COMMENTARY

A Silicon Valley state of mind: smart, open and disruptive

By Leon Hadar

WHEN I departed Washington, DC recently and boarded a plane to San Francisco, the residents of the capital of the United States, were full of anxiety and in an angry mood.

The images of terrorist attacks in Paris have recalled the national nightmare that followed the death and destruction of Sept 11, 2001.

Once again, politicians and pundits were warning that the United States was at war with radical Islam and that every effort should be made to protect the American people. When America is at war, security concerns override constitutional rights.

Nationalism flavoured with xenophobia seemed to be winning the day. One of the front-runners in the Republican presidential primaries said that he would "absolutely" want a data base of Muslims in the US and wouldn't rule out giving them special ID cards that noted their religion, while another one compared Syrian refugees to dogs. Some of them might be rabid, so Americans should keep them all out.

In a way, the events in Paris seemed to be shifting the balance of power in Washington to the direction of politicians bashing Muslims as well as Mexicans, Chinese and other foreigners.

But America started to look quite different after my plane landed in San Francisco and I was on my way to Palo Alto, California, to attend the Smart Nation, Silicon Valley Technology conference hosted by Stanford University. The Sim Kee Boon Institute (SKBI) and the Business Families Institute (BFI) at the Singapore Management University (SMU) organised it to discuss and explore Silicon Valley technologies and their potential, and how they could be relevant and beneficial to Singapore's Smart Nation programme.

And it wasn't only the blue sky and the dry weather that greeted me in the southern part of the San Francisco Bay Area of Northern California that made a difference. Call it the Zeitgeist, or the spirit of the age, that dominates Silicon Valley, home to many of the world's largest high-tech corporations, as well as thousands of startup companies, and which employs about a quarter of a million information technology workers.

At least 200 representatives from the Silicon Valley participated in the conference at Stanford University organised by the SKBI and the BFI, including startups, accelerators, incubators and venture capitalists from Silicon Valley, global investors and banks, as well as regulators from Singapore. The conference served as a platform for these companies and entrepreneurs to learn about the Smart Nation initiative in Singapore and to try to entice them to play a part in it.

Unlike the xenophobic state of mind I left in Washington, this island of creativity and commerce, exuded political and cultural freedom, unrestricted access to knowledge and information, as well as collaborative or cooperative management and decision-making rather than the authority of a central government that can, if it wants, close the doors of the country to immigrants from around the world.

Indeed, it would not be an exaggeration to note that the multicultural milieu of the Silicon Valley and Stanford would make Asians feel at home here. According to the *San Jose Mercury News*, Asian Americans occupy close to 30 per cent of professional jobs at the tech firms in the Silicon Valley (although only 14 per cent of executive jobs) and about a quarter of the incoming freshmen at Stanford.

In fact, while the anti-immigration volume has been rising to new highs, the technology industry in the Silicon Valley, led by Google and Facebook has been lobbying in support for two tech-focused bills, the Immigration Innovation Act and the Start Up Act that increase the cap on H-1B Visas from 65,000 to 115,000, eliminate per-country limits on visa petitioners and let spouses of H-1B visa holders work, and create a new visa category for foreign entrepreneurs.

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>
> **Prof Lee of the Sim Kee Boon Institute**

DIGITAL CURRENCY

In a way, the representatives of high-tech companies and start-ups as well as heads of venture capital companies that invest in the Silicon Valley and that participated in the conference were a reflection of the demographic mosaic that is America today, including immigrants, children of immigrants and holders of dual (or more) passports. They included Muslims as well.

John Kim, a managing partner at Amasia, a cross-border venture capital firm with presence in Singapore and the Silicon Valley exemplified the multinational atmosphere in the Smart Nation conference. He is a Korean-American whose career has taken him across a diverse range of operating and investing environments from early stage startups to fortune 500 companies. He started as an entrepreneur, founding music Internet and e-consulting businesses, later held senior trading and investment positions at Korean National Investments, Goldman Sachs and Mercuria Energy Group before co-founding Amasia. Mr Kim (who also founded an incorporated rock band called The Ally) spoke during the conference on one of his main preoccupations today, impact investing, socially responsible investing for the purpose of generating a measurable social and environmental impact alongside a financial return.

In that context, Mr Kim highlighted the important role that the emergence of digital currencies, like bitcoin, could play in promoting economic and social progress in South-east Asia, a home to 618 million people, where smartphone penetration has been expanding in a dramatic way.

Yet, there are major difference between the developed and developing countries in Asia, when it comes to banking. Only 4 per cent of Cambodia's population is banked, 21 per cent of Vietnam's and 27 per cent of Laos and the Philippines while Malaysia has 66 per cent and Singapore has 98 per cent of its population banked. Countries who need to address income gaps and provide opportunities for their people to store and transfer money are likely to adopt digital currencies like bitcoin as part of their strategy.

Indeed, the future of digital currency has been very much on the mind of David Lee, executive/academic director of SKBI, and professor of quantitative finance at the Lee Kong Chian School of Business. The driving force behind the conference at Stanford, Prof Lee is a world-renowned expert on the issue of the new financial technology, or FinTech, and the way it is, and will be, affecting our economic, social and political institutions. The subject has been a key research area for SKBI.

According to Prof Lee, the rise of FinTech companies has increased the awareness of the disruption and opportunities in areas such as digital banking, Internet finance and blockchain. The latter refers to a distributed database that maintains a continuously growing list of data records that are hardened against tampering, such as through the public ledger of transactions for crypto-currencies originally used in bitcoin.

Prof Lee estimated that global investments in FinTech ventures, covering sectors from remittances to loans to payments, have grown three times from US$4.05 billion in 2013 to US$12.21 billion in 2014. The developments in FinTech are still in their early stages; but they are expected to define and shape the future of the financial industry.

Although large amounts of funds are entering the market, Prof Lee is predicting that not all FinTech ventures will be successful, and stressed that various factors, both internal and external, are crucial.

Working with Ernie Teo from SKBI, Prof Lee has identified some of these factors, which he terms LASIC (Low margin, Asset light, Scalable, Innovative, and Compliance easy), that give an advantage to FinTech businesses.

FINTECH OPPORTUNITIES

Focusing on successful financial firms like Alibaba and M-PESA, the research conducted by Prof Lee and Prof Teo, concluded that the application of FinTech will result in lower business costs and profit margins and that in order to remain sustainable and profitable, companies will need to expand their business by embracing so-called financial inclusion, the delivery of financial services at affordable costs to sections of disadvantaged and low-income segments of society.

They estimate that 38 per cent of the world population has no formal bank accounts and that another 40 per cent that is underserved by banks, providing a huge potential market for financial institutions.

The current expectation is that FinTech upstarts will draw billion of dollars in investment in the coming years and that they will shake up finance the way that Uber or Airbnb have shaken up the taxi and hotel industries. At the same time, traditional retail banking companies are also adapting to the changes by tapping FinTech and in some cases by cooperating with some of the startups.

Because it's such a visible and trusted financial hub of the world, Singapore which absorbs about half of all the foreign direct investment in South-east Asia, is uniquely placed to take advantage of some of the new opportunities provided by the rise of FinTech.

And with the Silicon Valley being at the forefront of financial and smart technological innovation and creation, it could become, as Prof Lee puts it, "an ideal venue for Singapore to learn about the latest technologies and their applicability to our national initiative," or the Smart Nation vision.

LETTER TO THE EDITOR

Buyout offer for Zagro Asia fair and reasonable

ZAGRO Asia's major shareholder, Poh Beng Swee, is offering to buy over the shares of minorities and delist the company from the mainboard of SGX.

On hearing about the offer a couple of weeks ago, my initial reaction, as a shareholder, was that the offer was a little on the low side as the shares have a net asset value in the region of 35 cents.

However, on careful reconsideration, I am of the view that the offer is fair and reasonable. Here are some important factors to consider.

- The 30-cent offer is at a premium of 20 per cent to the price of about 25 cents before the delisting. That is a fair premium, considering Zagro has not traded at or around 30 cents for some time
- Zagro shares have been illiquid for some time. It is hard to buy or sell the shares in any quantity. Shareholders will be better off switching to more liquid counters on the SGX.
- The regular dividend of one cent per share each year has been a main attraction of Zagro for shareholders. At 25 cents, the yield was an attractive 4 per cent. However, at 30 cents, the yield drops to 3.3 per cent. There are many other shares listed on the SGX that offer a higher yield. So shareholders can easily switch from Zagro to higher yielding stocks of better quality (an example would be Venture Corp which yields close to 6 per cent at $8.50 with its annual 50-cent dividend.)
- If the delisting proposal does not go through at the forthcoming EGM (date to be announced), the offer of 30 cents per share will be withdrawn. Thereafter, it is VERY likely that the shares will fall back to the 25-cent level. What then for shareholders?
- On the other hand, if the delisting proposal goes through and the company is delisted, it will make no sense for shareholders to reject the 30-cent offer and stay on with the company. SGX rules will no longer apply and there will be much less protection for small shareholders, no corporate governance code to follow and no guarantee of being paid any dividend.
- Mr Poh does not appear desperate to take the company private. That means he is unlikely to increase the offer price from the 30 cents now on the table. He and related parties have been buying shares in the market of late, taking his direct and deemed interest above the original 67 per cent.

If the delisting proposal fails with more than 10 per cent voting against it at the EGM, he is likely to let Zagro continue as a listed company. The shares will go back to languish at 25 cents or thereabouts, probably.

So what is the best approach for small shareholders of Zagro? They could sell in the market now and lock in the 30-cent price. They will pay brokerage but, in return, they are insuring themselves against the delisting proposal not going through and the price dropping to 25 cents.

Alternatively, shareholders could wait for the formal offer and accept it and then wait for payment. All that will take up to three months. Rejecting the offer is not an option as it could incur a heavy opportunity cost, with the shares back at 25 cents.

Mano Sabnani

Demand for credit is increasing and the latest ECB survey of senior loan officers shows that banks have reversed their policy of tight standards for providing loans. PHOTO: AFP

No case for further monetary easing by ECB

Such a move would also create systemic problems in the banking sector

By Thierry Apoteker

MARKET participants seem to be positioning themselves for another bout of monetary easing by the European Central Bank (ECB). The apparent inability to push the inflation rate upwards against a background of tepid international trade is the major argument cited to support such expectations.

ECB board members, including chairman Mario Draghi, have given them credence by insisting in recent comments on the downside risks to growth and negative inflation figures. Expectations are therefore high that the ECB will announce another round of monetary easing this Thursday, either through a further cut in interest rates on bank deposits or a change in its quantitative easing programme of monthly bond purchases.

The candid observer would already find monetary policy in Europe exceptionally lax, with a zero policy rate and 60 billion euros (S$89.5 billion) of security purchases every month by the central bank. Are the economic situation and cyclical prospects so dire that we need to increase the already heavy dose of monetary stimulus?

To put it straightforwardly, I don't think so, and I believe that having central banks' policies increasingly hostage to market expectations is very dangerous from a systemic perspective.

Worries about imminent and dangerous deflation in the eurozone are overblown: Negative headline figures are directly related to lower commodity prices, in effect providing purchasing power for consumers and increasing margins for industrial users. Core inflation (which omits volatile energy and food prices) is above one per cent year on year and has visibly accelerated since the beginning of 2015. Demand for credit is increasing and the latest ECB survey of senior loan officers shows that banks have reversed their policy of tight standards for providing loans. Money supply measure by M2 is growing at 6 per cent per year, twice as fast as in the summer of 2014.

Tailwinds are still supportive of steady growth in the eurozone, notably low commodity prices and a weak euro exchange rate. Even more importantly, the cyclical recovery registered since the second quarter of 2014 has been predominantly fed by private consumption, itself nurtured by improving household confidence. And the ECB could rightly argue that household confidence was massively boosted by its own policy and commitment to "save the euro" back in the summer of 2012.

But we are today in a completely different setting: The "tail risks" of a disintegration of the eurozone that were with us since the Greek drama have by and large disappeared. Even when recognising that monetary policy has an influence through asset prices and wealth effects, we would argue that structural, political, institutional factors are once again much more critical.

Being French, I cannot but think that a repetition of terrorist attacks or even threats could possibly have a much greater influence. By the way, historical observations of roughly comparable events (Sept 11 in the US, the 2004 railway explosion in Madrid, the 2007 underground and bus attacks in London, and the attacks on the French satirical magazine *Charlie Hebdo* in January 2015) show that such events, whatever their gravity, symbolism or security implications, have not derailed underlying economic trends. Short-term shocks on retail sales and confidence are rapidly reversed.

It is very unlikely that a further decline in interest rates would alone initiate a substantial acceleration in credit demand or massive shift away from saving into spending, when policy rates are already at or close to zero. Surveys consistently show that the cost of finance is not today an issue for corporates in Europe.

In parallel, we have to ask whether eurozone bond yields are not again "mispricing" risks: Whatever the strength of German public finance, negative interest rates on most of the short to mid-segments of the yield curve are very difficult to justify, as are the extraordinary low yields for 10-year French or Italian Treasury Bonds (respectively 0.77 per cent and 1.40 per cent on Nov 27).

Would there be benefits from another round of currency depreciation, thanks to the further monetary divergence between the US? Indeed, the euro has weakened somewhat over the recent weeks from a range of US$1.10-1.15 per euro to US$1.06 at the end of November. The "timing coincidence" between the ECB easing announcement and a possible hike in Fed funds rates 10 days later could bring US dollar-euro exchange rate to parity for a short while. Indeed, other fundamental factors are playing in favour of the euro, including the cyclical recovery and strong external accounts.

US ECONOMY

But as for economic growth in the eurozone, we have to measure "second-round" effects of any further euro depreciation, in particular on the US. If international trade remains tepid, the dollar appreciation will weigh down on US activity. The quantitative models developed at TAC Economics show that a softening of US GDP (gross domestic product) growth below a threshold close to 2.5 per cent year on year would create a much stronger downward pressure on eurozone growth, therefore cancelling the gains from a cheaper currency.

We also need to remember that many economic observers are still pointing to excessive debt levels in most mature economies; aggregate financial leverage has not declined in the eurozone since the Lehman debacle. Moreover, many asset markets appear either neutral or overvalued when compared to fundamentals in terms of growth. It is therefore legitimate to question the need to encourage further borrowing by making funding even cheaper, which would lead to further divergence of asset prices from their fundamentals. This is especially the case when signs of possible systemic risk are reappearing, mostly concentrated again on banks (whereas in the US, such systemic concerns are more focused on non-bank financial institutions).

The bottom line is that risks of cyclical developments in the eurozone today do not suggest that monetary policy is too tight and requires further easing. The risks are that US growth could stall and that Europe could become a regular target of terrorist attacks. These are not risks that can be mitigated by the ECB. Further easing by the central bank would also increase another risk – that of systemic problems in the banking sector that the ECB has the mission to supervise.

The writer is chairman of TAC Economics, an economics research and consulting firm based in Paris. More information on TAC is available at www.taceconomics.com