

OTHER TOPICS

OPEN FOR BUSINESS IN MYANMAR

Hurdles Remain for Foreign Investors But Opportunities Abound

By William D. Greenlee Jr.

Following the recent transition from military to nominally civilian rule in 2011 and with the removal of the majority of international sanctions, foreign investors are now eager to grab a slice of the action in a fast-emerging economy described by the International Money Fund as the next Asian frontier and even tipped as the next Asian Tiger. With a geopolitically strategic position, a vast wealth of natural resources, an estimated population of around 60 million, strong economic growth, and untapped markets in virtually every industry, the country offers tremendous possibilities for foreign investors. But a number of difficulties remain, making investment here a potentially high-risk enterprise.

From 1988 until the end of 2013, pledged foreign direct investment in Myanmar exceeded \$44 billion, with the leading investments in power, oil and gas, mining, and manufacturing industries. Increasing investment is expected in the hotel and tourism, real estate, and retail sectors once these are opened to foreign investment in 2015.

The Current Climate

After decades of social and economic isolation, the new government under the presidency of Thein Sein is proactively pursuing an open-door policy to foreign investment. Unlike some of its Asian neighbors, Myanmar has not been able to simply evolve its economic system and encourage foreign direct investment; it first had to begin an evolution of its political system and pursue democracy. Although this presents significant challenges, it is believed by many that the country will be successful and Myanmar will ultimately be a stronger and more attractive economy for it.

While Myanmar is currently more stable than it has been for the majority of the time since independence from the

British in 1948, concerns remain that the gains made so far are not irreversible. UN Secretary-General Ban Ki-moon and others have identified ongoing ethnic conflict in border areas and increasing anti-Muslim violence as factors that, if not addressed, could provoke more upheaval and undermine the reform process.

The elections planned for 2015 will represent a further test for the current administration because Aung San Suu Kyi of the opposition National League for Democracy party (NLD) has stated she intends to run for the presidency. However, at this time, the Myanmar Constitution does not allow for her to do so. It is reported, though, that she may have up to 80 percent of the popular vote. Most believe that Thein Sein (and the Myanmar government generally) and Aung San Suu Kyi (and the NLD) will be able to come to some sort of agreement prior to the 2015 elections, which will likely involve only moderate constitutional reform initially, and thus avoid any unrest. All of the relevant parties have been working very well together for the past 18 months or so—in other words, since the time Aung San Suu Kyi and various other NLD members were voted into Parliament. The good news is that the Myanmar government appears very committed to continuing economic, political, and legislative reform and to courting overseas investment.

Positive Legislative Changes and Other Developments

There has been steady, although slow, progress with respect to making the changes necessary for commercial laws and other structural issues in Myanmar. According to U.K.-based global risk and strategic consulting firm Maplecroft, Myanmar has made the most significant improvements to its business environment of any country in 2014. Maplecroft points to significant steps being taken to create a transparent, well-understood playing field and to enhance investor protection. While this only translates to a change in ranking from the bottom in 2012 to fifth from the bottom in 2014, it has already resulted in significant improvements for business. Maplecroft forecasts that if

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Myanmar sustains its current trajectory, it may move out of the “extreme risk” category as early as the next one to three years. By way of comparison, all the hotly tipped economies of Brazil, Russia, India, China, Mexico, Indonesia, Nigeria, and Turkey (BRIC and MINT) are categorized as “high risk,” except for Turkey, which is classed as a “medium” risk.

The Foreign Investment Law, Notification, and Rules, 2012–2013

The Foreign Investment Law 2012 (FIL) and the accompanying Foreign Investment Notification 2013 (FI Notification) and Foreign Investment Rules 2013 (FI Rules) are the most notable pieces of legislation to be enacted with regard to facilitating foreign investment. They supersede the previous Foreign Investment Law of 1988 and provide significant incentives for overseas investors including land use rights, government guarantees, and tax exemptions and relief. While foreigners may not own land, in contrast to previous years, foreign investors can now secure control over land through long-term leases of up to 50 years, with the possibility of two extensions of 10 years each.

The FI Notification categorizes business activities into (i) those that are currently prohibited to foreign investment, (ii) those that require a joint venture with a Myanmar citizen, and (iii) those that are possible with 100 percent foreign investment but subject to other conditions, such as approval from the relevant ministry; compliance with other rules, regulations, and guidelines; and/or the requirement to carry out environmental/social impact assessments. Some of the conditions in fact impose a cap on the level of foreign investment, necessitating a joint venture with a Myanmar citizen, or require a joint venture to be undertaken with the state. Foreign investment is being actively encouraged in categories (ii) and (iii) and is also possible in the case of most category (i) activities, which are in theory prohibited subject to special permission from the government, although, in such cases, investment will usually be restricted to joint ventures with a maximum of 80 percent foreign investment.

The Foreign Exchange Management Law, 2012

The Foreign Exchange Management Law 2012 (FEM) replaced the strict approval requirements of the Central Bank of Myanmar (CBM) that existed under the previous Foreign Exchange Regulations Act 1947. These requirements required every foreign currency payment out of the country to be pre-authorized by the CBM. The law is intended to liberalize transfer payments and foreign exchange transactions

relating to current account transactions. However, with respect to capital account transactions, foreign currency may be retransferred abroad only after receiving pre-authorization from the CBM. The CBM involvement in foreign exchange transactions for the time being may represent a hurdle in certain scenarios; however, such transactions have been permitted in the past on a relatively regular basis and are currently so, as well.

New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958

Another development that should lend confidence to potential investors is the accession of Myanmar to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958. This means that foreign arbitration clauses should be permitted in agreements and Myanmar courts will be obligated to enforce foreign arbitration awards. Domestic legislation is still awaited to implement it, however, and the local judiciary must be educated and trained to ensure that the New York Convention and the implementing law are applied in accordance with international practice.

Myanmar may move out of the “extreme risk” category in one to three years.

Caveat Investor

Despite the myriad of opportunities, some investors are still cautious about entering the market in Myanmar. Government ministers have become so accustomed to foreign companies engaging in protracted discussions regarding potential investment, only to ultimately decline, that they have coined the acronym “NATO” (no action, talking only). Investor caution, however, is warranted. So what are the challenges and risks facing foreign investors in Myanmar?

Lack of Rule of Law

Concerns relating to Myanmar’s legal system and the lack of rule of law are cited as one of the principal obstacles by many investors. Many of the initial reforms were the result of “policy proclamation,” rather than substantive legislative and/or regulatory changes. While the legislative process has begun to

make progress, there are still a large number of laws that are old and are from colonial days. Those issued during the junta years (approximately 1962–2010) are vague, contradictory to prior laws, and problematic for foreign investment. The laws enacted in the last couple of years that have been issued by the executive branch (which is still dominated by former military officers) and approved by Parliament (which was only just recently created under the 2008 Constitution) do move in the right direction of encouraging foreign investment. However, they are still vague, they conflict with previous legislation, and they do not yet create a legal environment that allows for investment structures common in other international jurisdictions or for a clear understanding of rights and liabilities to enable a full appreciation of relevant risks.

Examples of used but outdated laws include the Oilfields Act, which dates back to 1918; the Companies Act, which dates back to 1914 (now set for revision with the assistance of the Asian Development Bank); and the Contract Act, which dates back to 1872. Examples of laws lacking specificity include both the FIL and the FEM, which are vague and have given rise to a number of uncertainties with respect to implementation.

Theory vs. Practice: The Disconnect

Potential foreign investors should also be aware that the procedure to be followed in theory is not necessarily the process followed by the ministries and government officials, who sometimes operate in accordance with long-established standard practices based on their own interpretations of applicable laws or simply practice, generally.

Policy, rather than legislation, guides the process in all sectors. For example, the executive branch determines when banking and financial services other than microfinance and insurance will be opened up to foreign investment. Initially, full-service licenses in these sectors were to be granted to foreign investors in 2015. More recently, certain officials have made public statements and written articles in state-owned newspapers indicating that up to five foreign bank licenses will soon be issued. Policy still controls.

The situation is improving, particularly for those working with agencies and authorities accustomed to dealing with foreign investment, such as the Myanmar Investment Commission (MIC) and Yangon City Development Council. However, investors should be prepared for a high level of bureaucracy, delays, and hurdles in obtaining the necessary approvals, registrations, and certifications required to conduct business.

Lack of Security

The inadequacy and inconsistency of the laws and the lack of an established practice for taking, perfecting, and enforcing security over assets have been and remain problems. Projects in the past have thus been financed via equity, and not debt. Current legislation (the Transfer of Property Act 1882, s59; Registration Act 1909, s17(1)(b); and Companies Act 1914,

s109) provides for the creation of mortgages and charges for property, including immoveable assets, but the Transfer of Immoveable Property Restriction Act of 1987 (passed, of course, during junta rule) effectively prohibits foreign ownership of land and the transfer of immoveable property by mortgage, acceptance of mortgage, exchange, or transfer. This applies as well to a foreign bank that needs title to sell a property in the event of default on a loan. In practice, even one foreign-owned share in a company will make that company a foreign company. Nominee ownership arrangements through Myanmar citizens are strictly prohibited. Section 17 of the FIL does, however, allow a Myanmar FIL company with one or more foreign shareholders to mortgage long-term leased property rights. Unfortunately, the ministries required to provide relevant approvals are reluctant to approve such debt structures, as they have never done so and are reticent to be the first. They provide another example of how practice, rather than the relevant law, controls.

There are currently several large transactions with influential parties working their way through the system. These should be sufficiently significant transactions such that the relevant ministers will themselves approve the use of long-term lease rights to be mortgaged and ultimately allow true debt financing of projects.

Charges over immoveable property are a potential option for foreign lenders, as they do not involve transfer of land. But problems remain with perfecting this form of security.

The law requires that the Myanmar Register of Companies (DICA) maintain a register of all mortgages and fixed and floating charges over company assets. However, in practice, this register is poorly maintained and the need to obtain prior approval prior to enforcement can be burdensome. Perfection of a security is, therefore, very difficult and the few mortgages taken are rarely, if ever, registered. This, too, will likely be evolving and improving in the near future.

Lack of Infrastructure

Another major concern for potential investors is the absence of both hard and soft infrastructures. The problem ranges from poor electricity supply and waste management (which presents a hurdle for manufacturers); to limited Internet and telecommunications service; to high logistical costs and weak road, rail, and port links and human resources; to the absence of a well-developed economic infrastructure.

The lack of a sophisticated banking and finance sector in what is still largely a cash economy is another major issue for foreign investors. No foreign banks are currently permitted to operate in Myanmar and, while this will likely change in the near future, at present the limited number of state-owned and private banks currently operating in the country lack the experience, expertise, capital, or liquidity to handle the financial requirements of large multinationals. Electronic transfer of funds both internally and internationally remains difficult, and easy loans, financial products, interbank operations, and

credit are all virtually nonexistent. Foreign investors often have to finance their operations through shareholder loans through the offshore parent company.

Lack of Capacity

Following the enactment of the FIL, the number of foreigners who want to invest in Myanmar has increased significantly. However, after many years of semi-isolation, there is a lack of skilled professionals and labor generally. Although the people of Myanmar are quick learners and very motivated, this shortage will likely remain an issue for at least the immediate future.

Biting the Bullet

Despite the challenges, many major foreign companies have invested in Myanmar. They include Ford, Coca-Cola, Pepsi, General Electric, Unilever, and Caterpillar, to name just a few. A typical corporate structure involves a holding company in Singapore (due to a strong double tax treaty), which is then used to incorporate a subsidiary in Myanmar.

Past experience indicates that the MIC prefers greenfield investments that can be set up and operated from the beginning under the FIL. However, while a foreign investor cannot control a 100-percent Myanmar-owned company through board appointments, the Myanmar Citizens Investment Law and certain new rules under the FIL appear to open the door to merger and acquisition transactions for Myanmar citizens and to foreigners who

want to invest in Myanmar targets. This is a tremendous step forward. There are several ways in which merger and acquisition transactions can be carried out in Myanmar, some of which have been tried and tested, while others are more theoretical in that the current laws, practices, and policies do not forbid them, but they have not been utilized to any great extent in Myanmar to date. As mentioned though—this will soon change.

While a number of industries are restricted to Myanmar citizens and companies, it is expected that the entry barriers for foreign investors in many business sectors will be relaxed over the coming years, particularly as the countries of the Association of Southeast Asian Nations (ASEAN) approach the target date of a single economic community by 2015. Arguably, testing and developing the new legal and regulatory framework by actually doing business in this new democracy will make the systems more robust and pave the way for further reform, which is already on a positive and steep track.

Although Myanmar is in the early stages of its ambitious evolution, the country is now opening up to foreign investment and, despite the challenges, many companies are establishing themselves there. After all, being first in a market, especially one with such potential, provides a real market advantage. Yes, such investors have a high tolerance for risk. However, with good advice, the risk can be managed and such management will allow for operating transparently and generating revenue. Early movers will likely enjoy the greatest benefits. ♦

