

Dunlop Holdings' finance director Kenneth Gardener, conceded it would be costly but pointed to benefits, including that of taking over the Dunlop trademark. "We are paying a premium," he said. "We felt [it] was worth it."

Just how the two sides arrived at the valuations of M\$5 for DMIB shares and M\$1.73 for Pegi has puzzled analysts here. On the basis of net tangible asset value, the figures over-rate DMIB and under-rate Pegi. Based on the balance sheet at the end of last year, DMIB's net asset value is only M\$1.54, while Pegi's, as at March 30, stood at M\$2.81. That will be diluted to M\$2 when the takeover is completed because of the issue of the 147 million new shares.

A similar imbalance shows up when the prices agreed are compared to the two companies' market worth. DMIB shares have fluctuated between M\$3.24 and

M\$4.66 on the Kuala Lumpur Stock Exchange this year and on the last trading day before the deal was announced closed at M\$4.10. Pegi closed the same day at M\$2.97, having traded up to M\$4.54 earlier in the year. Investors reacted predictably. A staggering 3.1 million Pegi shares were traded during the week, a fifth of the total turnover at the exchange, and the share dropped to M\$2.40. DMIB shares, however, jumped to M\$4.52 before falling back to M\$4.24. "The public are not very happy," one broker commented. "They'd rather take their money and run."

Analysts were worried, too, about how Pegi (via Eastwind) will finance the deal. Eastwind has no substantial assets other than its majority stake in Pegi, while Pegi's own financial position hardly gives it great strength. Profits, too, have been below the company's own forecast. Pegi's

financial weaknesses made its choice as a buyer for DMIB surprising. But according to Phoon, the initial cash outlay by Eastwind will in fact be covered by a loan for the full amount of M\$298 million which Standard Chartered Merchant Bank Asia, based in Singapore, is understood to have agreed to syndicate. The only security which Eastwind can apparently offer is its interest in Pegi, which after the deal is completed will amount to 100 million of Pegi's 196 million shares. That assumes Pegi minorities will have taken up the proposed three-for-one issue — a "disguised" rights issue, according to analysts. If they do, it will lighten Eastwind's financial burden by M\$125 million. Observers doubt, however, that all the minorities will take the bait, given the current state of the market. Phoon admits there could be problems. "We are going to ask our shareholders to come out

BANKING

A golden triangle

The Hongkong and Shanghai Bank, well established in China, gets the green light for an office in Taiwan

By Philip Bowring, Robert Delfs and Andrew Tanzer

A potentially important new bridge is being created between Taiwan and China. Last week the Taipei government announced that the Hongkong and Shanghai Banking Corp. (HSBC) was being given permission to set up a representative office in Taipei. Although several American and European banks have representative or branch offices in Taiwan as well as Peking (and Hongkong), the entry of the HSBC was seen to be unusually significant for three reasons:

► The HSBC would not even have considered setting up in Taiwan without a clear go-ahead from Peking.

► It is the first Hongkong-incorporated bank to set up an office in Taiwan.

► Taipei would not have allowed a bank with such long and close associations with China to establish an obvious presence unless it wished to see commercial ties between Taiwan and the mainland, via Hongkong, increased.

Both sides may wish to use the HSBC as an additional means of communication between Taipei and Peking. Foreign political figures, especially Singapore's Prime Minister Lee Kuan Yew, and Hongkong and overseas businessmen have been used as informal channels of communication in the past. But the HSBC, based in what both governments consider Chinese sovereign territory, could offer a secure vehicle for discussions as well as trade.

The timing of the announcement, coming when sensitivities over Taiwan's status have been raised by the United States arms sales question, does not appear significant. It is understood that the HSBC made its first informal approach to the

Taiwan authorities a little over a year ago.

An intriguing question now is whether a Taiwan bank will be allowed to set up in Hongkong. A normal, though not necessary, condition of foreign banks establishing offices in Taiwan is that Taiwan banks receive reciprocal treatment. Hongkong has a similar requirement. However, a problem could arise owing to the fact that the major Taiwan banks are government-owned or -run, thus acceptance of their presence in Hongkong might have unacceptable political implications. The most likely candidate would be Taiwan's International Commercial Bank of China which has both the strongest overseas links and the least formal government connections.

The approval by the Ministry of Finance (MoF) of the HSBC application reflects Taiwan's increasingly pragmatic approach to business — the same sort of pragmatism which permitted the Kuomintang to open up trade with Eastern Europe and to wink at indirect trade with China.

The government was willing to overlook the HSBC's pro-Peking reputation for several reasons. The bank is expected to help the island's currently hard-pressed exporters and to steer more investment capital from Overseas Chinese into Taiwan. It can also provide a new avenue of communication between Taiwan and the British-administered territory.

From all indications, Taiwan was keen to receive the application, which was approved by the MoF in the record time of one week. Approval came as no surprise to the HSBC, which had been testing the

Taiwan waters over the past year. This time the bank submitted a bulky formal application drawn up by a Taipei law firm. "They had every reason to think it would be approved," said Edward Chien, deputy director of the MoF's department of monetary affairs.

Officially, the HSBC got the ministry's nod because no Hongkong banks have branch or representative offices in Taipei, though the bank failed to meet the basic criteria for a representative office — US\$100 million of business with Taiwan in each of the three consecutive calendar years prior to application and term loans totalling US\$60 million over the same three years. However, a clause in the guidelines for foreign bank applications gives the MoF the option of opening the door to banks ranking among the "top 100 in the free world in terms of assets" (the HSBC ranked 29th in 1981) from countries not previously represented in Taiwan.

According to Chien, the bank fell "slightly below" the minimum requirement for term loans, but made a "convincing presentation" because of its huge trade-financing business with Taiwan. MoF figures show that in 1981 the HSBC did US\$758 million worth of export financing with Taiwan, including US\$214 million with Bank of Taiwan, its local correspondent bank. (Taiwan's exports to Hongkong in the year were US\$1.9 billion and imports US\$300 million.)

Taiwan reckons the HSBC presence in Taipei will boost trade with Hongkong. The bank's rapidly expanding global network could also help local manufacturers find new markets. "From all indications, I don't think they want to stay only in Hongkong," commented Chien. He noted the HSBC's recent bid — albeit unsuccessful — to acquire Royal Bank of Scotland, and the purchase of Marine Midland Banks in the US, which, he said, should give the Hongkong bank a stable long-term source of US dollar funds. The HSBC is regarded as particularly strong in attracting Overseas Chinese deposits and

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with a very big sum of money at a very difficult moment," he says.

Pegi and Eastwind could run into further financial trouble if, as seems likely, Malaysia's Foreign Investment Committee and Capital Issues Committee insist that the cash alternative being given to DM be extended to DMIB's minorities. If the committees stipulate a cash offer (at the same level being offered to Dunlop Holdings) for the 49 million minority shares in DMIB, then Eastwind-Pegi's cash needs will soar by M\$245 million. Standard Chartered is believed to have agreed to raise the extra amount — in Pegi's name.

A further area of uncertainty lies in the question of bumiputra participation. The takeover of DEB raised a storm of protest, led by Umno Youth leader Datuk Suhaimi Kamaruddin, that the bumiputra element in the restructured company

would be insufficient. Eventually the Foreign Investment Committee made it a condition of approving the deal that once the general offer is completed the share must be raised to 50% from the present 37.3%.

As if to pre-empt controversy, Ghafar announced immediately after the DMIB takeover was disclosed that Pegi would "invite bumiputra institutions to participate directly in DMIB" and that the shareholdings would "reflect the requirements of the New Economic Policy." The present bumiputra interest in DMIB is around 14.5%. After the initial purchase of the 51% DM block by Pegi this will go up to an estimated 32% while if a general offer is fully taken up it would dilute again to around 31%. So, a further new issue might be needed to take it up to the 50% mark which bumiputra elements will probably press for.

remittances from Hongkong and Southeast Asia. At present this means direct investment in industry, services or property, but perhaps not too much further down the road the Taiwan Stock Exchange will be opened to foreign investors.

Banks from Southeast Asia with Overseas Chinese links are already represented in Taipei. They include the Bangkok Bank, International Bank of Singapore and Metropolitan Bank and Trust of Manila. Taiwan-based investors have stakes in various banks in the region, but official representation of a Taiwan institution is limited to the First Commercial Bank, which has a restricted licence in Singapore.

When it opens, the office will be the ninth foreign bank representative office in Taipei. Most observers regard it as a stepping stone to a branch, for which the HSBC will probably move quickly to meet the trade and term-loans criteria. At present 25 foreign banks have branches in Taipei.

Chien said more than 20 banks have expressed interest in opening branches, but the MoF restricts entry to two a year. However, the HSBC, because it is the first Hongkong bank on the island, will probably not have to queue up.

The HSBC breakthrough seems to have caught the Chartered Bank on the hop. Chartered is No. 2 in Hongkong and is well represented in China. Because it is incorporated in Britain rather than Hongkong it might have been seen as being in a less sensitive political position. Chartered denies that it has made any approach to Taiwan. However, the Standard Bank of South Africa, part of the same London-based Standard Chartered group, is one of a number of South African banks which have recently made approaches to the MoF in Taipei.

Standard Bank of South Africa and Barclays National Bank of South Africa — respectively 59% and 63% owned by their London parents — have expressed interest in opening branches. Neither

satisfies the trade finance and loan criteria, though there may be scope for reciprocity. Two South African banks with local (rather than London) roots — Volkskas and Trust Bank — have expressed interest in representative offices in Taipei.

Bankers in Hongkong expressed surprise at the HSBC news. There had been no advance rumours that the bank was contemplating such a step. The HSBC is very active in China and has long had a branch in Shanghai. In the words of one rival, it is "one of the few, if not the only foreign bank which is making money in China." It is most active in Shenzhen Special Economic Zone and Guangdong province, through its traditional Hongkong clients, but is also involved in trade finance throughout China and in loans for several major projects.

Several banks maintain varying levels of activity in both China and Taiwan: Bank of America and Chase Manhattan have branches in Taiwan and representative offices in Peking; Lloyds opened a branch in Taiwan 18 months ago, while maintaining what a bank official said was a "highly amicable" relationship with China.

First National Bank of Chicago pulled out of Taiwan in 1979, either in the belief that it would be impossible to work in both places, or that suspending Taiwan operations would provide a valuable competitive edge in China. Today First Chicago has a very high profile in China, and as a participant in CCIC Finance, a Sino-US-Japanese joint venture that will provide financing advice to the China National Offshore Oil Corp., is well poised to take advantage of offshore oil developments in coming years. Right now, however, Taiwan is a much more profitable banking market than China.

The HSBC already plays a major role in financing bilateral trade between Taiwan and Hongkong. When the representative office is upgraded into a full branch office, the HSBC will be able to participate in local-currency financing, issue letters of credit and enter into direct relationships with local companies.

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