Structural obstacles remain with Myanmar's emergence

10/05/2013

It has been two years since Myanmar, the more recently-adopted name for Burma, started a process of political and economic opening. The release of Aung San Suu Kyi has attracted the most public attention. But a slew of reforms such as the relaxation of rules on foreign investment, giving the central bank greater autonomy, improving regulations and the recent adoption of the New York Convention to allow the enforcement of arbitration awards is exciting potential foreign investors.

Myanmar has a population of 60 million, underdeveloped infrastructure and untapped natural resources, which together make it an attractive growth proposition. A sign of the enthusiasm is the response to the tender for Myanmars two mobile telecoms licences. In April, 12 shortlisted bidders were named, including international players such as Vodafone, China Mobile, Telenor, Digicel, SingTel. Final bids on the licences are due in June, and the government is set to pick winning bidders before the end of that month, with SingTel thought to be among the front-runners.

Myanmars Directorate of Investment and Company Administration has estimated that around 1,300 foreign entities have either established a local business or a branch office since 2011. The past six months saw accounting firms Ernst & Young and PwC, Malaysian law firm ZICOlaw and Singaporean firm Rajah & Tann set up shop. The European Union formally lifted sanctions on Myanmar on 22 April.

More than 20 international banks most of them from elsewhere in Asia have also launched representative branches since 2011, including Standard Chartered Bank which established itself in January. This influx of international financial institutions, however, highlights one of the biggest hurdles to greater financial deregulation: foreign banks are still effectively prohibited from obtaining local banking licences.

Banks breaking-in

Myanmar has about 20 local commercial banks, broadly divided between state-owned entities and those owned by individuals. Experts claim there are few broadly-owned private lenders in the middle, although proposals on the horizon could theoretically change this. President Thein Sein has said that the government intends to let international banks enter joint ventures (JV) with local institutions, of which they can hold up to an 80% stake. They would be able to set up fully-owned subsidiaries at a later date.

As was seen in China and Vietnam, once the door is opened to some form of foreign ownership, then banks will make a bee-line for the market, says Dane Chamorro, director for the Asia-Pacific region at Control Risks. Indeed, it can be a profitable investment for a foreign bank to take a 20% stake in a local institution that is keen to grow but it remains a portfolio investment. It is unlikely that foreign banks will still not actually be able to do the banking.

Still, few observers seem to believe that the, usually influential, individual local bank owners would be willing to cede control to foreign players or even enter joint ventures. Some suggest they may press to prevent international banks getting their own banking licences altogether. One possible strategy for foreign banks would be to follow the example of Cambodia-based Acleda Bank, which in February obtained a local operating licence for micro finance services. This gives it a platform on which to build, though it would have a long way to grow to become a large corporate lender.

But without sophisticated financial markets or at least those attuned to the needs of international sponsors funding for infrastructure will not materialise. For example, the power sector is in a poor condition. Berwin Leighton Paisner has estimated Myanmars total installed capacity to be just 3,495MW, which goes some way to explaining the prevalence of blackouts in the country. Its 19 gas-fired power stations operate below their nameplate capacity, and its transmission networks also require investment.

Richard Nelson, the Singapore-based head of Herbert Smith Freehills South-East Asia energy group, believes new infrastructure will require foreign investment. One of the main issues is how to fund the projects, he says. These are not small-scale investments but will require billions of dollars in capital and the real question is how financeable would they be for commercial banks?

Nelson suggests that oil and gas probably remains the most developed sector for international investors. Activity in Myanmars oil and gas sector took off in 2011, when the country opened bidding for 18 blocks, half of them going to international players, including Chevron and Texaco. The country is rich in natural resources, and could easily produce more than its current output of nearly 20,000 barrels of crude oil and 1.5 billion cubic feet of natural gas.

Oiling the wheels

The tenders generating the most interest are those for onshore and offshore exploration and production licences. The Ministry of Energys opened bidding for 18 new onshore oil exploration blocks in January, and in April offered up 30 offshore blocks. The government did not provide detailed information on the blocks, other than to say that 11 are in shallow water and 19 in deep water. Bids are due by 14 June.

BP, Chevron, China National Offshore Oil Corporation, Petronas GAIL and Shell have all been tipped to enter the process and companies can only apply for up to three blocks in both the onshore and offshore rounds. A track-record of success in Myanmars oil and gas bidding will be key to generating confidence in other sectors. It is a framework that other sectors will need to replicate to reap similar benefits.

The oil & gas market benefits from a well-understood production sharing agreement structure that is based on the other international models, Nelson says. International investors are generally comfortable with that, in comparison to, say, the regime for developing brownfield or greenfield power projects, which tends to be carried out on a more ad hoc basis with the relevant government ministries.

The oil and gas sector is also open to foreign investment. International firms can hold 100% of deep water licences, though they need to sign a production-sharing contract with Myanma Oil and Gas Enterprise and feature a clause that allows the government to take a 25% stake in successful projects. In comparison, shallow water licences require foreign players to form joint ventures.

Not that developing oil and gas assets in Myanmar is without risks. The country benefits from relatively little offshore infrastructure, such as pipelines, and international oil companies may need to put up additional capital to develop that infrastructure if they win licences.

There is [also] a need to develop a downstream gas market to fuel new power generation facilities, so there will be an interesting trade-off between diverting more natural gas to the domestic market whilst continuing to generate foreign currency revenues from the more lucrative export prices, Nelson adds.

Non-oil needs

Infrastructure development in Myanmar lags behind oil and gas. The first crop of deals out to market has attracted impressive amounts of preliminary sponsor interest, but may not indicate how later deals will be structured or how much international bank interest there will be. The nearest projects to market include two airports Mandalay and Yangon. Yangon has prequalified 11 bidding groups, including Toyota Susho, Vinci Airport, ITNL International/Dublin Airport Authority, and a Bouygues Batiment/First Pacific consortium.

Perhaps a stronger steer on the likely structures comes from two other tenders; the construction of a terminal, storage tanks and port facility for the Myanma Port Authority and the construction of a second Bayinaung Bridge. Indications are that these will be offered on a build-operate-transfer (BOT) basis. The lack of international banks will not become pressing until the government tries to bring more deals to market. Political pressure, in terms of the elections timetable, is not helping the situation.

The next general election is scheduled for 2015, and the present administration wants to show progress has been made in infrastructure development to win another term, Chamorro says. Two years is a short timeframe to do that. Funding of the investments is also an issue. The financing will have to come from multilateral banks, aid or government coffers rather than commercial banks.

Nelson agrees that this is where export credit agencies (ECAs) and multilaterals will be crucial. Weve seen little in the way of international financings so far from commercial banks but they may be more willing to lend alongside the ECAs and multilaterals.

The Asian Development Bank (ADB), though, has just six proposed projects in Myanmar and only one of those would be a loan; a $150,000 facility to rehabilitate distribution networks in five townships in Yangon, Mandalay, Sagaing and Magwe. That said, the ADB did agree a new Myanmar interim country partnership strategy last October as part of its re-engagement with the country.

Risk profile

Despite reforms and pathfinder projects, Myanmar remains a risky proposition. The general election could result in a change of administration and policy direction, while civil unrest and corruption are not uncommon. The list of other risks financing, contractual, environmental, currency, repatriation, planning permissions and dispute resolution is long and not easily solved. There is also the matter of moving beyond the decades of neglect that Myanmars infrastructure and economy have experienced.

Myanmar remains a small economy in comparison to the size of the country, says Chamorro. Inflation risk is high because there is a poor track record of dealing with monetary crises and extremely limited professional capacity at the Central Bank ... there is a lack of human skills, a non-functioning education system, rudimentary financial markets and minimal established legal framework to support investment. Chamorro, however, expects Myanmar to develop a much bigger economy over time, although from a reform perspective it probably most resembles Vietnam in the early 1990s.

Even so, it remains difficult for foreign firms to launch a business in Myanmar. Few foreign sponsors and commercial banks have yet put serious money into the country. The limited commercial bank market means that such lenders will have a limited involvement in the current cycle of projects. There may be opportunities for corporate financings, notably in the telecoms and oil and gas sectors rounds, but the full emergence of a Myanmar project finance market appears to be some way off. Indeed, the country has yet to see financial close on a large-scale project financing.

There will be periods of ups and downs, where Myanmar is the darling for investors only for them to suddenly lose interest, Chamorro concludes. At the moment, Myanmar is a new, exciting, untapped market but while there is lots of interest, there is actually very little money that has been invested by Western multinationals.