</th>
<th>B-Index</th>
<th>B-Index</th>
<th>B-Index</th>
<th>B-Index</th>
<th>B-Index</th>
<th>Fiji's relative development</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>PHL</td>
<td>16.4</td>
<td>17.5</td>
<td>17.6</td>
<td>17.1</td>
<td>1.0</td>
<td>1.0</td>
<td>0.8</td>
<td>0.9</td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>FJI</td>
<td>16.9</td>
<td>18.0</td>
<td>22.0</td>
<td>19.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>THA</td>
<td>20.7</td>
<td>21.7</td>
<td>23.9</td>
<td>22.1</td>
<td>1.2</td>
<td>1.2</td>
<td>1.1</td>
<td>1.2</td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>NZL</td>
<td>21.7</td>
<td>22.6</td>
<td>31.7</td>
<td>25.3</td>
<td>1.3</td>
<td>1.3</td>
<td>1.4</td>
<td>1.3</td>
<td></td>
</tr>
<tr>
<td>1970</td>
<td>AUS</td>
<td>29.6</td>
<td>32.3</td>
<td>34.6</td>
<td>32.1</td>
<td>1.8</td>
<td>1.8</td>
<td>1.6</td>
<td>1.7</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>PHL</td>
<td>21.8</td>
<td>23.5</td>
<td>25.8</td>
<td>23.7</td>
<td>1.7</td>
<td>1.6</td>
<td>1.5</td>
<td>1.6</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>PNG</td>
<td>32.1</td>
<td>33.6</td>
<td>33.6</td>
<td>33.1</td>
<td>1.1</td>
<td>1.1</td>
<td>1.2</td>
<td>1.1</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>FJI</td>
<td>36.1</td>
<td>37.8</td>
<td>39.6</td>
<td>37.8</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>IDN</td>
<td>38.0</td>
<td>39.9</td>
<td>37.3</td>
<td>38.4</td>
<td>1.1</td>
<td>1.1</td>
<td>0.9</td>
<td>1.0</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>VUT</td>
<td>56.8</td>
<td>57.6</td>
<td>82.6</td>
<td>65.6</td>
<td>1.6</td>
<td>1.5</td>
<td>2.1</td>
<td>1.7</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>AUS</td>
<td>58.8</td>
<td>60.4</td>
<td>57.2</td>
<td>58.7</td>
<td>1.6</td>
<td>1.6</td>
<td>1.4</td>
<td>1.6</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>THA</td>
<td>60.6</td>
<td>62.2</td>
<td>63.4</td>
<td>62.0</td>
<td>1.7</td>
<td>1.6</td>
<td>1.6</td>
<td>1.6</td>
<td></td>
</tr>
<tr>
<td>1990</td>
<td>NZL</td>
<td>77.6</td>
<td>79.8</td>
<td>77.1</td>
<td>78.1</td>
<td>2.2</td>
<td>2.1</td>
<td>1.9</td>
<td>2.1</td>
<td></td>
</tr>
</tbody>
</table>

Source: Beck et al., 2003.

Selected results appear in table 4–3; details are provided in appendix 4–1. As the table and appendix show, alternative weight combinations produce minimum differences in Fiji’s banking development relative to the comparator countries. For instance, in 1970,
using any weight combination, New Zealand’s level of banking development was around 1.3 times that of Fiji’s. Thus, the B–Index appears not to be sensitive to different weight combinations.

For stock market development, the composite index is:

$$\text{SM–Index} = 0.5(\text{MCAPY}) + 0.5(\text{TRADE})$$

where,

- \(\text{SM–Index}\) = composite index for stock market development and where, a rising SM–Index denotes an expansion of the stock market sector; a falling index denotes a contraction of the sector;
- \(\text{MCAPY}\) = market capitalisation to GDP—a size measure of stock market development; and
- \(\text{TRADE}\) = total value of shares traded to GDP—an activity measure of stock market development.

The alternative weight combinations for SM–Index included the following:

(i) \(0.5(\text{MCAP}) + 0.5(\text{TRADE})\);
(ii) \(0.25(\text{MCAP}) + 0.75(\text{TRADE})\); and
(iii) \(0.75(\text{MCAP}) + 0.25(\text{TRADE})\).

Selected results of the sensitivity analysis appear in table 4–4; details are provided in appendix 4–2. As the table and appendix show, in this case, alternative weight combinations do produce notable differences in Fiji’s stock market development relative to comparator countries; in particular, Fiji's relative development appears to improve as greater weight is assigned to size (MCAPY) and it appears to worsen as greater weight is assigned to activity (TRADE). Nonetheless, this is not of much concern as Fiji's relative level of stock market development does not appear to change in any important, big-picture way. In any case, for reasons outlined in section 3.2, it is reasonable to assign at least 50% weight to TRADE and the rest to others.
Table 4–4: Sensitivity analysis of SM–Index—Fiji and selected Asia Pacific Countries

This table shows selected results of the sensitivity analysis on SM–Index, using the following weight combinations, details are provided in appendix 4–1:
(i) $0.5(\text{MCAP}) + 0.5(\text{TRADE})$ (column 3)
(ii) $0.75(\text{MCAP}) + 0.25(\text{TRADE})$ (column 4)
(iii) $0.25(\text{MCAP}) + 0.75(\text{TRADE})$ (column 5)

The selected AP countries include PHL and MNG from LGDP; IDN and THA from high GDP; and NZL and AUS from the DEV group. Columns 6–8 show Fiji's stock market development relative to comparator countries, with the colours reflecting the respective weight combinations. As the results show, various weight combinations produce notable differences in Fiji's stock market development relative to comparator countries. Nonetheless, this is not of much concern as Fiji's level of stock market development does not appear to change in any important way.

<table>
<thead>
<tr>
<th>Year</th>
<th>Country</th>
<th>SM-Index 1</th>
<th>SM-Index 2</th>
<th>SM-Index 3</th>
<th>SM-Index 4</th>
<th>SM-Index 5</th>
<th>SM-Index 6</th>
<th>SM-Index 7</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>FJI</td>
<td>2.1</td>
<td>3.1</td>
<td>1.1</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>MNG</td>
<td>3.1</td>
<td>3.8</td>
<td>2.4</td>
<td>1.4</td>
<td>1.2</td>
<td>2.1</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>IDN</td>
<td>24.7</td>
<td>27.4</td>
<td>21.9</td>
<td>11.7</td>
<td>8.8</td>
<td>19.8</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>THA</td>
<td>27.4</td>
<td>33.5</td>
<td>21.4</td>
<td>13.0</td>
<td>10.7</td>
<td>19.3</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>NZL</td>
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<td>60.0</td>
<td>30.8</td>
<td>21.4</td>
<td>19.2</td>
<td>27.8</td>
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</tr>
<tr>
<td>1997</td>
<td>PHL</td>
<td>47.3</td>
<td>58.8</td>
<td>35.7</td>
<td>22.3</td>
<td>18.8</td>
<td>32.3</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>AUS</td>
<td>57.2</td>
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<td>49.2</td>
<td>27.0</td>
<td>20.8</td>
<td>44.5</td>
<td></td>
</tr>
</tbody>
</table>

Source: Beck et al., 2003.

4.6 HISTORICAL BANKING DEVELOPMENT IN FIJI: 1970—2003

This section examines RQ 1–1, i.e. how well has the banking sector developed over the period 1970–2003? Extant literature and a perusal of the information provided by Fiji’s regulatory authorities led to the prior expectation that the banking sector may have developed positively over this period.

The B–Index values suggest that Fiji’s banking sector has developed steadily from 1970 to 1995. However, beyond 1995, the sector appears to be contracting; by 2001 the level of development reverted to 1989–90 levels. Table 4–5 and figure 4–3 provide B–index of Fiji and selected Asia Pacific countries; details are provided in appendix 4–3.
In this table, Fiji’s overall banking development situation is compared to selected AP countries, including PNG and VUT from SIDS; PHL and MNG from LGDP; IND and THA from high GDP; and NZL and AUS from the DEV group. (See section 4.4 for full names of countries.)

<table>
<thead>
<tr>
<th>Year</th>
<th>Fiji*</th>
<th>PNG</th>
<th>VUT</th>
<th>PHL</th>
<th>MNG</th>
<th>IDN</th>
<th>THA</th>
<th>NZL</th>
<th>AUS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>16.9</td>
<td>NA</td>
<td>NA</td>
<td>16.4</td>
<td>NA</td>
<td>NA</td>
<td>20.7</td>
<td>21.7</td>
<td>29.6</td>
</tr>
<tr>
<td>1975</td>
<td>19.1</td>
<td>19.9</td>
<td>NA</td>
<td>22.2</td>
<td>NA</td>
<td>NA</td>
<td>27.7</td>
<td>23.4</td>
<td>31.2</td>
</tr>
<tr>
<td>1980</td>
<td>23.7</td>
<td>18.7</td>
<td>NA</td>
<td>29.7</td>
<td>NA</td>
<td>NA</td>
<td>32.8</td>
<td>27.6</td>
<td>30.7</td>
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<tr>
<td>1985</td>
<td>30.6</td>
<td>28.2</td>
<td>50.7</td>
<td>23.5</td>
<td>NA</td>
<td>19.8</td>
<td>49.5</td>
<td>30.8</td>
<td>35.0</td>
</tr>
<tr>
<td>1990</td>
<td>36.1</td>
<td>32.1</td>
<td>56.8</td>
<td>21.8</td>
<td>NA</td>
<td>38.0</td>
<td>60.6</td>
<td>77.6</td>
<td>58.8</td>
</tr>
<tr>
<td>1995</td>
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<td>37.2</td>
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<td>104.8</td>
<td>81.6</td>
</tr>
<tr>
<td>2001</td>
<td>33.4</td>
<td>20.0</td>
<td>53.0</td>
<td>46.5</td>
<td>15.6</td>
<td>38.3</td>
<td>89.6</td>
<td>102.7</td>
<td>83.3</td>
</tr>
</tbody>
</table>

Source: Beck et al., 2003.
* At times of special events, such as political coups, GDP and ratios involving it (e.g. BPRVY) may be volatile. This highlights the need to not rely exclusively on data for any single year but rather to use data for a diverse range of years.

In 1970, Fiji’s banking industry (B–Index = 16.9) appears to have been better developed than most SIDS and all LGDP countries and at least one HGDP country—Indonesia.

Even at this stage, Fiji seems to have been substantially more developed than Cambodia and Lao at any time over the entire 1970–2003 period. Further, Myanmar was able to catch up with Fiji’s 1970 level of development in 1981, Solomon Islands in 1982, Indonesia in 1983, Tonga in 1984 and Vietnam in 1998.

Fiji’s banking sector in 1970 was around 4.5 times less developed than Japan’s (DEV) and around 3 times less than Singapore’s (DEV), apparently one of the most developed banking sectors in the AP region over the 1970–2003 period. However, Fiji measured more favourably against Thailand (HGDP) and New Zealand (DEV), which were only around 1.2 times more developed than Fiji.
By 1975, Fiji’s B–index had increased by 13.2% to 19.1% and the country’s banking industry continued to be better developed than most SIDS and LGDP countries; Fiji seems to have fallen slightly behind Papua New Guinea (SIDS) and the Philippines (LGDP) and perhaps still behind Vanuatu (SIDS) at this stage\(^4-4\). Further, Indonesia—a HGDP country—continued to lag behind Fiji. Moreover, while the banking industries of New Zealand and Australia continued to be better developed than Fiji’s, the rate of development in these countries (7.91% and 5.32%, respectively) was less than Fiji’s. However, Thailand—to which Fiji compared favourably in 1970—had developed more rapidly (33.6%) since 1970, making Fiji’s development less comparable to it now.

Fiji’s level of banking development in 1975 was equivalent to Thailand’s (HGDP) in 1970 and New Zealand’s (DEV) in 1971. Most other HGDP and DEV countries continued to be far more developed than Fiji; e.g. Japan—5 times, Singapore—3 times and Malaysia—2 times. However, Fiji continued to measure favourably against New

\(^{4-4}\) It should be noted that Vanuatu is a tax haven. As is shown later, the exceptionally high LLY is the main reason for its high BDI values; Fiji compares well with respect to BANKY and BPRVY.
Zealand (DEV), which had developed at a slower rate (7.9%) than Fiji since 1970 and was still only 1.2 times better developed than Fiji.

By 1980 Fiji’s banking industry had developed by a further 23.7% since 1975 to 23.7, surpassing once again Papua New Guinea’s development, which had actually declined by 5.7% from 19.8 to 18.7, making Fiji once again the most developed among the SIDS countries. Further, Fiji continued to be more developed than LGDP countries, except for the Philippines (29.6), which having developed at a faster rate (33.3%) than Fiji since 1975, continued to be better developed than Fiji. Moreover, Indonesia continued to be less developed than Fiji and while Australia’s and New Zealand’s better development was eminent, the rate of development in these countries was again less than Fiji’s; in fact Australia experienced negative growth (-1.57%) and New Zealand’s was 17.8%. Japan continued to be the most developed in the region, over 4 times better developed than Fiji.

Fiji’s level of banking development in 1980 was equivalent to Thailand’s (HGDP) in 1973 and New Zealand’s (DEV) in 1975. However, in 1980, New Zealand continued to be only 1.2 times more developed than Fiji. Moreover, Fiji’s banking sector was 1.3 times more developed than Papua New Guinea’s and twice more than Tonga’s.

Fiji’s positive development continued and by 1985 the country’s B–Index had increased by another 29.3% to 30.6. The country’s banking sector continued to be better developed than most SIDS and all LGDP countries. In this period, the Philippines’ banking industry experienced a major decline (20.9%), resulting in its B–index falling to 23.4 and thus being considerably less developed than Fiji’s. Moreover, Indonesia, a HGDP country, continued to fall behind Fiji, with the latter being 1.5 times better
developed than the former. Similarly, Fiji was 1.3 times more developed than the Philippines and almost twice as developed as Western Samoa. Further, countries such as Mongolia, Tonga and Solomon Islands may never have been as developed as Fiji was even in 1985. In 1985, Fiji’s level of banking development was equivalent to New Zealand’s (30.7) and very close Australia’s (34.9), indicating that the rate of development in Fiji may have been faster than in these developed countries.

However, Vanuatu, a SIDS country, appears to have developed at a much faster rate than Fiji; its B–Index (50.7) was 1.7 times more than Fiji’s. Data limitations prohibit construction of Vanuatu’s pre–1982 B–Index; however, even its 1982 Index (43) was beyond Fiji’s reach until 1992. Moreover, in 1985, Vanuatu’s banking sector (50.7) was relatively more developed than Thailand’s (49.4), Korea’s (44.2), Australia’s (34.9) and New Zealand’s (30.7). Consequently, Vanuatu was 1.6 times more developed than New Zealand and 1.4 times more than Australia.

Fiji’s level of development in 1985 was equivalent to Thailand’s (HGDP) in 1978, and Australia’s (DEV) in 1980. However, Fiji was able to catch up with New Zealand’s (DEV) level of development in 1985. Moreover, Fiji was almost twice more developed than Western Samoa (SIDS), 1.5 times more than Indonesia (HGDP) and 1.3 times more than the Philippines (LGDP).

By 1990, Fiji’s B–Index had increased to 36; the country’s banking sector continued to develop but the rate of development appears to have declined (17.8%) relative to previous years. However, it continued to be better developed than most SIDS and all LGDP countries. The Philippines—the LGDP country most comparable to Fiji—continued to be less developed than Fiji; in fact Fiji’s relatively faster rate of
development made its banking sector now 1.7 times more developed than the Philippines’.

However, Vanuatu—the only SIDS better developed than Fiji—had a B–index of 56.7, implying that Vanuatu’s banking sector was 1.6 times more developed than Fiji’s at this stage. Vanuatu’s level of development was equivalent to Australia’s (58.8) and better than Korea’s (49.2) and Indonesia’s (37.9). Moreover, Indonesia, the HGDP country, which appeared to be relatively less developed than Fiji up to now, developed substantially since 1985 (91.3%) to be better developed than Fiji in 1990. Further, New Zealand, to which Fiji had compared favourably against up to now, developed astronomically (151.9%) since 1985, making the level of the country’s development 2.2 times more than Fiji’s.

Fiji’s level of development in 1990 was equivalent to Malaysia’s in 1976 and Korea’s in 1980. However, while both Korea and Malaysia were more developed than Fiji in 1990, Fiji (17.8%) appears to have developed faster than both Korea (11.2%) and Malaysia (-10.1%) since 1985 such that these countries were not as relatively developed as they were in 1990. Japan (3.7 times) and Singapore (2.5 times) continued to be substantially more developed than Fiji. However, Fiji was over 4 times more developed than Myanmar and 11 times more than Lao.

Fiji’s strong and positive banking development continued and in 1995 the country’s B–Index was 44.2. Fiji continued to be better developed than most SIDS and all LGDP countries. Despite a substantial (79.4%) growth since 1990, the Philippines’ banking sector continued to remain less developed than Fiji’s.
Fiji continued to fall behind Vanuatu (50.9), however, Vanuatu had by now lost its more developed status against Korea (51.7) and Australia (67.4). Moreover, Indonesia (HGDP) and New Zealand (DEV), which Fiji had compared favourably to in the past, continued to be more developed than Fiji.

Fiji’s level of banking development in 1995 was equivalent to Korea’s in 1985 and Vanuatu’s in 1983. However, while both Korea and Vanuatu were more developed than Fiji in 1995, Fiji appears to have developed more rapidly (22.7%) relative to Korea (5.2%) and Vanuatu (-10.2%) since 1995 such that these countries were only 1.2 times more developed than Fiji in 1995 compared to 1.4 (Korea) and 1.6 (Vanuatu) times in 1990. Moreover, Fiji was 11 times more developed than Cambodia and twice more developed than Papua New Guinea and Western Samoa.

The positive development of Fiji’s banking sector appears to have reached its peak in 1995; Fiji’s B–Index appears to decline after 1995. In 2000, the B-Index was 35.3, down 20.2% since 1995, equivalent to its 1989–90 levels. In 2001, the index had declined further to 33.3, down a further 5.5% from 2000. While the contraction did not change Fiji’s better status relative to most SIDS and LGDP countries, it did significantly change Fiji’s status relative to the Philippines, which had been less developed than Fiji for at least the past 15 years. A growth of 21.4% since 1995 compared to Fiji’s 20.2% decline in the same period, resulted in the Philippines now being 1.3 times more developed than Fiji, reiterating the 1980 situation. By 2001, the Philippines was 1.4 times more developed than Fiji.

Moreover, albeit marginally (2%), Vanuatu’s banking sector continued to grow in the last five years, resulting in it now being 1.5 times more developed than Fiji. By 2001,
Vanuatu was 1.6 times more developed than Fiji. Further, Indonesia (HGDP) and New Zealand (DEV), countries which Fiji had occasionally compared favourably to in the past, continued to be better developed than Fiji; 1.1 and 3 times, respectively.

Fiji’s level of banking development in 2000 was equivalent to Malaysia’s in 1976, Korea’s in 1980 and Australia’s in 1985. In 2000, Malaysia was almost 3 times, Korea 2.2 times and Australia 2.3 times more developed than Fiji; these countries had never been more developed than Fiji in the past. Moreover, while Fiji continued to be significantly more developed than Papua New Guinea (1.7 times) Lao (3.9 times) and Cambodia (4.7 times), Fiji’s status relative to these countries had declined and the trend continued into 2001.

**Historical Banking Development: A Summary**

To answer RQ 1–1—how well has the banking sector developed over the period 1970–2003—the foregoing analysis suggests that development has been positive. Thus, the evidence appears to support the relevant working hypothesis. Overall, Fiji’s banking sector appears to have been (i) better developed relative to most SIDS (except Vanuatu and Mauritius) countries over 1970–2001; (ii) better developed relative to most LGDP countries up to at least 1995 (iii) better or similarly developed to at least one HGDP country (Indonesia) over 1970–2001; and (iv) comparable to at least two DEV (new Zealand and Australia) until 1985. Thus, Fiji’s banking sector appears to have developed relatively well.

Compared to most SIDS countries, Fiji’s level of development has always been strong. For instance, Fiji was similarly developed relative to Papua New Guinea in 1975 but by

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4-5 Vanuatu’s pre–1985 data is not available but available data suggests that Vanuatu may have been better developed than Fiji in this period.
1995, Fiji was almost twice as developed as the latter. Similarly, Fiji was 1.4 times more developed relative to Solomon Islands in 1980 but by 1995 it was 2.7 times more developed. While contraction of Fiji’s banking sector in the post–1995 period compromised Fiji’s strong relative position, Fiji continued to be better developed than most of the SIDS countries.

However, the post–1995 contraction appears to raise a few questions. After steady positive growth for 25 years—1970 to 1995—the subsequent significant decline (22.7%) in the five years to 2000 against Solomon Islands (29%) growth and Papua New Guinea’s less significant decline (9.3%) in the same period raises some concerns. Vanuatu’s relatively better position over the period 1982–2001 reinforces the concerns. While data limitations prevent computation of Vanuatu’s pre–1982 B–Index, available trends suggest that Vanuatu may have been better developed than Fiji over the entire 1970–2003 period. Vanuatu was 1.7 times more developed than Fiji in 1985 but Fiji appeared to catch up by 1995 when the ratio had declined to 1.2 times, however, Fiji’s post-1995 situation resulted in Vanuatu regaining its 1985 position by 2001.

A similar picture appears to emerge when comparing Fiji’s situation to LGDP countries. For instance, Fiji was 2.4 times more developed than Myanmar in 1971, which by 1990 had reached 4.2 times. Similarly, beginning with an equivalent level of development in 1970, Fiji was up to 1.7 times more developed than the Philippines by 1990. Beyond 1990, the LGDP countries appear to be developing at a faster rate than Fiji. For instance, in the five years to 1995, while Fiji experienced a 22.7% growth, Myanmar’s rate was 39.8%. Similarly, the Philippines experienced a substantial 79.4% growth in the same period. Moreover, while the Philippines continued to grow beyond 1995, by 21.4% into 2000, Fiji experienced a significant decline.
Occasionally, Fiji also appears to have done well against the better developed countries. For instance, Fiji was better developed than Indonesia in at least the 1980s; significantly so around 1981—2.1 times. Beyond 1989, Indonesia appears to have developed relatively faster to be better developed than Fiji but only marginally so. Similarly, Fiji occasionally appears to be comparable to two DEV—New Zealand and Australia. For instance, around 1985, the level of banking development in Fiji appears to be equivalent to the level in these developed countries.

4.7 HISTORICAL STOCK MARKET DEVELOPMENT IN FIJI: 1970—2003

This section examines RQ 1–2, i.e. how well has the stock market developed over the period 1970–2003? Extant literature and a perusal of the information provided by Fiji’s regulatory authorities led to the prior expectation that development of the stock market has been weak and discouraging.

Non–existence of markets and/or data limitations restricts the analysis here to the 1995–2003 period and comparative analysis mostly to HGDP and DEV; Mongolia and the Philippines are the only LGDP countries. Moreover, while Fiji’s size data is available for the 1995–2003 period, the activity and efficiency data is more restrictive, available only for 1997, 1998, 1999 and 2003. Table 4–6 and figure 4–4 provide SM–index of Fiji and selected AP countries; detailed results are provided in appendix 4–4.

In 1997, Fiji’s SM–Index was 2.1, the lowest among the Asia Pacific sample countries, indicating that Fiji’s stock market may have been the least developed among these countries; even Mongolia’s market appears to be better developed (1.45 times) than Fiji’s. The Philippines appears to be significantly (22.3 times) more developed than Fiji
and so do New Zealand (21.4 times), Australia (27 times) and Indonesia (11.6 times). The most developed around this time appear to be Singapore (SM–Index = 101.1) and Malaysia (SM–Index = 175), which are 47 and 82 times, respectively more developed than Fiji. At this stage, Fiji’s level of stock market development appears to be equivalent to the Philippines’ 1984 level.

Table 4–6: SM–Index—Fiji and selected AP countries, 1997–2003

In this table, Fiji’s situation is compared to selected AP countries, including PHL and MNG from LGDP; IND and THA from high GDP; and NZL and AUS from the DEV group. The selected countries are the same as that in table 4–5, excluding SIDS countries due to non–existent of market and/or unavailability of data.

<table>
<thead>
<tr>
<th>Year</th>
<th>Fiji</th>
<th>PHL</th>
<th>MNG</th>
<th>IDN</th>
<th>THA</th>
<th>NZL</th>
<th>AUS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>2.1</td>
<td>47.3</td>
<td>3.1</td>
<td>24.7</td>
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<td>2003</td>
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<td>1.6</td>
<td>13.7</td>
<td>61.3</td>
<td>24.9</td>
<td>82.5</td>
</tr>
</tbody>
</table>

Source: Beck et al., 2003.

By 1998, Fiji’s stock market appears to have developed by 35%; SM–Index increased to 2.9. While Fiji continued to be the least developed among the AP countries, its relative position appears to have improved against the sample countries. For instance, the Philippines was now only 11.3 times more developed, New Zealand 17 times, Australia 22 times, Malaysia 30 times and Singapore 32 times. Singapore and Malaysia were still the most developed markets in the region, however, their SM–Index had declined to 92.4 and 86.1, respectively. Other markets experienced similar decline in development in 1998. At this stage, Fiji’s level of stock market development appears to be equivalent to the Philippines’ in 1986 and Thailand’s in 1985.
In 1999, Fiji’s stock market appears to have contracted slightly; the SM–Index was now 2.6. However, while Fiji experienced a 6% decline, Mongolia experienced a more significant 30.1% decline such that Fiji now was better developed relative to Mongolia. New Zealand also experienced a significant 31.6% contraction so Fiji’s situation continued to improve against New Zealand, which was now only 12.4 times more developed than Fiji. However, other markets experienced positive development such that Fiji’s relative improvement in 1998 dwindled in 1999; the Philippines was now 15.1 times more developed than Fiji, Australia 26.2 times, Malaysia 39.9 times and Singapore 55.6 times. In 1999, Fiji’s level of stock market development appears to be equivalent to Thailand’s in 1984.

Fiji’s stock market appears to have developed substantially between 1999 and 2003; by 2003, its SM–Index was 17.1. Fiji was now more developed than Mongolia (10.6 times) and Indonesia (1.25 times). Moreover, its development status was now much closer to the Philippines’ (SM–Index = 21.4), New Zealand’s (24.9). Further, while Fiji continued to be less developed than most markets, its relative position seems to have
improved substantially. For instance, the most developed market in the AP region in 2003—Singapore—was now only 6.7 times more developed than Fiji; in the past Singapore had been up to 80 times more developed. Similarly, Australia was now only 4.8 times more developed compared to 27 times in the past. Nevertheless, it appears that some markets such as Japan, Malaysia and Singapore may have been more developed than Fiji’s 2003 level since at least 1980. Others, such as Australia, Korea and Thailand may have been more developed since at least the late 1980s. In 2003, Fiji’s level of stock market development appears to be equivalent to Australia’s in 1981 and New Zealand’s in 1991.

*Historical Stock Market Development: A Summary*

To answer RQ 1–2—how well has the stock market developed over the period 1970–2003—the foregoing analysis suggests that historical development has been weak. Thus, the evidence appears to support the relevant working hypothesis. Overall, Fiji’s stock market appears to have constantly been among the least developed across the sample countries. Although the pre–1996 data is not available, trends indicate that Fiji’s stock market in that period may have been substantially small and inactive. However, strong development appears to be emerging, particularly toward the end of the analysis period. By 2003, Fiji’s state of development appears to have improved substantially relative to a number of countries, including developed, that it rated poorly against earlier. Thus, despite the poor historical development, there may be some potential for further development.
4.8 STRENGTHS AND WEAKNESSES OF THE BANKING SECTOR

This section attempts to examine RQ 1–3 i.e. what are the strengths and weaknesses of the banking sector with regard to size, activity and depth? The working hypothesis is that the banking sector has expanded across size, activity and depth.

To examine this, the composite B–index has been disaggregated into its basic components: BANKY, LLY and BPRVY. BANKY is bank assets to GDP—a size measure of banking development—a rising BANKY denotes a size expansion and therefore development of the banking sector; a falling ratio denotes a contraction of the sector. LLY is bank liquid liabilities to GDP—a depth measure of banking development—rising LLY denotes a deepening and therefore development of the banking sector; a falling ratio denotes the opposite and therefore contraction of the sector. BPRVY is bank private sector credit to GDP—an activity measure of banking development—a rising BPRVY denotes rising activity and therefore development of the banking sector; a falling ratio denotes falling activity and therefore contraction of the sector. See appendix 2–2 for details.

4.8.1 The Size of Fiji’s Banking Sector—BANKY

At the beginning of the analysis period, in 1970, Fiji’s banking industry (BANKY = 15) appears to have been larger than most SIDS and LGDP countries, slightly larger than a DEV country—New Zealand (14.3) and substantially larger than a HGDP—Indonesia (0.03) (table 4–7). Table 4–7 and figure 4–5 provide BANKY of Fiji and selected AP countries; detailed results are provided in appendix 4–5. The Philippines (LGDP) was slightly larger than Fiji and Vanuatu (SIDS) may have been larger as well. Even at this stage, Fiji’s banking industry seems to have been significantly larger than Cambodia and Lao at any time over the entire 1970–2003 period. The largest banking sector in the
region in 1970—Japan—was about 5 times larger than Fiji; Australia was 2.1 times larger.

By 1975, the size of Fiji’s banking sector had increased by around 24% to 18.7, making it still larger than New Zealand (17.4), Indonesia (2.1) and perhaps most SIDS and LGDP countries. Among the SIDS, in addition to Vanuatu, Papua New Guinea also seemed to be larger than Fiji and the Philippines slightly more than it was in 1970. Japan now was 4.8 times larger than Fiji and Australia 1.8 times.

Table 4–7: BANKY–Fiji and selected AP countries, 1970–2001

In this table, Fiji’s situation is compared to selected AP countries, including PNG and VUT from SIDS; PHL and MNG from LGDP; IND and THA from high GDP; and NZL and AUS from the DEV group. The selected countries are the same as that in table 4–5.

<table>
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</table>

Source: Beck et al., 2003.

At the beginning of the second decade of analysis—in 1980—Fiji’s BANKY was 25.1, following an expansion of 34.5% since 1975 and continued to be larger than New Zealand (BANKY = 23.5), Indonesia (8.2) and most of SIDS and LGDP countries. Moreover, the size of Fiji’s banking industry became much more comparable to Australia’s (32.5), which was now only 1.3 times larger than Fiji. In 1980, the size of Fiji’s banking sector was equivalent to Thailand’s in 1972.

By 1985, Fiji’s BANKY had increased further to 33.5 and was now definitely larger than all SIDS (including Vanuatu) and LGDP (including the Philippines) countries. Moreover it continued to be larger than New Zealand and Indonesia. Further, relatively
greater expansion of Fiji’s banking industry made it even more comparable to Australia’s (37.5), which was now only 1.2 times larger than Fiji. In 1980, the size of Fiji’s banking industry was equivalent to Korea’s in 1979.

**Figure 4–5: BANKY–Fiji and selected AP countries, 1970–2001**

This graph compares size development of the banking sector (BANKY) in Fiji with selected AP countries, including PNG and VUT from SIDS; PHL and MNG from LGDP; IND and THA from HGDP; and NZL and AUS from the DEV group.

By 1990, Fiji’s BANKY had increased to 37.7. While it had expanded at a relatively slower rate (12.6%) since 1985, it continued to be larger than all SIDS and LGDP countries. However, the slow expansion resulted in New Zealand (which had expanded substantially in this period —198%) and Indonesia (which too had expanded significantly—69%) now being relatively larger than Fiji. In fact, New Zealand’s astronomical expansion made its banking sector much larger than Australia’s and Malaysia’s. The size of Fiji’s banking sector now was equivalent to Australia’s in 1985 and Korea’s in 1980.

In 1995, Fiji’s BANKY had increased further to 46.9 and Fiji’s strong position relative to SIDS and LGDP countries continued. Moreover, the size of Fiji’s banking sector
now was equivalent to Korea’s (48.6). However, Indonesia, New Zealand and Australia were still larger than Fiji.

In 2000, Fiji’s BANKY had declined to 37.2, reverting the size of the banking sector to its 1990 level. This decline did not alter Fiji’s relative position against most SIDS and LGDP countries, however, it did against Vanuatu (SIDS) and the Philippines (LGDP), which now had relatively larger banking sectors. Moreover, Korea was now twice as large as Fiji and Australia 2.36 times. Both banking sectors had not been so much larger than Fiji’s in the past. New Zealand too was much larger than Fiji—3.11 times.

The declining trend continued into 2001; Fiji’s BANKY was now 35.6, equivalent to its 1989 level. In addition to Vanuatu and the Philippines, Vietnam too now had a relatively larger banking sector. Vietnam’s pre–1996 data is not available, but in 2000 its banking sector was relatively smaller than Fiji’s. Interestingly, Vietnam’s banking sector was 5.1 times smaller than Fiji’s.

4.8.2 The Depth of Fiji’s Banking Sector—LLY

In 1970, Fiji’s LLY was 31.1, higher than most4–6 SIDS and all LGDP countries, including the Philippines (table 4–8). Moreover, it was higher than Indonesia’s (8.35), Thailand’s (29.4) and not too far from Malaysia’s (36.2). Thus, Fiji’s banking sector was relatively deep in 1970. Table 4–8 and figure 4–6 provide LLY of Fiji and selected AP countries; detailed results are provided in appendix 4–6.

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4–6 Vanuatu’s (SPI) pre–1982 data is not available.
Table 4–8: LLY–Fiji and selected AP countries, 1970–2001

In this table, Fiji’s situation is compared to selected AP countries, including PNG and VUT from SIDS; PHL and MNG from LGDP; IND and THA from high GDP; and NZL and AUS from the DEV group.

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Source: Beck et al., 2003.

In five years to 1975, Fiji’s LLY declined slightly (2.5%) to 30.3, but remained stronger than most SIDS and all LGDP countries plus Indonesia. Moreover, Fiji’s banking sector appeared as deep as Korea’s (30.6). Further, Fiji’s position did not change against Australia’s; the later continued to be 1.35 times deeper than the former. However, Thailand’s 18.7% and Malaysia’s 73.9% growth in the same period resulted in these countries now being financially deeper than Fiji.

Figure 4–6: LLY–Fiji and selected AP countries, 1970–2001

This graph compares depth development of the banking sector (LLY) in Fiji with selected AP countries, including PNG and VUT from SIDS; PHL and MNG from LGDP; IND and THA from HGDP; and NZL and AUS from the DEV group.

Source: Beck et al., 2003.
By 1980, Fiji’s LLY had increased to 32.7 and continued to be stronger than most SIDS and all LGDP countries plus Indonesia. Moreover, the country’s banking sector was now deeper than Korea’s 32.7 and better positioned against Australia, which was now only 1.15 times deeper than Fiji.

Fiji’s relatively strong and positive position (LLY = 37.1) continued into 1985; Fiji remained financially deeper than most SIDS and all LGDP countries plus Indonesia and now Korea as well. Moreover, Fiji continued to do well against Australia and was now almost as financially deep as Australia (38.4). However, Vanuatu’s LLY was 107.9 and the country’s financial sector was 2.9 times deeper than Fiji’s.

By 1990, Fiji’s LLY had increased to 44.9 and the country’s financial sector continued to be deeper than most SIDS and all LGDP countries plus Indonesia. However, the 20.9% increase was not sufficient to sustain its relatively strong position against Thailand (LLY = 67.3), Korea (50.5) and even Samoa (SIDS) (46.1). Moreover, Vanuatu’s 133.2 LLY made its financial sector almost 3 times deeper than Fiji’s.

Fiji’s LLY increased further to 51.7 by 1995 and most of SIDS, all of LGDP countries and Indonesia continued to fall behind Fiji. The country’s financial sector was once again deeper than Samoa’s, however, it was still much shallower than Vanuatu’s.

By 2000, Fiji’s LLY had dropped to 43.3 and was equivalent to its 1989–90 levels. While Fiji continued to be deeper than most SIDS and LGDP countries, in addition to Vanuatu, the Philippines had now also taken over Fiji; it was 1.45 times deeper than Fiji. Moreover, Indonesia had also deepened at a faster rate than Fiji such that it too was now 1.32 times deeper than Fiji.

Fiji’s situation appears to have worsened in 2001. The country’s LLY dropped further to 39.2 and was now equivalent to its 1987 level. While its relatively better position
against most SIDS and LGDP countries was intact, in addition to the Philippines, now Vietnam (LLY = 46.2) too appeared to have a deeper financial sector than Fiji. Vietnam’s pre–1996 data is not available but it was shallower than Fiji in 2000.

4.8.3 Level of Activity in Fiji’s banking sector—BPRVY

In 1970, Fiji’s BPRVY was 10.6 and possibly more active than most SIDS and most LGDP countries (table 4–9). Moreover, its activity level was similar to New Zealand’s 10.9. However, even at this stage, it was not as active as the Philippines’ banking sector (13.9). Further, the Australian banking sector appears to be significantly more active (2 times) than Fiji’s. Table 4–9 and figure 4–7 provide BPRVY of Fiji and selected AP countries; detailed results are provided in appendix 4–5.

Table 4–9: BPRVY–Fiji and selected AP countries, 1970–2001

In this table, Fiji’s situation is compared to selected AP countries, including PNG and VUT from SIDS; PHL and MNG from LGDP; IND and THA from high GDP; and NZL and AUS from the DEV group.

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<td>NA</td>
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<td>16.4</td>
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Source: Beck et al., 2003.

By 1975, Fiji’s BPRVY had increased by 28.5% to 13.7 and appears to remain more active than most SIDS and LGDP countries. Moreover, its activity level continued to be similar to New Zealand’s (14). However, Papua New Guinea (SIDS) appears to be more active (15.8) than Fiji and the Philippines continued to be more active (1.58 times).
Strong activity continued and by 1985, Fiji’s BPRVY was 25.8. The 40.5% increase in credit activity over this period was much higher than New Zealand’s 15.8% in the same period such that Fiji was now 1.3 times more active than New Zealand. Moreover, Fiji was also now more active than the Philippines (1.3 times) and Indonesia (1.6 times); Indonesia’s pre–1981 BPRVY data is not available. Further, Fiji was now more active than all LGDP and most SIDS countries; Vanuatu’s BPRVY was 30.9 (the country’s pre–1982 data is not available).

Figure 4–7: BPRVY–Fiji and selected AP countries, 1970–2001

This graph compares activity development of the banking sector (BPRVY) in Fiji with selected AP countries, including PNG and VUT from SIDS; PHL and MNG from LGDP; IND and THA from HGDP; and NZL and AUS from the DEV group.

While Fiji’s bank credit activity continued to grow into 1990, the rate of growth had declined (18.9%) such that Fiji’s BPRVY was now 30.8. While such growth was substantially more than Vanuatu’s (-2.8%) and the Philippines’ (-18.9%) so that Fiji now was more active than both, it was not sufficient to sustain Fiji’s relatively strong position against Indonesia and New Zealand. Both Indonesia’s and New Zealand’s bank activities had increased substantially in the same period, by 129.8% for Indonesia and 275.8% for New Zealand so that Indonesia was now 1.2 times and New Zealand 2.5
times more active than Fiji. In fact, New Zealand’s bank credit growth was so significant that it was now among the most active banking sectors in the region, next only to Singapore and Japan.

In the five years to 1995, Fiji’s BPRVY had increased further to 39.2 and continued to be better than all SIDS and LGDP countries, including Vanuatu and the Philippines. However, the increase was not sufficient to make the country’s bank credit to the private sector comparable to any of the HGDP and DEV countries.

By 2000, the country’s BPRVY had declined to 30.3 and was equivalent to its 1990 levels. Such decline resulted in Vanuatu (1.2 times) and the Philippines (1.3 times) now being more active than Fiji. Moreover, Vietnam, for which pre–1996 data is not available, appeared to be as active as Fiji, despite a relatively low BPRVY of 7.8 in 1996, when Fiji’s was 38.8 i.e. when Fiji was almost 5 times more active. However, Fiji was once again more active (1.5 times) than at least Indonesia.

A further decline occurred in 2001; Fiji’s BPRVY was now 29.3 and still higher than Indonesia’s 20.8 and most SIDS and LGDP countries. However, it continued to be lower than Vanuatu, Vietnam and the Philippines.

4.8.4 Banking Sector’s Strengths and Weaknesses: A Summary

To answer RQ 1–3—what are the strengths and weaknesses of the banking sector with regard to size, activity and depth—the foregoing analysis suggests that the sector has strengthened over time. Thus, evidence appears to support the relevant working hypothesis. The analysis illustrates that Fiji’s banking sector has been relatively strong across size, depth and activity aspects. That is, Fiji’s banking sector has historically
been relatively large, deep and active. Despite the post–1995 descending trends, Fiji’s banking sector appears to have become larger, deeper and more active over the years. More importantly, there is potential for further development in all of these areas.

Fiji’s banking sector has predominantly been larger, deeper and more active than countries such as Tonga, Solomon Islands, Western Samoa, Papua New Guinea, Lao, Myanmar, Mongolia, and Vietnam. Fiji has also occasionally been much larger, deeper and more active than the Philippines. Moreover, while Fiji appears to have had a less developed banking sector relative to Vanuatu at least since early 1980s, Fiji has had a larger and more active sector from late 1980s to late 1990s. Vanuatu’s exceptionally high liquidity has been a major reason for the country’s strong banking development. In this respect, Vanuatu has occasionally been among the deepest banking sectors in the Asia Pacific region, at times in second place.

Further, banking development in Fiji has over a significant part of the analysis period been much better than Indonesia’s, a HGDP country. For instance, Fiji’s banking sector has been deeper than Indonesia’s from 1970 to 1996; larger from 1970 to 1988; and more active for most of 1980s and in more recent times, since 2000.

Fiji’s level of banking development is also comparable to even New Zealand—a developed economy—over a significant proportion of the analysis period; Fiji has had a relatively larger and more active banking sector over at least 1970–87 period. Moreover, in the 1980s, the depth, size and activity of Fiji’s banking sector appear to be comparable to Australia’s.
4.9 STRENGTHS AND WEAKNESSES OF THE STOCK MARKET

This section attempts to examine RQ 1–4 i.e. what are the strengths and weaknesses of the stock market sector with regard to size, activity and depth? The relevant working hypothesis is that the market has expanded in size but activity and depth remain weak.

To examine this, the composite SM–index has been disaggregated into its basic components—MCAPY and TRADE. MCAPY is market capitalisation to GDP—a size measure of stock market development)—a rising MCAPY denotes size expansion and therefore development of the sector; a falling ratio denotes contraction of the sector. TRADE is value of stock traded to GDP—an activity measure of stock market development— a rising TRADE denotes increase in market activity and therefore development of the sector; a falling ratio denotes contraction of the sector. See appendix 2–2 for details.

4.9.1 Size Measure—MCAPY

The size of Fiji’s stock market seems to have increased over the 1995–2003 period. Moreover, it seems to have expanded rapidly from 2000, significantly outpacing Mongolia, which was comparable to Fiji up to 1999 (table 4–10). Fiji seems to have done well against the Philippines as well. The Philippines appears to be far more developed than Fiji up to 2001, especially pre–2001, however, over 2002–2003, Fiji appears to be catching up. Table 4–10 and figure 4–8 provide MCAPY of Fiji and selected AP countries; detailed results are provided in appendix 4–8.
Table 4–10: MCAPY–Fiji and selected AP countries, 1995–2003

In this table, Fiji’s situation is compared to selected AP countries, including PHL and MNG from LGDP; IND and THA from high GDP; and NZL and AUS from the DEV group.

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<td>16.0</td>
<td>65.3</td>
<td>3.6</td>
<td>18.3</td>
<td>28.3</td>
<td>36.0</td>
<td>102.3</td>
</tr>
<tr>
<td>2002</td>
<td>28.9</td>
<td>53.4</td>
<td>3.1</td>
<td>16.5</td>
<td>33.1</td>
<td>34.0</td>
<td>92.9</td>
</tr>
<tr>
<td>2003</td>
<td>34.2</td>
<td>39.6</td>
<td>3.1</td>
<td>20.4</td>
<td>56.4</td>
<td>36.1</td>
<td>93.7</td>
</tr>
</tbody>
</table>

Source: Beck et al., 2003.

Further, Fiji also appears to be comparable to most of HGDP countries in post–2000 period. By 2002, Fiji’s stock market appears to be larger than Indonesia’s and rapidly catching up with Thailand. However, while the size of Malaysia’s stock market appears to have declined over the 1995–2003 period, Fiji continues to be far less developed than Malaysia.

Figure 4–8: MCAPY–Fiji and selected AP countries, 1995–2003

In this graph, Fiji’s MCAPY is compared to selected AP countries, including PHL and MNG from LGDP; IND and THA from high GDP; and NZL and AUS from the DEV group.

Source: Beck et al., 2003.
Similarly, Fiji appears to have caught up with New Zealand (a DEV) by 2002 and was not too far behind Japan. However, the size of Fiji’s stock market still needs to increase much more rapidly to be comparable to Australia and Singapore.

Albeit still relatively small, size expansion of Fiji’s stock market appears to be the highest among the Asia–Pacific sample countries in the 1995–2003 period. Apparently, most countries—including Singapore, Japan, New Zealand, Thailand, Malaysia, Indonesia and the Philippines—appear to have experienced contractions in their stock market size over this period. Moreover, in most cases, such decline appears more noticeable in the post 2000 period. Fiji, on the other hand, appears to have grown constantly over the 1995–2003 period and strongly in the post 2000 period.

Further, while some of these markets, such as Singapore, Malaysia and Australia remain distinctly larger than Fiji, some others, which may have also been noticeably larger than Fiji’s in 1995 appear not to be so by 2003. For instance, among the DEV—New Zealand—which was significantly larger than Fiji in 1995, was almost the same size as Fiji by 2003. Among the HGDP, Indonesia’s stock market appears much smaller than Fiji’s by 2003. Among the LGDP—the Philippines which not only was considerably larger than Fiji but also larger than Indonesia, Korea, Thailand, Australia, New Zealand and Japan in 1995, appears only slightly larger than Fiji in 2003. Further, Fiji’s size in 2003 is comparable to Korea’s in 2001 and Thailand’s from 2000 to 2002.

Indeed, as figure 4–8 shows, the size of Fiji’s stock market appears much smaller than the sample countries in 1995. However, while still relatively small in 2003, rapid growth in the post 1999 period appears to make Fiji’s stock market less substantially smaller than others. For instance, in 1995, the Australian stock markets were about 25
times larger than Fiji’s but by 2003 it was only about 3 times larger. Similarly, the New Zealand stock market appears to have declined from being around 20 times larger in 1995 to about the same size in 2003. Even the largest stock markets in the sample countries in 1995 are not distinctively larger in 2003.

4.9.2 Activity Measure—TRADE

Unfortunately, in Fiji’s case, the TRADE data is more limited than MCAPY. Available only is data for 1997, 1998, 1999 and 2003. However, some meaningful insight can be drawn from even such limited data. Again, SIDS countries are excluded from the analysis due to unavailability of data and/or non–existence of stock markets.

Table 4–11: TRADE–Fiji and selected AP countries, 1997–2003

In this table, Fiji’s situation is compared to selected AP countries, including PHL and MNG from LGDP; IND and THA from high GDP; and NZL and AUS from the DEV group.

<table>
<thead>
<tr>
<th>Year</th>
<th>Fiji</th>
<th>PHL</th>
<th>MNG</th>
<th>IDN</th>
<th>THA</th>
<th>NZL</th>
<th>AUS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>0.1</td>
<td>24.2</td>
<td>1.7</td>
<td>19.2</td>
<td>15.3</td>
<td>16.2</td>
<td>41.2</td>
</tr>
<tr>
<td>1998</td>
<td>0.2</td>
<td>15.3</td>
<td>1.3</td>
<td>10.4</td>
<td>18.5</td>
<td>18.9</td>
<td>43.3</td>
</tr>
<tr>
<td>1999</td>
<td>0.1</td>
<td>25.9</td>
<td>0.3</td>
<td>13.4</td>
<td>33.8</td>
<td>19.9</td>
<td>47.9</td>
</tr>
<tr>
<td>2003</td>
<td>0.1</td>
<td>3.4</td>
<td>0.1</td>
<td>7.0</td>
<td>66.1</td>
<td>13.7</td>
<td>71.3</td>
</tr>
</tbody>
</table>

Source: Beck et al., 2003.

While the size of the stock market (MCAPY) in Fiji may have increased over the 1995–2003 period, market activity or liquidity appears not to have increased proportionately. In fact, Fiji appears to have performed so poorly in this aspect that there is little basis for comparison with the sample countries for which comparative data is available (table 4–11). For instance, its trading activities appear even inferior to Mongolia’s, which not only appears to have the smallest stock market among the sample countries almost constantly over the 1995–2003 period but has also had rather unimpressive size development over this period. Table 4–11 and figure 4–9 provide TRADE of Fiji and selected AP countries; detailed results are provided in appendix 4–9.
Fiji’s trading activities appear to be even worse than Indonesia’s, whose stock market size had gradually declined to be smaller than Fiji’s by 2003. While Fiji may have done well in size development against even the more developed countries (e.g. New Zealand) or historically large stock markets (e.g. Australia, Singapore), its trading activity appears substandard and disappointing against the entire sample countries.

**Figure 4–9: TRADE–Fiji and selected AP countries, 1997–2003**

In this graph, Fiji’s MCAPY is compared to selected AP countries, including PHL and MNG from LGDP; IND and THA from high GDP; and NZL and AUS from the DEV group. The selected countries are the same as that in table 4–5, excluding SIDS countries due to non-existent of market and/or unavailability of data.

![Graph showing trade comparison](image)

Source: Beck et al., 2003.

In 1997, while the size of Fiji’s stock market appears equivalent to Mongolia’s, its trading activity was about 18 times less than Mongolia’s and continued to be notably less in the following years. Similarly, while the Indonesian stock market was only 7 times larger than Fiji’s in 1997, its market liquidity was many times more. In 1998, Indonesia was only 5 times larger but its liquidity was substantially more. By 2003, the activity gap between the two countries had narrowed slightly but remained significantly large. Similar patterns emerge when comparing Fiji’s trading activities against other countries. Excluding Mongolia, which had similar activity to Fiji’s in 2003, the lowest among the other sample countries—the Philippines’ liquidity was 38 times better than Fiji’s.
4.9.3 **Market Efficiency—TURN**

Although efficiency has not been included in the SM–Index for reasons of consistency with the B–Index, where efficiency was not included due to unavailability of relevant data, some inference can be made about the efficiency of the stock market as some data for this is available. However, available data is as restrictive as that of TRADE and therefore the analysis is similarly restricted.

To measure stock market efficiency, TURN—the ratio of the total shares traded to market capitalisation—is used, i.e. the ratio of stock market activity or liquidity (TRADE) to market size (MCAPY). Given that this indicator is the ratio of a stock to flow variable, the BDL data has been deflated using a procedure similar to that of MCAPY. A small but active stock market is expected to have high TURN values; a large but less active market is expected to have low values—larger values indicate better stock market development.

While the TURN values appear to be somewhat larger than TRADE values, their continued relative triviality continues to restrict meaningful comparative analysis. However, given that TURN values are predominantly determined by TRADE values, in view of Fiji’s rather inactive stock market, the country’s market also appears relatively inefficient.

4.9.4 **Stock Market Strengths and Weaknesses: A Summary**

To answer RQ 1–4—what are the strengths and weaknesses of the stock market sector with regard to size, activity and depth—the foregoing analysis suggests that the market may have expanded in size but remains weak in activity and depth. Thus, evidence
appears to support the relevant working hypothesis. Evidently, activity and efficiency of Fiji’s stock market have been and continue to be substantially low relative to the sample countries. In fact, Fiji may have performed very poorly in these areas. Thus, further stock market development in Fiji may require a huge effort. However, the situation is not entirely gloomy. Some hope has been offered by the strong positive size development of the sector. Among other things, the size development indicates that firms may have some willingness to list; recent trends indicate that more firms may list. The issue at hand would now be to encourage more trading and sale of new shares.

4.10 CHAPTER SUMMARY

This chapter addressed RQ 1: how well has the financial sector in Fiji developed in the past and what are its strengths and weaknesses? The answer to this question is investigated using a comprehensive world-wide database and cross-country comparative analysis. The comparator countries include twenty developing and developed countries of the Asia-Pacific region. The developing countries were grouped into South Pacific Island (SIDS), low GDP (LGDP) and high GDP (HGDP) countries. Moreover, the main question was decomposed into the following related and more specific questions: (RQ 1–1) how well has the banking sector developed over the period 1970–2003? (RQ 1–2) how well has the stock market developed over the period 1970–2003? (RQ 1–3) what are the strengths and weaknesses of the banking sector with regard to size, activity and depth? and (RQ 1–4) what are the strengths and weaknesses of the stock market sector with regard to size, activity and depth?

Results show that Fiji’s banking sector may have been more developed relative to a number of countries over selected periods of time. For example, it was (i) more
developed relative to most SIDS (except Vanuatu)\textsuperscript{4–7} countries over 1970–2001; (ii) more developed relative to most LGDP countries up to at least 1995 (iii) more or similarly developed to at least one HGDP country (Indonesia) over 1970–2001; and (iv) comparable to at least two developed countries (New Zealand and Australia) until 1985. Thus, Fiji’s banking sector appears to have developed relatively well.

Further, Fiji’s banking sector has become larger, deeper and more over the years. More importantly, there appears to be prospect for further development in all of these areas and thus of the banking sector. Moreover, the extent of such development appears considerable. However, Fiji’s stock market appears to have consistently been among the least developed across the sample countries. Although the pre–1996 data is not available, the trends indicate that Fiji’s stock market in that period may have been very small and inactive. However, some development appears to be emerging, particularly toward the end of the analysis period. By 2003, Fiji’s state of development appears to have improved relative to a number of countries, including developed countries that it rated poorly against earlier.

Moreover, while further stock market development is possible, it may require a huge effort; activity and efficiency of Fiji’s stock market have been, and continue to be, substantially low relative to the sample countries. In fact, Fiji may have performed very poorly in these areas. However, the situation is not entirely gloomy. Some hope has been offered by the strong positive size development of the sector. Among other things, the size development indicates that firms may have some willingness to list; recent trends indicate that more firms may list.

\textsuperscript{4–7} Vanuatu’s pre–1985 data is not available but available data shows Vanuatu to be better developed than Fiji.
Evidently, the banking industry may be developed much more promptly and rapidly; stock market development would be much slower and require a huge effort. Thus, for economic growth and other benefits of financial development, it would be in the interest of policy makers and other relevant authorities to focus more on developing the banking sector rather than the stock market. Yet, the current focus appears to be more on developing the stock market, with little, if any, talk about developing the banking sector.

In any case, it is the volume of activity in both the banking and stock markets that needs to be enhanced, as this would mean more funds available to the private sector, which while fostering financial development may also foster economic growth (see section 2.4 for details). For the banking industry, the question is how to enhance bank credit to the private sector and for the stock market is how to encourage more issuing and trading of new shares. These issues are the subject of the ensuing chapters.
Chapter 5

Legal Institutions and Financial Development in Fiji

5.1 OVERVIEW

This chapter examines the influence of a key supply–side determinant of financial development—legal institutions—on Fiji’s financial development. In essence, the chapter addresses the second research question (RQ 2) of this study—what is the role of legal institutions\textsuperscript{5-1} for financial development in Fiji?

The supply–side legal theory of financial development asserts that the legal protection of investors (suppliers of funds)\textsuperscript{5-2} is critical for continued and increased supply of funds to the financial sector and thereby for constructive development of financial systems (e.g. La Porta et al., 1998). Legal investor protection encompasses both the mandating of legal rights and the appropriate enforcement of these rights.

Investors are the suppliers of funds to the private sector firms for their formation and growth, activities that underpin financial development. Funds may flow from the ultimate suppliers (such as households) to business firms indirectly (i.e. via financial intermediaries, such as commercial banks) or directly (e.g. facilitated by financial markets, such as stock markets). See figure 5–1 below, reproduced from Chapter 2. Funds that flow via financial intermediaries would be at the discretion of the intermediary. Such funds are normally issued as loans or credit and are expected to be paid back with interest. The intermediaries then become creditors of the private sector

\textsuperscript{5-1} ‘Legal institutions' as used in this study incorporates both the 'legal rights' of investors and the 'quality of enforcement' of these rights, which in turn may be influenced by factors such as constitutional, political and legal developments, including political coups. In this study, the survey of opinions regarding the quality of law enforcement was conducted in 2006, thus it reflected, to some extent, the effects of the 1987 and the 2001 coups.

\textsuperscript{5-2} It must be noted again that investors include creditors and shareholders. With respect to creditors, this study focuses on commercial banks. While depositors (households and others) may supply funds to commercial banks, their legal protection is usually well defined in legislature across countries.
firms. Thus, adequate legal protection of such creditors appears important for the development of intermediaries and thus for financial development.

Funds that flow directly to ultimate demanders would be at the discretion of the ultimate suppliers. Stock markets being a primary means of organised funds transfer here, the suppliers of funds need to purchase shares in firms and thereby become their shareholders. Thus in this case, it would be the legal protection of the shareholders that would matter for the supply of non-intermediated funds, development of financial markets, and more generally, financial development.

**Figure 5–1: Financial development: A supply perspective**

The volume and extent of the flow of funds from the ultimate suppliers to the ultimate demanders via organised channels determine the level of a country’s financial development. Such funds may be transferred via financial intermediaries and/or markets. The former process involves supply of credit and the latter, supply of equity funds, at the discretion of intermediaries and ultimate suppliers, respectively. Suppliers discouraged by financial sector conditions may supply their funds to firms via alternative channels.

Answers to RQ 2 appear important for exploring ways to accelerate financial development in Fiji, from a supply perspective. If it is established that legal institutions have been essential for past financial development in Fiji and are likely to be essential for further development then the legal theory would be shown to hold in the case of Fiji and there would be a strong case to strengthen legal institutions as a priority. However, if legal institutions have not been and/or are not likely to be essential for further development then the legal theory may be less applicable in the case of Fiji.
The rest of the chapter is organised as follows. The next section outlines the specific research questions to be addressed in this chapter and discusses the prior expectations relating to each of these questions. Section 5.3 assesses the level of legal rights of creditors and shareholders and the quality of law enforcement. Section 5.4 examines the influence of legal institutions on historical financial development in Fiji. Section 5.5 considers the importance of legal institutions for further financial development. Section 5.6 summarises the main findings of the chapter and identifies some important gaps that remain in knowledge about these matters.

5.2 SPECIFIC QUESTIONS AND PRIOR EXPECTATIONS

The main question being addressed in this chapter—what is the role of legal institutions in Fiji’s financial development—may be investigated more effectively by examining the following, related sub-questions.

Historically,

RQ 2–1: what has been the level of legal rights of creditors?
RQ 2–2: what has been the level of legal rights of minority shareholders?
RQ 2–3: what has been the quality of enforcement of these rights?
RQ 2–4: how may legal institutions have affected banking development? and
RQ 2–5: how may legal institutions have affected stock market development?

Potentially,

RQ 2–6: is enhancement of legal institutions important, or even essential, for further banking development? and
RQ 2–7: is enhancement of legal institutions important, or even essential, for further stock market development?

Prior expectations or ‘working hypotheses’ have been formed regarding each of these sub-questions based on:
(i) the supply of law argument;
(ii) the demand for law argument; and
(iii) findings from Chapter 4 (financial development in Fiji).

Essentially, the supply of law argument asserts that legal origin (supply) determines the adequacy/quality of legal institutions such that countries with common law heritage tend to have better legal protection while countries with French civil law tend to have poorer legal protection for investors (see chapter 2 for details). Laws in Fiji, as in most parts of the South Pacific region, including Australia and New Zealand, have been modelled on the English common laws. The English legal and government systems were imposed on Fiji during the 1874–1970 colonisation period. Investor protection laws in Fiji, thus, have originated from the English common law.

In view of the above, it is expected that both the creditor and minority shareholder rights and law enforcement mechanisms in Fiji have been historically strong and/or have progressively improved. On this basis, it can be expected that legal institutions may have played a key role in any banking and/or stock market development in the past. However, Chapter 4 demonstrates, inter alia, that while the development of the banking sector may have been positive in the past that of the stock market has not been impressive. This suggests that at least the legal rules of creditors (banks are creditors) may have been historically strong and/or progressively improved but that of shareholders may have been historically weak and unimproved.

An alternative, competing theory as to how legal institutions may affect financial development is the demand for law argument (e.g. Berkowitz et al., 2003; Pistor, 2002). For legal institutions to be effective, Berkowitz et al. (2003) argue that investors should
demand for it so that the legislated laws become functional. Demand in turn requires
the law to be contextually meaningful so that users (investors) would have an incentive
to use and demand relevant authorities (law makers and enforcers) to enforce and
develop it; development requires that legal intermediaries and institutions enhance its
quality responsively. This argument may well apply in the case of Fiji, for reasons
outlined below.

It has been observed that a gap frequently exists between the rules in the books and
those in practice (e.g. Pistor, 2002). Given that this gap exists even in the countries
where laws originated (origins), it would be reasonable to expect a larger gap in
countries that borrowed or were imposed with these laws (transplants). Indeed,
Berkowitz et al. (2003) do find legal institutions in the origins to be significantly more
effective than in transplants. The results hold even when controlling for GDP,
suggesting that wealth *per se* does not determine effectiveness of institutions (La Porta
et al., 1998).

For a ‘transplant’ country like Fiji, it is reasonable to expect that the proper functioning
of imported investor laws requires that the country’s investors be not only aware but
also understand the importance and implications of the existence and/or absence of
relevant laws. In applying a transplanted rule, the transplant country is effectively
applying the rule developed in foreign circumstances to its own, most likely different,
local circumstances, resulting in the likelihood of different interpretations of the same
rule. Such ambiguous interpretations may lead to either the rule not being applied at all
or applied in a manner inconsistent with the original perception and intention.
Consequently, the perception and trustworthiness of institutions implementing these
rules may become suspicious, having negative implications for future demand for legal institutions.

An implication of the argument advanced by Berkowitz et al. (2003) is that if Fiji has adopted the English laws in a manner sensitive to local conditions, the rules would have become more meaningful and enforcement more effective. Further, the use of these rules would be much more extensive with a much greater desire to allocate resources for further enforcement and development. Moreover, institutions and intermediaries responsible for enforcement and development would be working more effectively.

Further, if Fiji has adopted and thus given meaning to the English investor laws then it would be deemed to have been receptive to the foreign laws (Berkowitz et al., 2003). The legal–adaptability channel (Beck et al., 2001a) is based on the premise that a transplant’s legal system may need to adapt to the country’s changing commercial and financial conditions to maximise the finance–growth outcome. Systems that adapt slowly to these changes are likely to exhibit wider gaps between the commercial and financial needs of the economy and the ability of the legal system to efficiently support these needs.

Signs of adaptability or adaptation may be evident in any level of ‘change’ made to the transplanted laws as this would indicate that the suitability of the foreign rules had been considered and amendments made accordingly to incorporate local conditions and practices (Berkowitz et al., 2003). Adaptation may not necessarily require significant changes; merely making an informed choice about alternative laws may suffice. An informed choice may be reflected by an extensive comparative research before adopting a set of foreign rules. Adaptation, however, may not be necessary if a country is
familiar with the imposed or borrowed legal system, such as where countries share a common but not too distant, legal history.

As assessed by Hughes and Ahmadu (2001), law makers in Fiji have not made significant changes to either the creditor or the shareholder legal rules nor conducted a comparative study of available laws to identify the best for local conditions. Therefore, it is expected that the English investor laws have not been well adapted to suit local conditions. Further, Fiji was ‘colonised’ with English common laws and appears not to have had much choice in the initial enactment or implementation processes. Moreover, it is expected that the locals were not given an opportunity to familiarise themselves with the enacted laws.

In view of the less favourable socio-economic and political background of the country it is reasonable to believe that majority, if not all, of the minority shareholders in Fiji would be locals. A quick perusal of the stock exchange’s shareholding information appears to confirm this belief. Thus, in view of the lack of adaptability and familiarity argument presented above, investor laws, especially rules, are expected to be relatively unimportant to these shareholders. Consequently, there may not have been an incentive to use and/or demand relevant authorities to develop the rules. Thus, according to the demand for law argument, legal rules of shareholders in Fiji are expected to be historically weak and unimproved. This expectation appears to be reinforced by findings from chapter 4—past stock market development appears to be disappointing, which may have been due to, inter alia, the historically weak and unimproved shareholder legal rules.
While the shareholders in Fiji may mainly be locals, the major creditors are Australian banks. Laws in Australia too were transplanted from England, however, unlike the case in Fiji, the English ‘settled’ in Australia, bringing the English laws with them. Thus, at least the Australian banks would generally be more familiar with the transplanted laws. Therefore, the major creditors in Fiji are expected to be familiar with the country’s investor laws. In turn, these major creditors may have had an incentive to use and demand relevant authorities to enforce and develop investor laws. Accordingly, creditor legal rules in Fiji are expected to be historically strong and/or improved over the years. This expectation also appears to be reinforced by findings from Chapter 4—the banking sector appears to have developed positively in the past, which may have been due to, *inter alia*, the historically strong and/or progressively improved creditor legal rules.

Both the supply and the demand for law arguments in conjunction with findings from Chapter 4 suggest that legal rules for creditors may also have historically been strong and/or progressively improved but that of shareholders may have been historically weak and unimproved. However, given that legal institutions constitute both rules and enforcement quality, it is also possible that even creditor rules may not have been as strong, rather high quality enforcement may have been the reason for positive banking development in the past. The counter argument, based on the stock market scenario, is that even the quality of enforcement may not have been adequate.

With regard to the importance of legal institutions for further stock market development, while a high proportion of the shareholders (including potential) may be unfamiliar with the specifics of individual rules and regulations, they may well be familiar with the basic notion of legal protection, especially, the importance and implications of enforcement. Thus, despite a possible lack of knowledge and
understanding of the specific laws, shareholders are generally expected to rate highly the need for legal protection for stock market participation. In any case, if stock market development is seen to be as important as banking development in Fiji, enhancement of supporting legal institutions would appear to be important.

Similarly, while the banking sector may have developed positively in the past, bank credit to private sector (BPRVY, as denoted in this study) appears to have declined in the post–1995 period despite the constantly high liquidity levels. ADB (2001b) cites ‘the difficulty in using the legal system for collecting on non–performing loans’ (p15), as a reason for the lack of bankable projects. Could this be a main reason for the decline in BPRVY and thus banking development in the post–95 period? Is it the case that legal institutions have not been able to keep up with creditor demands? In any case, in view of the declining BPRVY and given the importance of this for financial development, visible enhancement of legal institutions would only serve to stimulate further development of the banking sector.

While enhancement of legal institutions may be important for further banking development in Fiji, it may not be essential, as the sector appears to have developed well in current circumstances. Moreover, given that banking profits have only tended to rise in the post–1995 period (e.g. White, 1999), it is possible that banks’ business strategies have changed such that credit activities have become less important for making profits. Thus, future BPRVY may not change desirably regardless of the adequacy of legal institutions.

Similarly, enhancement of shareholder legal rules may also not be essential as the expected lack of specific knowledge may imply that the law itself will be less essential
for further stock market development; enforcement though, being a more subjective matter, may perhaps be more important.

On the basis of the above, the prior expectations are that legal rights of creditors have historically been strong and/or progressively improved but that of the shareholders have historically been weak and have not improved and that law enforcement has historically been of average quality. It is also expected that legal rights have played an important role in banking development but not law enforcement and that both have not been important for stock market development. Further, enhancement of legal institutions is expected to be important, but not essential, for further banking and/or stock market development.

5.3 **LEGAL INVESTOR PROTECTION IN FIJI**

This section assesses the level of legal rights of creditors and shareholders and the quality of law enforcement. La Porta et al. (1998) variables are used to determine the level of investor legal rules in Fiji, which have been sourced from the country’s Companies and Bankruptcy Acts. The study’s sample countries are used for comparative analysis, where Fiji’s situation is compared with the averages of countries in different legal origin categories and also with countries in the Asia Pacific region. Further details can be found in section 3.4.

The main legal rights of creditors and shareholders in Fiji are enshrined in the Companies Act, 1985, which is a revised edition of the 1967 Act. The Companies Act in Fiji was first introduced in 1925, modelled on the United Kingdom Companies Act of 1925. While there have been two revisions since the first introduction, the rights of creditors and shareholders in Fiji have not changed since 1925.
5.3.1 Legal Rights of Creditors

This section attempts to examine RQ 2–1 i.e. what has been the level of legal rights of creditors in Fiji? In this study, the creditors are confined to the commercial banks. A review of the relevant theory and findings from Chapter 4 led to the prior expectation that legal rights of commercial banks in Fiji may have historically been strong and/or progressively improved.

Five variables are used to assess creditor rights (CR), namely: automatic stay on assets (STAY); ranking in distribution of profits (RANK); consensual procedures for going into liquidation (CONSENT); management’s power in reorganisation (MANAGE); and legal capital reserve requirement (RESERVE). STAY is a measure of the ability of secured creditors to gain possession of collateral following issue of a reorganisation petition. RANK reflects the ranking of creditors in the distribution of proceeds from a disposition of assets. CONSENT is in relation to filing for liquidation—management may have powers to unilaterally file for reorganisation without creditors’ consent or such consent may legally be required. MANAGE looks at the rights of management (borrowing company’s) pending a resolution of reorganisation; it may have legal rights to continue managing the company or it may be required to exit the company.

A score of 1 is assigned if legal rules relating to these variables are in favour of creditors, 0 otherwise. Scores of the first four variables are aggregated to obtain a creditor rights index (CRI) where values could range from 0 to 4; with higher scores indicating stronger legal protection of creditors from managers. A legal system is deemed to favour creditors against management and thus is ‘pro–creditor’ or ‘anti–management’ where, STAY is not allowed (secured creditors are able to gain possession of collateral following issue of a reorganisation petition); RANK is first (secured creditors are ranked first in the distribution of proceeds from disposition of assets);
CONSENT is required (creditors’ consent is required in filing for reorganisation; management can not file unilaterally); and MANAGE is not allowed (management’s right to continue managing ceases pending resolution of reorganisation). RESERVE is a remedial measure, essentially compelling firms to maintain a minimum capital level to avoid liquidation.

Fiji scores zero on each of the first four variables (table 5–1, below), giving an overall creditor rights index (CRI) score of zero as well. (CRI equals the sum of the scores of the first four variables i.e., STAYS, RANK, CONSENT and MANAGE). That is, secured creditors in Fiji do not have legal powers to gain possession of their collateral following issue of a reorganisation petition (STAY = 0); are not legally ranked first in the distribution of proceeds from disposition of assets (RANK = 0); their consent is not legally required in filing for reorganisation i.e. management may file unilaterally (CONSENT = 0); and management of the firm in liquidation may continue to manage pending resolution of reorganisation and therefore threat of dismissal does not exit (MANAGE = 0).

RESERVE—a remedial creditor rights measure—is used as a substitute for weak legal protection of creditors. Countries with weak legal protection of creditors are expected to have RESERVE (a legal reserve requirement) in place. RESERVE compels firms to maintain a certain level of capital to avoid automatic liquidation; it protects creditors against complete waste and/or misappropriation of capital by insiders. In Fiji’s case, creditors are deprived of even this legal protection.

The CRI score of zero implies that Fiji’s legal system strongly favours management against creditors and thus is primarily ‘pro–management’ or ‘anti–creditor’. Such scoring places Fiji among the worst in terms of legal creditor protection across the 49
comparator counties; it is the worst across the English group and much lower than even the worst of legal origin category averages—the French average (1.58) (table 5–1, panel A). Countries in the La Porta et al. (1998) sample with CRI equal to zero include Columbia, France, Mexico, Peru and the Philippines—all in the French group.

Table 5–1: Creditor legal rights—Fiji and the rest of the world

Panel A of table 5–1 compares Fiji’s creditor rights with other countries, where values could range from 0 to 4; with higher scores indicating stronger legal protection of creditors from managers. The 49 comparator countries are categorised according to their legal origin, being English (18), French (21), German (6) or Scandinavian (4), which spans across Europe, North and South America, Asia and Australia. The zero scores for Fiji indicate that creditors in Fiji do not have these legal rights; Fiji’s situation thus is weak against the averages of various sub–groups and the total sample.

Panel B compares Fiji’s creditor rights with the Asia–Pacific countries, which, excluding China, are from the 49 comparator countries.

Panel A: Fiji and rest of the world classified by legal origin

<table>
<thead>
<tr>
<th>Legal Origin</th>
<th>STAY</th>
<th>RANK</th>
<th>CONSENT</th>
<th>MANAGE</th>
<th>CRI</th>
</tr>
</thead>
<tbody>
<tr>
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<td>0.89</td>
<td>0.72</td>
<td>0.78</td>
<td>3.11</td>
</tr>
<tr>
<td>French</td>
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<td>0.65</td>
<td>0.42</td>
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</tr>
<tr>
<td>German</td>
<td>0.67</td>
<td>1.00</td>
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<td>0.33</td>
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</tr>
<tr>
<td>Scandinavian</td>
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</tr>
<tr>
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</tr>
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<td>Fiji</td>
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<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
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</table>

Panel B: Fiji and Asia–Pacific

<table>
<thead>
<tr>
<th>Country</th>
<th>STAY</th>
<th>RANK</th>
<th>CONSENT</th>
<th>MANAGE</th>
<th>CRI</th>
</tr>
</thead>
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<td>1</td>
<td>4</td>
</tr>
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<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Malaysia</td>
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<td>1</td>
<td>4</td>
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<td>1</td>
<td>3</td>
</tr>
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<td>Sri Lanka</td>
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<td>1</td>
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<td>0</td>
<td>0</td>
<td>0</td>
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<td>0.7</td>
<td>0.6</td>
<td>0.6</td>
<td>0.8</td>
<td>2.8</td>
</tr>
</tbody>
</table>

Source: LLSV (1998), except China (Allen et al., 2005) and Fiji (present research). LLSV data is for 1993 and Fiji data has not changed since 1925.

Fiji’s relatively weak legal creditor protection is also evident in panel B of table 5–1, which compares Fiji’s situation with other less developed countries (LDCs) in the Asia–
Pacific (AP) region. Across the ten LDC countries, Fiji’s ranking is the worst (equal only to that of the Philippines). The lowest CRI score among the LDCs (excluding Fiji and the Philippines) is two—for China—all others have a score of three or more, with five countries having the best (CRI = 4) legal rights protection laws, better than even some developed countries such as Australia and the United States. All other LDCs are at least 50% better than Fiji.

To answer RQ 2–1, the foregoing suggests that the level of legal rights of creditors has been historically weak and/or not progressively improved. This finding appears inconsistent with (i) the supply of law argument—that origin determines the quality of law; (iii) the demand for law argument—that familiarity may have resulted in strong creditor legal rules; and (iii) findings from Chapter 4—that the positive banking development may have been due to strong creditor rules. Creditor rules in Fiji have historically been neither strong nor progressively improved. Thus, the prior expectation—that the legal rights of creditors in Fiji have historically been strong and/or progressively improved—is not borne out by the evidence. Instead, it appears that the level of legal rights of creditors has always been weak.

5.3.2 Legal Rights of Shareholders

This section examines RQ 2–2, i.e. what has been the level of legal rights of minority shareholders in Fiji? A review of the relevant theory and findings from Chapter 4 led to the prior expectation that legal rights of shareholders may have historically been weak and have not improved.

Variables for shareholder rights (SHR) include proxy voting by mail (PROXY); share blocking before meetings (BLOCK); cumulative voting/proportional representation on board of directors (VOTE); legal protection against perceived oppression (OPP); preemptive rights to new issues (PRE); percentage of share capital needed to call an
extraordinary shareholders’ meeting (PERC); one–share–one–vote (ONE); and mandatory dividend (MAND).

PROXY significantly encourages and allows shareholders to exercise one of their fundamental rights; rules that require voting in person, or by an authorised representative, deprive shareholders of this basic right. Thus, a country that legally allows voting by mail is deemed to provide the best protection to minorities. BLOCK addresses a fundamental right to transfer shares; laws requiring shareholders to deposit their shares with the company or a financial intermediary several days prior to the meeting or controlling shareholders ability to block share transfers imply that the shareholders can not transfer shares at will. VOTE, which empowers minorities via more effective representation on boards, appears to be an effective means of measuring the protection of shareholder rights. While controlling shareholders still get to elect most board members, minorities too have a say in electing without the support of controlling shareholders.

PRE protects minority shareholders from dilution of their shares, which occurs when new shares are issued to favoured investors, related parties or controlling shareholders at substantially discounted prices. ONE indicates that dividend rights are tightly linked to voting rights, which dilutes dominance by insiders. Such powers can be diluted in many ways including via non–voting shares, low– and high–voting shares, founders’ shares with extremely high voting rights, voting rights determined by duration of shares, or directly restricting the total number of votes regardless of the number of shares held. MAND is treated differently from others; it is presumed to be a legal substitute for weaknesses in other measures.
The first six variables, referred to as anti–director rights (ADR), measure how well national laws protect minority shareholders from management and/or controlling shareholders; a fundamental function of corporate governance. A legal system is deemed to provide the best protection to minorities against management and/or controlling shareholders and thus is ‘anti–director’ where, PROXY, VOTE, and PRE are allowed; BLOCK is not allowed; PERC is less than or equal to the world median of 10; and OPP is in place.

For each of the first five variables, a score of 1 is assigned if the law favours minorities, 0 otherwise. In case of the sixth ADR, a lower percentage is deemed to favour minorities; thus, a score of 1 is assigned if the required percentage is at or below the world median of 10 and 0 otherwise. The scores of these six variables are then aggregated to obtain an ‘anti–director’ rights index (ADRI). The ADRI could range between 0 to 6, with higher scores indicating stronger legal protection of minority shareholders from managers and controlling shareholders.

ONE is also deemed to provide strong protection for minorities; a score of 1 is assigned if a country has ONE rule only, i.e. in the absence of all of the other rules/practices; 0 otherwise. The mandatory dividend (MAND) measure of SHR is treated differently from others; it is a legal substitute for weaknesses in other measures.

Table 5–2 shows that minority shareholders in Fiji do not have a legal right to mail their votes (PROXY = 0), can not legally elect their representatives on the board of directors (VOTE = 0), and do not have legal pre–emptive rights to new issues (PRE = 0). On a positive note, however, they are not legally required to deposit their shares prior to a meeting (BLOCK =1), have legal protection against perceived oppression (OPP = 1);
and require only 10 percent of share capital to call an extraordinary shareholders’ meeting (PERC = 1).

**Table 5–2: Shareholder legal rights—Fiji and the rest of the world**

Panel A of table 5–2 compares Fiji’s shareholder rights with 49 other countries categorised per their legal origins. A zero score for Fiji indicates that shareholders in Fiji do not have the respective legal right; a score of one indicates existence of the respective right. Fiji’s ADRI is 3; the ADRI scores could range from 0 to 6, with higher scores indicating better legal protection. Fiji’s situation thus is strong compared to the averages of various sub–groups and the total sample.

Panel B compares Fiji’s shareholder rights with the Asia–Pacific countries, which, excluding China, are from the 49 comparator countries.

| **Panel A: Fiji and rest of the world classified by legal origin** |
|----------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Legal Origin         | PROXY | BLOCK | VOTE | OPP | PRE | PERC | ADRI |
| English              | 0.39  | 1.00  | 0.28 | 0.94 | 0.44 | 0.09 | 4.00 |
| French               | 0.05  | 0.57  | 0.29 | 0.29 | 0.62 | 0.15 | 2.33 |
| German               | 0.00  | 0.17  | 0.33 | 0.50 | 0.33 | 0.33 | 2.33 |
| Scandinavian         | 0.25  | 1.00  | 0.00 | 0.00 | 1.00 | 0.10 | 3.00 |
| Sample Ave           | 0.18  | 0.17  | 0.27 | 0.53 | 0.53 | 0.11 | 3.00 |
| **Fiji**             | 0.00  | 1.00  | 0.00 | 1.00 | 0.00 | 1.00 | 3.00 |

<table>
<thead>
<tr>
<th><strong>Panel B: Fiji and Asia–Pacific</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Country</strong></td>
</tr>
<tr>
<td>Hong Kong</td>
</tr>
<tr>
<td>India</td>
</tr>
<tr>
<td>Pakistan</td>
</tr>
<tr>
<td>Malaysia</td>
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<td>China</td>
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<tr>
<td><strong>Fiji</strong></td>
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<tr>
<td>South Korea</td>
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<tr>
<td>Thailand</td>
</tr>
<tr>
<td><strong>Sample Ave</strong></td>
</tr>
</tbody>
</table>

Source: LLSV (1998), except China (Allen et al., 2005) and Fiji (present research). LLSV data is for 1993 and Fiji data has not changed since 1925.

Fiji’s ADRI thus equals 3, which is the same as the Scandinavian and total sample averages (table 5–2, panel A); the Scandinavian average ranks only second to the best protection in the world, provided by English common law. Moreover, Fiji is better than French and German averages. Against this background, perhaps, MAND is not warranted; the relevant legislations do not require companies in Fiji to pay out a certain
fraction of their declared earnings as dividends. Further, a one–share–one–vote (ONE) is also not legally mandated.

Compared to the developing AP countries (panel B, table 5–2), Fiji falls somewhere in the middle in terms of ADRI rankings. Fiji’s ADRI is similar to that of China, the Philippines and Sri Lanka, better than Indonesia, South Korea and Thailand and very close to sample averages. This rating contrasts with creditor rights, which was the worst across the sample.

To answer RQ 2–2, the above analysis suggests that despite the lack of progressive improvements, the level of legal shareholder rights in Fiji may historically have been relatively strong. This finding does appear consistent with (i) the supply of law argument—that origin determines the quality of law. However, it appears inconsistent with (ii) the demand for law argument—that lack of familiarity and/or adaptability would have resulted in weak shareholder legal rules; and (ii) findings from Chapter 4—that the weak stock market development could be a result of weak legal rules. The relevant working hypothesis was influenced by (ii) and (iii) above—suggesting that shareholder rules in Fiji would historically be weak and/or not progressively improved. The evidence does not appear to support the prior expectation. Instead, it appears that the level of legal shareholder rights in Fiji have always been relatively strong.

5.3.3 Quality of Law Enforcement

In examining the adequacy of legal protection of investors in Fiji, I am able to assess the adequacy of rules only at this stage; relevant data on the quality of enforcement is not available. However, this aspect is analysed later in the chapter (section 5.5) when the views and opinions of the shareholders, creditors and other stakeholders are examined on the importance of legal institutions for financial development in Fiji. Thus, RQ 2–
3—what has been the quality of enforcement of investor rights in Fiji—is examined later. Nevertheless, an assessment of the rules only is an important first step towards an assessment of legal institutions; one needs to keep in mind that enforcement quality may not matter if the rules did not exist.

5.4 LEGAL INSTITUTIONS AND FINANCIAL DEVELOPMENT: A HISTORICAL PERSPECTIVE

This section examines RQ 2–4 and 2–5, that is, it examines the influence of legal institutions on historical financial development in Fiji. Due to lack of ‘enforcement quality’ data on Fiji at this stage, the analysis in this section is confined to legal rules only; analysis on law enforcement is conducted later, in section 5.5.

5.4.1 Banking Development

This section examines RQ 2–4 i.e. how may legal institutions have affected banking development in Fiji? A review of the relevant theory and findings from Chapter 4 led to the prior expectation that legal rights have played an important role in banking development but not law enforcement.

Since the rights of creditors have not changed since 1925, STAY, RANK, CONSENT and MANAGE and CRI would not have changed over the 1970—2003 period—the period of financial development analysis conducted in chapter 4. Table 5–3 below illustrates this fact.

Creditor rights have constantly been very weak and not changed over the entire 1970–2003 period. In contrast, Fiji’s banking sector shows signs of positive development over the same period (see Chapter 4 for details); by most measures, development had been positive until at least 1995. This appears to indicate that legal rules may not have
been important for commercial banks in Fiji. Is it then the case that, perhaps, the banks have been satisfied with the *quality of law enforcement*?

**Table 5–3: Creditor legal rights and banking development in Fiji, 1970–2000**

Table 5–3 attempts to trace changes in banking development measures such as LLY (liquid liabilities to GDP), BANKY (bank assets to GDP), BPRVY (bank private sector credit to GDP) and the composite banking development index (B-Index—developed in chapter 4) over 1970–2003 that may have resulted from a change in a fundamental creditor legal right, such as STAY. Fiji’s creditor rights values come from table 5–1; banking development values come from chapter 4. As table 5–3 shows, creditor rights have not changed and been constantly weak over this period, however, banking development measures have changed.

<table>
<thead>
<tr>
<th>Year</th>
<th>STAY</th>
<th>RANK</th>
<th>CONSENT</th>
<th>MANAGE</th>
<th>CRI</th>
<th>B–Index</th>
<th>LLY</th>
<th>BANKY</th>
<th>BPRVY</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>16.9</td>
<td>31.1</td>
<td>15.1</td>
<td>10.7</td>
</tr>
<tr>
<td>1975</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>19.1</td>
<td>30.3</td>
<td>18.7</td>
<td>13.7</td>
</tr>
<tr>
<td>1980</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>23.7</td>
<td>32.7</td>
<td>25.2</td>
<td>18.4</td>
</tr>
<tr>
<td>1985</td>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>30.6</td>
<td>37.2</td>
<td>33.6</td>
<td>25.9</td>
</tr>
<tr>
<td>1990</td>
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</tr>
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</tr>
<tr>
<td>2000</td>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>35.3</td>
<td>43.4</td>
<td>37.3</td>
<td>30.3</td>
</tr>
</tbody>
</table>

How then have legal institutions affected banking development in Fiji? This question is examined by illustrating the above situation in figure 5–2 below. Variables for creditor legal rules include STAY, RANK, CONSENT and MANAGE; that for enforcement include EFJS, RoL, COR, EXP and REP. All of these variables form legal institutions, which per literature, matters for banking development—and thus should be reflected by positive changes in depth (LLY), size (BANKY) and activity (BPRVY).

Figure 5–2 illustrates that a change in legal rules and/or enforcement mechanisms is likely to result in a corresponding change in size, activity and/or depth of a banking sector. For example, Levine (1999) finds that countries that allow STAY tend to have lower BPRVY. Similarly, where MANAGE is allowed and RANK is not first, financial intermediaries are less well developed. Levine (1999) also finds enforcement of laws to be positively correlated to banking development.
The legal institution analysis has till now been limited to an assessment of rules only (relevant enforcement data is not available); while the rules have not changed over the years, the banking industry has expanded across size, activity and depth. Moreover, the rules have remained very weak over a long period of time.

**Figure 5–2: The legal institutions—banking development link**

Figure 5–2 shows how legal institutions (rules and enforcement quality) may affect banking development. E.g. a positive change in STAY (rule) is likely to have a corresponding effect on the size, activity and/or depth of the banking sector.

Against this background, one may argue that at least the *rules* may not have mattered for past banking development in Fiji. While the quality of law enforcement is not known at this stage, the end results would not change regardless. The possible scenarios for *law enforcement* in Fiji include strong, weak or average quality. Combining these scenarios with legal rules we get: (i) weak rules plus strong enforcement; (ii) weak rules plus average enforcement; or (iii) weak rules plus weak enforcement.

If we now examine these likely scenarios on any of the measures of banking development—LLY, BANKY or BPRVY—the results are likely to be as follows:

1. **weak** rules plus **strong** enforcement and positive banking development;
2. **weak** rules plus **average** enforcement but positive banking development; or
3. **weak** rules plus **weak** enforcement but positive banking development.
To answer RQ 2–4, if (1) (above) were true then it would appear that legal institutions—in the form of strong enforcement mechanisms—have indeed fostered banking development in Fiji. Accordingly, the relevant working hypothesis would appear to be substantiated. However, if (2) or (3) were true then it may appear that legal institutions had not really mattered for past banking development in Fiji, especially in case of (3). Accordingly, the relevant working hypothesis would appear to be unsubstantiated; legal institutions may historically have not been important for banking development in Fiji. However, to answer RQ 2–4 fully, it is important to analyse the quality of law enforcement in Fiji as well, which is addressed in section 5.5. For now, it appears that legal *rules*, at least, may not have been important for banking development in the past, thus, the relevant part of the prior expectation is not borne out by the evidence.

5.4.2 Stock Market Development

This section examines RQ 2–5 i.e. how may have legal institutions affected stock market development in Fiji? A review of the relevant theory and findings from Chapter 4 led to the prior expectation that legal institutions (both rules and enforcement) may not have been important for stock market development.

While stock market activity has existed in Fiji since 1979, relevant variables for measuring stock market development are available for only 1995—2003 period. Hence, for the purposes of examining the changes to legal shareholder rights vis–a–vis stock market development, there was an inclination to confine the analysis to the 1995—2003 period. However, the facts and results obtained in section 4.6 indicate that market activity in the pre–1997 and size in the pre–1995 periods would have been relatively insignificant. Moreover, legal shareholder rights are obtainable for a much longer period. Therefore, it is possible to comment on the pre–1995 situation as well. The
analysis begins by examining how shareholder rights may have changed over this period followed by stock market development over the same period.

As with creditor rights, legal rights of shareholders in Fiji, that is—PROXY, VOTE, BLOCK, OPP, PRE and PERC—have not changed since 1925. Consequently, the ADRI has not changed as well. While this would be the case since 1979, Table 5–4 illustrates this fact over the 1995—2003 period only.

**Table 5–4: Shareholder legal rights and stock market development in Fiji, 1995–2003**

Table 5–4 attempts to trace changes in stock market development measures such as TRADE (trading volume) and MCAPY (market capitalisation to GDP) and the composite stock market development index (SM-Index—developed in chapter 4) over 1995–2003 that may have resulted from a change in a fundamental shareholder legal right. Fiji’s creditor rights values come from table 5–2; banking development values come from chapter 4. As table 5–4 shows, on one hand, shareholder rights have not changed but remained relatively strong over this period, on the other, MCAPY has changed distinctly but not TRADE.

<table>
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<th>BLOCK</th>
<th>VOTE</th>
<th>OPP</th>
<th>PRE</th>
<th>PERC</th>
<th>ADRI</th>
<th>MCAPY</th>
<th>TRADE</th>
<th>SM-Index</th>
</tr>
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<td>10.7</td>
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</tr>
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</tbody>
</table>

Chapter 4 noted that the positive and strong size growth may indicate positive development of Fiji’s stock market. However, legal shareholder rights in Fiji have not changed over many years. Is MCAPY then a good indicator of stock market development? Could recent size development be a lagged effect of constant strong rules? Could it be a result of possible improvement(s) in the quality of law enforcement?

While MCAPY has been widely used in the literature for this purpose (e.g. Demirgüç–Kunt and Levine, 2001b; Beck et al., 2001b; 2003; Rajan and Zingales, 2003b), the
measure has inherent weaknesses. For instance, while large MCAPY values may indicate a correspondingly large market, it may also overestimate the actual amount of external financing. Shares in a company may be held by outsiders (minority shareholders) as well as insiders (founders). It is the proportion of shares held by the outsiders (external financing) that matters for stock market development, not internal financing. For example, if only 10% of a firm’s equity is held by outsiders (90% by insiders), then MCAPY gives a ten fold overestimate of how much has actually been raised externally (e.g. La Porta et al., 1997). Indeed, size is not robustly correlated with growth, capital accumulation and productivity improvements, i.e. simply listing on the stock exchange does not necessarily foster resource allocation (e.g. Levine and Zervos, 1998a; Beck et al., 2005a).

Trading activities appear to be more important indicators of stock market development. However, data limitations often compel researchers to utilise the more readily available MCAPY data. Focussing thus on TRADE, it appears that trading activity in Fiji has been remarkably low. Moreover, efficiency—related to activity—has been weak as well. Thus, we find that over a period of time while legal rules have remained relatively strong and have not changed; (i) the size of the stock market (MCAPY) has increased in recent years; (ii) activity in the market (TRADE) has remained constantly low; and (iii) market efficiency (TURN) has remained constantly low. Focussing then on the more important measure(s) of stock market development it appears that while legal rules have remained relatively strong, stock market development has been relatively weak.

Do legal institutions then matter for stock market development in Fiji? I examine this by illustrating the above situation in figure 5–3. Variables for shareholder legal rules include PROXY, BLOCK, VOTE, OPP, PRE, and PERC; that for enforcement include EFJS, ROL, COR, EXP and REP. All of these variables form legal institutions, which
per literature, matters for stock market development. The latter may be reflected by changes in MCAPY, TRADE and TURN.

Figure 5–3 below illustrates that a change in legal rules and/or enforcement mechanisms is likely to result in a corresponding change in size, activity and/or efficiency of stock markets. For example, improvement in PROXY is likely to result in enhancement of TRADE. The legal institution analysis till now has been limited to an assessment of rules only (relevant enforcement data is not available); while the rules have not changed over the years, stock market size has increased but activity and efficiency have remained constantly low. However, the rules have remained relatively strong over a long period of time.

**Figure 5–3: The legal institutions—stock market development link**

Figure 5–3 shows how legal institutions (rules and enforcement quality) may affect stock market development. E.g. a positive change in PROXY (rule) is likely to have a corresponding effect on the size, activity and/or depth of the stock market sector.

Given this background, one may argue that the increase in the size of the stock market is a lagged effect of the constantly strong rules. However, that effect is obviously absent when applied to activity and/or efficiency of the market. Thus, legal *rules*, at least, may not have mattered for past stock market development in Fiji. While the quality of law enforcement is not known at this stage, the end results would not change regardless. The possible scenarios for law enforcement in Fiji include strong, weak or average quality. Combining these scenarios with legal rules we get: (i) strong rules plus strong
enforcement; (ii) strong rules plus average enforcement; or (iii) strong rules plus weak enforcement.

If we now examine these likely scenarios on the more important measures of stock market development—TRADE or TURN—the results are likely to be as follows:

1. **strong** rules plus **strong** enforcement but weak SM development;
2. **strong** rules plus **average** enforcement but weak SM development; or
3. **strong** rules plus **weak** enforcement but weak SM development;

To answer RQ 2–5, if (1) (above) were true then it would appear that legal institutions did not matter for past stock market development in Fiji. Accordingly, the relevant working hypothesis would appear to be substantiated, i.e. legal institutions may not have been historically important for stock market development. However, if (2) or (3) were true then there is a possibility that average or weak enforcement mechanisms are discouraging development of the stock market. Accordingly, the relevant working hypothesis would appear to be unsubstantiated; legal institutions, in the form of law enforcement, may have been important for stock market development. However, as stated previously (last paragraph, section 5.4.1) to answer RQ 2–5 fully, it is important to analyse the quality of law enforcement in Fiji as well, which is addressed in section 5.5. For now, it does appear that legal **rules**, at least, may not have been important for stock market development in the past, thus, the relevant part of the prior expectation appears to be supported by the evidence.

5.5 **SHOULD LEGAL INSTITUTIONS BE ENHANCED FOR FURTHER FINANCIAL DEVELOPMENT IN FIJI?**

5.5.1 **A Brief Introduction**

This section examines RQ 2–6 and 2–7, i.e. is enhancement of legal institutions important, or even essential, for further banking and/or stock market development.
Per sections 5.3 and 5.4, since weak creditor legal rules have not discouraged banking development in Fiji and strong shareholder legal rules have not encouraged stock market development, it appears that reforms or otherwise strengthening of investor legal rules may not be essential—at least in the short to medium term—for further banking and/or stock market development. However, lack of data prevents me from making similar comments on the quality of enforcement. Assuming that enforcement quality was indeed weak or average, would strengthening this per se enhance financial development in Fiji?

It appears important to ask if strengthening the quality of enforcement is essentially important for further development of Fiji’s financial sector. For that matter, while the status of rules is known, it appears important to ask if strengthening of the rules would still be necessary for further development of Fiji’s financial sector. In the event that both were not essential for further financial development, it may be the case that the legal theory of finance did not hold prominently in the case of Fiji; at least, rules do not seem to have played a critical role in past development. That is, improvements in legal institutions may then not be necessary for Fiji’s financial development.

Given that it is the creditor and shareholder that need the legal protection, it appeared reasonable to obtain the answers to the above issues from the creditors and shareholders themselves, plus experts for independent views. The views were obtained via an interview schedule (for details, see section 3.4). Specifically, the intention was to determine, on the basis of investor and expert views, the following for Fiji: (i) is there a need to enhance rules and/or enforcement quality for further banking development? and (ii) is there a need to enhance rules and/or enforcement quality for further stock market development?
5.5.2 **Respondent Profiles**

This section discusses the profiles of the creditor, shareholder and expert respondents. Details of recruitment etc. are provided in section 3.3.

*Creditor profile*

As noted in section 3.3.3, there are only five banks in Fiji, with two of them (the majors) controlling up to 72% of total banking assets and 75% of total loans in Fiji (see table 4–2 for details). Therefore, it was important to include a greater proportion of these banks in the sample. A total of 14 senior officers and other executives were interviewed. Of these, nine or 65% were from the majors. Most of the respondents had over 10 years of senior management and corporate lending experience. Some had moved across banks.

*Shareholder profile*

A total of 230 shareholder respondents were interviewed; of these 20% were current and the rest, potential shareholders. Table 5–5 provides a summary profile of these respondents. Most respondents happened to be males, in the 20–40 age group and with post–secondary education. Of the current shareholders, majority (68%) held shares in a single listed company; of the rest, 28% had shares in two and 4% in four companies. Also, majority (60%) had been a shareholder for less than 5 years with a very small proportion (6%) participating for a maximum of 15–20 years and the rest for 5—10 years (23%) or 10—15 years (11%).

*Expert profile*

A total of 15 experts were interviewed. These included chief executives and other senior officers and personnel at the Reserve Bank of Fiji, Capital Markets Development Authority, South Pacific Stock Exchange, accounting firms, such as KPMG and...
PricewaterhouseCoopers and senior business (Accounting, Finance and Economics) academics at the University of the South Pacific.

Table 5–5: Summary profile of shareholder respondents interviewed in the opinion survey conducted for this research

Table 5–5 shows the profile of the 230 shareholder respondents interviewed. All numbers are in percent of the respective categories, except the last row. E.g. 67.8% of all respondents happened to be males, with a similar proportion within both the current and potential shareholder sub-groups.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Current Shareholders</th>
<th>Potential Shareholders</th>
<th>All Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less than 20 yrs</td>
<td>0.0</td>
<td>4.9</td>
<td>3.9</td>
</tr>
<tr>
<td>20 to 40 yrs</td>
<td>89.3</td>
<td>83.7</td>
<td>84.8</td>
</tr>
<tr>
<td>More than 40</td>
<td>10.7</td>
<td>11.4</td>
<td>11.3</td>
</tr>
<tr>
<td>Gender</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Male (%)</td>
<td>68.1</td>
<td>67.8</td>
<td>67.8</td>
</tr>
<tr>
<td>Female</td>
<td>31.9</td>
<td>32.2</td>
<td>32.2</td>
</tr>
<tr>
<td>Education</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Secondary</td>
<td>6.4</td>
<td>7.7</td>
<td>7.4</td>
</tr>
<tr>
<td>Tertiary</td>
<td>93.6</td>
<td>92.3</td>
<td>92.6</td>
</tr>
<tr>
<td>Occupation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Academic</td>
<td>14.9</td>
<td>20.2</td>
<td>19.1</td>
</tr>
<tr>
<td>Financial service industry</td>
<td>21.3</td>
<td>20.8</td>
<td>20.9</td>
</tr>
<tr>
<td>Public servant</td>
<td>31.9</td>
<td>16.9</td>
<td>20.0</td>
</tr>
<tr>
<td>Professional firm</td>
<td>12.8</td>
<td>16.4</td>
<td>15.7</td>
</tr>
<tr>
<td>Other (includes private sector)</td>
<td>19.1</td>
<td>25.7</td>
<td>24.3</td>
</tr>
<tr>
<td>Shareholder status</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current shareholder</td>
<td></td>
<td></td>
<td>20.4</td>
</tr>
<tr>
<td>Potential shareholder</td>
<td></td>
<td></td>
<td>79.6</td>
</tr>
<tr>
<td>Number of respondents</td>
<td>47</td>
<td>183</td>
<td>230</td>
</tr>
</tbody>
</table>

5.5.3 Importance Of Legal Rules

Creditor view

To determine the importance of legal rules in Fiji, creditors were asked to rate on a scale of 1 (major obstacle) to 7 (no obstacle) legal problems they experienced in relation to each of STAY, RANK, CONSENT, MANAGE and RESERVE. For instance, in relation to STAY, did they experience legal difficulties at the time of repossession of debt collateral? Other values on the scale denote the following obstacles: 2 = high; 3 = high to moderate; 4 = moderate; 5 = moderate to low; and 6 = low. Results of creditor views are shown in table 5–6, which displays the views of all banks. The overall views are shown in the last column, referred to as creditor rights (CR).
Generally, banks in Fiji appear to be more than moderately concerned about legal problems associated with issues in relation to liquidation of a borrower (table 5–6) The mean CR obstacle score for all respondents was 3.6, indicating that banks had certain concerns with legal complications/difficulties that may arise in liquidating debts. However, the majors (mean CR score = 3.9) appeared less concerned than smaller banks (mean CR score = 3). Further, while CR was more than a ‘moderate’ obstacle for 80% of the small bank respondents and for 44% of the large bank respondents, it was also less than ‘moderate’ obstacle for 44% of the large banks.

**Table 5–6: Legal rules obstacle to bank private sector credit in Fiji**

Table 5–6 portrays the views of the most important creditors in Fiji (commercial banks) with respect to each of the legal creditor rights variable used in this study. The results are displayed by bank size (large and small) as well as by total sample. A 1–7 scale was used to obtain responses, where 1 = major obstacle, 7 = no obstacle. E.g. the average total sample score on STAY was 2.8, indicating a view that, not being able to legally repossess debt collateral was moderate obstacle for banks in lending to the private sector.

<table>
<thead>
<tr>
<th>Bank size</th>
<th>STAY</th>
<th>RANK</th>
<th>CONSENT</th>
<th>MANAGE</th>
<th>RESERVE</th>
<th>CR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large banks</td>
<td>Mean</td>
<td>3.1</td>
<td>4.4</td>
<td>3.9</td>
<td>3.7</td>
<td>4.3</td>
</tr>
<tr>
<td></td>
<td>Std Deviation</td>
<td>2.0</td>
<td>2.0</td>
<td>1.0</td>
<td>1.4</td>
<td>1.7</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>1.0</td>
<td>1.0</td>
<td>2.0</td>
<td>2.0</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>6.0</td>
<td>7.0</td>
<td>5.0</td>
<td>6.0</td>
<td>6.0</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>2.0</td>
<td>5.0</td>
<td>4.0</td>
<td>3.0</td>
<td>4.0</td>
</tr>
<tr>
<td></td>
<td>Std Deviation</td>
<td>2.2</td>
<td>3.0</td>
<td>3.4</td>
<td>2.8</td>
<td>4.2</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>1.3</td>
<td>1.2</td>
<td>0.5</td>
<td>0.8</td>
<td>1.3</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>4.0</td>
<td>4.0</td>
<td>4.0</td>
<td>4.0</td>
<td>6.0</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>2.0</td>
<td>3.0</td>
<td>3.0</td>
<td>3.0</td>
<td>4.0</td>
</tr>
<tr>
<td>Small banks</td>
<td>Mean</td>
<td>2.8</td>
<td>3.9</td>
<td>3.7</td>
<td>3.4</td>
<td>4.3</td>
</tr>
<tr>
<td></td>
<td>Std Deviation</td>
<td>1.8</td>
<td>1.9</td>
<td>0.9</td>
<td>1.3</td>
<td>1.5</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>1.0</td>
<td>1.0</td>
<td>2.0</td>
<td>2.0</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>6.0</td>
<td>7.0</td>
<td>5.0</td>
<td>6.0</td>
<td>6.0</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>2.0</td>
<td>4.0</td>
<td>4.0</td>
<td>3.0</td>
<td>4.0</td>
</tr>
</tbody>
</table>

Moreover, none of the respondents viewed overall CR as a major or no obstacle, i.e. the two extreme situations were ruled out. While ‘high obstacle’ was the common worst situation, ‘low obstacle’ was the best for large banks and ‘moderate’ for small banks. Further, the scores for small banks were less dispersed (std. dev = 0.707) than that for
large banks (std. dev = 1.453). Nonetheless, there was no correlation between bank size and overall CR obstacle (Pearson Chi–Square = 0.449).

Across the legal rules, STAY appeared to be of most concern overall (mean = 2.8). For 71% of all respondents, this rule was more than a moderate obstacle; for the rest it was moderate or less. Further, 14% ranked this as a major obstacle; 7% as no obstacle. However, smaller banks were relatively more concerned (mean = 2.2—almost high obstacle) than the major banks (mean = 3.1); 80% of the small bank and 67% of the large bank respondents ranked STAY as more than ‘moderate’ obstacle. The above is also confirmed by the range (for small banks highest to moderate and for large banks highest to lowest) and dispersion of the scores (std dev for small banks = 1.304 and for large banks = 2.0). Nonetheless, there was no correlation between bank size and STAY; Pearson Chi–Square = 0.521.

The legal rule respondents were least concerned about was RANK. However, the overall mean of 3.9 was not too encouraging; even the rule that was of relatively least concern to the creditors was still of ‘moderate’ concern. Around 43% of the respondents ranked this rule as more than a moderate obstacle, the proportions per bank size being 60% for small and 33% for large. Moreover, the mean score for small banks (3.0) was lower than that for large banks (4.4). Thus, smaller banks were again more concerned about this rule as well. However, the Pearson Chi–Square of 0.178 suggested no significant correlation between bank size and RANK.

With respect to RESERVE—the remedial legal rule—the concerns of banks in Fiji appeared to be more encouraging; the overall mean of 4.3 was better than that of the core legal rule scores. The mean scores of both the small and large banks were around the overall score.
To recap, banks in Fiji do appear to have some concern about their legal rule protection. Of the five variables, STAY i.e. not being able to repossess debt collateral in liquidation, appears to be of most concern.

**Shareholder awareness**

Respondents were asked if they knew (1—Yes; 2—No; or 3—Don’t know) whether or not the relevant legislation in Fiji mandated each of the six shareholder variables i.e. PROXY, VOTE, PRE, BLOCK, PERC, OPP, ONE and MAND. Incorrect or ‘don’t know’ responses were deemed to indicate that respondents’ were less informed of their basic legal rights and/or of their existence or absence and hence an indication that legal protection may be less important for stock market development in Fiji. In any case, to confirm, respondents were asked a direct question on how important legal issues were for stock market investment.

Table 5–7 shows the shareholder legal rules awareness levels on the first six (the ADRI variables) of the 230 respondents interviewed. None of the respondents was fully informed (maximum value of 6 not obtained) or nearly fully informed (value of 5 not obtained either) about their basic legal rights as a shareholder in Fiji. Only 16.6% of the respondents were moderately or slightly better informed. Most respondents (83.5%) were either ill-informed (53.1%) or totally ignorant (30.4%); sum of values for 0 to 2. The mean overall score was 1.3, suggesting that the average awareness level was indeed very low; equal to almost ‘total ignorance’.

Moreover, the mean score of the potential shareholder group was relatively worse; a much higher proportion (34.4%) of potential shareholders appeared ‘totally ignorant’—the median score was also relatively higher. However, there was no significant correlation between shareholder status and awareness levels (the Pearson Chi–Square is
0.123), i.e. being a shareholder or not did not seem to significantly matter for being informed about one’s legal rights in Fiji.

Table 5–7: Shareholder awareness of legal rights in Fiji

Table 5–7 shows the shareholder legal rights awareness levels of the shareholder respondents. A zero awareness level indicates total ignorance, 3 indicates moderately informed and 6 indicates full knowledge. E.g. 30.4% of all respondents were totally ignorant of the rights and the mean awareness level of 1.3 indicates that the average awareness level was very low.

<table>
<thead>
<tr>
<th>Awareness level</th>
<th>Current Shareholders</th>
<th>Potential Shareholders</th>
<th>All Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>14.9</td>
<td>34.4</td>
<td>30.4</td>
</tr>
<tr>
<td>1</td>
<td>31.9</td>
<td>27.3</td>
<td>28.3</td>
</tr>
<tr>
<td>2</td>
<td>34.0</td>
<td>22.4</td>
<td>24.8</td>
</tr>
<tr>
<td>3</td>
<td>12.8</td>
<td>10.4</td>
<td>10.9</td>
</tr>
<tr>
<td>4</td>
<td>6.4</td>
<td>5.5</td>
<td>5.7</td>
</tr>
<tr>
<td>Total</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Mean awareness</th>
<th>Std Deviation</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Shareholders</td>
<td>1.6</td>
<td>1.1</td>
<td>1.0</td>
<td>4.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Potential Shareholders</td>
<td>1.3</td>
<td>1.2</td>
<td>1.0</td>
<td>4.0</td>
<td>1.0</td>
</tr>
<tr>
<td>All Respondents</td>
<td>1.3</td>
<td>1.2</td>
<td>1.0</td>
<td>4.0</td>
<td>1.0</td>
</tr>
</tbody>
</table>

Expert awareness

The experts’ mean awareness score on creditor rights was 0.6 and on shareholder rights was 1.8, an indication that despite their deemed familiarity, experience and high level of awareness, the selected knowledgeable individuals were not sufficiently aware of the basic legal rights of creditors and shareholders in Fiji. Only 7–8% were fully aware of the basic investor legal rights; 33% were totally ignorant of shareholder rights and 69% of the creditor rights. Around 90% were up to moderately informed in case of both legal rules. The ignorance level in relation to the shareholder rules was similar to that of the shareholders themselves and indicates that the experts were no better informed than the investors.

Across the creditor legal rules, experts seemed to be most familiar with CONSENT; however, the awareness level was only 33%; the least known rule was STAY, which appears to be a fundamental basic legal creditor right. Across the shareholder legal
rights, experts seemed to be most familiar with BLOCK (47%) and least with PRE (7%).

5.5.4 Quality of Law Enforcement

The enforcement measures include efficiency of the judicial system (EFJS), rule of law (RoL), corruption (COR), risk of expropriation (EXP) and the likelihood of repudiation by government (REP). The first two entail enforcement proper and the others reflect government’s position toward business in general. EFJS includes the efficiency and integrity of the legal environment as it effects business, particularly foreign firms; RoL includes the law and order tradition in the country; COR includes bribes connected with import and export licenses, exchange controls, tax assessment, policy protection, or loans; EXP is the risk of outright confiscation or forced nationalisation of assets; REP is the risk of a modification in a contract taking the from of a repudiation, postponement or scaling down due to budget cutbacks, indigenisation pressure, a change in government, or a change in government economic and social priorities.

To determine the quality of law enforcement in Fiji, respondents (shareholders, creditors and experts) were asked to indicate, on a scale of 1 (worst/totally flawed) to 10 (best), their assessment on each of EFJS, RoL, COR, EXP and REP plus ACT—the substitute for weak enforcement. The scores between 1 and 10 denote the following: 2 = very low; 3 = low; 4 = below average; 5 = average; 6 = above average; 7 = good; 8 = high; and 9 = very high.

Creditor view

As with the legal rules, banks in Fiji also appear to be concerned about the quality of law enforcement (table 5–8). The overall mean score for law enforcement was 5.2, indicating a view that the quality of enforcement was perceived by the most important suppliers of credit in Fiji to be just average. Moreover, the mean scores for both large
and small banks were around 5 as well. Further, 43% of all respondents perceived the quality to be below average, which also reflected the views of both the small and large banks.

However, it is the smaller banks which may generally be more sceptical of the quality of enforcement as indicated by the dispersion of scores—while the large bank scores were dispersed between 3.4 and 8.2, that of the small banks were between 3.6 and 6.6. Moreover, none of the respondents viewed overall law enforcement as totally flawed; the lowest score was 3.4. Further, 47% perceived the quality to be average or better, with the highest overall score being 8.2.

Table 5–8: Law enforcement obstacle to bank private sector lending in Fiji: creditors’ view

Table 5–8 portrays the views of the most important creditors in Fiji (commercial banks) with respect to each of the law enforcement variable used in this study. The results are displayed by bank size (large and small) as well as by total sample. Responses were obtained on a 1–10 scale where, 1 = worst/totally flawed and 10 = best quality. E.g. the average total sample score on EFJS was 6.0, indicating a view that, on average, banks were not too concerned with the efficiency of Fiji’s judicial system per se, however they may be concerned with the overall quality of law enforcement (mean = 5.2).

<table>
<thead>
<tr>
<th>Bank size</th>
<th>EFJS</th>
<th>Rol.</th>
<th>COR</th>
<th>EXP</th>
<th>REP</th>
<th>ACT</th>
<th>LawEnf</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large banks</td>
<td>Mean</td>
<td>5.7</td>
<td>5.6</td>
<td>3.9</td>
<td>5.9</td>
<td>5.2</td>
<td>7.0</td>
</tr>
<tr>
<td></td>
<td>Std. Deviation</td>
<td>1.3</td>
<td>1.3</td>
<td>2.0</td>
<td>2.9</td>
<td>3.3</td>
<td>1.7</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>3.0</td>
<td>3.0</td>
<td>1.0</td>
<td>2.0</td>
<td>2.0</td>
<td>5.0</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>7.0</td>
<td>7.0</td>
<td>7.0</td>
<td>10.0</td>
<td>10.0</td>
<td>9.0</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>6.0</td>
<td>5.0</td>
<td>4.0</td>
<td>5.0</td>
<td>4.0</td>
<td>7.0</td>
</tr>
<tr>
<td>Small banks</td>
<td>Mean</td>
<td>6.8</td>
<td>5.4</td>
<td>3.8</td>
<td>4.8</td>
<td>4.2</td>
<td>6.6</td>
</tr>
<tr>
<td></td>
<td>Std. Deviation</td>
<td>0.5</td>
<td>1.9</td>
<td>1.8</td>
<td>1.5</td>
<td>2.6</td>
<td>1.7</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>6.0</td>
<td>2.0</td>
<td>1.0</td>
<td>3.0</td>
<td>1.0</td>
<td>4.0</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>7.0</td>
<td>7.0</td>
<td>5.0</td>
<td>7.0</td>
<td>8.0</td>
<td>8.0</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>7.0</td>
<td>6.0</td>
<td>5.0</td>
<td>5.0</td>
<td>4.0</td>
<td>7.0</td>
</tr>
<tr>
<td>All banks</td>
<td>Mean</td>
<td>6.0</td>
<td>5.5</td>
<td>3.9</td>
<td>5.5</td>
<td>5.5</td>
<td>4.9</td>
</tr>
<tr>
<td></td>
<td>Std. Deviation</td>
<td>1.2</td>
<td>1.5</td>
<td>1.9</td>
<td>2.5</td>
<td>2.9</td>
<td>1.6</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>3.0</td>
<td>2.0</td>
<td>1.0</td>
<td>2.0</td>
<td>2.0</td>
<td>4.0</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>7.0</td>
<td>7.0</td>
<td>7.0</td>
<td>10.0</td>
<td>10.0</td>
<td>9.0</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>6.5</td>
<td>6.0</td>
<td>4.5</td>
<td>5.0</td>
<td>4.00</td>
<td>7.0</td>
</tr>
</tbody>
</table>

The legal enforcement variable of most concern to respondents was COR. The overall mean score was 3.9, with individual scores dispersed between 1 and 7 for large banks and 1 and 5 for small banks, reflecting again a more pessimistic view of small banks
and a perception that corruption in government could indeed be a major impediment for law enforcement quality in the country. Moreover, 50% of the respondents ranked COR as more than moderate obstacle. Surprisingly, larger banks were more sceptical (55%) than the smaller banks (40%), however, the rest of the small banks (60%) appeared indifferent. The Pearson Chi–Square of 0.620 indicated that there was no significant correlation between bank size and COR.

EFJS appeared to be the enforcement variable banks were least concerned about; the overall mean was 6.1—indicating that the concern of banks was diminishing—were less than moderately concerned about this variable. The lowest overall score was 3, with 7% of the respondents regarding EFJS as a major concern; however, none of the respondents viewed EFJS as totally or seriously flawed. Further, 71% of the scores were 6 to 7 i.e. a large number of respondents viewed it to be of relatively less concern in terms of law enforcement in Fiji.

Again, the smaller banks appeared relatively less concerned with this variable; the mean score being 6.8 compared to large banks’ 5.7. Moreover, the individual scores of smaller banks were dispersed between 6 and 7; that of larger banks was between 3 and 7. Further, the std. dev for smaller banks was 0.447 and that of larger banks was 1.323. However, there was no correlation between bank size and EFJS; the Pearson Chi–Square was 0.304.

The overall rating for ACT—the substitute for weak enforcement—was more encouraging; the overall mean was 6.9, with larger banks appearing relatively more content with the quality (mean of 7 versus 6.6). The lowest score was 4—moderate concern—associated with only 7% of respondents. Moreover, only 21% of the respondents viewed ACT to be of average or substandard quality; 36% perceived it to be of relatively high quality.
Shareholder view

Shareholders appear to have similar concerns as creditors about the quality of law enforcement in Fiji. The overall mean score was 5.1 (table 5–9), suggesting that their perception of the quality was also just average with the potential shareholders (mean = 5.0) appearing to be more sceptical than the current shareholders (5.4). However, the median for both was similar (5). Moreover, the Pearson Chi–Square of 0.092 indicates a lack of significant correlation between shareholder status and enforcement quality.

Table 5–9: Shareholder view on law enforcement quality in Fiji

Table 5–9 portrays the views of the shareholders in Fiji with respect to each of the law enforcement variable used in this study. The results are displayed by shareholder status (current and potential) as well as by total sample. E.g. the average total sample score on EFJS was 4.9, indicating a view that, on average, shareholders were concerned with the efficiency of Fiji’s judicial system and also with the overall quality of law enforcement (mean = 5.1).

<table>
<thead>
<tr>
<th>Shareholder Status</th>
<th>EFJS</th>
<th>Rol.</th>
<th>COR</th>
<th>EXP</th>
<th>REP</th>
<th>ACT</th>
<th>ENFI</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Shareholders</td>
<td>Mean</td>
<td>5.4</td>
<td>5.5</td>
<td>3.4</td>
<td>6.6</td>
<td>5.9</td>
<td>7.0</td>
</tr>
<tr>
<td></td>
<td>Std. Deviation</td>
<td>2.0</td>
<td>2.3</td>
<td>2.3</td>
<td>2.9</td>
<td>2.6</td>
<td>2.3</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>6.0</td>
<td>6.0</td>
<td>3.0</td>
<td>7.0</td>
<td>6.0</td>
<td>8.0</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>10.0</td>
<td>10.0</td>
<td>9.0</td>
<td>10.0</td>
<td>10.0</td>
<td>8.0</td>
</tr>
<tr>
<td>Potential shareholders</td>
<td>Mean</td>
<td>4.8</td>
<td>5.2</td>
<td>3.6</td>
<td>6.0</td>
<td>5.5</td>
<td>7.4</td>
</tr>
<tr>
<td></td>
<td>Std. Deviation</td>
<td>2.3</td>
<td>2.4</td>
<td>2.4</td>
<td>3.1</td>
<td>2.9</td>
<td>1.9</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>5.0</td>
<td>5.0</td>
<td>3.0</td>
<td>6.0</td>
<td>5.0</td>
<td>8.0</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>10.0</td>
<td>10.0</td>
<td>10.0</td>
<td>10.0</td>
<td>10.0</td>
<td>9.0</td>
</tr>
<tr>
<td>All Shareholders</td>
<td>Mean</td>
<td>4.9</td>
<td>5.3</td>
<td>3.6</td>
<td>6.2</td>
<td>5.6</td>
<td>7.3</td>
</tr>
<tr>
<td></td>
<td>Std. Deviation</td>
<td>2.3</td>
<td>2.4</td>
<td>2.4</td>
<td>3.1</td>
<td>2.9</td>
<td>1.9</td>
</tr>
<tr>
<td></td>
<td>Median</td>
<td>5.0</td>
<td>5.0</td>
<td>3.0</td>
<td>6.0</td>
<td>5.0</td>
<td>8.0</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>10.0</td>
<td>10.0</td>
<td>10.0</td>
<td>10.0</td>
<td>10.0</td>
<td>9.0</td>
</tr>
</tbody>
</table>

The individual enforcement scores were dispersed between 1 and 9, with both extreme scores being associated with potential shareholders. However, the dispersion for current shareholders was not any better, ranging from 2 to 8. Further, around 19% of all respondents appeared seriously concerned with the quality of enforcement (scores 1–3),
56% viewed the quality as average or substandard (scores 1-5) and only 7% had little concern (scores 8–9).

Resonating the concerns of creditors, the shareholders too were most concerned with the COR variable of enforcement quality; the overall mean score was 3.6, slightly worse than the creditor score of 3.9. Around 57% of all respondents seemed seriously concerned with high levels of corruption in the country (score of 1–3; 26% viewed it to be of the highest level—1). Further, around 82% perceived the levels to be average or high. However, there was no correlation between shareholder status and COR (Pearson Chi–Square was 0.377).

The variable of least concern to the shareholders was EXP, attracting an overall mean score of 6.2, which, however, was not too encouraging. Nevertheless, a smaller proportion (24%) of all respondents was seriously concerned with the level of this risk in the country. Further, a smaller proportion (47%) perceived the risk as average or higher level and 41% expressed little concern.

Again, like the creditors, shareholders’ appeared quite content with ACT—the substitute for weak enforcement. The overall mean score was 7.3 with a median of 8, indicating that shareholders viewed the country’s accounting standards to be of relatively high quality. Indeed, a very small proportion (2.6%) of respondents was seriously concerned (scores 1–3) about ACT standards. Moreover, a relatively small proportion (20%) viewed it as average or substandard and 54% perceived it to be of relatively high standard.

**Expert view**

The views of experts on the quality of law enforcement in Fiji were similar to that of the creditors and shareholders. The overall view was that the quality was average (mean =
COR stood out as the issue of most concern (mean = 3.7) and EXP as the issue of least concern (mean = 6.8). Moreover, the rating for the accounting standard (ACT) was 7.2. Thus, all respondent types had similar concerns with the quality of law enforcement in Fiji.

Fiji versus rest of the world

Earlier, due to data limitations, it was possible to compare Fiji’s legal rules situation only with the rest of the world. However, comparison of the enforcement quality situation is now also possible. In doing this, the views of shareholders, creditors and experts have been aggregated. The results appear in table 5–10 below; panel A compares Fiji’s situation with the rest of the world categorised per the four legal origins and panel B compares Fiji’s situation with countries in the Asia–Pacific region.

Per panel A of table 5–10, Fiji’s situation does not appear too impressive. Fiji’s enforcement quality index (ENFQI) is 5.1, which is not only significantly less than the sample average (7.4) but also less than the lowest across the legal families (that of French, 6.6). Law enforcement in Fiji may thus be at least 30% less efficient than the average of all countries and at least 20% less efficient than the least efficient group—the French countries. Moreover, it appears to be only half as efficient as the most efficient group—the Scandinavian countries. Further, while Fiji’s legal system was modelled on the English legal system, Fiji appears to be at least 30% less efficient than the English group. However, Fiji’s situation may not be the worst across comparator countries; it appears better than at least seven; three being of English origin and four of the French.

Across the enforcement variables, Fiji’s best performance appears to be in relation to EXP and worst in relation to COR. In terms of EXP, Fiji appears to be 36% more risky than the least risky group (Scandinavia) and 17% more than the riskiest group (French).
However, Fiji appears to be less risky than at least 10 of the comparator countries; five being of the French origin and five of the English.

With respect to COR, Fiji’s situation is relatively worse. Fiji appears 65% more corrupt than the least corrupt group (Scandinavian) and 39% more corrupt than the most corrupt group (French). Moreover, only four of the comparator countries may be worse than Fiji (two French and two English).

**Table 5–10: The quality of law enforcement—Fiji and the rest of the world**

Panel A of table 5–10 compares Fiji’s law enforcement quality with other countries. The 49 comparator countries are categorised per their legal origin, being English (18), French (21), German (6) or Scandinavian (4), which spans across Europe, North and South America, Asia and Australia. The scores indicate the quality of each variable, where 1 is the worst and 10 is the best, thus, Fiji’s EFJS is deemed to be of average quality (5.1).

Panel B compares Fiji’s law enforcement quality with the Asia–Pacific countries, which, excluding China, are from the 49 comparator countries. Averages have been determined for all AP countries (sample average) as well as for less developed AP countries (LDC average).

**Panel A: Fiji and rest of the world classified by legal origin**

<table>
<thead>
<tr>
<th>Legal Origin</th>
<th>EFJS</th>
<th>RoL</th>
<th>COR</th>
<th>EXP</th>
<th>REP</th>
<th>ENFQI</th>
<th>ACT</th>
</tr>
</thead>
<tbody>
<tr>
<td>English</td>
<td>8.2</td>
<td>6.5</td>
<td>7.1</td>
<td>7.9</td>
<td>7.4</td>
<td>7.4</td>
<td>6.9</td>
</tr>
<tr>
<td>French</td>
<td>6.6</td>
<td>6.1</td>
<td>5.9</td>
<td>7.5</td>
<td>6.8</td>
<td>6.6</td>
<td>5.1</td>
</tr>
<tr>
<td>German</td>
<td>8.5</td>
<td>8.7</td>
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<td>9.5</td>
<td>9.5</td>
<td>8.8</td>
<td>6.3</td>
</tr>
<tr>
<td>Scandinavian</td>
<td>10.0</td>
<td>10.0</td>
<td>10.0</td>
<td>9.7</td>
<td>9.4</td>
<td>9.8</td>
<td>7.4</td>
</tr>
<tr>
<td>Sample Ave</td>
<td>7.7</td>
<td>10.0</td>
<td>6.9</td>
<td>8.1</td>
<td>7.6</td>
<td>7.4</td>
<td>6.1</td>
</tr>
<tr>
<td><strong>Fiji</strong></td>
<td>5.1</td>
<td>5.3</td>
<td>3.6</td>
<td>6.2</td>
<td>5.5</td>
<td>5.1</td>
<td>7.3</td>
</tr>
</tbody>
</table>

**Panel B: Fiji and Asia–Pacific**

<table>
<thead>
<tr>
<th>Country</th>
<th>EFJS</th>
<th>RoL</th>
<th>COR</th>
<th>EXP</th>
<th>REP</th>
<th>ENFQI</th>
<th>ACT</th>
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</thead>
<tbody>
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<td>China</td>
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<td>na</td>
<td>na</td>
<td>na</td>
</tr>
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<td>Philippines</td>
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<td>2.9</td>
<td>5.2</td>
<td>4.8</td>
<td>4.1</td>
<td>6.5</td>
</tr>
<tr>
<td>Pakistan</td>
<td>5.0</td>
<td>3.0</td>
<td>2.9</td>
<td>5.6</td>
<td>4.9</td>
<td>4.3</td>
<td>na</td>
</tr>
<tr>
<td>Indonesia</td>
<td>2.5</td>
<td>3.9</td>
<td>2.2</td>
<td>7.2</td>
<td>6.</td>
<td>4.4</td>
<td>na</td>
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<tr>
<td>Sri Lanka</td>
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<td>5.0</td>
<td>6.1</td>
<td>5.3</td>
<td>5.0</td>
<td>na</td>
</tr>
<tr>
<td><strong>Fiji</strong></td>
<td>5.1</td>
<td>5.3</td>
<td>3.6</td>
<td>6.2</td>
<td>5.5</td>
<td>5.1</td>
<td>7.3</td>
</tr>
<tr>
<td>Thailand</td>
<td>3.3</td>
<td>6.3</td>
<td>5.2</td>
<td>7.4</td>
<td>7.6</td>
<td>5.9</td>
<td>6.4</td>
</tr>
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<td>8.0</td>
<td>4.2</td>
<td>4.6</td>
<td>7.8</td>
<td>6.1</td>
<td>6.1</td>
<td>5.7</td>
</tr>
<tr>
<td>South Korea</td>
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<td>5.4</td>
<td>5.3</td>
<td>8.3</td>
<td>8.6</td>
<td>6.7</td>
<td>6.2</td>
</tr>
<tr>
<td>Malaysia</td>
<td>9.0</td>
<td>6.8</td>
<td>7.4</td>
<td>7.9</td>
<td>7.4</td>
<td>7.7</td>
<td>7.6</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>10.0</td>
<td>8.2</td>
<td>8.5</td>
<td>8.3</td>
<td>8.8</td>
<td>8.8</td>
<td>6.9</td>
</tr>
<tr>
<td>Singapore</td>
<td>10.0</td>
<td>8.6</td>
<td>8.2</td>
<td>9.3</td>
<td>8.9</td>
<td>8.9</td>
<td>7.8</td>
</tr>
<tr>
<td>Australia</td>
<td>10.0</td>
<td>10.0</td>
<td>8.5</td>
<td>9.3</td>
<td>8.7</td>
<td>9.3</td>
<td>7.5</td>
</tr>
<tr>
<td>Japan</td>
<td>10.0</td>
<td>8.9</td>
<td>8.5</td>
<td>9.7</td>
<td>9.7</td>
<td>9.4</td>
<td>6.5</td>
</tr>
<tr>
<td>New Zealand</td>
<td>10.0</td>
<td>10.0</td>
<td>10.0</td>
<td>9.7</td>
<td>9.3</td>
<td>9.8</td>
<td>7.0</td>
</tr>
<tr>
<td>Sample Average</td>
<td>6.8</td>
<td>6.1</td>
<td>5.6</td>
<td>7.1</td>
<td>6.7</td>
<td>6.4</td>
<td>5.1</td>
</tr>
<tr>
<td>LDC Average</td>
<td>6.2</td>
<td>4.9</td>
<td>4.5</td>
<td>6.9</td>
<td>6.4</td>
<td>5.3</td>
<td>6.8</td>
</tr>
</tbody>
</table>

Source: LLSV (1998), except China (Allen et al., 2005) and Fiji (present research).
Further, Fiji’s enforcement quality does not appear too impressive even when compared to the Asia–Pacific region only or just the less developed AP countries (LDC–AP) (table 5–10, panel B). The AP and LDC–AP sample averages are 6.4 and 5.3, i.e. on average 25% and 4% more efficient than Fiji, respectively. However, while Fiji appears to be up to 25% more efficient than the least efficient AP country (the Philippines), it is also up to 34% less efficient than the most efficient LDC–AP country (Malaysia) and 48% less efficient than the most efficient AP country (New Zealand).

With respect to EXP, Fiji is 8% more risky than the LDC–AP average and 20% more risky than the AP average. Moreover, while Fiji appears 18% less risky than the riskiest AP country (the Philippines), it is also 36% more risky than the least risky AP country (New Zealand) and 23% more risky than the least risky LDC–AP country (Malaysia). With respect to COR, Fiji appears 40% more corrupt than the AP average and 15% more than the LDC–AP average. Further, while Fiji appears 66% less corrupt than the most corrupt AP country (Indonesia), it is also 64% more corrupt than the least corrupt AP country (New Zealand) and 52% more corrupt than the least corrupt LDC–AP country (Malaysia).

On a more positive note, however, the quality of accounting standards in Fiji (ACT) appears relatively high. Fiji scores 7.3 on this measure, which is 20% better than the global sample average of 6.1. Moreover, Fiji appears to have the second best quality across the legal groups, with the best (Scandinavian, 7.4) being only 1.5% better. Further, Fiji appears to be at least 42% better than the worst group (French) and only eight (16%) of the comparator countries may have better accounting standards than Fiji’s (five English and three Scandinavian).
Fiji’s situation appears equally strong against the countries in the AP and LDC–AP regions. On average, Fiji’s accounting quality is 9% better than LDC–AP countries and 6% better than AP countries. Further, Fiji’s situation is 28% better compared to the AP country with the worst quality accounting standards (India) and only 7% worse than that of the country with the best quality (Singapore) and 4% worse than the LDC–AP country with the best quality (Malaysia).

In short, the opinion survey shows that all types of respondents (creditors, shareholders and experts) view law enforcement in Fiji to be of average quality. Moreover, the enforcement variable of most concern is commonly COR (corruption). However, respondents appear to be content with ACT (accounting standards), which may indeed be substituting for the otherwise average enforcement quality.

5.5.5 Should Legal Institutions Be Enhanced For Further Banking Development?

This section examines RQ 2–6, i.e. is enhancement of legal institutions important, or even essential, for further banking development. A review of the relevant theory and findings from Chapter 4 led to the prior expectation that enhancement of legal institutions would be important, but not essential, for further banking development in Fiji.

The basis for the above prior expectation was initially provided in section 5.2, being that banks are expected to be familiar with the notion of legal protection for investors and particularly their own legal rights and therefore have an incentive to use and demand relevant institutions to enforce and develop these. However, in view of the past situation, enhancement may not be essential. In the paragraphs that follow, the results and findings thus far are consolidated to answer the above question and thereby determine whether the above working hypothesis should be accepted or rejected.
It was demonstrated in section 5.3.1 that the actual legal rule protection of creditors in Fiji was very weak; it was the worst among the 49 comparator countries. However, in section 5.4.1, a tentative conclusion was reached that after all, at least, legal rules may not be essential for further banking development in Fiji since the banking sector had developed positively in the past without adequate legal rules.

However, findings per section 5.5.3 may appear to question the strength of the above tentative conclusion. Results show that banks are concerned about the legal issues in relation to private sector credit in Fiji, with smaller banks relatively more concerned. Nonetheless, the level of concern not being seriously high, makes it difficult to say whether enhancement of rules is essential for further banking development in Fiji; it does appear relatively more important for smaller banks. In any event, the larger banks would only gain from any enhancement of the rules. Moreover, creditors in Fiji appear to be deprived of the most basic legal rights. It would be reasonable to improve that situation.

Enhancement of legal creditor rules could occur progressively. Law/policy makers may consider making incremental improvements to creditor legal rights. A good starting point appears to be STAY; banks appear to be most concerned about injunctions and delayed court procedures in relation to repossession of debt collateral in liquidation. Similarly, improvement could next be made to MANAGE and so on.

Further, from section 5.5.4, it appears that creditors may also be concerned about the quality of law enforcement. Perhaps, it is indeed the perceived high quality of ACT that has substituted for the otherwise weak enforcement quality. If banks continued to be content with ACT in the future, significant and positive changes to law enforcement
may not be required urgently. Moreover, it is the smaller banks that appear more concerned about the quality of law enforcement; the more important drivers of banking development appear less concerned. Accordingly, the quality of law enforcement also appears not to be too pressing an issue for banks in Fiji.

However, the real question is how long this could prevail; if the perception on enforcement did not change positively and conspicuously without much delay, despite its high quality, ACT by itself may not be sufficient for too long. In fact, the effect of this could already be setting in; following a relatively positive development, the banking sector appears to have been contracting in the post–1995 period, by 2001 the level of development appears to have reverted to 1989–90 levels. Perhaps, unpleasant credit experiences resulting from inadequate legal protection are an important reason for this. For instance, absence of STAY—the legal rule of most concern to creditors—could be a reason for the decline in the post–1995 credit to the private sector (BPRVY). Similarly, this could also be a result of the perception that COR was high.

In any case, 83% of the respondents stated that legal protection was more than moderately important for their banks; 67% considered it to be most important. While, the overall scores on both the rules and the enforcement quality were average, some variables—such as STAY and COR, respectively—appear to be of some concern to the creditors. Perhaps, it is not every aspect of the rule and enforcement that need to be urgently strengthened; progressive strengthening or even an undertaking that the adequacy of the rules and quality of enforcement are going to be reviewed and appropriate action taken, may suffice.

To answer RQ 2–6, in view of the foregoing, it is difficult to say if enhancement of legal institutions is essential for further banking development in Fiji. However, there is little doubt that enhancement would be beneficial. The current legal protection for
creditors is considerably weak; basic legal rules are non–existent and the quality of law enforcement is only average. Perhaps, an undertaking by the authorities to positively and conspicuously review the enforcement mechanisms with a view to improving the quality could be an important initial step. The evidence appears to support the relevant prior expectation—that enhancement of legal institutions would be important, but not essential, for further banking development in Fiji.

5.5.6 Should Legal Institutions Be Enhanced For Further Stock Market Development?

This section addresses RQ 2–7, i.e. is enhancement of legal institutions important, or even essential, for further stock market development. A review of the relevant theory and findings from Chapter 4 led to the prior expectation that enhancement of legal institutions would be important, but not essential, for further stock market development in Fiji.

The basis for the above prior expectation was initially provided in section 5.2; essentially, that lack of adaptability and familiarity is expected to make investor laws less meaningful to the shareholders. Nevertheless, it was expected that while a high proportion of the shareholders (including potential) may be unfamiliar with the specifics of individual rules and regulations, they may well be familiar with the basic notion of legal protection, including the importance and implications of law enforcement. Thus, despite a possible lack of knowledge and understanding of the specific laws, shareholders were generally expected to rate highly the need for legal protection for stock market participation. However, the expected lack of specific knowledge may have implied that the law itself would be less essential for further stock market development in Fiji; enforcement though, being a more subjective matter, may be more
important. The following consolidates the results and findings thus far to answer the
above question and thereby determine whether the above working hypothesis should be
accepted or rejected.

It was shown in section 5.3.2 that legal rule protection of shareholders in Fiji has been
relatively strong; Fiji has fared well against the comparator countries. In section 5.4.2,
a tentative conclusion was reached that enhancement of legal rules may not be
important for further stock market development in Fiji since development had not been
promising in the presence of historically strong rules.

Further, the findings per section 5.5.3 appear to suggest that shareholders either assume
that they are legally well protected or they are not aware of the basic legal rights they
are entitled to; the case being relatively, but not significantly, worse for potential
shareholders. The results support the conjecture that the lack of adaptability and
familiarity, coupled with the fact that the minority shareholders were mainly locals,
would indeed make investor laws less meaningful to these investors.

Specific legal rules may then not be an immediate concern for shareholders, who may
be content, believing that the relevant regulator(s) and the stock exchange, were aware
of the importance of their legal protection and that they were indeed already adequately
protected. On basis of the foregoing then, it may be argued that enhancement of legal
rules, at least, may not be too essential for further stock market development in Fiji.

However, it would be imprudent for shareholders to confide in the system to take
responsibility for their legal protection. While the shareholder awareness overall mean
score was 1.33, suggesting that the average awareness level was indeed very low; equal
to almost ‘total ignorance’, that of the experts was not any better; the expert mean score was 1.8, an indication that on average, experts were not aware of two-thirds of the basic shareholder legal rights. Moreover, 33% were totally ignorant of these rights—more than the shareholders themselves (30.4%).

The above signals a rather precarious situation for shareholders; for instance, if the very deemed guardians of the disparate and vulnerable investors—CMDA and SPSE—are themselves not sufficiently informed of the basic shareholder legal rights, it would indeed be extremely challenging for these institutions to understand the predicament of the ones they are expected to protect and/or to improve the situation. Thus, shareholders need to be cautious; in fact they need to be made aware of the existing situation.

The awareness campaign may include educating the shareholders as well as the regulators plus others in society about the importance of basic legal protection for minority shareholders and that the investors in Fiji are relatively well protected. Moreover, in view of the enormous benefits to be derived from a constructive development of the stock market, and given that past development has been rather weak, law makers may consider strengthening the legal rules to make the shareholders feel more comfortable and confident. A good starting point would be the rule relating to PROXY, which appears to have increasingly become a fundamental right of shareholders. Thus, while on one hand enhancement of legal rules for further stock market development in Fiji may appear not to be essential, on the other, it would be most beneficial to do so, at least progressively.
The situation relating to enhancing the quality of law enforcement for further stock market development appears similar to that relating to the legal rules component; there may be arguments supporting that enhancement is essential and also that it is not essential. Shareholders’ concern for law enforcement is not distinctively clear; while they may not be too discontent with the quality, they are not too pleased either.

The argument that enhancement may not be essential is similar to that of creditors; thus, like the banks, if the shareholders too continued to be content with ACT, enhancement of law quality may not be too pressing a priority. However, as argued above, for constructive further development of the stock market, it appears important to pay attention to at least the more serious concerns of shareholders—e.g. COR; an undertaking to sincerely deal with this would be a good starting point.

Further support for the case that enhancing legal rules and/or enforcement quality may be important for further stock market development is provided by the finding that 96% of the respondents stating that legal protection was important for their participation in the stock market; with 67% strongly expressing its importance. The overall mean was 6.4; that for current shareholders was 6.4 and for potential shareholders was 6.3, with 7 being the median score across the groups.

To answer RQ 2–7, it is also difficult to say if enhancement of legal institutions is essential for further stock market development in Fiji. However, as noted previously, (section 5.5.5) there is little doubt that enhancement would be beneficial. The evidence appears to support the relevant prior expectation—that enhancement of legal institutions would be important, but not essential, for further stock market development in Fiji.
5.5.7 Legal Reforms: A Word Of Caution

While the above findings and analysis do seem to suggest some reforms to Fiji’s investor laws, such suggestions need to be considered cautiously. The finding that legal rules reform may not be essential is in fact encouraging; legal reforms may prove to be difficult due to likely opposition by powerful interest groups. An important objective of a reform or otherwise strengthening of legal investor rules would be to better protect the rights of ‘outsiders’—the suppliers of credit and equity funds to corporations. Adequately protected creditors and shareholders are likely to be more inclined to supply funds resulting in greater levels of funds available to the private sector. The difficulty of addressing weak legal investor rights, though, emanates from the very authority expected to initiate it—government.

These policy making bodies may be reluctant to initiate reforms for fear of surrendering to the financiers (creditors and shareholders) the regulatory control they may be enjoying over large corporations (La Porta et al., 2000; Coffee, 1999). Such political opposition may be exacerbated by these large corporations themselves who may fear that improved rights of outsiders may result in reduced control over ownership and cash flows. Such opposition becomes more pronounced as the proportion of family-owned business increases, which appears to have been the case across countries—from Latin America, to Asia, to Western and Eastern Europe (La Porta et al., 2000).

Further, large corporations are often able to finance business operation and growth with internally generated funds or through captive or closely connected outside financiers—usually banks (Rajan and Zingales, 2003). La Porta et al. (1997) show that in countries with weak investor protection, a substantial share of bank credit goes to a few large corporations. The weak investor protection—low financial development situation benefits both the corporation and the financier (banks)—both are able to protect their
positional rents, which is likely to be competed away with financial development. The mutual ‘rent protection’ objectives enable financiers to solicit the support of firms in return for privileged access to finance and protection of confidentiality. These incumbents have large economic power to collectively determine the development of the financial sector through political influence. The result often is to keep the system as is.

The proportion of family–owned businesses in Fiji appears to be substantial (ADB, 2001b; Chand, 2002) and a number of these appear to be large, indicating that a change in the legislation to enhance the powers of financiers is likely to receive strong political opposition. Further, banks appear to have enjoyed substantial positional rents over many years (e.g. White, 1999; CIFS, 1999) and may not like to upset these corporations by supporting initiatives to enhance investor rights. In fact, they are likely to support large corporations’ position in opposing at least improvements to shareholder rights—improved shareholder rights is likely to result in development of the stock markets, which in turn is likely to erode banks’ positional rents. Perhaps, this explains the finding that despite their presumed familiarity with legal rights, banks have to date not required authorities to review/enhance investor protection laws in the country. If they are able to produce high levels of profits in an environment of weak investor legal protection, they may be content with status quo.

Indeed, in over eight decades—since the adoption of the British investor laws in 1925—there appears to be no meaningful amendment to the relevant legislation; at least the creditor and shareholder rights examined in this study have not changed in that period. However, banks have indicated that some improvement to their legal protection would be desirable. Perhaps, some improvement to the quality of law enforcement would suffice, which may also be sufficient for shareholders whose current legal rights are
relatively strong. In any case, improvements to shareholder legal rights are likely to be strongly opposed. For example, firms are likely to oppose increased voting rights (such as legislation of PROXY) of outside shareholders.

5.6 CHAPTER SUMMARY

This chapter examined the influence of a key supply-side determinant of financial development—legal institutions—on Fiji’s historical and prospective financial development. In essence, the chapter addressed RQ 2 of this study—what is the role of legal institutions in Fiji’s financial development?

A cross-country analysis, using secondary data, shows that the legal rights of creditors in Fiji have historically been weak and/or not improved progressively but those of shareholders have historically been strong. Further, it is shown that legal institutions (both rules and enforcement) may not have played an essential role in either banking or stock market development in the past: while the banking industry has developed positively despite weak legal rules and average enforcement, development of the stock market has not been impressive despite strong rules and average enforcement.

The question of whether enhancement of legal institutions is essential for further development of banking and stock market was investigated via an opinion survey of creditors and shareholders, the very party whose legal protection is agreed in the literature to be paramount for meaningful development of the respective sectors. Examination of the primary data shows that both the creditors and shareholders are concerned about their legal protection as investors. Perhaps the post–1995 decline in banking development and the generally weak stock market development have been caused by an emerging realisation/experience of relatively weak protection via rules and/or enforcement. Thus, legal institutions may be important for financial development in Fiji. However, it is less clear that reforming or otherwise enhancing
legal institutions is *essential* for further development. Legal institutions appear not to have been essential for development in the past and the opinion survey does not find creditors and shareholders to be too concerned about the situation.

It is possible that while legal institutions play a major role in more developed economies, their role may not be so essential in less socio–economically developed countries like Fiji. Perhaps other supply–side determinants of financial development, such as politics and culture (see section 2.6) are equally, or even more, important than legal institutions for a country like Fiji. As the framework developed in chapter 2 suggests, demand–following determinants, favouring alternative channels of finance (the subject of the next chapter) may also play an important role in these countries. Nevertheless, even for Fiji, in terms of legal institutions, some enhancement of investors’ legal protection appears desirable; perhaps the quality of enforcement may be enhanced, that of the rules does not appear advisable due to the likely opposition by powerful interest groups. A simultaneous awareness and educational campaign would also be useful, as it may highlight Fiji’s relative better comparative position as appropriate, such as that of the highly rated ACT—accounting standards.

In exploring ways to enhance financial development in Fiji, this chapter examined the influence of an important supply–side determinant; the next chapter examines the influence of some demand–side determinants.
Chapter 6
Alternative Finance and Barriers to
Financial Development in Fiji

6.1 OVERVIEW

As outlined in the framework developed in section 2.5, while the supply of funds appears important for financial development, the demand for funds appears equally important for the purpose. Thus, while it is important to explore and understand the factors critical for continued and increased supply of funds, such as legal protection of investors—the subject of chapter 5—it appears equally important to explore and understand the factors that may determine the demand for financial sector funds.

Accordingly, this chapter examines the influence of some likely demand-side determinants of financial development on Fiji’s historical and prospective financial development. Adverse attributes of these determinants are likely to result in firms turning away from the financial sector to alternative sources. In view of the expectation that the level of alternative finance in Fiji has been significant in the past and likely to be so in the future, it becomes important to acquire a reasonable understanding of the extent and nature of these sources and the reasons for their preference relative to financial sector funds so as to explore ways to make the latter more attractive for accelerating financial development.

Thus, this chapter attempts to answer the third research question (RQ 3) of this study i.e. what is the role of demand-side factors in firms’ reliance on alternative finance? In this study, the term ‘alternative finance’ includes ANY funding source for a firm that is

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6-1 In this study, the demanders of funds are confined to the private sector firms; see section 2.3 for details.
NOT from the formal financial sector, i.e. anything other than domestic bank and/or stock market finance in case of Fiji, such as founders’ capital and retained earnings.

The rest of the chapter is organised as follows. The next section reviews the definition of alternative finance and provides a method for measuring it. Section 6.3 outlines the specific research questions to be addressed in this chapter and discusses the prior expectations in relation to each of these questions. Section 6.4 investigates the importance of alternative finance in Fiji. Section 6.5 analyses the nature and trends of alternative finance. Section 6.6 examines how various factors may have influenced the preference for alternative finance. Section 6.7 explores the possibility of encouraging firms to use more financial sector funds. Section 6.8 summaries the main issues and findings of the chapter.

6.2 ALTERNATIVE FINANCE: CONCEPTUAL AND MEASUREMENT ISSUES

To put things into perspective, it appears important to review the definition of alternative finance first. Alternative finance (hereafter, ALT) is defined in this study to be any source of firm finance NOT from the formal financial sector. As noted in chapter 2, (see figure 2–7) firms may obtain funds from various sources, which may be categorised into internal or external. The internal sources may include founder’s equity, family/friend equity/loan and retained earnings. The external sources may be further separated into that from financial and non-financial sectors, where the former includes financial institutions (e.g. bank credit) and financial markets (e.g. stock market equity) and the latter includes trade and other credit, inter-company/shareholder/director loans, money lenders and others. Thus, from the private sector perspective, financial sector funds may be but only one of many funding options for business operation and growth.
The definition of ALT requires further important clarification. As chapters 2 and 5 (s 2.4 and 5.4.2, respectively) note, while size is an important measure of both intermediary and market development, activity appears to be a relatively more important measure. For example, while a country’s stock market capitalisation (size as measured by MCAP) may be increasing; indicating thus a growth in size of the market, activity (TRADE) in the market may be relatively low. Thus, while a large number of companies may be listed on the domestic stock exchange, trading may be low; it is the volume and frequency of trading of shares that matters more for stock market development.

That is, MCAP may substantially overestimate stock market development. For example, if 90 percent of a firm’s equity is held by the ultimate owners, their subsidiary companies and/or their families and friends and only 10 percent by the public, then MCAP gives a tenfold overestimate of stock market development (e.g. La Porta et al., 1998). It is the publicly held (tradeable) shares that matters for stock market development. Thus, only actual ‘public’ shares are considered as stock market finance; others (held by the ultimate owners, their subsidiary companies and/or their families and friends) are included in ALT.

To summarise the concept of ALT so far,

\[
\begin{align*}
TFF &= FS + ALT \\
&= (BANK + SM) + ALT \\
&= [BANK + (SMPE + SMNPE)] + ALT \\
&= (BANK + SMPE) + ALT
\end{align*}
\]

where,

\[
\begin{align*}
TFF &= \text{total firm funding,} \\
FS &= \text{financial sector funds (banks and stock markets);} \\
ALT &= \text{alternative sources (all others)} \\
BANK &= \text{total funds from bank;} \\
SM &= \text{total funds from the stock market;} \\
SMPE &= \text{stock market public equity;} \\
SMNPE &= \text{stock market non–public equity—held by the ultimate owners, their subsidiary companies and/or their families and friends and is included in ALT in equation (4).}
\end{align*}
\]
Thus, firm funding (TFF) may broadly come from the formal financial sector (FS) and/or non–financial sector—alternative—sources (ALT) (equation 1). In the case of Fiji, this study confines financial sector funds to banks (BANK) and the stock market (SM) (equation 2). The shares issued via stock markets may be held by the general public (no association/relationship with the company)—SMPE—or by the ultimate owners, their subsidiary companies and/or their families and friends—SMNPE. It is the SMPE proportion of the issued shares that are most likely to be traded and therefore determines TRADE in the market and thus market development. SMNPE is less likely to be traded and therefore makes little contribution to market development and should thus be excluded from formal financial sector funds and included in ALT.

Figure 6–1: Financial development: A demand perspective

The private sector may obtain finance from various sources, including the financial sector; the volume and extent of demand for this may importantly determine the level of a country’s financial development, such that increased demand for financial sector funds is likely to foster financial development.

Other components of ALT include funds from fundraising; state budget; foreign direct investment, relationship and reputation–based channels; private credit/lending agencies; coalitions among producers and retailers; cross–listed accounts, and all informal sources. Conceptually then, and as summarised in figure 6–1, ALT is defined as any

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source of finance other than domestic bank finance (BANK) and stock market public equity (SMPE).

6.3 SPECIFIC QUESTIONS AND PRIOR EXPECTATIONS

The main question being addressed in this chapter—what is the role of alternative finance for financial development in Fiji—may be investigated more effectively by examining the following, related sub-questions.

Historically,

RQ 3–1: what has been the relative importance of alternative channels of finance?

RQ 3–2: how have various factors influenced firms’ preference for alternative sources?

And

Potentially,

RQ 3–3: can financial sector funds be made more attractive to the firms?

Prior expectations or ‘working hypotheses’ have been formed regarding each of these sub-questions based on:

(i) the demand for funds argument developed in chapter 2; and

(ii) findings from Chapter 4 (financial development in Fiji).

As section 2.5 notes, while literature appears abundant with studies on the supply–side determinants of financial development, it appears scarce on the demand–side determinants. However, this study (Chapter 2) advances arguments to illustrate that for financial development, the demand for financial sector funds may at least be as important as its supply. The study also identifies some likely demand–side determinants of financial development. For reasons outlined below, it would appear that the specific attributes of the identified determinants, may in the case of Fiji, be such
that the private sector firms are discouraged from using financial sector funds and encouraged to turn to alternative finance much more for business operation and growth.

Fiji is a developing economy dictated by a financial sector of colonial legacy—a consequence of imported systems. The country’s financial sector has historically been dominated by foreign institutions or otherwise influenced by them (see section 4.3). Further, regulatory practices have also been imported or heavily influenced by foreign/international practices. Occasionally, there has also been extensive government control and intervention (e.g. Reddy, et al. 2004). Further, borrower creditworthiness has usually been suspicious and default risk perceived to be relatively high (e.g. White, 1999).

In these circumstances, practices and procedures in the formal financial sector are likely to be designed to ration credit or otherwise exclude a large number of potential borrowers (e.g. Germidis et al., 1991). Government–initiated credit rationing has included regulatory and moral suasion strategies to influence bank credit to priority sectors to support development (Reddy et al., 2004). Bank credit has also been used to positively influence liquidity, inflation and foreign reserve levels. Such practices are likely to have influenced post–regulation lending practices and strategies of banks, such that the specific attributes of the identified demand–side determinants—paperwork and bureaucracy, collateral, disclosure and costs—are likely to have strongly discouraged use of financial sector funds and influenced greater preference for alternative finance.

For example, disclosure–related concerns and consequences, which arise particularly where firm ownership structures have strong family base, are expected to feature prominently in encouraging firms to turn to alternative sources. Family–ownership appears to be prevalent in Fiji (ADBb, 2001; Chand, 2002). Moreover, ADB (2001b)
suggests that family–owned firms in Fiji tend to be highly secretive about their business affairs. Thus, it is expected that disclosure will feature prominently in firms’ preference for funding sources; formal sources require high levels of disclosure and are thus likely to be less attractive than many alternative channels. Stock market listing, especially, requires high levels of public disclosure and therefore is expected to be of more concern to family–owned businesses, which may explain the relatively small number of listed firms.

In over 25 years of existence, only 16 companies have listed on the stock exchange. The multi–million dollar, family–run local companies choose not to list. The listed companies include local subsidiaries of multinationals or divested state enterprises (Chand, 2002). Many well established, multi–million dollar companies, such as the Punja, Vinod Patel, Tappo and Motibhai, group of companies, are family–owned and –run and yet to list.

Moreover, Chapter 4 highlights that trading or TRADE (Total value traded/GDP), which represents activity in the stock market, and is also very low in Fiji (section 4.8.2). Fiji’s stock exchange—South Pacific Stock Exchange (SPSE)—requires listed firms with issued and paid up capital of over FJD500,000 to issue at least 10% of total shareholding to the general public (SMPE); similarly a 15% requirement applies to firms with issued and paid up capital of FJD200,000 to 500,000 and 25% for less than 200,000. Most listed and potentially listable firms would fall in the first category and accordingly would not be compelled to issue more than 10% of the shares to the public, i.e. up to 90% may be held by parent, subsidiary or associate companies, directors and members of their families and/or their nominees and not be traded.
In view of the foregoing, it is expected that the extent of stock market non-public equity (SMNPE) would be much larger than the public equity/share in Fiji (SMPE), such that, in terms of equation (4) above—\[TFF = (BANK + SMPE) + ALT\], where SMNPE is part of ALT and SMPE is part of the financial sector funds—the proportion of ALT is expected to be greater than financial sector funds even where funds are seen to be raised via financial markets.

Similarly, costs too are expected to importantly drive firms away from the financial sector, particularly in case of bank finance (BANK). Indeed, Sharma and Reddy (2003) find cost to be an important deterrent to basic banking services in Fiji. This view is shared by White (1999) and CIFS\(^{6-2}\) (1999). For example, the CIFS reports that the cost of banking services in Fiji has been high and had increased substantially over the years, making these services increasingly unaffordable for many customers. Collateral and paperwork requirements are also likely to be contributing to these results.

Findings from Chapter 4 show that bank credit to private sector (BPRV) has been declining since the mid 1990s. For example, the banking sectors of some comparator countries such as Indonesian—which appeared less developed than Fiji in previous decades—lent much more to the private sector in the 1990’s, and hence surpassed Fiji’s development. Moreover, the banking sector of even New Zealand—which was doing worse than Fiji in the 1970’s and while performing better than Fiji in the 1980’s but ranking only slightly above Fiji, continued to grow substantially in the 1990’s to not only considerably outpace Fiji’s development but also to occupy the second highest position among all countries in the sample, next only to Japan. In the 10–year period to 2003, Fiji’s average BPRVY (34%) was less than its 1990’s average, indicating a fall in

\(^{6-2}\) CIFS is the Report of the Committee of Inquiry into Fiji’s Financial System, initiated and funded by Fiji government.
bank credit to private sector. Moreover, Fiji fell behind Vanuatu and Philippines, which it had constantly outpaced previously.

In view of the foregoing, firms are likely to be using more alternative sources relative to bank credit for business operation and growth, such that, in terms of equation (4) above—\( TFF = (BANK + SMPE) + ALT \)—the proportion of ALT is expected to be generally greater than BANK finance, where bank finance is an option.

Nevertheless, firms may be encouraged to use more financial sector funds relative to alternative sources. The former could be made more attractive via favourable changes to the attributes of the demand determinants such as costs, paperwork and bureaucracy, disclosure and collateral requirements. For example, if the deemed high costs, high levels of disclosure, collateral and paperwork are indeed found to be discouraging the use of financial sector funds, appropriate levels of moderation in these attributes are likely to help in making the financial sector funds more attractive.

On the basis of the above, the prior expectations are that alternative finance has been extensive in Fiji and the specific attributes of the identified demand–side determinants of financial development, in the case of Fiji, have been such that the private sector firms have been discouraged from using financial sector funds and encouraged to turn to alternative finance much more for business operation and growth. Nonetheless, financial sector funds may be made more attractive to the firms with appropriate levels of positive moderation in the attributes of the identified factors.

6.4 EXTENT OF ALTERNATIVE FINANCE IN FIJI

This section attempts to examine RQ 3–1 i.e. what has been the relative importance of alternative channels of finance in Fiji? Arguments advanced in Chapter 2 and findings
from Chapter 4 led to the prior expectation that alternative finance has been extensive in Fiji.

To ascertain the relative importance and extent of ALT, two approaches have been used: (i) primary survey to obtain the views of the firms on its relative importance; and (ii) analysis of secondary data to confirm the actual likely extent.

6.4.1 Survey Results

Section 3.3 provides details of the survey. Table 6–1 provides an industry profile of the 75 firms interviewed. The categorisation of the business sector was initially obtained from Fiji ‘Yellow Pages’ and subsequently condensed as displayed in table 6–1. In addition to business type/sector, a number of other issues was also considered, including size, date and place of incorporation, listing status, and ownership type. Responses obtained, on a 1 to 7 Likert scale, were entered into appropriately designed excel spreadsheets.

Table 6–1: Industry profile of firms analysed for this research

Table 6–1 shows industry categorisation of the 75 firms interviewed in the opinion survey conducted for this study to understand various issues in relation to alternative finance and financial development in Fiji. Please see section 3.3.3 for information on selection of firms.

<table>
<thead>
<tr>
<th>Business category/sector</th>
<th>Business Code</th>
<th>No. of firms interviewed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Airlines, Air Services &amp; Port</td>
<td>AIR</td>
<td>3</td>
</tr>
<tr>
<td>Build Const, Hardware, Homeware</td>
<td>BCHH</td>
<td>12</td>
</tr>
<tr>
<td>Consumables</td>
<td>CONS</td>
<td>11</td>
</tr>
<tr>
<td>Exporters</td>
<td>EXP</td>
<td>4</td>
</tr>
<tr>
<td>General Retail &amp; Wholesale</td>
<td>GRW</td>
<td>13</td>
</tr>
<tr>
<td>Media</td>
<td>MEDIA</td>
<td>2</td>
</tr>
<tr>
<td>Office Supplies</td>
<td>OSPL</td>
<td>7</td>
</tr>
<tr>
<td>Post &amp; Telecommunication</td>
<td>P&amp;T</td>
<td>2</td>
</tr>
<tr>
<td>Property &amp; Vehicle Rental Services</td>
<td>PVR</td>
<td>5</td>
</tr>
<tr>
<td>Textiles Fabrics &amp; Footwear</td>
<td>TFF</td>
<td>7</td>
</tr>
<tr>
<td>Vehicles (New &amp; Used)</td>
<td>VEH</td>
<td>4</td>
</tr>
<tr>
<td>Others</td>
<td>OTH</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>75</td>
</tr>
</tbody>
</table>
From the firm perspective, to determine the importance of various sources of funds for operation and growth of their businesses, respondents were asked to rate a list of sources from 1 to 7, where, 1 = least important; 4 = moderately important; 7 = most important; below 4 = less important and above 4 = highly important. The list of funding sources (see table 6–2) on which responses were obtained, was developed on the basis of (i) what would normally be considered a source of funds for firms; (ii) the information disclosed in annual reports of firms in Fiji; and (iii) additional sources likely to be used in developing economies e.g. money lenders. While microfinance and cooperatives may also be additional sources of business funds in Fiji, neither the primary survey nor the secondary data revealed use of these sources by the sample firms. Moreover, as noted by Kinivuwai, the Director of Microfinance in Fiji, the main beneficiaries have been women and indigenous Fijians in rural areas6-3; it may not be an important source of funds for business firms, particularly those in the urban areas, such as the ones included in the sample.

Analysis of responses obtained shows (table 6–2) that the most important source of funding for firms in Fiji is own capital (mean 5.7) followed closely by retained earnings (mean 5.5). Domestic bank (mean 2.3) and stock market (mean 1.3) appear to be relatively unimportant sources. That is, funding from ALT channels appears to be more important than the formal financial sector channels; the maximum importance ranking for the domestic bank source was only 3—less than moderate. Moreover, some ALT channels appear to be remarkably more important than the financial sector channels. For instance, own capital and retained earnings appear twice as important as bank and up to four times more important than stock market finance.

Table 6–2: Importance of various funding sources for firms in Fiji

Table 6–2 shows funding sources for firms in Fiji ranked by importance on a scale of 1 to 7, where 1 is least important, 4 moderately important and 7 most important. Thus, ‘own capital’ emerged as the most important source of funds and domestic stock market as the least important. Generally, financial sector sources (domestic bank and stock market) were ranked less important than alternative sources.

<table>
<thead>
<tr>
<th>Funding Source</th>
<th>No. of responses</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Own capital</td>
<td>70</td>
<td>5.7</td>
<td>1.815</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>53</td>
<td>5.5</td>
<td>1.185</td>
</tr>
<tr>
<td>Trade credit</td>
<td>73</td>
<td>4.9</td>
<td>1.630</td>
</tr>
<tr>
<td>Other credit</td>
<td>71</td>
<td>4.6</td>
<td>1.555</td>
</tr>
<tr>
<td>Inter-company loans</td>
<td>53</td>
<td>3.9</td>
<td>2.315</td>
</tr>
<tr>
<td>Director loans</td>
<td>60</td>
<td>3.9</td>
<td>1.914</td>
</tr>
<tr>
<td>Shareholder loans</td>
<td>37</td>
<td>3.0</td>
<td>1.900</td>
</tr>
<tr>
<td>Equity from friend/family</td>
<td>64</td>
<td>2.8</td>
<td>1.717</td>
</tr>
<tr>
<td>Loan from family/friend</td>
<td>65</td>
<td>2.8</td>
<td>1.727</td>
</tr>
<tr>
<td>Domestic bank</td>
<td>75</td>
<td>2.3</td>
<td>0.506</td>
</tr>
<tr>
<td>Moneylenders</td>
<td>53</td>
<td>2.3</td>
<td>1.751</td>
</tr>
<tr>
<td>Domestic stock market</td>
<td>75</td>
<td>1.3</td>
<td>1.220</td>
</tr>
</tbody>
</table>

Surprisingly, loans and equities from families and friends appear less important than would generally be expected in a developing country. However, there seems to be considerable reliance on trade and other credit and inter–company and director loans. Discernibly, the two loans would be from related parties; perhaps, the two credits are also from related parties. Accordingly, these could be used in lieu of loans and equities from families and friends.

Further, firms across business sectors appear to have similar preferences for funding sources. For example, while own capital (an alternative source) ranks most important for up to 80% for all firms across sectors, bank (a financial sector source) is not ranked most important by any firm in any sector (table 6–3). Moreover, bank’s maximum importance as a source of funds is merely average across sectors. On the other hand, own capital is highly important for 54% to 100% of firms across sectors. Similar trends are observed when comparing firms by ownership and size; being family or non–family owned, small or large does not appear to matter.
Table 6–3: Importance of own capital vis-à-vis bank funds for firms in Fiji

Table 6–3 compares the importance of ‘own capital’ (an important alternative source) with bank funds (an important financial sector source) across various groups of firms in Fiji. The values in the table are in percent and the selected business categories are those with 5 or more firms (see table 6–1). This table reiterates the relative importance of alternative sources of funds in Fiji as shown in table 6–2. E.g. own capital is most important for up to 80% of the firms across the business sectors; bank is not at all important for any firm in any sector.

<table>
<thead>
<tr>
<th>Importance</th>
<th>BCHH</th>
<th>CONS</th>
<th>GRW</th>
<th>OSPL</th>
<th>OTH</th>
<th>ALL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>9</td>
<td>0</td>
<td>9</td>
<td>0</td>
<td>0</td>
<td>22</td>
</tr>
<tr>
<td>2</td>
<td>9</td>
<td>67</td>
<td>0</td>
<td>55</td>
<td>8</td>
<td>43</td>
</tr>
<tr>
<td>3</td>
<td>0</td>
<td>36</td>
<td>0</td>
<td>23</td>
<td>0</td>
<td>57</td>
</tr>
<tr>
<td>4</td>
<td>18</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>8</td>
<td>0</td>
</tr>
<tr>
<td>5</td>
<td>18</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>8</td>
<td>0</td>
</tr>
<tr>
<td>6</td>
<td>27</td>
<td>0</td>
<td>20</td>
<td>0</td>
<td>8</td>
<td>0</td>
</tr>
<tr>
<td>7</td>
<td>18</td>
<td>0</td>
<td>80</td>
<td>0</td>
<td>67</td>
<td>0</td>
</tr>
</tbody>
</table>

To partially answer RQ 3–1—what has been the relative importance of alternative finance channels in Fiji—the alternative channels of finance do appear to be much more important than the financial sector sources for the operation and growth of business in Fiji; it is now increasingly likely that the use of these sources is indeed extensive. The next sub-section investigates the likely actual situation. In the meantime, the evidence so far appears to support the prior expectation.

6.4.2 Annual Report Results

To further understand the likely extent of ALT, the annual reports of 27 firms over a 30–year period were examined. Despite time and other resource constraints, it was possible to collect reasonable historical information on the 27 firms. Table 6–4 provides a summary profile of these firms. There were only 13 listed firms in Fiji at the time of data collection and all had been included in the sample. In addition, the sample covered a wide range of business types/sectors in Fiji, including consumables (food, drinks, etc.); building–construction; hardware; and home ware. The size of a firm was determined on the basis of average assets over the 1980–2003 period, such that small = less than $20m; medium = $20m to $100m; and large = more than $100m average.
assets over this period. The total assets of these firms were equivalent to 50–60% of the country’s GDP over this period.

Table 6–4: Summary profile of firm respondents interviewed in the opinion survey conducted for this research

Table 6–4 shows selected characteristics of the 27 firms whose annual reports were analysed to understand the likely extent of alternative finance in Fiji. E.g. 48.1% were listed on the stock exchange and 25.9% were family–owned.

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Listing status</strong></td>
<td></td>
</tr>
<tr>
<td>Listed</td>
<td>48.1</td>
</tr>
<tr>
<td>Unlisted</td>
<td>51.9</td>
</tr>
<tr>
<td><strong>Size</strong></td>
<td></td>
</tr>
<tr>
<td>Small</td>
<td>51.9</td>
</tr>
<tr>
<td>Medium</td>
<td>29.6</td>
</tr>
<tr>
<td>Large</td>
<td>18.5</td>
</tr>
<tr>
<td><strong>Ownership</strong></td>
<td></td>
</tr>
<tr>
<td>Family</td>
<td>25.9</td>
</tr>
<tr>
<td>Non-family</td>
<td>74.1</td>
</tr>
</tbody>
</table>

Using the balance sheet information and equation 4, the total value of ALT for each firm was determined as follows:

\[
TFF = (BANK + SMPE) + ALT \quad (4)
\]

Thus, \[
ALT = TFF - (BANK + SMPE) \quad (4–1)
\]

The total value of BANK for each firm i.e. total borrowing from domestic banks—including overdrafts, short–term and long–term loans—could be determined without much difficulty from the balance sheet in conjunction with the notes. The total value of SMPE was determined as follows. Section 3.3 (b) of the SPSE listing rules require that published accounts of listed firms include, *inter alia*, ‘a distribution schedule of each class of equity security setting out the number of holders and percentage in various categories’. The names of directors, founders and their associates are also reported in the financial statements, together with their respective shareholding in the company. This information enabled separating shares into that held by the ultimate owners, their subsidiary companies and/or their families and friends (SMNPE) and that held by the...
public (SMPE). Thus, the difference between TFF and the sum of BANK and SMPE produced ALT.

Due to gaps in the data collected, the analysis period was confined to 1980—2003. Over this time period, an analysis of the situation at three focal points—1980, 1990 and 2000—gives a reasonable indication of the historical importance of various funding sources for firms in Fiji; where possible, comparison with 2003 data gives an indication of more recent trends. Complete respective relevant data was available for 13 (not necessarily that of listed firms) of the 27 firms. For these 13 firms, as panel A of table 6–5 shows, indeed, ALT finance channels have historically been by far the most important source of funding; in fact, funding from the formal financial sector has been very low, with the stock market being a rather insignificant source. The mean ALT source for the three time points is around 91% i.e. a significant level of funding for these firms was obtained from sources other than the formal financial sector.

Table 6–5: Extent of alternative finance


Panel A shows the extent of alternative finance in Fiji; the values are in percent. Annual reports of 27 firms were analysed over the 1980–2003 period and 1980, 1990 and 2000 used as focal points; results of the 13 firms with the complete respective data and that of all firms (27) are shown in the respective sections of panel A. E.g. in 1980, on average, 92% of total funds for the respective groups were sourced from alternative channels; only 8% came from the financial sector.

<table>
<thead>
<tr>
<th></th>
<th>Firms with complete 3 point data</th>
<th>All firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>92</td>
<td>92</td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>8</td>
<td>12</td>
</tr>
<tr>
<td>Minimum</td>
<td>79</td>
<td>69</td>
</tr>
<tr>
<td>Maximum</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Survey of firms in Fiji per present research
Panel B: Other developing countries and regions

Panel B shows the proportion of firm assets financed from alternative sources in other developing countries and regions and across various income groups; the values are in percent. E.g. in Bangladesh, 70% of firm assets is financed from alternative sources.

<table>
<thead>
<tr>
<th>Across Countries</th>
<th>Alternative Finance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>70</td>
</tr>
<tr>
<td>Brazil</td>
<td>86</td>
</tr>
<tr>
<td>China</td>
<td>79</td>
</tr>
<tr>
<td>India</td>
<td>67</td>
</tr>
<tr>
<td>Indonesia</td>
<td>84</td>
</tr>
<tr>
<td>Nigeria</td>
<td>70</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>94</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Across Regions</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>81</td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td>68</td>
</tr>
<tr>
<td>(excluding China)</td>
<td></td>
</tr>
<tr>
<td>East Europe and Central Asia</td>
<td>87</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>79</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>87</td>
</tr>
<tr>
<td>South Asia</td>
<td>77</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Across Income Groups</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Low Income</td>
<td>83</td>
</tr>
<tr>
<td>Middle Income</td>
<td>83</td>
</tr>
<tr>
<td>High Income OECD</td>
<td>79</td>
</tr>
</tbody>
</table>

Source: Allen et al., 2005

On a positive note, the high use of ALT is not too uncommon in developing economies. Panel B of table 6–5 (also in chapter 2, shown as table 2-2) highlights the extent of ALT across seven developing economies, geographic regions and income groups across the world. However, Fiji’s average is still relatively high, indicating that use of ALT in this developing country may be on the higher side.

From the financial sector perspective, the most encouraging situation appears to be recorded in 2000 with funding from this source rising to as much 31% (ALT = 69). However, that was for only 1 out of the 13 firms (7.7%). Moreover, the mean for ALT in that year is still relatively high and 5 out of 13 firms (39%) had obtained funds exclusively (100%) from ALT sources. Thus, over the 20–year period—(1980—2000)—the prominence of ALT as a source of funding for firms in Fiji appears not to have withered; more than 90% of all funding appears to have been constantly sourced from ALT channels.
The results appear similar with all 27 firms. As Panel A of table 6–5 shows, the ‘all firm’ mean ranges from 87% to 92%. It is interesting, however, to note that the mean appears to be declining, albeit slightly. The 2003 ‘all firm’ mean continued in that direction—down to 86%. Interesting also is the observation that the funding from the financial sector may have increased for some firms over the 20–year period—the minimum ALT appears to have constantly declined from 79% to 43%, i.e. funding from the financial sector would have increased from 21% to 57% for these firms.

Table 6–6 shows the extent of alternative finance by listing status, using all 27 firms; the values are in percent. As the table shows, listed firms appear to use more funds from the financial sector compared to unlisted firms. E.g. in 2000, the ALT mean for listed firms was 81% while that for unlisted firms was 94%, i.e. on average, listed firms used 19% funds from the financial sector; unlisted firms used only 6%.

<table>
<thead>
<tr>
<th>Listing Status</th>
<th>1980</th>
<th>1990</th>
<th>2000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Listed</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>88</td>
<td>90</td>
<td>81</td>
</tr>
<tr>
<td>Std. Dev</td>
<td>9</td>
<td>12</td>
<td>17</td>
</tr>
<tr>
<td>Minimum</td>
<td>79</td>
<td>74</td>
<td>43</td>
</tr>
<tr>
<td>Maximum</td>
<td>97</td>
<td>100</td>
<td>96</td>
</tr>
<tr>
<td>Unlisted</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>95</td>
<td>89</td>
<td>94</td>
</tr>
<tr>
<td>Std. Dev</td>
<td>07</td>
<td>15</td>
<td>8</td>
</tr>
<tr>
<td>Minimum</td>
<td>79</td>
<td>54</td>
<td>79</td>
</tr>
<tr>
<td>Maximum</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>All</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>92</td>
<td>89</td>
<td>87</td>
</tr>
<tr>
<td>Std. Dev</td>
<td>8</td>
<td>14</td>
<td>15</td>
</tr>
<tr>
<td>Minimum</td>
<td>79</td>
<td>54</td>
<td>43</td>
</tr>
<tr>
<td>Maximum</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Analysis by listing status of firms6–4, using all 27 firms, shows that firms listed on the stock exchange may be using relatively more funds from the financial sector compared to unlisted firms. While there is no significant correlation between listing status and finance source, the ALT mean, minimum and maximum statistics appear more favourable for listed firms (table 6–6). For instance, in 2000, the ALT mean for listed firms was 81% while that for unlisted firms was 94%, i.e. on average, listed firms used 19% funds from the financial sector; unlisted firms used only 6%. An implication of this trend could be that while trading activities (TRADE) in the stock market may be

6–4 It should be kept in mind that most of the listing on SPSE occurred subsequent to the establishment of a call market in 1996.
undesirably low (see section 4.8.2), resulting in a sluggish development of the sector, encouraging firms to list may have a positive impact on overall financial development. Perhaps, unlisted firms are less inclined to use financial sector funds.

Analysis by size of firms (table 6–7) shows that smaller firms may generally be using relatively more funds from the financial sector—the small firm ALT mean and minimum statistics are constantly lowest for each of the three point times. Moreover, as with the listing status analysis, the trend for small firms appears to have become more favourable by 2000. Further, the medium firms in turn appear to be using more funds from the financial sector than the larger firms. While there is no significant correlation between firm size and finance source, results do suggest that use of funds from the financial sector may be falling as firm size increases; perhaps, as Guiso et al. (2004) and Rajan and Zingales (2003b) assert, larger firms are indeed less inclined to use financial sector funds.

Table 6–7: Extent of alternative finance in Fiji by size of firms

Table 6–7 shows the extent of alternative finance by size, using all 27 firms. As the table shows, smaller firms appear to use more funds from the financial sector compared to larger firms. E.g. in 2000, the ALT mean for small firms was 83% while that for large firms was 97%, i.e. on average, small firms used 17% funds from the financial sector; large firms used only 3%.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Small</td>
<td>Mean</td>
<td>88</td>
<td>79</td>
</tr>
<tr>
<td></td>
<td>Std. Deviation</td>
<td>9</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>79</td>
<td>54</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>100</td>
<td>97</td>
</tr>
<tr>
<td>Medium</td>
<td>Mean</td>
<td>94</td>
<td>96</td>
</tr>
<tr>
<td></td>
<td>Std. Deviation</td>
<td>08</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>79</td>
<td>74</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Large</td>
<td>Mean</td>
<td>97</td>
<td>99</td>
</tr>
<tr>
<td></td>
<td>Std. Deviation</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>97</td>
<td>99</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>98</td>
<td>100</td>
</tr>
<tr>
<td>All</td>
<td>Mean</td>
<td>92</td>
<td>89</td>
</tr>
<tr>
<td></td>
<td>Std. Deviation</td>
<td>08</td>
<td>14</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>79</td>
<td>54</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>
Guiso et al (2004) demonstrate, *inter alia*, that financial development is differentially important for large and small firms; the real beneficiaries being smaller firms and potential entrepreneurs. Rajan and Zingales (2003b) propose that larger firms may indeed use less financial sector funds, in the interest of protecting their economic power and positional rents, which are likely to be competed away with development.

To answer RQ 3–1 more fully, the evidence appears to support the prior expectation—the use of alternative finance by firms in Fiji does seem to be extensive. While the situation may not be too different from that in other developing economies, it is still a concern for Fiji’s prospective financial development. This leads to RQ 3–2: how have various factors influenced firms’ preference for alternative sources? First, however, it appears useful to examine the nature and historical trends of the various alternative sources. Understanding the nature (type) appears useful in understanding firms’ preference(s) for different sources of alternative finance and the trends would be helpful in understanding the likelihood of making the financial sector funds more attractive so that these may substitute for the alternative sources. For example, if it is seen that firms do not have a rigid pattern (type and trend) of financing, the possibilities of making the financial sector funds more attractive to them may be enhanced.

### 6.5 Nature and Trends in Alternative Finance in Fiji

In this study, ALT is defined as anything NOT from the formal financial sector. That is, any funding other than from banks and/or the stock market. To understand the nature of ALT, in consonance with the obtained balance sheet format, various aspects of capital and liability components for the sample firms were examined. Since public equity (stock market) financing would be part of capital and bank finance part of liabilities, these are separated and examined as the non–public equity capital (hereafter, NPEC)
and non–bank liability (hereafter, NBL) sources, respectively, to understand the nature of ALT, which is the sum of NPEC and NBL. (Please see section 3.5.1 for details.)

Table 6–8: Financial sector versus alternative funding trends in Fiji, 1980–2003

As table 6–8 shows, NPEC is clearly the dominant funding source for firms in Fiji, followed by NBL. NPEC has constantly constituted at least half of all funding sources, rising from 50% in 1980 to 56% by 2003.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank</td>
<td>Mean</td>
<td>8</td>
<td>10</td>
<td>11</td>
</tr>
<tr>
<td></td>
<td>Std. Dev</td>
<td>8</td>
<td>14</td>
<td>14</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>21</td>
<td>46</td>
<td>48</td>
</tr>
<tr>
<td>SMPE</td>
<td>Mean</td>
<td>0</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>(Stock Market Public Equity)</td>
<td>Std. Dev</td>
<td>0</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>1</td>
<td>1</td>
<td>10</td>
</tr>
<tr>
<td>NPEC</td>
<td>Mean</td>
<td>50</td>
<td>50</td>
<td>52</td>
</tr>
<tr>
<td>(Non Public Equity Capital)</td>
<td>Std. Dev</td>
<td>28</td>
<td>24</td>
<td>35</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>-1</td>
<td>-1</td>
<td>-92</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>94</td>
<td>85</td>
<td>89</td>
</tr>
<tr>
<td>NBL</td>
<td>Mean</td>
<td>42</td>
<td>40</td>
<td>35</td>
</tr>
<tr>
<td>(Non Bank Liability)</td>
<td>Std. Dev</td>
<td>27</td>
<td>24</td>
<td>38</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>6</td>
<td>11</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>97</td>
<td>101</td>
<td>1.2</td>
</tr>
<tr>
<td>Total funding</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

At this juncture, it appears important to revisit the definition of ALT as stated in equation (4):

\[ TFF = (BANK + SMPE) + ALT \]  \hspace{1cm} (4)

Now that ALT includes NPEC and NBL, equation (4) may be extended as follows:

\[ TFF = (BANK + SMPE) + (NPEC + NBL) \]  \hspace{1cm} (5)

Where, NPEC (non–public equity capital) includes all forms of capital other than SMPE (stock market public equity) i.e. for unlisted firms, NPEC would be the total capital; for listed firms, NPEC includes shares held by the ultimate owners, their subsidiary companies and/or their families and friends. Thus, to understand the nature of ALT, we need to understand the nature of NPEC and NBL.
The decomposition of TFF for all 27 firms is presented in table 6–8. The sum of the components equals 100%. For example, in 1980, in form of equation (5) above, we get:

$$TFF = (BANK + SMPE) + (NPEC + NBL) \quad (5)$$

$$\begin{align*}
100 & = (8 + 0) + (50 + 42) \\
(5–1)
\end{align*}$$

In this case, as at other times, NPEC is clearly the dominant funding source; on average, making up at least half of the total funding needs over the 1980–2000 period, increasing gradually to 56% by 2003. Over the 1980–2000 period, average TFF in Fiji appears to be as follows:

$$TFF = 0.1BANK + 0.01SMPE + 0.52NPEC + 0.37NBL \quad (5–2)$$

Graphically, the 1980–2000 average TFF may be illustrated as in figure 6–2 below.

Thus, NPEC is likely to have provided over half firm funding followed by NBL. However, there is some encouraging news as well. While on one hand, NPEC appears to have funded up to 96% of firm assets, on the other hand, it appears to have also created huge deficits for firms, in excess of 100% (as a result of huge accumulated losses). Moreover, there appears to be significant variation in the use of NPEC by firms—standard deviation had increased to 4.5 by 2003. Thus, while NPEC may be the most popular source overall, it appears possible to encourage firms to reduce its use, and possibly, increase use of financial sector funds.

Similarly, it appears possible to encourage firms to move away from the next popular source—NBL—the use of which appears to have declined over the years—from 43% in 1980 to 32% by 2003. While some of the difference may have been absorbed by NPEC, some certainly, albeit a small proportion, has been absorbed by the financial sector. More importantly, it is this trend that needs to be strongly encouraged and strengthened—a withdrawal from alternative sources and increased move toward the
financial sector. This could occur progressively, with even very modest (e.g. 2% pa would not be ambitious at all) but constant rise in the total BANK and SMPE funding.

Figure 6–2: Firm funding trends in Fiji, 1980–2003

As figure 6–2 shows, over 1980–2003, on average, the NPEC (non public equity capital) component of ALT appears to have dominated TFF in Fiji; only 11% of the funds appear to have been sourced from the financial sector.

To formulate strategies for accomplishing this, though, requires foremost an adequate understanding of the nature and the relative attractiveness of the components of NPEC and NBL. The rest of the present section examines the first issue i.e. nature and use of these components; the reasons for their relative attractiveness are investigated in section 6.5. The nature of NPEC components are examined before that of NBL; but first, some analysis on above by listing status and firm size.

Analysis by listing status displays some interesting results. For instance, in 1980 and 1990, NPEC was clearly the most popular funding source for both listed and unlisted firms. However, while NPEC was relatively more important for unlisted firms in 1980, the trend had reversed by 1990; it was now relatively more important for listed firms. Further, while NPEC continued to be the most important funding source for listed firms up to 2003—from 48% in 1980 to 66% by 2003 (table 6–9), its relative importance appears to have declined significantly for unlisted firms—from 51% in 1980 to 28% by
2003. For unlisted firms, the fall in NPEC appears to have been replaced significantly by NBL, another ALT component.

Table 6–9: Financial sector versus alternative funding trends in Fiji, 1980–2003—by listing status

As table 6–9 shows, for listed firms, NBL appears to have decreased over the years—from 48% in 1980 to 66% in 2003—with the difference being taken up by NPEC and the financial sector. For unlisted firms, it is NPEC that appears to have decreased with the difference being taken up mostly by NBL; the addition to financial sector funds appears minimal, if any.

The rise in NPEC for listed firms appears to have resulted from a decline in NBL, falling steadily from 41% in 1980 to 18% by 2003. For unlisted firms, the decline in NPEC appears to have been soaked up significantly by NBL, rising from 44% in 1980 to 68% by 2003. While these trends—a fall in one ALT component and a rise in another—leaves the overall ALT use much the same over the years, it also indicates that firms may not be too rigid in their funding strategies; it may be possible to make financial sector sources more attractive to them. Generally, for listed firms, use of NPEC would have to be discouraged; for unlisted ones, use of NBL would have to be discouraged.

Analysis by size shows a similar trend (table 6–10)—NBL and/or NPEC dominate funding of firms of all sizes. However, again firms appear not too rigid in their funding strategies, indicating a possibility that financial sector funds could be made more attractive to them. For small and medium firms, use of NPEC would have to be discouraged; for larger firms, use of NBL would have to be discouraged.
Table 6–10: Financial sector versus alternative funding trends in Fiji, 1980–2003—by size

As table 6–10 shows, smaller firms appear to be using more financial sector funds compared to larger firms; the mean for small firms was 11% to 19% over the analysis period while that of large firms was 0% to 7%.

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Small</td>
<td>NPEC</td>
<td>44</td>
<td>46</td>
<td>44</td>
<td>49</td>
</tr>
<tr>
<td></td>
<td>NBL</td>
<td>45</td>
<td>35</td>
<td>39</td>
<td>37</td>
</tr>
<tr>
<td></td>
<td>Fin Sector</td>
<td>11</td>
<td>19</td>
<td>17</td>
<td>14</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
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<td>Medium</td>
<td>NPEC</td>
<td>59</td>
<td>68</td>
<td>62</td>
<td>65</td>
</tr>
<tr>
<td></td>
<td>NBL</td>
<td>35</td>
<td>28</td>
<td>27</td>
<td>23</td>
</tr>
<tr>
<td></td>
<td>Fin Sector</td>
<td>6</td>
<td>4</td>
<td>11</td>
<td>12</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Large</td>
<td>NPEC</td>
<td>32</td>
<td>19</td>
<td>57</td>
<td>68</td>
</tr>
<tr>
<td></td>
<td>NBL</td>
<td>66</td>
<td>81</td>
<td>38</td>
<td>25</td>
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<tr>
<td></td>
<td>Fin Sector</td>
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</tr>
<tr>
<td></td>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

6.5.1 Non–Public Equity Capital Sources

The main constituents of NPEC are equity, retained earnings and reserves. Equity includes all forms other than public, such as that from ultimate owners, their subsidiary companies and/or their families and friends. (Loans from families and friends may possibly be included here.) Also, all of these may be funded from outside Fiji (FDIs). Retained earnings are the normal unallocated profits. Reserves include asset revaluation, replacement, etc.

As table 6–11 shows, equity has constantly been the most important component of NPEC over 1980–2000, making up 50% to 70% of total NPEC and increasing to 93% by 2003. Noteworthy, though, is the relatively subdued use of equity in 1990. Further, while equity may have financed up to 105% of firm assets, in other cases, its use has been relatively trivial—financing up to only 10% of assets. This trend suggests that firms may be persuaded to use less of even an important competing non–financial sector source like equity.
Table 6–11: Non–public equity capital (NPEC) financing trends in Fiji, 1980–2003

As table 6–11 shows, equity is by far the most popular NPEC funding source; in fact, it appears to be the single most important funding source for firms in Fiji; all figures are in percent.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total NPEC</td>
<td>Mean</td>
<td>50</td>
<td>50</td>
<td>52</td>
</tr>
<tr>
<td></td>
<td>Std. Deviation</td>
<td>28</td>
<td>24</td>
<td>35</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>-1</td>
<td>-1</td>
<td>-92</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>94</td>
<td>85</td>
<td>89</td>
</tr>
<tr>
<td>Equity</td>
<td>Mean</td>
<td>30</td>
<td>25</td>
<td>36</td>
</tr>
<tr>
<td></td>
<td>Std. Deviation</td>
<td>27</td>
<td>19</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>0</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>105</td>
<td>85</td>
<td>121</td>
</tr>
<tr>
<td>Ret Earnings</td>
<td>Mean</td>
<td>0</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td>Std. Deviation</td>
<td>19</td>
<td>12</td>
<td>41</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>40</td>
<td>29</td>
<td>56</td>
</tr>
<tr>
<td>Reserves</td>
<td>Mean</td>
<td>19</td>
<td>20</td>
<td>15</td>
</tr>
<tr>
<td></td>
<td>Std. Deviation</td>
<td>25</td>
<td>22</td>
<td>21</td>
</tr>
<tr>
<td></td>
<td>Minimum</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td></td>
<td>Maximum</td>
<td>85</td>
<td>64</td>
<td>82</td>
</tr>
</tbody>
</table>

Reserves appear to be the next important component of NPEC followed by retained earnings. In some cases, up to 80% of firm assets appear to be financed by reserves. Being a rather ambiguous source, this situation appears to require further investigation to better understand such occurrence. (Perhaps, non-audit requirements allow firms to do this.) However, the relatively lower average scores indicate less concern for reserves as a competing non–financial source; the zero minimum use is also encouraging. Thus, firms may be encouraged to use less of this non-financial sector funds as well.

Interestingly, retained earnings are not as popular a non-financial source as may have been expected of firms that rely extensively on alternative sources for funding. The maximum use of retained earnings rises to only 56%, with the minimum being substantially below zero. Persuading firms to further reduce the use of this competing non–financial source appears possible.
Analysis by listing status shows equity to be by far the most important component of NPEC for both listed and unlisted firms, with the proportion increasing significantly for both by 2003; more so for unlisted firms. However, there is a fluctuation in the use of equity by both listed and unlisted firms—periods of low and periods of high use—indicating a likelihood that both types of firms may be encouraged to reduce the use of this competing non–financial funding source, especially so for listed firms.

Use of reserves appears to have declined for unlisted firms over the years; from 22% in 1980 to 13% by 2003. For listed firms, after a rise in 1990 (26%), it was back to 1980 levels (15%) by 2003. The relatively low use of reserves by both listed and unlisted firms also indicates a likelihood of encouraging both listed and unlisted firms to move away from reserves as a source of finance.

Retained earnings appears mostly negative for unlisted firms, with the mean falling to –51% in 2003. For listed firms too, retained earnings have not been too high; the highest average is recorded in 2003 at 10%. Thus, this competing non–financial funding source appears not to pose a major threat for a financial sector source.

Analysis by size also shows equity to be the most popular NPEC for firms of all sizes, especially so for smaller firms; for instance in 2003, while large firms used 40% of equity on average, small firms used 60%. However, while equity financing for small firms appears to have increased from 43% in 1980 to 60% in 2003, it was notably down in 1990 at 24%. Moreover, for large firms, it was below 20% in 1980 and 1990, before rising to 40% by 2003. Thus, trends suggest a likelihood of encouraging firms of all sizes to reduce the use of equity as a financing source.

Use of reserves seems to be falling for small and medium firms but rising for large firms. However, the rising trend for large firms is not alarming as this source funded
only 22% of assets on average in 2003; the ratio was 11% for small firms and 18% for medium firms in 2003. Thus, discouraging the use of reserves for asset financing appears possible for firms of all sizes; particularly for smaller firms.

Retained earnings is the least popular NPEC for firms of all sizes. Moreover, it has been mostly negative for small firms, for instance, -10% on average in 1990 and -17% in 2003. For large firms, it was 11% in 2003, the highest over the 1980–2003 period. Thus, retained earnings does not appear to be a major threat for financial sector funds with respect to firms of any size.

6.5.2 Non Bank Liability Sources

The main components of NBL are creditors and accruals (trade and other), provisions (income tax, dividends, employee benefits etc.), related party loans (inter–company, director and shareholder) and foreign loans (bank and other).

As table 6–12 shows, creditors and accruals (CA) appears to be the most important component of NBL, rising from around 30% of the total in 1980 to 40% by 2003. Moreover, its maximum use as an overall funding source also increased from around 35% in 1980 to 75% in 2003. However, the all firm mean of 10% to 13% over 1980–2003 and the 1% minimum use indicate a high likelihood of encouraging firms to reduce the use of this funding source.

Related party loans (RPL) appear to be the next important NBL, fluctuating around 28% to 38% of the total over the 1980–2003 period. While not the most important NBL component, its maximum use as a funding source, rising to 183% is noteworthy; for such firms, RPL would be not only the sole/primary source of funding but would have to be large enough to cover (in some cases, considerable) accumulated losses which produce negative NPEC. However, again, the all firm mean of 3% to 14% over 1980–
2003 and the zero minimum use indicate a likelihood of encouraging firms to reduce the use of this funding source as well.

Table 6–12: Non–bank liability (NBL) financing trends in Fiji, 1980–2003

As table 6–12 shows, creditors and accruals (CA) is the most popular NBL source; in fact it ranks as the 3rd most popular source overall; all figures are in percent.

<table>
<thead>
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</thead>
<tbody>
<tr>
<td>NBL Mean</td>
<td>43</td>
<td>40</td>
<td>35</td>
<td>32</td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>27</td>
<td>24</td>
<td>38</td>
<td>48</td>
</tr>
<tr>
<td>Minimum</td>
<td>6</td>
<td>11</td>
<td>04</td>
<td>3</td>
</tr>
<tr>
<td>Maximum</td>
<td>97</td>
<td>101</td>
<td>192</td>
<td>208</td>
</tr>
<tr>
<td>CA Mean</td>
<td>13</td>
<td>13</td>
<td>10</td>
<td>13</td>
</tr>
<tr>
<td>Std. Deviation</td>
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<td>11</td>
<td>8</td>
<td>17</td>
</tr>
<tr>
<td>Minimum</td>
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<td>0</td>
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<tr>
<td>Maximum</td>
<td>35</td>
<td>36</td>
<td>32</td>
<td>75</td>
</tr>
<tr>
<td>Prov Mean</td>
<td>6</td>
<td>8</td>
<td>7</td>
<td>5</td>
</tr>
<tr>
<td>Std. Deviation</td>
<td>6</td>
<td>10</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>Minimum</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Maximum</td>
<td>17</td>
<td>38</td>
<td>22</td>
<td>18</td>
</tr>
<tr>
<td>RPL Mean</td>
<td>12</td>
<td>3</td>
<td>14</td>
<td>9</td>
</tr>
<tr>
<td>Std. Deviation</td>
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<td>5</td>
<td>38</td>
<td>35</td>
</tr>
<tr>
<td>Minimum</td>
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<td>0</td>
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<td>0</td>
</tr>
<tr>
<td>Maximum</td>
<td>95</td>
<td>16</td>
<td>183</td>
<td>147</td>
</tr>
<tr>
<td>FL Mean</td>
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<td>9</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>Std. Deviation</td>
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<tr>
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<td>00</td>
<td>0</td>
</tr>
<tr>
<td>Maximum</td>
<td>29</td>
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<td>49</td>
<td>4</td>
</tr>
<tr>
<td>Other Mean</td>
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<td>5</td>
</tr>
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<td>Std. Deviation</td>
<td>14</td>
<td>18</td>
<td>7</td>
<td>14</td>
</tr>
<tr>
<td>Minimum</td>
<td>0</td>
<td>-8</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Maximum</td>
<td>4</td>
<td>64</td>
<td>34</td>
<td>59</td>
</tr>
</tbody>
</table>

Provisions make up the third largest component of NBL; around 13 to 20% of the total. However, its maximum use as a funding source is much lower than CA and/or RPL—around 17% to 38% only. Moreover, the all firm mean of 5% to 8% and the zero minimum use, make it possible to encourage firms to reduce use of provisions as a funding source.

Loans from foreign sources, such as banks, also appear to have been an important funding source for some firms, with maximum use being as high as 49% (1980).
However, the maximum use appears to have fallen sharply to 4% by 2003. Moreover, the all firm mean in 2003 was also very low (0.3%); in fact, the mean had been around 3% in 1980 and 2000, peaking at 9% in 1990. Further, the minimum use over the 1980–2003 period appears to be zero. These trends indicate a possibility of firms to move away from foreign loans as a funding source.

Analysis by listing status shows that listed firms may be relying relatively less on CA as a source of funding—while the mean for unlisted firms remained around 13% over 1980–2000 and increased to 18% by 2003, that of listed firms dropped from 14% in 1990 to around 8% in 2000 before rising to 11% in 2003. Moreover, while the maximum use by unlisted firms increased to 75% in 2003 from around 33% in the previous period, that of listed firms had dropped to around 22% in 2003 from around 36% in 1990. Thus, it appears possible to encourage both listed and unlisted firms to reduce the use of CA as a source of funding; particularly so for listed firms.

Similarly, listed firms appear to rely relatively less on RPL as a source of funds; for these firms, the already low RPL mean of 3% in 2000 dropped to nil by 2003, for unlisted firms, following a low 2% in 1990, the mean surged to 25% in 2000 and further to 32% in 2003. Moreover, while the maximum use by unlisted firms was substantially high (e.g. 147% in 2003) that by listed firms was only 20%. However, the minimum use by unlisted firms was zero over the period 1980–2003. Thus, it also appears possible to encourage both listed and unlisted firms to reduce the use of RPL as a source of funding; particularly so for listed firms.

Provisions appear to be more prominent for listed firms; while the mean has declined for both groups, that of listed firms remains higher in 2003. In terms of the maximum use too, while that of unlisted firms has dropped from 38% in 1990 to 4% in 2003, that

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6–5 The marked shift by firms away from foreign sources is an interesting issue for future research.
of listed firms remained around 20% in this period. Thus, it also appears possible to encourage both listed and unlisted firms to reduce the use of provisions as a source of funding.

Listed firms tend not to use foreign loans at all, with mean, minimum and maximum being nil in 2000 and 2003. Moreover, its use by unlisted firms appears to be declining by 2003 as well; the mean fell from 120% in 1990 to 60% in 2000 and further to 10% in 2003, with the maximum also down to 4% in 2003 from 49% in 2000. The probability of listed firms using foreign loans in the future appears unlikely and the unlisted firms may be encouraged to reduce its use.

Analysis by size shows that it is the smaller firms that use relatively more CA. Moreover, while the mean for large firms appears to be declining over 1980–2003, that of small and medium firms has not changed over this period, with that of small firms being the largest in 2003. The maximum trends also show that while that of large firms has tended to decline over the years, that of small firms had increased substantially in 2003 after a relatively steady trend in the previous years; that of medium firms has also been rather steady but lower than small and higher than large firms. However, for small firms, the minimum has declined over the years, from 40% to 10%. Thus, it appears possible to encourage firms of all sizes to minimise the use of CA as a source of funding.

Similar trends are displayed in relation to RPL; again, it is the smaller firms that tend to use more of this source of funding—the mean was the highest for small firms over the period and lowest for large firms. However, the mean has been declining for small firms—24% in 2000 to 14% in 2003. In terms of maximum use, that of small firms has been substantially more than others, rising to as much as 183% in 2000; however, it dropped to 147% by 2003. Moreover, the minimum for all sizes of firms was zero
across the period, including small firms and the standard deviation for small firms has been relatively high, up to 54%. Thus, it appears possible to encourage firms of all sizes to minimise the use of RPL as a source of funding.

With respect to provisions, the smaller firms tend to use less of this NBL compared to larger firms. The mean for small firms declined from an already low score of 5% in 1980 to 3% by 2003 while that of large firms hovered around 8–10% in this period; that of medium firms also declined to 5% by 2003. Moreover, small firms have tended to use no provisions at all while for the others it has been 2–4%. Thus, it appears not too difficult to encourage firms of all sizes to minimise the use of provisions as a source of funding.

Funding from foreign sources has tended to decline for all sizes of firms, especially for smaller firms, which had a mean of 0% in 2003, that of medium and larger firms was 10%. In previous years, it was the large firms that used relatively more of this source—the maximum increased steadily from 29% in 1980 to 49% in 2000 but dropped abruptly to 2% in 2003. These trends suggest a high possibility of encouraging firms of all sizes to reduce further the use foreign loans as a source of funds.

**6.5.3 Firm Funding: An Assessment**

Across all forms of funding, equity (an NPEC) is by far the most important single source for firms in Fiji. On average, funding from this source increased from 30% in 1980 to over 50% by 2003. The next most important single source appears to be reserves (another NPEC). While the use of this source declined from 19% in 1980 to 14% by 2003, it continued to be the second most important source of funding on average. Together, these NPEC sources (equity and reserves), funded around 50% of firm assets over 1980–2000, rising to 67% by 2003.
The next most important single source appears to be creditors and accruals (an NBL), on average, providing around 13% of total funding over 1980–2003. Similar proportion of funding appears to be sourced from related party loans (another NBL), although, the ratio had dropped to 9% by 2003. The sum of these sources (equity, reserves, creditors and related loans) funded around 75% of firm assets over 1980–2000, rising to 86% by 2003.

Of the two financial sector sources, historically, bank finance has been substantially more prominent, providing 8–11% of total funding. Its prominence, however, is little match for the above competing non–financial sector sources. Occasionally, even the otherwise low ranked—provisions and foreign loans (both NBL)—appear to be equivalent to bank finance. For example, in 1990, bank finance provided 9.7% of total funding; foreign loans provided 8.9% and provisions 8.2%.

The above example of 1990 is interesting because it appears to provide some insight into firm funding preferences. In 1990, equity financing appears to have temporarily dropped to around 25% and related party loans to 3%. While some of the funding gap appears to have been filled by bank finance, the use of provisions and foreign loans also increased in this year. In fact, while bank funding increased by 27%, provisions increased by 41% and foreign loans by a massive 178%. Moreover, retained earnings appear to be unusually high in this year as well. This may indicate a generally greater preference for non-financial sector funding sources.

However, on a more positive note, bank funding appears to be increasing over the years. In 1980, it ranked 6 out of 10 as the single most important funding source on average. By 1990, it was in the fourth place—much more important than related party loans. In 2000, while related loans bounced back as an important funding source and ranked above bank finance again, the latter, remained in the fourth place, having slightly edged
creditors; it was also not too far behind related loans. That ranking continued into 2003 as well; creditors had regained their usual position and related loans once again ranked below bank finance.

Moreover, the ranking of public equity finance (stock market) appears to have improved as well, from the last position in 2000 to 8th in 2003. The total funding from the financial sector (bank plus stock) appears to have increased gradually but steadily from 7.6% in 1980 to 12.4% by 2003. However, there is still obviously a long way to go in encouraging or otherwise getting firms to use more funding from the financial sector.

To summarise, we can now further extend equation (5) as follows:

\[
TFF = (\text{BANK} + \text{SMPE}) + (\text{NPEC} + \text{NBL})
\]  

(5)

\[
TFF = \text{Financial Sector} + [(\text{EQ} + \text{RE} + \text{RES}) + (\text{CA} + \text{RPL} + \text{PROV} + \text{FL} + \text{OTH})]
\]  

(6)

where, \(\text{EQ}\) = Equity component of NPEC \\
\(\text{RE}\) = Retained Earnings component of NPEC \\
\(\text{RES}\) = Reserves component of NPEC \\
\(\text{CA}\) = Creditors and Accruals component of NBL \\
\(\text{RPL}\) = Related Party Loans component of NBL \\
\(\text{PROV}\) = Provisions component of NBL \\
\(\text{OTH}\) = Other component of NBL

Further, equation 5-2 may be extended as follows:

\[
TFF = 0.1\text{BANK} + 0.01\text{SMPE} + 0.52\text{NPEC} + 0.37\text{NBL}
\]  

(5–2)

\[
TFF = 0.1\text{BANK} + 0.01\text{SMPE} + 0.35\text{EQ} + 0\text{RE} + 0.17\text{RES} + 0.12\text{CA} + 0.06\text{PROV} + 0.1\text{RPL}
\]

\[+ 0.03\text{FL} + 0.06\text{OTH}
\]  

(5-3)

Graphically, this may be shown as in figure 6–3 below.
Figure 6–3: Firm funding trends in Fiji, 1980–2003—further analysis

As figure 6–3 shows, equity and reserves make up more than half of the total funding for firms in Fiji; 89% in total appears to come from ALT sources, only 11% from the financial sector.

To further develop Fiji’s financial sector, from the demand perspective, the coefficients of BANK and SMPE need to be increased and that of others need to be reduced. The foregoing trends and patterns do indicate a possibility of persuading firms to achieve this objective; firms appear not to be too rigid in their funding patterns. For example, while equity (excluding public shares) is by far the single most important funding source for most firms in Fiji, it appears possible to encourage both listed and unlisted firms across all sizes to move away from this financial sector competing source and use more bank and/or stock market funds; the case seems stronger for listed firms. Similarly, it appears possible to encourage both listed and unlisted firms across all sizes to move away from creditors and accruals—the next most important single source of funds; again the case appears more likely for listed firms. This being the case, it appears important that more firms be encouraged to list. While development of the banking sector appears more promising for further financial development in Fiji, firms may still be encouraged to list even if trading was not going to improve; listed firms appear to use more financial sector funds, generally.
However, if firms’ use of ALT sources were to decrease, financial sector sources would have to be made more attractive; thus a need to understand firm perceived barriers to financial sector sources, which is the subject of the next section.

6.6 **BARRIERS TO FINANCIAL SECTOR FINANCE**

6.6.1 **Overview**

This section investigates *RQ 3–2* i.e. how have various factors influenced firms’ preference for alternative sources? Arguments advanced in Chapter 2 and findings from Chapter 4 led to the prior expectation that the specific attributes of the identified demand–side determinants of financial development, in the case of Fiji, have been such that the private sector firms have been discouraged from using financial sector funds and encouraged to turn to alternative finance much more for business operation and growth.

On the basis of discussions provided in sections 2.7.4 and 6.3, the following broad groups of factors have been used: (i) costs; and (ii) practices and procedures; where, costs include the interest cost of borrowing plus fees and charges (transaction costs) and practices and procedures include collateral requirements and paperwork. In relation to the latter, borrowers may be dissatisfied with (i) the inconvenience (e.g. their own time and effort in gathering information and bank time in appraising and making a decision) caused by perceived bureaucracy (procedures) and/or unreasonable requirements (such as collateral) and/or (ii) the level of disclosure required. Thus, both inconvenience and disclosure aspects of practices and procedures are examined.

6.6.2 **Access To Funds**

Earlier analysis noted that ALT was indeed extensive in Fiji. Prior to examining the specific reasons for high preference for ALT sources, in view of ‘access’ being an
important component in the definition of financial development adopted in this study, it appeared appropriate to ascertain the level of difficulty borrowers experienced in generally accessing various sources of funds. Thus, respondents were asked to rate, on a scale of 1 (very difficult to obtain) to 7 (not difficult to obtain), the accessibility of various sources of funds for the operation and growth of their business to date. Table 6–13 lists the funding sources included in the questionnaire, with the corresponding groupings, in consonance with earlier tables in this chapter. Table 6–13 also displays, in descending order, the firm–perceived mean difficulty in accessing these funding sources.

Table 6–13: Difficulty in obtaining various sources of funds in Fiji—firm view

As table 6–13 shows, on a scale of 1 (very difficult to obtain) to 7 (not difficult to obtain), equity appears to be the most accessible funding source; in fact most ALT sources appear more accessible than financial sector sources.

<table>
<thead>
<tr>
<th>Funding Source per Questionnaire</th>
<th>Corresponding Category</th>
<th>N</th>
<th>Mean</th>
<th>Min</th>
<th>Max</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity-Founder</td>
<td>NPEC Equity</td>
<td>66</td>
<td>5.9</td>
<td>1</td>
<td>7</td>
<td>1.6</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>NPEC Ret Earn</td>
<td>47</td>
<td>5.1</td>
<td>1</td>
<td>7</td>
<td>1.5</td>
</tr>
<tr>
<td>Loan-Inter Company</td>
<td>NBL RPL</td>
<td>38</td>
<td>5.0</td>
<td>1</td>
<td>7</td>
<td>1.7</td>
</tr>
<tr>
<td>Credit-Trade</td>
<td>NBL CA</td>
<td>70</td>
<td>4.9</td>
<td>1</td>
<td>7</td>
<td>1.3</td>
</tr>
<tr>
<td>Loan-Family</td>
<td>NBL RPL</td>
<td>50</td>
<td>4.6</td>
<td>1</td>
<td>7</td>
<td>1.9</td>
</tr>
<tr>
<td>Loan-Director</td>
<td>NBL RPL</td>
<td>46</td>
<td>4.6</td>
<td>1</td>
<td>7</td>
<td>1.6</td>
</tr>
<tr>
<td>Equity-Family</td>
<td>NPEC Equity</td>
<td>50</td>
<td>4.5</td>
<td>1</td>
<td>7</td>
<td>1.9</td>
</tr>
<tr>
<td>Credit-Other</td>
<td>NBL CA</td>
<td>67</td>
<td>4.4</td>
<td>1</td>
<td>7</td>
<td>1.4</td>
</tr>
<tr>
<td>Loan-Shareholder</td>
<td>NBL RPL</td>
<td>33</td>
<td>4.2</td>
<td>1</td>
<td>7</td>
<td>1.2</td>
</tr>
<tr>
<td>Money Lenders</td>
<td>NBL RPL</td>
<td>41</td>
<td>4.0</td>
<td>1</td>
<td>7</td>
<td>1.9</td>
</tr>
<tr>
<td>Bank</td>
<td>Bank</td>
<td>72</td>
<td>3.0</td>
<td>1</td>
<td>5</td>
<td>1.4</td>
</tr>
<tr>
<td>Other</td>
<td>Bank</td>
<td>6</td>
<td>2.2</td>
<td>1</td>
<td>6</td>
<td>2.0</td>
</tr>
<tr>
<td>Stock Market</td>
<td>PE PE</td>
<td>27</td>
<td>1.9</td>
<td>1</td>
<td>6</td>
<td>1.4</td>
</tr>
</tbody>
</table>

It is not surprising that founders’ equity (mean = 5.9) is the most accessible funding source; noted as ‘equity’ in the foregoing discussion, this was by far the single most important funding source over the 1980–2003 period. The next most available source is

---

6–6 The adopted definition is: ‘the ease with which any entrepreneur or company with a sound project can obtain finance and the confidence with which investors anticipate an adequate return’ (for details, see section 2.2).
retained earnings (5.1), followed by inter–company loan (5.0) trade credit (4.9), loan from families and friends (4.6), director loan (4.6), equity from families and friends (4.5) non–trade credit (4.4) and shareholder loan (4.2).

The emergence of retained earnings as the second most accessible source of funding is interesting. In the foregoing discussion it was noted that this source, on average, was one of the least important, yet, it is one of the most available. An implication here is that retained earnings could become an important source if profitability of firms improved. On the contrary, it is also possible that profits are/would not being/be retained. In case of the latter, it is possible that the profits are not properly accounted/recorded due to non–audit requirements.

The difficulty ranking of the rest of the sources is less surprising; indeed, following equity, these are the more important sources per the earlier analysis. Trade and other credits (CA) and inter–company, director and shareholder loans make up the related party loans (RPL)—have been shown to be important sources of firm funding. Within the CA group, however, it is the trade credit that appears more accessible. Similarly, within the RPL group, inter–company loans appear to be more accessible, followed by director and shareholder loans.

Funding from families and friends—equity and loans—are also reasonably accessible—much more than bank finance. While this equity may be part of the ‘equity’ discussed earlier, the grouping for loans, though, is not clear—it could be part of the ‘equity’ as reported in the financials or it could be part of the related party loans (see also discussion in relation to table 6–2). In any case, loans from families and friends appear to be an important ALT source.
Funding from money lenders, the extent of which could not be ascertained from the financial reports, also appears to be more accessible than bank finance. Commonly known to be a very expensive form of borrowing, it is interesting to note that it still ranks above bank finance in terms of accessibility, suggesting that while costs may be an important deterrent in borrowing from the financial sector, other factors are likely to be equally or more important. Perhaps, funds from money lenders are being used as venture capital and accordingly, included in equity.

Since bank finance would be the most important formal financial sector fund, it was decided to ascertain if there was a difference between the accessibility levels of short-term (including overdrafts) and long-term loans. Respondents were thus also asked to rank on a scale of 1 (major obstacle) to 7 (no obstacle), the level of difficulty in obtaining the two forms of finance. The average difficulty level of around 2.4 for both suggests that obtaining both forms of bank finance may be equally and highly difficult.

Up to 80% of the respondents found it highly difficult to obtain both forms of bank finance, with 38% finding short-term and 32% long-term loans, extremely inaccessible. Moreover, for 32% of the respondents, obtaining both forms of bank loan was extremely difficult. For up to 60% of the respondents, obtaining at least one of these was highly difficult. Less than 10% of the respondents seemed to have minimum difficulty in obtaining either form of bank loan.

Access to bank finance ranks relatively low; in fact with a firm–perceived difficulty level equal to 3.0, this funding source raises an important question: what are the reasons for such low accessibility of bank finance? The difficulty level of stock market finance is worse, requiring a similar investigation. This question is investigated in the following sections.
6.6.3  **Cost Of funds**

To determine how costs may be deterring the use of financial sector funds, respondents were asked to rate—on a scale of 1 (very expensive) to 7 (least expensive)—the cost of the various sources of funds their businesses had used to date. At this stage, respondents were informed that costs included everything—such as interest, legal, appraisal, documentation, administration and monitoring.

Bank and stock market finance (mean = 2.6) were perceived by firms to be highly expensive sources of funds (table 6–14), twice as expensive as the least costly perceived source—founders’ equity (mean = 5.3). At the outset, this emerges as an important reason for high accessibility and use of founders’ equity and respectively, low accessibility and use of financial sector finance. Following founders’ equity, family loan and equity (4.8) and director and inter–company loans (4.7) appear to be the relatively less expensive sources of funding. With respect to stock market finance, while the overall mean was 2.6, the unlisted firms (mean = 2.5) seemed more concerned about the costs than the listed firms (3.2).

A point needs to be made about inter–company loans. While these are relatively less costly, surprisingly, they may not always be as inexpensive as may seem from a reading of some financial reports—the minimum of 1 indicates that it could be relatively expensive. In such cases, firms indicated that inter-company transactions were purely business transactions and that they had little other options. However, for some firms, funding from this source appeared to be a free source of funds—free of interest and other costs.

The only source more expensive than bank and/or stock market finance appears to be money lending. While the common perception that money lending is a highly expensive funding source appears to hold true for Fiji as well, the mean of 2.2 suggests
that it may not be too costly compared to both financial sector sources. If indeed money lending is a relatively expensive source of funding in Fiji, is it possible that firms are not adequately informed about the real cost of bank/stock market financing? Surely, financial sector funds have to be far much cheaper than money lending, at least. This (mis)perception may be due to a widespread belief that financial sector funds are simply expensive and/or lack of trust in the sector, which in turn influence firms to believe that other ALT sources are cheaper.

Table 6–14: Cost of various sources of funds in Fiji—firm view

As table 6–14 shows, on a scale of 1 (very expensive) to 7 (least expensive), equity appears to be the least expensive funding source; in fact, most ALT sources appear cheaper than financial sector funds.

<table>
<thead>
<tr>
<th>Funding Source per Questionnaire</th>
<th>Corresponding Categories</th>
<th>N</th>
<th>Min</th>
<th>Max</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity-Founder</td>
<td>NPEC Equity</td>
<td>67</td>
<td>1</td>
<td>7</td>
<td>5.3</td>
<td>2.1</td>
</tr>
<tr>
<td>Loan-Family</td>
<td></td>
<td>49</td>
<td>1</td>
<td>7</td>
<td>4.8</td>
<td>1.9</td>
</tr>
<tr>
<td>Equity-Family</td>
<td>NPEC Equity</td>
<td>46</td>
<td>1</td>
<td>7</td>
<td>4.8</td>
<td>1.6</td>
</tr>
<tr>
<td>Loan-Director</td>
<td>NBL RPL</td>
<td>45</td>
<td>1</td>
<td>7</td>
<td>4.7</td>
<td>1.6</td>
</tr>
<tr>
<td>Loan-Inter Company</td>
<td>NBL RPL</td>
<td>37</td>
<td>1</td>
<td>7</td>
<td>4.7</td>
<td>1.9</td>
</tr>
<tr>
<td>Retained Earnings</td>
<td>NPEC Ret Earn</td>
<td>43</td>
<td>1</td>
<td>7</td>
<td>4.4</td>
<td>1.6</td>
</tr>
<tr>
<td>Credit-Trade</td>
<td>NBL CA</td>
<td>71</td>
<td>1</td>
<td>7</td>
<td>4.0</td>
<td>1.6</td>
</tr>
<tr>
<td>Loan-Shareholder</td>
<td>NBL RPL</td>
<td>30</td>
<td>1</td>
<td>7</td>
<td>4.0</td>
<td>1.4</td>
</tr>
<tr>
<td>Credit-Other</td>
<td>NBL CA</td>
<td>67</td>
<td>1</td>
<td>7</td>
<td>3.9</td>
<td>1.4</td>
</tr>
<tr>
<td>Stock Market</td>
<td>PE PE</td>
<td>31</td>
<td>1</td>
<td>5</td>
<td>2.7</td>
<td>1.3</td>
</tr>
<tr>
<td>Bank</td>
<td>Bank Bank</td>
<td>71</td>
<td>1</td>
<td>6</td>
<td>2.6</td>
<td>1.2</td>
</tr>
</tbody>
</table>

On the other hand, bank and stock market finance may indeed be relatively expensive. Accordingly, high cost of financial sector borrowing would indeed be an important reason for the relatively low accessibility to these funds and, therefore, a less preferred source of funding. Since bank loans are by far the more important and common source of financial sector funds, to better understand the banking cost concerns, respondents were asked to rate on a scale of 1 (major obstacle) to 7 (no obstacle), the problems associated with interest rates and fees and charges in obtaining a bank loan. That is, respondents were asked to indicate the extent to which the different cost components...
hindered/discouraged a decision to borrow from banks. To clarify, the various costs were grouped as follows: (i) interest included the explicit, advertised, publicised, interest cost of borrowing; and (ii) fees and charges included all other transaction costs, such as legal, loan appraisal, documentation, administration, monitoring.

A mean of 2.3 for both indicates that both cost components pose high levels of obstacle in obtaining a bank loan and that both are considered to be equally high. Interest rates were of moderate or higher obstacle for 92% of the respondents and fees and charges for every respondent in the sample. Moreover, interest rates were a major obstacle for 41% and less than moderate obstacle for only 6% and fees and charges were a major obstacle for 23% and less than moderate obstacle for none. Both were a major obstacle for 20% of the respondents.

Thus, costs appear to be an important deterrent to financial sector funds in Fiji. While this may be so, it is difficult to comprehend the perception that costs of borrowing from money lenders may not be too different from that of banks and stock markets. On the other hand, financial sector funds may indeed be relatively high, an issue that needs further investigation.

6.6.4 Practices And Procedures

Undoubtedly, practices and procedures would be most extensive in the case of borrowing from the formal financial sector, especially for bank finance. For some alternative sources, these would be minimal or even non-existent, including in the case of loan or equity from family/friend, related party loans (inter–company, director, shareholder) or even trade credit. For various reasons, including regulatory, investor protection and systemic stability, banking and stock market transactions can not be informal; they need to be adequately detailed and documented. For instance, in applying for a bank loan, a borrower would normally be required to submit past and
projected financials, cash flow statements, make capital contributions, provide information for appraisal of character, etc.

As noted earlier, practices and procedures may include collateral and paperwork and may be unpopular due to inconvenience and/or disclosure related issues. To understand borrowers’ views on these issues, respondents were asked to rate on a scale of 1 (major obstacle) to 7 (no obstacle), the problems associated with collateral requirements, paperwork and bureaucracy and disclosure requirements in obtaining bank loans. In asking the questions, respondents were informed that: (i) collateral requirements included ability to provide appropriate and adequate collateral; (ii) paperwork and bureaucracy included ability to provide all documents (such as past, current and projected financials), in the form, manner and frequency (for appraisal and subsequent monitoring) required by banks, the time and effort in gathering such information and the time taken by banks to make a decision, complete documentation and disburse funds, and the complexity/simplicity of contractual agreements; and (iii) disclosure requirements basically referred to a borrower’s willingness to provide all requested information (personal, business) on an on–going basis.

The mean obstacle for collateral was 3.1—indicating that respondents were not too happy with banks’ requirements in relation to appropriateness and adequacy of collateral. While 20% of the respondents deemed collateral to be a major obstacle, 20% also deemed it to be of less than moderate obstacle. However, it was regarded as moderate or higher obstacle by 81%. Respondents indicated that bank collateral requirements were usually too rigid relative to alternative channels, where collateral requirements were much more flexible and occasionally not even required. They also indicated that they were not too happy about the fact that some types of collateral were not even considered by banks and these were all they could offer. There was also a
sentiment that they were prepared to make up for shortfalls in collateral with increased commitments otherwise.

The mean obstacle for paperwork was 3.6—not as bad as that for collateral but still more than moderate obstacle. Moreover, 8% deemed paperwork to be a major obstacle and 23% as less than moderate obstacle but 77% as moderate or higher obstacle. Respondents indicated that they were concerned about the time taken in gathering the required information, appraisal, decision making and disbursement of bank funds—the lengthy process discouraged application for bank loans and therefore to resort to faster processing and delivery of credit obtained via alternative channels. Alternative channels may not require much documentation as well, are more flexible with easily understood contractual agreements, which also tend to be less formal.

With regard to stock market finance, practice and procedures appear to be dictated mainly by listing rules. Respondents were asked to rate, on a scale of 1 (major obstacle) to 7 (no obstacle), the problems associated with SPSE’s listing requirements for listing on the stock exchange. The overall mean was 3.8—slightly better than the inconvenience related to collateral and paperwork requirements of bank loans. However, the mean response was not too encouraging—while it indicated that the SPSE listing rules may be less of an obstacle relative to bank practices and procedures, it is still only moderate, not better. Further, unlisted firms (mean = 3.8) appeared more concerned than listed firms (mean = 4.3). Moreover, around 70% indicated that it was moderate or higher obstacle. Thus, there may be some concerns about SPSE requirements relating to issues such as restructure of companies, mandatory public shares, and disclosure of information to the public. Further investigation would be useful.
As noted earlier, practices and procedures relating to bank and stock market finance are expected to be unpopular due to inconvenience and/or disclosure related issues. The foregoing shows that firms may indeed be inconvenienced by these; both procedural aspects of banks may be difficult for firms to satisfy in obtaining a bank loan, with collateral being the more difficult one, similarly, SPSE listing rules may not be too appealing to firms.

Practices and procedures for bank/stock market finance are likely to become more unpopular if inconvenience is exacerbated by borrowers’ reluctance to disclose information, especially to the public. The extensive paperwork and bureaucracy of formal sector financing tends to disclose the wealth of firms and may be seen as an impediment to a borrower intending to evade taxes and/or where expected, sharing wealth with extended family members (Germidis, 1990).

The mean disclosure for bank loans was 3.9; 15% of the respondents deemed it to be a major obstacle and 60% as moderate or higher obstacle. The mean for stock market was 2.7 with 24% considering it to be a major obstacle and 95% as moderate or higher obstacle. While both may be considered to be important obstacles, it appears that firms may be more comfortable disclosing the required information to banks than making it publicly available. Confidentiality or secrecy of information appears to be rather important for firms; disclosure to banks would still keep information away from the public domain. Thus, the ADB (2001b) claim regarding the secretive nature of firms in Fiji appears to be valid—the general notion that family firms may be less inclined to disclose information appears to be true for Fiji as well.

Given that alternative financial transactions tend to be highly informal and may even exit without formal contracts and that this could be an important attraction of alternative sources, an attempt was also made to obtain respondents’ views on the importance (1 =
not important; 7 = very important) of a formal contract in relation to a credit or other borrowing for business operation and growth. A formal contract was defined as one requiring a formal agreement to adhere to specified terms and conditions, including duration, interest and other costs, and time and mode of repayment or in case of equity from family/friend, profit/management sharing policies/opportunities. An informal contract would specify these issues less clearly or just suffice with some record of a transaction with a mutual understanding of terms and conditions.

Table 6–15: Importance of a formal contract for trade credit and loan/equity from family/friend in Fiji—firm view

As table 6–15 shows, on a scale of 1 (not important) to 7 (very important), a formal contract appears less important where a loan/equity has been derived from family/friend; contracts for trade credit also appears not highly important. Moreover, negotiating a trade credit was not an obstacle, 1 = major obstacle; 7 = no obstacle.

<table>
<thead>
<tr>
<th></th>
<th>Family/friend loan/equity</th>
<th>Trade credit</th>
<th>Negotiating trade credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mean</td>
<td>2.8</td>
<td>3.9</td>
<td>5.1</td>
</tr>
<tr>
<td>Std. Dev.</td>
<td>1.9</td>
<td>1.9</td>
<td>1.3</td>
</tr>
<tr>
<td>Minimum</td>
<td>1.0</td>
<td>1.0</td>
<td>2.0</td>
</tr>
<tr>
<td>Maximum</td>
<td>7.0</td>
<td>7.0</td>
<td>7.0</td>
</tr>
</tbody>
</table>

As table 6–15 shows, formal contractual requirements for a loan or equity from family/friend may be relatively less important (mean = 2.7) than where credit had been obtained from regular suppliers (mean = 3.9). However, the mean for trade credit was also only moderate, indicating that there may be reasonable flexibility in formalising a credit involving regular suppliers; indeed some respondents mentioned that formal contracts were not too important in case of trade credit from a long-standing supplier and/or from related companies, including in the case of a company associated via a substantial shareholder/director—that only some record of a transaction was sufficient.

Respondents were also asked to rate on a scale of 1 (major obstacle) to 7 (no obstacle) the difficulty in re-negotiating a trade credit. As table 6–15 further shows, there appears to be little difficulty (mean = 5.14) in re-negotiating any formal/informal terms.
and conditions of a trade credit. Some respondents mentioned that the usually long-standing trade credit relationships built on trust, honesty and faith made it easy to request for more time to pay, reconsideration of costs and charges in times of difficulty with an understanding of making up for any reduced profits/margins to the supplier in good times.

While the informal nature of transactions does have its advantages from the borrowers’ perspective, it also reinforces the finding that disclosure may indeed be an important factor influencing firm decision to borrow—alternative channels provide a means for concealing information, true profits and wealth and thereby an opportunity to evade taxes. Unfortunately, these characteristics can not be incorporated into finance obtained from the formal financial sector, making it difficult to persuade firms to borrow from banks and/or via public equities. However, how this may be moderated is also the subject of the next chapter.

To answer RQ 3–2—how have various factors influenced firms’ preference for alternative sources—the evidence appears to support the prior expectation that the specific attributes of the identified demand–side determinants of financial development, in the case of Fiji, have been such that the private sector firms have been discouraged from using financial sector funds and encouraged to turn to alternative finance much more for business operation and growth. For example, firms view the cost of financial sector funds to be generally much higher than the alternative sources. Similarly, the level of disclosure is an issue of much concern with respect to financial sector funds.
6.7 FURTHERING FINANCIAL DEVELOPMENT—MAKING FINANCIAL SECTOR FUNDS MORE ATTRACTIVE

Section 6.3 showed that the use of ALT in Fiji is extensive; the previous section discussed the reasons for its wide use. This section explores how this situation is likely to change in the future. That is, this section examines RQ 3-3—can financial sector funds be made more attractive to the firms? It is expected that financial sector funds could be made more attractive to the firms with appropriate levels of positive moderation in the attributes of the identified factors.

Indeed, if costs and practices and procedures strongly influence decision making, the discussions in section 6.6 indicate that genuine fundamental changes could make financial sector funds sufficiently more attractive. To ascertain the importance of costs and procedures and practices for future borrowing from banks, respondents were asked to rate such importance on a scale of 1 (not important) to 7 (very important). Interest rates emerged as the most important (mean = 6.1) decision-making factor, followed by fees and charges (mean = 5.7), collateral (mean = 5.4), disclosure (mean = 5.0) and paperwork (mean = 4.8). Thus, all factors appear highly important.

Around 60% of the respondents stated that interest rate was very important, with only 5.5% saying it was less than moderately important. A smaller proportion (42.5%) considered fees and charges to be very important with only 9.6% saying it was less than moderately important. Thus, interest rate appears to be the most important cost factor that may need to be reviewed urgently to entice firms to borrow more from banks. However, a simultaneous review of fees and charges also appears highly warranted.

Of the practice and procedure factors, collateral ranked as the more important issue, with 21% noting that its was very important and 17% that it was less than moderately important while 17% noted that paperwork was very important and 21% that it was less
than moderately important. Thus, while both issues need to be examined, that relating to appropriateness and adequacy of collateral may need more urgent attention.

It appears that the relevant authorities would need to initiate a transparent and sincere undertaking to review the above issues in relation to bank loans and that this would have to be initiated without much delay—there appears to be a need to conspicuously reduce the cost, collateral and paperwork requirements in relation to bank loans. If the concerns of borrowers could be addressed favourably, they could be induced to borrow more from banks—64% indicated they would definitely be encouraged to consider bank finance as an important option and/or or increase bank borrowing; 25% were undecided and only a small proportion (11%) responded negatively.

Similarly, respondents indicated that favourable ramification of issues of concern (as discussed in section 6.6) would encourage them to issue more shares to the public and/or to list on the stock exchange—32% were positive, 44% did not respond and 24% responded negatively. A reason for the non–response or negative response could be disclosure—earlier discussions note that disclosure was an important issue of concern; relatively more for stock market finance. Thus, positive changes to costs and other issues *per se* may not be adequate to entice companies to list and/or issue additional shares. Around 22% of the unlisted firms indicated that disclosure was a major deterrent to listing on the stock exchange; 65% indicated that it was more than a moderate obstacle. It should be kept in mind that a number of the unlisted respondent companies were large and highly listable. Disclosure of information to banks is also a sensitive issue. While costs and practices and procedures would have to be reviewed and reduced and/or made more flexible, it may not automatically result in desirable levels of increase in bank and/or stock market finance. Thus, the issue of disclosure
would have to be investigated as well, including educating the firms on the importance of disclosure requirements.

Unfortunately, there appears to be no sign/plan at either the government or industry level for addressing these issues at this stage. In fact, it appears that there may not be much understanding of these issues and how they are contributing to relatively low use of financial sector funds for firm funding in Fiji. Following a recommendation of the CIFS (1999), there was some talk about addressing the high banking cost concerns, however, nothing has eventuated to date. Reports by international organisations such as the ADB (2001) have highlighted the need to boost financial sector credit to the private sector but there appears to be little recommendation on how financial sector funds may be made more attractive to the private sector.

However, if financial sector funds were to be made more attractive, costs and practices and procedures, collateral and disclosure requirements of bank and stock market finance would have to be urgently reviewed with the intention of moderating these. The question is: how can this be achieved? Chapter seven explores some possibilities.

To answer RQ 3–3—can financial sector funds be made more attractive to the firms—evidence does appear to support the expectation that financial sector funds may indeed be made more attractive to the firms with appropriate levels of positive moderation in the attributes of the identified factors. For example, the deemed relative high costs would have to be appropriately moderated. Similarly, disclosure concerns would have to be positively addressed.

6.8 CHAPTER SUMMARY

While continued and increased supply of funds to the financial sector is important for financial development, the demand for these funds appears equally important for the
purpose. Arguably, regardless of the extent and magnitude of supply, in a situation of suppressed demand, the financial sector may not develop as desired. In the extreme case, a firm may have no funding at all from the formal financial sector. Such a firm may rely extensively on founder and/or family/friend equity or borrowing, retained earnings, reserves, inter–company loans, shareholder loans, private credit/lending agencies and other relationship– and reputation–based financing channels such as other entrepreneurs, business partners including retailers, suppliers, etc.

Accordingly, this chapter examines the extent of alternative finance in Fiji and explores ways to encourage firms to use more financial sector funds for business operation and growth. That is, the chapter addresses the third research question (RQ 3) of this study—what is the role of demand–side factors in firms’ reliance on alternative finance? Using both primary (survey of firms) and secondary (annual reports of firms) data, it is shown that the use of alternative finance has indeed been extensive over the 1980–2003 period for firms across size, ownership and listing status; in all cases, it appears to have financed 80% to over 90% of firm assets. While the situation may not be too different from that in other developing economies, it is still a concern for Fiji’s prospective financial development.

It appears that costs and practices and procedures—the usual factors—are the key drivers of preference for alternative finance. That is, the less favourable costs and practices and procedures of bank and stock market finance make these less attractive compared to alternative sources. For instance, firms believe that banking and stock market costs are a lot higher than those of alternative sources. They also believe that collateral requirements are stringent, paperwork and bureaucracy excessive and disclosure requirements undesirable compared to alternative sources.
In fact, the highly flexible and the amorphous nature of operations, credit terms to meet specific needs, minimal paperwork, easily understood rules and regulations, faster processing and delivery of credits, and access to amounts corresponding to requirements and capacity of borrowers make the alternative sources highly attractive. Other notable attractions of alternative finance include little or no collateral requirements (which is substituted by personal relationships, borrower’s credit history and social norms), relatively low transaction costs, zero reserve requirements and little or non-disclosure.

However, financing trends over a period of time (1980 to 2000) show that firms may be persuaded to move away from alternative sources and toward the financial sector for funding needs. The trick would be to make the financial sector funds more attractive in terms of costs and practices and procedures. For instance, bank credit to private sector would have to be made conspicuously and significantly cheaper both in terms of interest and fees and charges, adequacy and appropriateness test for collateral would have to be made less stringent, disclosure requirements would have to be moderated and the time taken to apply for a loan and receive a response would have to be reduced.

Unfortunately, absence of indications or plans to address these issues would in the meantime continue to make financial sector funds less attractive and therefore impede financial development. In fact, it appears that there may not be much understanding of these issues at the government or industry level and how they are contributing to relatively low use of financial sector funds for firm funding in Fiji. Fortunately, these issues appear addressable and how they may be tackled is the subject of the next chapter.
Chapter 7

Enhancing Financial Development in Fiji: Strategies and Recommendations

7.1 OVERVIEW

The ultimate objective of this study is to explore ways to accelerate financial development in Fiji. That is, to answer RQ 4: *how may financial development in Fiji be accelerated?* Answers to this question are guided by findings per the other questions—RQ 1, 2 and 3, i.e. (RQ 1) how well has the financial sector in Fiji developed in the past and what are its strengths and weaknesses; (RQ 2) what is the role of legal institutions in Fiji’s financial development; and (RQ 3) what is the role of demand–side factors in firms’ reliance on alternative finance?

RQ 1 provided an important background for investigating RQ 2 and 3. Among other things, it was important to ascertain the potential for further development of the financial sector before investigating the importance of legal institutions (RQ 2) and the reasons for expected higher preference for alternative finance compared to financial sector funds (RQ 3)—two key issues of this study—for exploring ways for furthering financial development in Fiji. RQ 1, 2 and 3 were examined in chapters 4, 5 and 6, respectively; this chapter explores, recommends and provides strategies for enhancing financial development, based on the results and findings per chapters 4, 5 and 6, the essence of which are recapitulated below.

Per chapter 4 (RQ 1), further financial development in Fiji appeared possible and the banking industry appeared to be in a better position to be developed much more promptly and rapidly compared to the stock market. While further stock market
development appeared possible, it would require substantial effort; activity and efficiency of Fiji’s stock market have been and continue to be very low—stock market development would be much slower and require substantial effort. Thus, it would be in the interest of policy makers and other relevant authorities to focus more on developing the banking sector rather than the stock market. However, per chapter 6 findings, encouraging firms to list would still be an important consideration as listed firms tend to use more financial sector funds generally compared to unlisted firms.

Per chapter 5 (RQ 2), an important finding that emerged was that while it may not be essential to strengthen the legal rights of banks and shareholders and the related enforcement mechanisms for further banking and/or stock market development in Fiji, there is little doubt that some enhancement would generally be beneficial. Thus, from a supply perspective, the challenge is to explore ways that on one hand, involve minimum changes to investor laws, and on the other, are seen to proactively enhance investor protection.

Per chapter 6 (RQ 3), an important finding that emerged was that while alternative finance had been important in the past and likely to be so in the future, a review of the attributes that discourage use of financial sector funds and thus encourage firms to turn to alternative sources, appears important for financial development from a demand perspective. That is, to make the financial sector sources more attractive, it appears important to review the specific attributes of costs, collateral and disclosure requirements and paperwork and bureaucracy with a view to moderating and/or reducing these conspicuously.

Accordingly, further financial development in Fiji should entail, at least, ways to (i) to maintain and/or encourage increased supply of funds via strengthened legal protection
of banks and shareholders, without reforms to investor laws; and (ii) moderate or reduce price and terms and conditions associated with bank and stock market finance in order to entice the private sector to use more of these sources for business formation, operation and growth.

While banks are important suppliers of credit to the private sector and thus legal protection may determine the volume and extent of the credit supply, the price and terms and conditions of such credit, on the other hand, determines the volume and extent of the demand for such credit. Similarly, while shareholders are important suppliers of equity funds to the private sector and thus legal protection may determine the volume and extent of the equity supply, on the other hand, stock markets, which facilitate the supply of such funds, may have terms and conditions that may not appeal to the private sector.

Thus, strategies for further banking development in Fiji would have to include, on one hand, ensuring adequate legal protection of banks and on the other, ensuring that costs and conditions of bank credit are reasonably attractive to the private sector. Similarly, strategies for further stock market development would have to include, on one hand, ensuring adequate legal protection of shareholders and on the other, ensuring that costs and conditions of listing on the exchange and/or issuing more shares to the public are reasonably attractive to the private sector.

In view of the foregoing, to enhance financial development in Fiji, this study proposes the following. With respect to enhancing supply of funds:

S–1: improve the country’s corruption rating—COR; and
S–2: enhance the country’s accounting standards—ACT.

The likely political opposition to law reforms must be kept in mind.
With respect to enhancing demand for funds:

D–1: reduce corporate taxes for all firms, especially for listed firms;
D–2: moderate the cost of bank credit to the private sector; and
D–3: moderate procedural requirements for bank credit to the private sector.

7.2 STRATEGIES FOR ENHANCING THE SUPPLY OF FUNDS

This section outlines strategies for encouraging banks to supply more credit to the private sector and households to participate more actively in stock trading. The supply–side determinant focus of this study is legal protection of investors; the strategies and recommendations too are in relation to this. That is, the focus is on enhancing legal protection of investors. There are two separate but related issues here: (i) legal rights of investors; and (ii) enforcement of these rights. Weak legal protection may require enhancement of both or one for further financial development.

The questions have been: (i) is enhancement of creditor legal rights essential for further banking development? (ii) is enhancement of shareholder legal rights essential for further stock market development? (iii) is enhancement of the quality of law enforcement essential for further financial development? Strategies and recommendations that follow are based on the findings per foregoing questions. To understand the questions and related findings and recommendations better, it appears important to review the legal rules and enforcement variables used in this study. Table 7–1, reproduced from chapter 3, summarises these variables.

The above questions may now be rephrased as: (i) is enhancement of \textit{STAY}, \textit{RANK}, \textit{CONSENT}, \textit{MANAGE}, and/or \textit{RESERVE} essential for further banking development? (ii) is enhancement of \textit{PROXY}, \textit{BLOCK}, \textit{VOTE}, \textit{OPP}, \textit{PRE}, \textit{PERC}, and/or \textit{MAND} essential
for further stock market development? (iii) is enhancement of EFJS, RoL, COR, EXP, REP and/or ACT essential for further financial development?

Table 7–1: Variables used in this study to assess investor legal protection in Fiji

Five creditor rights, eight shareholder rights and five enforcement quality variables are used to assess investor legal protection in Fiji. E.g. one of the creditor rights is STAY, which stands for a stay or injunction on assets of a firm in liquidation.

<table>
<thead>
<tr>
<th>Variable category</th>
<th>Variable–Abbreviated form</th>
<th>Variable–Extended form</th>
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<tbody>
<tr>
<td>Creditor rights</td>
<td>STAY</td>
<td>Stay on assets</td>
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<tr>
<td></td>
<td>RANK</td>
<td>Ranking in profit sharing</td>
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<tr>
<td></td>
<td>CONSENT</td>
<td>Consent before liquidation</td>
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<tr>
<td></td>
<td>MANAGE</td>
<td>Management’s power after liquidation</td>
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<td></td>
<td>Reserve</td>
<td>Reserve capital requirement</td>
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<td>Shareholder rights</td>
<td>PROXY</td>
<td>Proxy voting by mail</td>
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<tr>
<td></td>
<td>BLOCK</td>
<td>Share blocking before meetings</td>
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<tr>
<td></td>
<td>VOTE</td>
<td>Voting for representative on BOD</td>
</tr>
<tr>
<td></td>
<td>OPP</td>
<td>Protection against oppression</td>
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<tr>
<td></td>
<td>PRE</td>
<td>Pre–emptive rights</td>
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<tr>
<td></td>
<td>PERC</td>
<td>Percent of share capital required to call a meeting</td>
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<tr>
<td></td>
<td>ONE</td>
<td>One–share–one–vote</td>
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<tr>
<td></td>
<td>MAND</td>
<td>Mandatory dividend</td>
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<tr>
<td>Enforcement quality</td>
<td>EFJS</td>
<td>Efficiency of the judicial system</td>
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<tr>
<td></td>
<td>RoL</td>
<td>Rule of law</td>
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<td></td>
<td>COR</td>
<td>Corruption</td>
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<td></td>
<td>EXP</td>
<td>Expropriation risk</td>
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<td></td>
<td>REP</td>
<td>Repudiation risk</td>
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<tr>
<td></td>
<td>ACT</td>
<td>Accounting standards</td>
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7.2.1 Summary Of findings From Chapter Five

The findings per section 5.5.5 include the following. Banks appear to be concerned about the legal issues in relation to private sector credit in Fiji, with smaller banks being relatively more concerned. Nonetheless, the level of concern being not seriously high, made it difficult to say whether enhancement of any of the legal rules variables was essential for further banking development in Fiji. However, creditors in Fiji appear to be deprived of all of the listed, most basic legal rights. It would therefore be reasonable to at least improve that situation.
Further, it appears that creditors may also be concerned about the quality of law enforcement. Perhaps, it is indeed the perceived high quality of ACT that has substituted for the otherwise perceived average enforcement quality. If banks continued to be content with ACT in the future, significant and positive changes to law enforcement may not be required urgently. Moreover, it is the smaller banks that appear more concerned about the quality of law enforcement; the larger banks appear less concerned. Accordingly, the quality of law enforcement also appears not to be too pressing an issue for banks in Fiji.

However, some rule and enforcement variables—such as STAY and COR, respectively—appear to be of relatively more concern to the creditors. Perhaps, it is not every aspect of the rule and/or enforcement that need to be strengthened; strengthening of some may suffice.

With regard to shareholders, findings appear to suggest that these investors either assume that they are legally well protected or they are not aware of the basic legal rights they are entitled to; the case being relatively, but not significantly, worse for potential shareholders. The results support the conjecture that the lack of adaptability and familiarity, coupled with the fact that the minority shareholders were mainly locals, make legal rights less meaningful to these investors.

Chapter 5 thus suggests that specific legal rules may not be an immediate concern for shareholders, who may be content, believing that the relevant regulator(s) and the stock exchange were aware of the importance of their legal protection and that they were indeed already adequately protected. It is thus argued that enhancement of legal rules, at least, may not be essential for further stock market development in Fiji.
The situation relating to enhancing the quality of law enforcement for further stock market development appears similar to that relating to the legal rules component; there may be arguments supporting that enhancement is/is not essential. Shareholders’ concern for law enforcement is not distinctively clear; while they may not be too discontent with the quality, they are not too pleased either.

In view of the above, for maintaining and/or enhancing the supply of financial sector funds in Fiji, the following recommendations and strategies are proposed.

7.2.2 Recommendation S–1: Improve Fiji’s Corruption Rating—COR

Corruption (COR) appears to be the law enforcement variable of most concern to investors as well as experts in Fiji; banks rated it 3.9 out of 10, shareholders 3.6, and experts 3.7 (low values indicate high levels of corruption and high values indicate low levels). The all respondent rating was 3.6, which compared adversely against all of La Porta et al. (1998) legal origin sub–groups; French average was 7.5, English 7.9, German 9.5, Scandinavian 9.7, and sample average 8.1. According to Transparency International—a global anti–corruption civil society organisation—Fiji’s corruption rating was 4 out of 10 in 2005, similar to the results of this research.

While not weighted, COR could easily be one of the more visibly important variables determining a country’s law enforcement quality. The fight against COR ranks high on many countries’ reform agendas. Essentially, COR includes bribes connected with import and export licenses, exchange controls, tax assessment, policy protection, or loans. It involves abuse of trusted power for private gain. Consequently, it threatens the very foundations of financial development. If Fiji’s COR rating could be improved, not only would this improve the overall enforcement quality but also help improve other
components of enforcement, such as EFJS (efficiency of the judicial system), leading to further improvement of the enforcement quality. Not to mention, this will improve overall investor protection in the country with a likely result of further financial development. Even if the legal rules were to remain static, improved and better enforcement quality may well substitute for any weakness in the legal rights. For example, among other things, Netherlands’ relatively high enforcement quality appears to compensate for the country’s relatively weak legal rules in fostering a well–developed financial system (La Porta et al., 1997, 1998). Improving Fiji’s COR rating appears possible.

While Fiji’s COR rating may have been 4 in 2005, Transparency International ranked Fiji 55th among 180 developed and developing countries globally and 9th among 24 developed and developing Asia–Pacific countries. Thus, despite the low 4.0 rate, the not too depressing cross–country comparative ranking provides a positive basis for improving the situation. In more recent times, the Fiji Government has assertively been campaigning against and taking constructive steps to reduce the occurrence of corruption in the country (The Fiji Times, 2007; 2008).

Among other things, the 2007 enactments of the Fiji Independent Commission Against Corruption (FICAC) and the Prevention of Bribery reflect the strong commitment of the government to fight corruption. The independence of the FICAC appears to be soundly safeguarded; it is accountable only to the President of Fiji, ensuring that politicians, government ministers, executives and employees and all other citizens may be investigated and will not be able to influence the work of the organisation. A number of elite organisations, such as the Fiji Sports Council, Native Lands Trust Board, Fiji Institute of Technology and Airports Fiji Limited, have already been investigated by FICAC.
Further, the government has been engaged in ‘cleaning’ the civil service, other government/public institutions and also the judicial system, which have constantly been alleged to be corrupt, to varying degrees (e.g. Reddy et al., 2004). For example, some highly ranked civil servants, board members, executives and members of the judiciary have been suspended to facilitate impartial investigations of alleged abuse of office and other corrupt practices.

Also in recent times, a number of NGOs have become increasingly active in campaigning against and raising public awareness of the occurrence and alarming consequences of corruption. For example, Transparency International’s Fiji sector has become increasingly engaged in raising public awareness and advancing general public education in matters relating to the nature and consequences of corruption in business transactions etc.

Government does appear to be committed to reducing the occurrence of corruption in the country. Its commitment and action are commendable and achievements promising. However, it is critical that all of these must be perceived by both the local and international communities to be highly transparent, unprejudiced, independent, non-partisan, and respectable. The COR ratings are usually based on surveys of these respondents, therefore, the perception of these communities is indeed vital. While the government appears to be mindful of the importance of these virtues, there appears to be a number of contentious issues. For instance, while the independence of the FICAC appears to have been carefully considered, other issues do raise questions, including the recruitment/appointment of the executive and other officers, the relevant qualifications, training and experiences of these officers, the checks against the likely abuse of the extensive powers by the officers themselves, etc.
The FICAC is the first ever organisation of this type in Fiji. Its objectives are praiseworthy and its ability to reduce the instances of corruption in Fiji appears promising. However, unless the communities are reasonably satisfied with the issues raised above, the establishment of the FICAC may do little to improve the COR rating for Fiji. Similarly, the processes involving suspension and investigation of the suspended executives, board members, civil servants, etc. need to be scrutinised carefully and the public at large ensured without doubt that all actions have been proper, lawful and in the best interest of the country. The various NGO’s could play an important role here; their services need to be adequately supported and recognised.

There may be many other strategies available to the government in its fight against corruption; the government may indeed be pondering on these. However issues such as, unconditional transparency and fairness will always be major concerns. To resolve these issues, it is recommended that the government seek international technical and financial assistance. In terms of technical assistance, New Zealand is recommended. This is a country geographically close to, and always much concerned about Fiji’s welfare. Moreover, it is one with the lowest levels of corruption and otherwise high quality enforcement levels; New Zealand may also provide some financial support, the rest and perhaps, the bulk of the financial support could come from multinational organisations such as ADB and the World Bank, which otherwise regularly provide financial aid to Fiji.

It is recommended that technical support be obtained from an individual country rather than a multinational organisation such as ADB because while ADB may be concerned about the welfare of Fiji, it’s own COR is not rated, New Zealand’s is and highly; the latter’s accomplishments are on record. This perception appears important for the communities. In chapter 5, while comparing Fiji’s law enforcement quality with the
Asia–Pacific countries, it could be seen that New Zealand’s was the best in the region; 9.8 out of 10, almost perfect (see table 5–10). Moreover, it had the lowest possible COR level of 10 (1 = highest level and 10 = lowest level); the next best was Australia’s and Japan’s at 8.5. New Zealand also scored 10 out of 10 on two of the law enforcement variables, EFJS and RoL; no other country in the sample could match New Zealand’s feat. Further, Transparency International has constantly ranked New Zealand as a country with the best possible COR rating among 180 developed and developing countries globally; New Zealand’ 2007 COR rating is 9.4.

7.2.3 **Recommendation S–2: Enhance Fiji’s Accounting Standards—ACT**

Perhaps, the greatest protection for investors in Fiji is currently provided by the country’s high quality accounting standards—ACT—used as a substitute for weak law enforcement. Investors and experts rate Fiji’s ACT standard 7.29 out of 10, which falls below only the Scandinavian average of 7.40 i.e. it ranks higher than even the English average (6.96)—English laws are shown to provide the best investor protection in the world (see table 5–10). Moreover, across the Asia–Pacific region, Fiji’s ACT standard appears to be one of the best, almost on par with the Australian quality (7.50). Essentially, investors and experts have high confidence in Fiji’s accounting systems.

In July 1995, the International Accounting Standards Committee (IASC, now IASB—Board) and the International Organisation of Securities Commission (IOSCO) agreed to develop a set of international accounting standards (IAS, subsequently changed to IFRS—International Financial Reporting System) to provide a single high quality, comprehensible and enforceable accounting standards for business enterprises across countries. Fiji is among the 100 or so countries globally which require or permit the use of, or have a policy of convergence with IFRS. Commencing with selective adoption of
the IFRS in 2002, the Fiji Institute of Accountants (FIA)\textsuperscript{7–2} fully adopted and endorsed the standards in June 2006, setting the effective date of compliance as 1 January 2007 (FIA, 2007, Sept). Previously, Fiji’s generally accepted accounting principles had been founded on the British, Australian, New Zealand and the IASB systems.

While the progressive adoption of the IFRS has enabled accountants to enhance their experience and confidence in dealing with the requirements of the IFRS, the country has been reasonably endowed with resources and expertise to comply with any FIA issued standard, including the IFRS. Renowned international accounting firms, such as KPMG and PricewaterhouseCoopers and numerous other well established firms operate in Fiji. Local FIA members (a large proportion) usually obtain their qualifications from the University of the South Pacific where IFRS issues are an important and extensive part of the curriculum.

Further, compliance does not appear to have been an issue of concern despite the less favourable socio–economic conditions of the country—the level of compliance with accounting standards in Fiji appears to be comparable to that in Australia, New Zealand, UK and US (Pathik, 2000). Here, the proactive role of the FIA merits commendation.

For example, to operate an accounting firm in Fiji requires FIA membership with a Charted Accountant (CA) status and at least three years of experience with an established accounting firm. Members are required to adhere to the FIA’s Accounting and Auditing Standards Board (FAASB) requirements, which are approved and promulgated by the Institute’s Council. Non–members and expelled members are not allowed to provide accounting related services to clients; expulsion is usually a result of non–compliance with mandatory standards/requirements.

\textsuperscript{7–2} FIA was established in 1972 in accordance with the FIA ACT, 1971.
In view of the above, there is little wonder that the investors and experts view ACT in Fiji to be of high quality. The full adoption of the IFRS, subsequent to the opinion survey of this research, is likely to have changed more positively the opinions on the quality of ACT; it is now likely to be better than 7.29. If the rating for COR could be improved to 7, as proposed in section 7.2.2, and that of ACT to, say 9, both the enforcement quality and the substitute for law enforcement would improve substantially. As argued in section 7.2.2, improving the COR rating is possible. Similarly, improving the ACT rating also appears possible.

While the full adoption of the IFRS is likely to have improved the ACT rating to beyond 7.29, a number of unresolved issues is likely to prevent the rating to increase to 9. With the IFRS now in place the private sector would be required to comply with international accounting standards and more stringent disclosure, which are indeed expected to enhance the confidence of investors. However, while compliance may not be an issue of concern, it is largely self-initiated and regulated; absent are both independence of the FAASB and legislative support for the standards. Moreover, there is no legal requirement for unlisted firms to produce audited financial statements and the legislature is silent on accountabilities of the accountants. Further, the private sector firms required to comply with the IFRS standards in Fiji are confined to those with annual group turnover or assets of FJD20m or more, listed companies, and entities where the foregoing companies hold more than 20% shares.

The FAASB, which develops accounting and auditing standards for Fiji, comprises members drawn from accounting firms, public and private sectors and academia, more recently dominated by practicing auditors; the members are appointed by the FIA Council. Currently, the AASB is neither independent nor legally empowered to
implement or enforce its standards. Moreover, the accountabilities of the accountants are not clear.

Further, while financial reports are generally prepared in accordance with FAASB, companies are not legally required to do so. There is no legal requirement for non-listed companies in Fiji to have their books audited. Further, where auditing is required, there is no legal basis for preparing financial statements, allowing, *inter alia*, for significant freedom in selecting accounting policies. For instance, while the Banking Act 1995 requires bank borrowers to submit audited financial statements as part of the paperwork required for appraising and monitoring credit, there is no reference to the FAASB. Similarly, the stock exchange listing rules do not refer to FAASB as well.

The differential reporting systems for larger and/or listed firms versus smaller and/or unlisted firms may have merit e.g. the diverse size, structure, nature of operations and ownership/management of the two groups is likely to require different accounting information needs and decision making processes—the latter group need not comply with the more complex requirements of the former. However, it is this group of private sector entities that needs more financial support for formation, operation and growth. Thus, if the SMEs were to be provided more financial sector funding, in view of enhancing legal investor protection, disclosure by these entities would also need to be improved.

Realising the different needs and requirements of SMEs, the IASB has commenced work on developing a separate set of financial reporting standards for these entities. It is likely that FAASB will embrace these as well. However, the adoption and implementation of that is likely to take a while yet. In the meantime, it appears prudent, in the interest of not delaying the country’s financial development process unnecessarily, to require all SMEs to adopt an acceptable level of reporting.
In view of the above and in improving the rating for ACT in Fiji, it is recommended that the FAASB be legally empowered to issue, enforce and monitor accounting standards in Fiji. It is also recommended that all borrowers of financial sector funds—potential and existing—be required to comply with FAASB requirements. That is, at least, both RBF and SPSE must require that borrowing firms comply with FAASB requirements.

While it appears important to enhance the powers of FAASB, it is also important to improve the independence of the board. Thus, it is recommended that legislature also provide for composition and appointment processes of the FAASB. The accountabilities of the accountants also need to be clarified and legislated.

As with COR, attempting significant improvements to the ACT rating without international technical and financial assistance, may prove to be a difficult undertaking. Hence, it is recommended that a multinational organisation such as ADB be approached for financial and technical support.

7.3 STRATEGIES FOR ENHANCING DEMAND FOR FUNDS

This section outlines strategies for encouraging the private sector to borrow more funds from the banks and consider listing and/or issuing more stocks to the public. The demand–side determinants in this study have included costs and practices and procedures where, costs include the interest cost of borrowing plus fees and charges (transaction costs) and practices and procedures include collateral and disclosure requirements and paperwork. The strategies and recommendations too are in relation to this. That is, the focus is on making financial sector funds more attractive than alternative sources with respect to attributes of these factors. The questions have been: (i) what has been the relative importance of alternative channels of finance; (ii) how have various factors influenced firms’ preference for these sources; and (iii) can financial sector funds be made more attractive to the firms? Strategies and
recommendations that follow are based on the findings per foregoing questions. To understand the questions and related findings and recommendations better, it appears important to review the definition of alternative finance (ALT) as used in this study.

This study defines ALT as any source of finance other than domestic bank finance (BANK) and stock market public equity (SMPE). Examples of ALT include stock market non–public equity (SMNPE), retained earnings, reserves, related party loans (shareholders, directors, related companies), creditors and accruals (trade and others), provisions (income tax, employee benefits), money lending, foreign direct investment, cross listed accounts, informal sources, and anything else (see section 2.7 for details).

The above questions may now be rephrased as: (i) what has been the importance of SMNPE, retained earnings, related party loans etc for firms in Fiji relative to bank and SMPE finance; (ii) how have costs and practices and procedures influenced the preference for SMNPE, retained earnings, related party loans etc versus bank and SMPE finance; and (iii) can bank and SMPE funds be made more attractive to the private sector firms in Fiji.

7.3.1 Summary Of Findings

Using primary (survey of firms) and secondary (annual reports of firms) data, this study finds that use of alternative finance has indeed been extensive over the 1980–2003 period for firms across size, ownership and listing status. While the situation may not be too different from that in other developing economies, it is still a concern for Fiji’s prospective financial development.

Further, it appears that costs and practices and procedures—the usual factors—are also the key drivers of preference for alternative finance. That is, the less favourable
attributes of costs and practices and procedures of bank and stock market finance make these sources less attractive compared to alternative sources. For instance, firms believe that banking and stock market costs are a lot higher than those of alternative sources. They also believe that collateral requirements are stringent, paperwork and bureaucracy excessive and disclosure requirements undesirable, compared to alternative sources.

In fact, the highly flexible and the amorphous nature of operations, credit terms to meet specific needs, minimal paperwork, easily understood rules and regulations, faster processing and delivery of credits, and access to amounts corresponding to requirements and capacity of borrowers make the alternative sources highly attractive. Other notable attractions of alternative finance include little or no collateral requirements (which is substituted by personal relationships, borrower’s credit history and social norms), relatively low transaction costs, zero reserve requirements and little or nil disclosure.

However, financing trends over a period of time show that firms may be persuaded to move away from alternative sources and toward the financial sector for funding needs. The trick would be to make the financial sector funds more attractive in terms of costs and practices and procedures. For instance, bank credit to the private sector would have to be made conspicuously cheaper both in terms of interest and fees and charges, adequacy and appropriateness test for collateral would have to be made less stringent, disclosure requirements would have to be moderated and the time taken to apply for a loan and receive a response would have to be reduced.

In view of the above, for enhancing the demand for financial sector funds in Fiji, the following recommendations and strategies are proposed7–3.

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7–3 Future research may consider using Tobin’s Q for analysis of the issues here.
7.3.2 **Recommendation D–1: Reduce Corporate Tax**

In proposing strategies for increasing the supply of funds, this study recommends, *inter alia*, that the ACT standards be enhanced, a result of which is likely to be increased disclosure of firms’ financial positions. Ironically, disclosure is already a major issue of concern to the borrowers of funds; in fact, a factor that may strongly be discouraging firms to borrow from the banks and or via the stock market.

Firms in Fiji appear to have a culture of not being comfortable revealing information. Moreover, public disclosure requirements of the stock market appears to be more confronting than the more confined bank disclosure. Thus, while on one hand, more disclosure is likely to enhance the confidence of investors (banks and households) to supply more funds (credit and equity) to the private sector, on the other, it may further reduce demand for financial sector funds; the net effect being little, if any, impact on financial development.

This dilemma may be resolved by dealing favourably with other concerns of borrowers such as cost and conditions of borrowing, strategies for which are discussed later. In addition, it appears important to examine the possibility of reducing corporate taxes for firms generally and particularly for listed firms. Tax implications could well be an important reason for reluctance to disclose; tax evasion does appear to be an attraction of alternative finance. In fact, while listed firms refrained from making a comment on this issue, many unlisted firms did not hesitate from making it known that the current tax policies were a hindrance to business growth in the country—33% stated that this was more than moderate obstacle. Thus, providing reasonable tax incentives may, *inter alia*, encourage firms to list on the stock exchange and thereby help resolve the disclosure issues.
The former chief executive officer (CEO) of SPSE believed that tax incentives would indeed encourage more firms to list on SPSE (Chaudhary, 2005). The CEO’s comments were published on the eve of the Fiji Government’s 2006 National Budget Announcement. The recommendation was to have at least a 10% difference so that listed firms would have to pay a corporate tax of 21% compared to the 31% for unlisted firms. The CEO believed that the differential tax would encourage at least 100 more companies to list. Similar recommendations have recently been made by an academic at the University of the South Pacific on the eve of the 2008 National Budget Announcement. The recommendation is for a minimum 6% reduction in corporate tax across the board, i.e. applicable not only to listed but also to unlisted firms.

If the current level of financial disclosure is encouraging tax evasion by firms (as discussed in section 6.6) it is recommended that corporate taxes be reduced for all companies (e.g. 5–6%) and further reduction be applied to listed companies only (e.g. 10–12%). While government may be reluctant to consider this stance in view of perceived lost revenues; the overwhelming potential benefits make the lost revenue argument relatively insignificant. The potential benefits include: (i) significant savings in costs and time in tracking tax evaders, which appears to be a major concern for the government; (ii) increase in new investments (including foreign); (iii) new stock market listings (iv) financial development; and (v) economic growth. Again, international technical and financial support may be sought to initiate and implement tax reforms in the country.

7.3.3 Recommendation D–2: Moderate The Cost of Funds

From the demand perspective, cost of funds appears to contribute significantly to the relative low preference and use of banking funds for the operation and growth of businesses in Fiji. To summarise, borrowers viewed banking costs to be highly
expensive (mean = 2.6: panel A of table 7–2) compared to alternative forms of finance (where 1 = most expensive and 7 = least expensive). Moreover, both interest and fees (mean = 2.3: panel B of table 7–2) were deemed to highly impede access to bank finance (where 1 = major obstacle and 7 = no obstacle) but also deemed to be relatively important (interest mean = 6.1 and fee mean = 5.7) in making a decision to borrow or not from banks. That cost may importantly be impeding firm access to bank finance is a sentiment shared by experts as well. Panel B of table 7–2 shows that experts believe that both interest and fees may be important obstacles for both potential (PB) and existing (EB) borrowers.

Table 7–2: The cost related difficulties to bank borrowing in Fiji

This table presents the views of various respondents on issues relating to cost of banking funds in Fiji. Panel A presents the views of borrowers and banks on the question of how expensive banking funds have been, where 1 = most expensive and 7 = least expensive. Thus, borrowers find banking funds to be relatively expensive (mean = 2.6).

In Panel B, the cost has been split into its main components, interest and fees and the views of borrowers and experts presented on the difficulty (1 = major obstacle; 7 = no obstacle) these may be creating for accessing bank credit. Experts’ views were obtained in relation to both potential (PB) and existing borrowers (EB). As can be seen, the mean is very similar and low across various aspects, indicating that the borrowers and experts regards interest and fees to be a high obstacle in accessing bank credits.

<table>
<thead>
<tr>
<th>Panel A: Views on bank costs</th>
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<tbody>
<tr>
<td><strong>Respondent</strong></td>
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<tr>
<td>Borrower</td>
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<tr>
<td>Bank</td>
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</table>

<table>
<thead>
<tr>
<th>Panel B: Cost as an obstacle to borrowing</th>
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</thead>
<tbody>
<tr>
<td><strong>Respondent</strong></td>
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<tr>
<td>Borrower</td>
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<td></td>
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<tr>
<td>Expert</td>
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</table>

However, not surprisingly, the banks themselves believe otherwise—that banking costs are not high at all (panel A of table 7–2). Moreover, a reading of the CIFS (1999) report and an evaluation of mission statements suggests that the banks do not seem to
have much orientation towards social and/or corporate responsibility in Fiji. Banking costs are likely to continue to rise, resulting in continued low preference for and use of bank funds for business formation, growth and expansion and thereby low financial development. It appears that some form of intervention, direct or indirect is inevitable to persuade banks to review and reduce their cost of lending to the private sector. First, however, there is a need to justify intervention by the appropriate authorities—the recommendation is to require banks in Fiji to become socially responsible. Such justification, inter alia, may be based on profitability analysis. An example of which, using WBC 1999–2005 financials, is shown below.

WBC’s business segments are shown in table 7–3. While the business segment reporting does not necessarily separate assets, revenue and profits in terms of location, the geographic segmentation does so and includes Australia, New Zealand and Others. The last category includes Pacific Islands, Asia, Americas and Europe. While the Fiji operations have been lumped with the ‘Others’, it has been possible to examine this segment’s profitability separately as Fiji data is available on Reserve Bank of Fiji’s Website.

Table 7–3: Business segments of Westpac Banking Corporation

This table shows the various geographical and business segments of Westpac; Fiji is included in the ‘Others’ category.

<table>
<thead>
<tr>
<th>Business segment</th>
<th>Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business and Consumer</td>
<td>Service and product development facilities for consumer and small and</td>
</tr>
<tr>
<td>Institutional Banking</td>
<td>medium businesses across Australia</td>
</tr>
<tr>
<td>New Zealand Banking</td>
<td>Services to corporations institutions and government customers across</td>
</tr>
<tr>
<td>BT Financial Group</td>
<td>Banking and wealth management services to consumer and retail business</td>
</tr>
<tr>
<td>Others</td>
<td>WBC’s wealth management operations in Australia</td>
</tr>
</tbody>
</table>

Business and Technology solutions and Services (BTSS), Group Treasury, **Pacific Banking**, and Head Office functions. BTSS performs the back office function and the **Pacific** group includes Cook Islands, **Fiji**, Papua New Guinea, Samoa, Solomon Islands, Tonga and Vanuatu.
Table 7–4 (below) highlights the profitability of WBC’s various segments over the 1999–2005. Evidently, over this period, Fiji’s performance has been the most outstanding and the most profitable across WBC’s business and geographic segments. Moreover, Fiji’s profitability ratios have been exceptionally high compared to other segments, including the Australian and the New Zealand geographical segments. An indication of Fiji segment’s relative strong profitability in 1999 and 2005—the beginning and the end of the analysis period—is given below.

In 1999, Fiji’s pre–tax (before tax–bt) ROE (return on equity) was distinctively the highest across all segments; 2.3 times more than the Group’s and up to 17 times more than other segments. Fiji’s pre–tax ROA (return on assets) was also the highest across the segments; 2.5 more than the Group’s and up to 3.6 times more than other segments, including 2.8 times more than the Australian and 2.6 times more than the New Zealand geographical segments. Similar trends were displayed for post–tax ratios. Fiji’s PM (profit margin) was also by far the highest across the segments; twice more than the Group’s and other segments, including the Australian and the New Zealand geographical segments.

In 2005, although Fiji’s pre–tax ROE (64.5%) may have declined significantly compared to its 1999 rate, it was still conspicuously the highest across all segments; twice more than the Group’s and up to 19 times more than other segments—it was only up to 9 times more than other segments in 1999. The segment’s pre–tax ROA was also clearly the highest across all segments; 3.5 more than the Group’s and up to 3.7 times more than all other segments, including 3.5 times more than the Australian and 2.6
times more the New Zealand geographical segments. Similar trends are displayed for post–tax ratios.

Table 7–4: Profitability of Westpac Banking Corporation’s (WBC) business and regional segments, 1999–2005

This table compares the profitability of WBC’s Fiji operation with that of the bank’s other business and regional sectors. As the table shows, Fiji operations appear to be highly profitable over the 1999–2005 period.

<table>
<thead>
<tr>
<th>Year</th>
<th>Business Segment</th>
<th>ROA (bt)</th>
<th>ROE (bt)</th>
<th>PM (bt)</th>
</tr>
</thead>
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<td>2005</td>
<td>Group</td>
<td>1.5%</td>
<td>23.6%</td>
<td>20.6%</td>
</tr>
<tr>
<td></td>
<td>BCB</td>
<td>1.4%</td>
<td>4.5%</td>
<td>19.6%</td>
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<tr>
<td></td>
<td>BTFG</td>
<td>2.6%</td>
<td>9.6%</td>
<td>34.8%</td>
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<tr>
<td></td>
<td>WIB</td>
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<td>4.1%</td>
<td>27.8%</td>
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<td></td>
<td>NZB</td>
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<td>7.5%</td>
<td>21.4%</td>
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<tr>
<td></td>
<td>Other</td>
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<td>-0.3%</td>
<td>7.8%</td>
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<tr>
<td></td>
<td>Fiji</td>
<td>5.2%</td>
<td>64.5%</td>
<td>60.6%</td>
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<td></td>
<td>Aust</td>
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<td>19.8%</td>
<td>24.3%</td>
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<td>68.9%</td>
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<tr>
<td></td>
<td>Other</td>
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<td></td>
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<td>26.9%</td>
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<td>Aust</td>
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<td>11.3%</td>
<td>16.6%</td>
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<td></td>
<td>NZ</td>
<td>2.0%</td>
<td>42.4%</td>
<td>25.6%</td>
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<td></td>
<td>Other</td>
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<tr>
<td>2001</td>
<td>Fiji</td>
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<td>27.2%</td>
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<tr>
<td></td>
<td>Other</td>
<td>5.4%</td>
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<td>24.4%</td>
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</table>


Notes: * ROA = Return on Assets; ROE = Return on Equity; PM = Profit Margin; bt = before tax (or pre–tax)

Fiji’s PM too was still the highest across the segments; in fact, while the ROE may have declined, the PM had increased substantially from 40% in 1999 to 60% in 2005. Moreover, it was now up to 3 times more than the Group’s and other segments (compared to twice in 1999).
Profitability assessment

It should be noted that, Fiji’s performance in this period has been far stronger than any of the WBC segments despite the fact that the Fiji’s socio–economic conditions are likely to be among the worst and the number of customers likely to be the least across all segments, especially compared to the Australian and New Zealand geographical segments. With respect to the customer base, in 2005, WBC’s BCB segment’s network of 813 branches and 1653 ATMs across Australia indicates that the segment’s customer base would have to substantially larger than Fiji’s with a total population of around 0.85 million, served by five different banks and the NZ segment had a customer base of around 1.4 million, served by a network of 195 branches and 471 ATMs.

Further, while some segments may have occasionally suffered losses or otherwise recorded negative returns, the Fiji segment has not been in this situation at any time, including the time of political instability in 2000. Despite the political problems, the Fiji segment’s performance was stronger than other segments, providing thus a testimony of strong profitability of the Fiji segment. It is highly likely that the Fiji segment’s performance may have been equally strong in the pre–1999 period and likely to be so in the post–2005 period.

In addition to the strong profitability, the capital position of WBC’s Fiji segment appears strong as well. In consonance with international practice, banks in Fiji are required to hold minimum capital in accordance with the Basel Accord. Over the 1999–2005 period, the capital adequacy ratio (CAR) of the Fiji segment has been above the minimum 8% requirement; it has fluctuated around 9 to 14%.
A similar profitability and capital situation is expected of other banks operating in Fiji, such as that of ANZ’s. Accordingly, it appears reasonable to require banks in Fiji to lower their interest and other charges on loans to the private sector in Fiji. Perhaps, the most reasonable approach would be to require these banks to become more socially responsible. Alternatively, in view of the important benefits of financial development, appropriate regulation of interest and fees and charges may be considered, in addition to the normal requirements.

To dispel any doubts about findings and views presented in this research in relation to the cost of financial sector funds, the relevant authorities may consider conducting an independent, comprehensive review of related issues, including comparing costs in other countries.

7.3.4 Recommendation D–3: Moderate Collateral And Other Procedures

Reduced costs per se may not have the desired level of impact on private sector borrowing; other issues also need to be examined. Given the importance of practices and procedures (e.g. collateral and paper work) in mitigating potential losses arising from asymmetric information, moral hazard and adverse selection issues, any argument to make these more flexible would normally be difficult to justify. However, in view of, on one hand, the importance of increased bank lending to private sector for financial development in Fiji and on the other hand, the pessimistic perception of the private sector on these issues, it appears important to carefully explore the possibility of indeed making these more flexible.

From the demand perspective, the ratings for both collateral (mean = 3.1) and paperwork (mean = 3.6) suggests that firms have much difficulty in satisfying these requirements of banks in obtaining loans (1 = major obstacle and 7 = no obstacle).
Experts tend to share the concerns of borrowers. Their mean response to questions on problems associated with collateral and paperwork from the borrowers’ perspective ranged from 2.7 to 3.2 (panel A, table 7–5), suggesting that both potential and existing bank borrowers may indeed have difficulty in providing appropriate and adequate collateral and satisfactorily meeting paperwork requirements in obtaining loans.

Table 7–5: Procedural related difficulties to bank borrowing in Fiji

This table presents the views of various respondents on the question of how collateral requirements and paperwork (includes bureaucracy) may be impeding access to bank credit in Fiji, where 1 = major obstacle and 7 = no obstacle. Expert and bank views were obtained in relation to both potential (PB) and existing borrowers (EB). Further, paperwork was divided into appropriate financial statements (Paper1) and other documents such as valuations, feasibility studies, pro forma statements etc. (Paper2).

Panel A: Borrowers’ perspective

<table>
<thead>
<tr>
<th>Respondent</th>
<th>Procedure</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrower</td>
<td>Collateral</td>
<td>74</td>
<td>1</td>
<td>7</td>
<td>3.1</td>
<td>1.64</td>
</tr>
<tr>
<td></td>
<td>Paperwork</td>
<td>74</td>
<td>1</td>
<td>7</td>
<td>3.6</td>
<td>1.46</td>
</tr>
<tr>
<td>Expert</td>
<td>Collateral_PB</td>
<td>13</td>
<td>1</td>
<td>7</td>
<td>2.7</td>
<td>1.70</td>
</tr>
<tr>
<td></td>
<td>Paper_PB</td>
<td>13</td>
<td>1</td>
<td>7</td>
<td>2.9</td>
<td>2.06</td>
</tr>
<tr>
<td></td>
<td>Collateral_EB</td>
<td>13</td>
<td>1</td>
<td>7</td>
<td>2.9</td>
<td>1.78</td>
</tr>
<tr>
<td></td>
<td>Paper_EB</td>
<td>13</td>
<td>1</td>
<td>7</td>
<td>3.2</td>
<td>2.15</td>
</tr>
</tbody>
</table>

Note: Collateral = collateral requirements; Paper = paperwork and bureaucracy in general

Panel A: Banks’ perspective

<table>
<thead>
<tr>
<th>Respondent</th>
<th>Procedure</th>
<th>N</th>
<th>Minimum</th>
<th>Maximum</th>
<th>Mean</th>
<th>Std Dev</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank</td>
<td>Collateral_PB</td>
<td>14</td>
<td>1</td>
<td>6</td>
<td>3.6</td>
<td>1.60</td>
</tr>
<tr>
<td></td>
<td>Paper1_PB</td>
<td>14</td>
<td>1</td>
<td>5</td>
<td>3.3</td>
<td>1.32</td>
</tr>
<tr>
<td></td>
<td>Paper2_PB</td>
<td>14</td>
<td>1</td>
<td>5</td>
<td>3.6</td>
<td>1.28</td>
</tr>
<tr>
<td></td>
<td>Collateral_EB</td>
<td>14</td>
<td>1</td>
<td>7</td>
<td>4.9</td>
<td>2.17</td>
</tr>
<tr>
<td></td>
<td>Paper1_EB</td>
<td>14</td>
<td>2</td>
<td>7</td>
<td>4.9</td>
<td>1.29</td>
</tr>
<tr>
<td></td>
<td>Paper2_EB</td>
<td>14</td>
<td>3</td>
<td>7</td>
<td>5.0</td>
<td>1.18</td>
</tr>
<tr>
<td>Expert</td>
<td>Collateral_PB</td>
<td>13</td>
<td>2</td>
<td>7</td>
<td>3.1</td>
<td>1.44</td>
</tr>
<tr>
<td></td>
<td>Paper1_PB</td>
<td>13</td>
<td>1</td>
<td>4</td>
<td>2.2</td>
<td>0.83</td>
</tr>
<tr>
<td></td>
<td>Paper2_PB</td>
<td>13</td>
<td>2</td>
<td>7</td>
<td>3.3</td>
<td>1.49</td>
</tr>
<tr>
<td></td>
<td>Collateral_EB</td>
<td>13</td>
<td>2</td>
<td>6</td>
<td>3.4</td>
<td>1.44</td>
</tr>
<tr>
<td></td>
<td>Paper1_EB</td>
<td>13</td>
<td>1</td>
<td>5</td>
<td>2.9</td>
<td>1.31</td>
</tr>
<tr>
<td></td>
<td>Paper2_EB</td>
<td>13</td>
<td>2</td>
<td>5</td>
<td>3.4</td>
<td>1.31</td>
</tr>
</tbody>
</table>

However, the experts also appear to sympathise with the banks in this respect, contrary to the views on costs. Their mean response to similar questions (see above) posed from the banks’ perspective ranged from 2.9 to 3.4, (panel B, table 7–5) similar to the response obtained from the borrowers’ perspective. Thus, they appear to believe that banks may be experiencing difficulties in relation to obtaining adequate and appropriate collateral, financials and other documents from firms seeking a loan.
The banks themselves appear to have different degrees of concerns for potential and existing borrowers; they seem more concerned about the difficulty in obtaining these from the potential borrowers (panel B, table 7–5); perhaps, once a relationship has been established, banks are better able to persuade/compel their clients to comply with requirements. Perhaps, a fear of business failure (especially if own capital has been used) or losing collateralised assets give existing customers little choice but to comply, even if they had difficulty in doing so.

Interestingly, banks also appear to believe that the criteria for collateral and paper requirements in Fiji are rather stringent; their mean response to the question ‘how would you generally rate (the requirements for these) in relation to business loans’ was around 3 (where 1 = high and 7 = low). This point, on one hand, banks believing that requirements are stringent, on the other, not having much trouble in requiring at least the existing customers to comply, raises an important question: are the collateral and procedural requirements for obtaining a bank loan in Fiji reasonable in view of the local circumstances? If no, can these be made more flexible?

A number of issues are worth noting in terms of appropriateness and adequacy of collateral and other procedural requirements (hereafter, terms and conditions) for bank loans in Fiji. Generally, these, like many other requirements, are determined by the Reserve Bank of Fiji (RBF) regulations and policies. In this case, the relevant RBF policies are Banking Statement Policy (BSPS) No. 37–4 on Loan Classification and Provisioning for Impaired Assets and BSPS No.1 on Capital Adequacy Requirements. These policies, like most others, are largely adoptions of the recommendations of the

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See reservebank.gov.fj (Regulatory Framework, Prudential Standards and Guidelines)
Basel Committee. Often, in view of consistency with international practices, Basel Committee recommendations are applied and imposed on banks in Fiji without much amendment and adaptation. Thus, the adequacy and appropriateness of terms and conditions of banks in Fiji, a small developing nation, would not be much different from that in say, an industrialised country, such as Australia.

Such high standard requirements, while on one hand, may well serve to foster a sound functioning banking system, on the other hand, may have serious adverse implications for demand for bank credit in Fiji, where the local circumstances are distinctly different from that of industrialised countries; the circumstances, of course, are far less favourable. Ultimately, the situation may be like this: sound banking system, on one hand, but little financial development, on the other.

Ironically, while there is little financial development, there appears to be constant excess liquidity in the banking system (e.g. ADB, 2001, 2004). Thus, increased bank lending to the private sector appears possible. If terms and conditions are indeed contributing to what the banks call ‘lack of bankable projects’, it is important to review the terms and conditions situation in view of the local circumstances.

The liquidity position of banks in Fiji is shown in table 7–6; the table uses ANZ and WBC as individual bank examples. RBF does not require banks to maintain any specific level of liquidity anymore; all specific requirements (such as Unimpaired Liquid Asset Ratio) were removed by 1999 (Reddy et al, 2004). Current guidelines (Liquidity Risk Management Requirements for Banks), *inter alia*, encourage banks to self-monitor trends in certain ratios, such as total loans (TL) to total deposits (TD); liquid assets (LA) to total assets (TA); and LA to TD ratios. Table 7–6 confirms ADB
(2004, 2001) etc. claims of excess liquidity in the banking system. Moreover, banks like ANZ and WBC appear to have relatively more capacity to increase lending to the private sector.

### Table 7–6: Liquidity position of banks in Fiji

This table shows the liquidity position of banks in Fiji; ANZ and WBC are used to show positions of large banks. In this table, TL = total loans; TD = total deposits; LA = liquid assets; and TA = total assets and the various ratios used, such as TL/Td are used by the Reserve Bank to assess liquidity in the system.

<table>
<thead>
<tr>
<th>Year</th>
<th>TL/TD</th>
<th>LA/TA</th>
<th>LA/TD</th>
</tr>
</thead>
<tbody>
<tr>
<td>WBC  2005</td>
<td>80.17%</td>
<td>22.98%</td>
<td>26.01%</td>
</tr>
<tr>
<td>2000</td>
<td>86.89%</td>
<td>19.85%</td>
<td>23.65%</td>
</tr>
<tr>
<td>ANZ  2005</td>
<td>81.34%</td>
<td>24.48%</td>
<td>26.97%</td>
</tr>
<tr>
<td>2000</td>
<td>79.70%</td>
<td>27.22%</td>
<td>30.85%</td>
</tr>
<tr>
<td>All banks 2000</td>
<td>78.89%</td>
<td>16.35%</td>
<td>21.01%</td>
</tr>
<tr>
<td>2005</td>
<td>83.96%</td>
<td>14.63%</td>
<td>18.33%</td>
</tr>
</tbody>
</table>

Source: RBF (www.reservebank.gov.fj)

Section 7.3.3 exemplified the likely profitability and capital positions of banks in Fiji. For example, WBC Fiji’s return on equity (ROE) was substantially larger than that of other segments, regions and of the group operations. Table 7–7 recapitulates the 2005 pre–tax ROE of Fiji versus the Group position; 64.5% for Fiji and 23.6% for the Group. The table also suggests that a 25% ROE (BT) for Fiji operations would still be reasonable for WBC, such that Fiji operation profits could reasonably drop to $15m to $20m for WBC.

### Table 7–7: Return on equity of WBC: A recapitulation

This table recaps the 2005 ROE (bt) of WBC, used as an example to show strong profitability of banks in Fiji relative to other geographical and business sectors; that of Fiji and the Group are shown here. The table suggests that a much lower ROE (bt) for Fiji operations would still be reasonable, which would importantly allow for more credit to the private sector on more flexible terms and conditions.

<table>
<thead>
<tr>
<th>ROE (bt)</th>
<th>Net Profit (bt)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiji</td>
<td>Actual</td>
</tr>
<tr>
<td>WBC 2005</td>
<td>64.50%</td>
</tr>
</tbody>
</table>
An important implication of the above suggestion is that the difference in profit levels (actual less reasonable—around $25m) may be lent to the private sector without the normal expectations of recovery. That is, this amount may be lent on more flexible terms and conditions. This is only one example of how banks may be encouraged to increase lending to the private sector; surely, more than $25m of the total bank funds could be made available using this approach. Even $50m additional loans to the private sector on more flexible terms and conditions would certainly contribute to formation of many new enterprises and growth of existing small businesses, which appear to need financial sector funds more than the larger, well-established firms.

Flexibility of terms and conditions will require, inter alia, a review of RBF’s relevant supervisory policies. For example, BSPS No. 1 (capital adequacy) & 3 (loans classification) will have to be reviewed. The policies would have to be made more adaptable to local circumstances. The policies may, at least, be made more flexible for loans to new enterprises and existing small businesses. RBF may like to seek professional/external assistance in doing this. With regard to prudential supervision of financial institutions by the RBF, there may be a broader argument for a review of the entire framework; there have been some suggestions that the type of supervision being generally applied, which is in line with practices in industrialised economies, may not be the most appropriate for an economy like Fiji. This broader issue is beyond the scope of this study and may be pursued in a separate research.

The above recommendation to provide market-friendly means of relaxing constraints to firms, especially new and existing small enterprises, is not an unreasonable one; literature highlights cases around the world where financial institutions have developed specific techniques to lend to small, opaque firms with little or no collateral (see for
example, Beck and Demirgüç, 2006; Berger and Udell, 2006; Klapper, 2006). Based on soft information and long-term relationships, such ‘relationship’ lending has long been seen as a major lending technology benefiting mainly small and medium enterprises, and for well-established foreign banks like ANZ and WBC, facilitating this process would not be difficult.

7.3.5 Public Awareness, Education And Involvement

Since public perceptions drive a country’s law enforcement ratings, which in turn importantly determine the level of a country’s investor protection and thus the potential for financial development, it is critical that any action taken to improve the country’s law enforcement quality be highly transparent and well disseminated to the public at large, which would, of course, include investors. Information dissemination should ensure international awareness. Secrecy and confidentiality should be dispelled as much as possible. Instead, the public should be encouraged to scrutinise actors and hold them accountable. All proposals, initiatives and progress should be made very clear to the public; public should have a right to information.

Accordingly, it is recommended that the campaign to improve the COR and the ACT ratings begin with raising public awareness and education of the importance of adequate legal investor protection for sustainable financial development. The public should be made aware of Fiji’s current situation in relation to both the legal investor rights and law enforcement quality. That is, the results of this research and other relevant studies/surveys must be availed to the public. In doing so, Fiji’s better comparative situation against selected developed and developing countries should be highlighted as suggested in chapter 5.

Following the initial awareness and education, it is recommended that the public be informed of the proposals to improve the quality of law enforcement in the country,
beginning with COR and ACT. The relative importance of COR and ACT, as discussed in this study, should be highlighted. Subsequently, details of strategies to improve these should be disseminated to the public, with the rationale for the adopted strategies. Public should then be constantly kept informed of the progress being made.

Public awareness and education may also resolve the problems in relation to shareholder and regulator knowledge gaps regarding basic investor legal rules and generally about legal protection. Similarly, the public should be made aware of and informed about the steps taken/considered to address the concerns of the main users of financial sector funds in the country—the private sector firms—in relation to costs, disclosure, and procedures.

7.4 CHAPTER SUMMARY

This chapter provided strategies and recommendations for enhancing financial development in Fiji based on the findings per chapters four, five and six. Chapter four highlighted that further financial development in Fiji was possible. Chapter five explored the possibility of enhancing the supply of funds and focussing on legal institutions as a key supply–side determinant of financial development concluded that while enhancement of legal institutions was not essential, some enhancement would still be desirable. Chapter six explored the possibility of enhancing the demand for funds and focussing on costs and practices and procedures as likely demand–side determinants of financial development, concluded that the demand for financial sector funds could be increased if the specific attributes of these factors, which have favoured alternative channels in the past, could be moderated.

Legal institutions encompass legislated rules and their enforcement quality. Keeping in mind the likely difficulties associated with legal rule reforms, this study proposes that the quality of law enforcement be improved; in particular, it is proposes and outlines
strategies for improving the ratings of corruption (COR) and accounting standards (ACT) in the country.

For enhancing the demand for financial sector funds by the private sector, this study proposes the following. For dealing with disclosure related issues the proposal is to reduce corporate taxes, as it appears that firms may currently be encouraged to use alternative sources to avoid the perceived high levels of taxes. Raising funds via organised channels requires, *inter alia*, disclosure of wealth, which in turn is subjected to tax payments. Firms may be less concerned about disclosure if tax rates were lower.

For dealing with the perceived high cost of financial sector funds, it is proposed that banks in Fiji be encouraged, via social responsibility motives, to moderate the cost of funds to the private sector. This appears possible in view of the relatively high profitability of the Fiji segment operations of the country’s foreign–dominated banking sector. The high profitability together with the constantly high levels of liquidity appear also to justify moderating some of the legal procedural requirements that banks are subjected to. Such requirements may be effective in fostering a sound functioning banking system, however, they may also be hindering financial development.

Thus, improvements to the quality of law enforcement via improved ratings of corruption and accounting standards, reduction in corporate taxes, and moderation of costs and procedural requirements, as outlined in this study, are expected to desirably enhance Fiji’s financial development. Moreover, public awareness, education and involvement are also recommended in initiating and implementing the proposed actions.
Chapter 8

Main Findings, Limitations and Further Research

This chapter summarises the key issues and findings of this study. It also discusses some limitations of the study and outlines directions for further research.

8.1 ABOUT THIS STUDY

This study is motivated by an expanding literature on the finance–growth nexus, which essentially asserts that financial development may foster economic growth via the private sector. Noting Fiji’s modest economic growth relative to international standards and other economies with similar socio-economic characteristics, this study explores ways for enhancing financial development in the country, keeping in mind that these may have a bearing on Fiji’s economic growth and may potentially be of interest to other developing economies, particularly in the Pacific. Motivation is also derived from financial development in itself being a topic of expanding research interest.

Advancing the argument that financial development may require enhancing both the supply and demand for financial sector funds, this study explores the possibility of encouraging (i) suppliers to make more funds available to the private sector via the financial sector; and (ii) the private sector to rely more on financial–sector funds for formation, expansion and growth of business.

A number of theories, including the theory of law, politics, culture and endowment have been advanced in the recent literature to explain obstacles to the supply of funds to the organised channels of finance. The legal theory emphasises the importance of legal investor protection and asserts that the origin of laws determines the adequacy of legal institutions. Proponents of the political and cultural theories agree with the law–finance
view in principle but disagree that legal *origin* is a key determinant of legal institutions; proposing that ‘politics’ and ‘culture’, respectively, also importantly shape legal institutions. The endowment view is a historical account of the cross-country development processes and appears less important for accelerating development. For this reason, and time and resource constraints of this study, the legal theory is an important starting point in exploring and proposing strategies for enhancing the supply of funds in Fiji.

However, the literature appears short on the demand side arguments. Nonetheless, recognising that economic agents, especially those in the private sector, may obtain funds from many sources, this study endeavours to identify and ascertain the influence of some likely factors on the private sector’s preference for funding. Noting that only funds obtained through organised channels would contribute to financial development, this study classifies and describes the non-financial sector sources as ‘alternative finance’. Essentially, from the demand perspective, the study then explores the possibility of, and proposes strategies for, making the financial sector funds more attractive to the private sector.

The study recognises that investigating the above issues would first require an adequate understanding of the financial sector’s past development trends and its current strengths and weaknesses. Accordingly, the study begins by investigating these issues in relation to the country’s banking sector and stock market.

8.2 **RESEARCH QUESTIONS AND MAIN FINDINGS**

As stated in Chapter 1, the study proposes to investigate past trends and the current state of financial development in Fiji, analyse the influence of legal institutions and other
factors on financial development, and explore ways in which financial development can be further promoted. For doing these, a number of questions are developed, which: (RQ 1) assess how well the banking sector and the stock market have developed over the period 1970–2003 and their strengths and weaknesses; (RQ 2) examine the role of legal institutions in financial development; (RQ 3) investigate the role of demand–side factors in firms’ reliance on alternative finance; and, on the basis of these, (RQ 4) explore ways for enhancing financial development in Fiji.

To investigate RQ 1, the study uses a comprehensive set of cross–country data—the ‘Financial Structure Database’—compiled by Beck et al. (2003) to compare Fiji’s situation to 20 developing and developed economies in the East Asia and Pacific region over a 33 year period. To assess the overall banking and stock market development trends, a number of composite indices are constructed specifically for this research. The strengths and weaknesses are investigated in relation to each sector’s size, activity and depth aspects.

The study finds Fiji’s overall banking development trends to be positive over the period 1970–2003 as the relevant composite index for Fiji was on average:

(i) higher than for most South Pacific developing countries over most of this period;
(ii) higher than for most developing, low–GDP countries up to at least 1995;
(iii) higher/similar to at least one developing, high–GDP country over 1970–2001; and
(iv) comparable to New Zealand and Australia until at least 1985.

Further, Fiji’s banking sector appears to have generally become larger, more active and deeper over the 1970–2003 period.
However, results show, using the relevant composite index, that the country’s stock market has been among the least developed across the sample countries. Trends indicate that the market has been substantially small and inactive. Nonetheless, the rising size trend towards the end of the analysis period indicates hope for further development. If indeed, more firms are willing to list, it is the trading and efficiency of the market that requires greater attention; without more trading, market development would be constrained even if more firms were to list. It has been shown in this study that trading has been exceptionally low. Overall, the banking sector appears to have more scope for development. Moreover, it is the activity in both the banking sector and the stock market which is identified as requiring attention—more bank credit to the private sector and more issues and trading of public equity are likely to lead to meaningful further financial development.

In exploring ways and developing strategies for enhancing the supply of bank credit and public equity funds to the private sector, the main question asked is: (RQ 2) what is the role of legal institutions in Fiji’s financial development? Legal institutions encompass the mandating of legal rights and the appropriate enforcement of these rights. The study uses primary and secondary data to investigate issues in relation to this question. The primary data comes from an opinion survey of the main suppliers (creditors and shareholders) and independent knowledgeable individuals, conducted specifically for this research. Using a structured questionnaire, the views of 14 senior officers and executives of the five banks in Fiji, 230 existing and potential shareholders and 15 independent individuals were systematically obtained and analysed. The secondary data was sourced from Fiji’s relevant legislation and other literature on financial development, which enables the country’s situation to be compared to 49 other countries across Europe, North and South America, and Australasia.
Results show that:

(i) the legal protection of creditors (banks) in Fiji is weak;
(ii) the legal protection of minority shareholders is relatively strong;
(iii) at least the legal rights may not have been too important for past banking and stock market development; and
(iv) both creditors and shareholders may not be too concerned about the legal issues in relation to private sector credit or for participating in stock trading.

Thus, while legal institutions may be important for enhancing the supply of bank credit and public equity funds generally, results of this study indicate that there may not be an urgency to strengthen these in the case of Fiji, an interesting finding in light of the prominence of the law–finance school in recent literature. However, noting that some enhancement would generally be reasonable and keeping in mind the potential difficulties associated with legal reforms, this study recommends enhancement of the quality of law enforcement component of legal institutions via (i) improvement to Fiji’s corruption rating; and (ii) enhancement of the country’s accounting standards.

In relation to the demand for financial-sector funds, the question is: (RQ 3) what is the role of demand–side factors in firms’ reliance on alternative finance? Again, both primary and secondary data are used to investigate answers. The primary data is also from an opinion survey, as described earlier; the opinions of 75 private sector firms and 15 experts were obtained and analysed. The secondary data relating to annual accounts of firms in Fiji was also gathered and compiled specifically for this research; information was obtained on 27 firms across various size, business type and listing status, over a 30 year period.
Results show that:

(i) the use of alternative channels of finance may be far greater than that of financial–sector funds for the operation and growth of firms in Fiji;

(ii) non–public equity capital may be the most important single source, followed by creditors and accruals—the sum of these appear to have funded around 75% of firm assets on average over the period 1980–2000, rising to 86% by 2003; and

(iii) of the two financial sector sources, bank credit appears more prominent, financing around 10–11% of assets, with stock market financing being around 1% on average.

The reasons for greater preference for alternative finance seem to lie in the higher costs and greater disclosure, collateral and procedural requirements of financial–sector funds relative to alternative sources. In relation to costs, perhaps there is a widespread belief that financial sector funds are simply expensive. Perhaps, a lack of trust in the financial sector is a cause of this (mis)perception. However, results also indicate that financial sector funds can be made more attractive to the private sector and to do that, this study proposes that (i) corporate taxes be reduced for all firms, especially for listed firms; (ii) the cost of bank private sector credit be moderated; and (iii) the procedural requirements in relation to bank private sector credit be moderated as well.

In investigating issues and providing strategies for further developing Fiji’s financial sector, this study makes a number of contributions. First, additional, systematic knowledge is now available on the historical development, strengths, weaknesses and scope for further financial development. Second, a timely new perspective on the growing law–finance view is now provided, particularly in relation to developing and/or
‘transplant’ economies. The finding that the role of legal institutions may not be as important for financial development as the literature appears to suggest, while pertaining only to Fiji, may require some qualification or modification to the law–finance theory for universal application.

Third, the importance of demand–side factors on financial development is provided. Literature is extensive on the supply–side but short on the former. The ‘alternative finance’ approach advanced in this study for exploring ways to enhance the demand for financial–sector funds provides a useful starting point, particularly for developing economies (including now–rapidly developing) where the alternatives to the formal financial sector remain a highly important source of funding for the private sector.

Further, the indices constructed and other methods employed in this study to gather and systematically organise and analyse both primary and secondary data for investigating financial development related issues, may be of interest to other researchers in the case of countries, particularly developing economies. Moreover, the strategies proposed for enhancing the supply of, and demand for, financial sector funds are likely to have public policy implications, not only for Fiji, but for other developing economies, particularly in the Pacific.

8.3 LIMITATIONS OF THE STUDY AND FUTURE RESEARCH DIRECTIONS
8.3.1 Limitations
While this study makes a number of contributions, as outlined above, there may be other challenges for Fiji with regard to the supply and demand for financial–sector funds. Given the limited information available and the constraints faced by a study at the PhD (as opposed to the official or the professional, post-doctoral) level, this research
has only been able to focus on two areas—the role of legal institutions and factors that make alternative channels of finance more attractive. Further research is required to gain additional insights.

For instance, while legal institutions may be the most widely accepted key supply–side determinant of financial development in the literature, understanding and tackling issues related to these per se may not foster supply desirably. Investigation of other supply–side determinants, such as politics and culture, would also be useful for developing a more comprehensive set of strategies for enhancing the supply of funds in Fiji.

Similarly, there may be other demand–side factors as important as those used in this research. The factors used in this research were identified on the basis of literature and common knowledge; perhaps, there are other factors specific to Fiji. Thus, deepening the research to identify these and to investigate their influence on the various sources of firm funding would be useful for developing more comprehensive strategies for enhancing the demand for financial–sector funds.

There may also be some issues in relation to the primary data used for this study. The data was obtained from the wider Suva area. While this data may reasonably represent the country’s situation, a wider survey involving a greater geographical coverage may enrich understanding. Similarly, more firms in various categories, including business type and size, may also be useful. Further, the techniques employed in obtaining the data may be strengthened.
8.3.2 **Future Research**

Developing the financial sector in a less developed country is always likely to generate worthwhile research interest, especially if such development may result in higher levels of growth. In the case of Fiji, investigation of politics and culture in relation to financial development are interesting areas of research. The basic methods and techniques used in this research, particularly in relation to collecting and analysing primary data, may also be applied in the case of investigating issues in relation to politics and culture on financial development. Moreover, research on any issue in relation to financial development across–countries, such as across the Pacific island economies, would also be highly useful for relevant authorities as well as for international organisations such as ADB and the World Bank in their endeavours to help improve growth and development in these countries. For instance, it may be useful to examine the relationship, if any, between size of economies and income levels vis-à-vis financial development. A regression model may be estimated controlling for these factors. There is also potential for examining the rate of growth of banks vis-à-vis stock markets.

Meanwhile, it is hoped that this study provides useful insight into two important challenges in relation to developing financial sectors in the developing economies of the Pacific and offers techniques and methods for extending the study across the Pacific and developing economies elsewhere. The implications are important and broad.
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