A managing director of Templeton Investments, Mark Mobius has made his name as one of the most successful emerging-markets fund managers over the past 15 years.

Here, Mobius discusses the rise of emerging markets, the Asian financial crisis, the essential need for law and governance, and the issue of debt relief.

Why Developing Countries Aren't Rich

INTERVIEWER: Why do you think some countries are rich and some countries are poor?

MARK MOBIUS: I've come to the conclusion it's about corruption, really, at the end of the day. What I mean by that is of course there's different degrees of corruption. Every country has some corruption, but in the emerging markets the corruption goes all the way to the top, so therefore the population does not have faith in government structures, in law and order, because if you have corruption, in essence you don't have the rule of law; you have the rule of people. And that's really what separates a poor from a rich country, because there's no shortage of money. There's absolutely no shortage of money in this world, plenty of money. The problem is is where that money is willing to go, and as we've learned from the debt crisis now—we were just talking just recently to people about Malaysia, Indonesia, [Thailand], the crisis and everything—if you really dig down deep enough, the problem is law and order. If someone lends money to a company or to a country and does not get paid back, they're not going to come again, or at least they're not going to come in a long while, and that's one of the reasons why I'm strongly against debt forgiveness for the poor nations of the world, because that's the worst thing you can do to a nation is allow them to get away from their debts and obligations. It's a very bad lesson, because it means that for the future they will try and do that again, and eventually they'll have no credibility again, and no capital will go to that country.

Now we're not only talking about foreign capital; we're talking about domestic capital, because you have to only go to Switzerland or any of these havens and you find out that a lot of the money there is from emerging markets, from developing countries, from the poorer countries. So in fact there's plenty of wealth, you know, coming from those countries, but it's not going back. It's going to the U.S. treasurer; it's going into places where people feel safe.

So the whole mentality about loans to countries and foreign aid and so forth, their mentality has to change. They have to start thinking about what is at the bottom of wealth and how is wealth created, how is growth created. And we've seen that time and time again, and unfortunately, the World Bank, the IMF, and all these multilateral institutions tend to make things worse by bailing out countries. If these countries were not bailed out, then they would have to come to their senses and adopt responsible policies to attract capital.

INTERVIEWER: So it's a lot of these institutions that we take for granted—legal structure, property rights, banks that will loan money so that people can acquire capital, that sort of thing—that a lot of these developing countries don't have?

MARK MOBIUS: They have the patina of these. They have "banks," but these banks are really institutions for transferring wealth from the poor to the rich. Why do I say that? Well, what happens is that the poor are putting their deposits in these banks; the money is siphoned off and lent to people related to the bank, the bank owners and their friends and families, and those loans are never paid back. So the banks go bankrupt. And then the depositors are left out in the cold or the government bails the bank out, and then if the government bails the bank out, of course the government's currency becomes worthless, because they are never going to be paid back. So then they go to the IMF or the World Bank, they get a bailout, money flows in that's never paid back, and it's a vicious circle. And of course what happens, ironically, is that the money that flows into these people that have taken loans out of the bank, where do they put that money? Swiss banks. Where do Swiss banks put it? U.S. Treasury. (laughs) So that gets cycled back in again. Yeah, this is the problem. They really have to rethink the whole process.

The Lure of Emerging Markets

INTERVIEWER: What got you interested in, or what's keeping you interested in, [emerging markets]? Do you want to help the developing world, or are you in it for business reasons because you can make a good profit? What's driving you?

MARK MOBIUS: Well, the whole rationale is that these emerging countries grow faster than the developed markets, and of course there's a wide range. I mean, you've got countries like Nigeria where the corruption is so deep you don't want to go in; you don't want to even get close to the country. And then you have a country like South Africa, which has a tremendous infrastructure, both physical and legal infrastructure where you feel much safer and you want to invest. But overall, if you take all of these countries and you average their growth rate, you'll see that their growth rate is about double that of the United States, Japan, Western Europe. So what we're trying to do is capture that growth and of course make money for investors. But of course the risks are very great, because there's no free lunch. If you want to capture that growth, you've got to take many more risks. so there's a balance, and of course it's our job to try and minimize the risks and maximize the returns. It doesn't always work out that way, but that's the objective.

INTERVIEWER: And we just filmed you taking the subway to work when obviously you can afford a car if you want, but I read that you often try and get a feel for a country by, you know, traveling around the way people have to and get a sense of the way it works. Talk a bit about the way you get a feel for a country.

MARK MOBIUS: Yeah, that's exactly right. I like to sort of mingle and get down to where people are working, observe the factories. We do a lot of factory visits. We visit every company in which we invest, try to get a sense of the management. What is their psychology? Where are they coming from? What is their objectives? Are their objectives in line with shareholders', because that's very important. Corporate governance has become a very, very important issue for us, because we realize that in a lot of these countries, the interests of shareholders are not really being met. Now, you have many conflicting pressures, so we try to get on the ground and get a feel for these kind of things. Very often we're misled and we make the wrong decisions, but the longer you do it, I mean, the great thing about this business is that the more you do it, the more experience you have, the more pain that you suffer. You tend to be more successful, and of course you always have to think from a long-range point of view. You can't be a short-range thinker; otherwise you'd be dead. You know, one crisis and you'd be out of the picture. You wouldn't be able to survive.

1987: The Birth of the "Emerging Market"

INTERVIEWER: Let's talk a bit about the early '90s and the incredible boom that we saw. I mean, the whole buzzword of the "emerging market" became popular back then. What was that period like, and why did this emerging-market boom suddenly sort of take off?

MARK MOBIUS: Well, the story really started in 1986, '87, when the IFC [International Financial Corporation] came up with the concept of an emerging market. You must remember that if you studied economics before then, like I did, it wasn't called the emerging markets; it was called undeveloped countries, Third World, the South—you know, the many other terms that were not as euphemistic as "emerging." But the IFC came up with the word "emerging markets," and well, they started thinking about the need for capital markets, because they knew that these countries could not get enough money just from the multilateral institutions, the World Bank and so forth. So they said they'd rather develop their own capital markets, stock markets, and so forth. So we saw a whole revival of capital-market activity. We started our first fund in 1987, February of 1987, and in those days there, if you looked throughout the whole world, at all of the so-called emerging markets, there were only six countries in which we could invest, either because the government prohibited investments or.... You must remember in a lot of countries, the model was "Okay, let's close our borders; let's nurture our own industries, protect them from any outside interference or competition, and they will become rich." And that model didn't work. But a lot of countries still had policies in place which prevented the inflow and outflow of capital which had foreign exchange controls and so forth and so on. So we only had six countries in which we could invest, six out of 50, 60 countries.

INTERVIEWER: Which ones were they?

MARK MOBIUS: They were in Asia. Five of them were in Asia, and one of them was in Latin America. Mexico was the only one in Latin America. And that was it. That was the only place we could invest. Now it's 40 countries we can go into, so there's a whole revival in thinking in opening up these markets, and the IFC have promoted that sort of thing. And then as money started flowing into these markets, the size of the markets is so small that any small amount of money coming in pushed prices up dramatically. And of course prices were cheap. They were great bargains, but the weight of money meant that these markets would perform spectacularly. And of course as the word spread, more and more countries said, "Hey, I want some of this; let's open up our markets and start floating companies." And that's how the whole thing got started. Everybody was making a lot of money, and in 1993, one of our funds went up by 60 percent. That's unfortunately when my sister-in-law decided to invest in the fund, and of course the next year we had a disaster (laughs). But this is very typical of what happens in markets, very similar to the dot-com boom that we've gone through recently.

The Ordinary Investor and Vulnerability

INTERVIEWER: But where was that big money coming from? Was it new wealth created on Wall Street going somewhere else, or were people taking money from old industries and putting them into the emerging market? Where was it coming from?

MARK MOBIUS: Well, it was mainly institutional money—some retail money from the U.S. particularly, but also institutional money.

INTERVIEWER: What does that mean, "institutional money"?

MARK MOBIUS: That means pension funds-- CalPERS, you know, the big pension fund in California. Every state in the U.S. has some kind of a state pension fund. Teachers in Canada, Ontario teachers' retirement fund, that sort of thing.

INTERVIEWER: Ordinary people?

MARK MOBIUS: Ordinary people, pension funds of these ordinary people. But what was happening at the same time was that the consultants to these funds said to them, "Now look, we've studied the markets around the world, and we realize that if you just invest in Canada or just invest in the U.S. you're not going to get the best returns, and your vulnerability will be greater." Now these consultants equate risk with vulnerability. When they talk about risk, they mean vulnerability. That means, you know, you're going to get lots of movements up and down, and you won't get a steady steam of returns. And so they said: "The best way to solve this problem is by going into international. You should put portions of your funds overseas," which was quite a revolutionary concept to, you know, somebody sitting in Kentucky or in Illinois or whatever state. The idea of putting money in these foreign countries was something that was revolutionary, but these consultants convinced these people to do that, and the returns started to get better, and the vulnerability did go down, because these countries were disparate; they behaved differently. One was up, and another was down, and then over a time period you'd have a smooth movement.

So as these large institutions became global, a small portion of what they put globally went into emerging markets. And of course that small portion was enormous, you know, when you consider a fund typical of these funds would—you're talking not millions, but billions. You just need to take 1 percent, 2 percent, and that has a very big impact on these emerging markets, and that's what happened. So you had these flows coming in. Now to give you an example, we started in 1987 with $100 million under management, and within five years it was up to about $5 billion. I mean, that was the kind of growth that you were seeing. And we were not the only ones. There were other fund managers who were having the same thing.

So the weight of money led to the obvious inevitable crisis, because a lot of companies were listed that shouldn't have been listed. These countries did not have the legal structures. One of the problems now, for example, in Thailand, you had these big banks but no bankruptcy laws, so that when you know a company went bankrupt, the bank could not collect because it would be tied up in the banks for years and years. And even after years of litigation they wouldn't be able to collect anyway. So that's what we're faced with now, and that's where the changes are coming, because the talk about this euphemistic term "corporate governance" is nothing more than stopping the theft. That's really what we're talking about—installing some law and order in these countries so that their own institutions can grow and can collect their loans and so forth.

Overlooking the Framework: The U.S. Push to Open Up Markets

INTERVIEWER: I was interviewing Robert Rubin, and we were talking to him about when the Clinton administration comes into office, it was in '93, and what we're talking about has already gone under way. But it seems like they encouraged more countries to open up, both the trade liberalization to open up and financial markets as well. Was that your sense of what was going on, and what impact did it have?

MARK MOBIUS: Yeah, that definitely was the policy and still is the policy of the U.S., the policy of opening up. And the whole process of WTO [World Trade Organization] is not only about trade; it's about investment, about opening countries to invest, foreign investment, and having flows both ways, free flows. So I think the Clinton administration went a long way towards encouraging that sort of thing. And of course previous administrations also continued that along the same line, that "Look, you've got to have private enterprise; you've got to have free flows of capital, and that will benefit these emerging countries." What was overlooked, unfortunately, was the corporate governance aspects. These policymakers thought that money alone would do the trick, and we're now realizing that money is secondary. The institutional framework is primary. If you have the right institutional framework, if you have rule of law, then this will automatically draw capital into these countries. And you'll get capital that you didn't know existed, because there are lots of flows around the world that go beyond what anyone can count and what is being observed by the official statistics.

INTERVIEWER: Rubin said that everywhere he went, he told them that they had to reform the institutions at the same time and that he really pushed that. What do you think of that?

MARK MOBIUS: Well, I know, and I think a lot of people like Rubin and others, other policymakers and politicians, in the U.S. particularly, tried to push that idea. The problem is that the vested interests in these countries are very strong. I mean, you're talking about a lot of money and a lot of money being made within the current framework, and so it's difficult to change as a result, because if somebody has the choice of reform and putting a million dollars in his pocket, you can guess what choice he's going to make, assuming that he knows he's not going to go to jail if he grabs that million dollars. So they will mouth a lot of reforms. They'll talk about reform. They'll commiserate about how corrupt their country is, but they will participate in the corruption themselves because there's money in it. And it's only through coercion that you will get change, and that means rule of law. I mean, this is the situation in the U.S. People in the U.S. are not angels either, but when they have the threat of the SEC, a strong security exchange commission who can punish them over their heads, when they have a court system that is rather uncorrupted, when they have the threat of class-action lawsuits, they tend to behave themselves, and that's what you need in these countries, unfortunately.

Thailand's Boom and Bust

INTERVIEWER: We were just in Thailand and talked to people there, and we filmed at one project where I think you were involved in the financing, Bangkok Land, Muang Thang Thani, near the airport. What was the vision behind that?

MARK MOBIUS: The vision was great. The vision was to take this huge tract of land and build a city basically between the downtown, congested Bangkok and the airport. So the concept was excellent. The problem was that it was financed to a great degree by U.S. dollars, and as I mentioned previously, the U.S. dollar loans suddenly went very, very sour when the Thai baht devalued, because people like the people that built Bangkok Land, who built Muang Thang Thani, were getting their income in Thai baht, but they had to pay in U.S. dollars. So there was mismatch. So if you look at the Thai crisis, a lot of people say, "Oh, it was bad loans, wasn't it?" The problem was the government and the government policies on exchange rates, because we will not change the exchange rate against the U.S. dollar, and of course the logic for the businessmen was very clear: You borrow U.S. dollars because you can get U.S. dollars at 8 or 10 percent, and you don't borrow in Thai baht because it's going to cost you 20 or 30 percent. So anybody with a brain said: "Look, if I don't have any currency risk, why am I borrowing baht? I'll borrow U.S. dollars." And that is really the cause of the crisis.

INTERVIEWER: Why did you decide to get involved with that one new city?

MARK MOBIUS: We thought the concept was excellent, that the location was very good. The idea of building an integrated city with all facilities was very good, which was revolutionary to some degree in Thailand, and we thought it would make sense, but then when these loans went sour, they got in trouble [and weren't] able to sell them.

INTERVIEWER: You talked about pain before, the pain in the business.

MARK MOBIUS: Yeah, that's right. There's a lot of pain when that happens, because you see the stock price go down by half or by 70 percent or 80 percent, and you've got to take the losses; you've got to be willing to take these losses.

INTERVIEWER: I mean, you're right in Thailand. I'm sure you hear all the time that there's a lot of—I wouldn't call it resentment, but a lot of people here say the money that came in was, you know, money that didn't really care about Thailand. As soon as we had a problem it all just pulled out. Where did speculation fit into all this?

MARK MOBIUS: I know people like George Soros and other heads of the management were blamed for the Thai baht crisis, but is it their fault when the Central Bank adopts an unrealistic policy; when the Central Bank, knowing full well that the Thai baht is overvalued, because, you know, you don't have to be a rocket scientist. You only have to take the inflation rate in Thailand and the inflation rate in the U.S. and do a very simple calculation on a monthly basis. If you track that ratio—inflation in the U.S., inflation in Thailand—and you track it, you have the so-called purchasing power parity line. And again, you don't need to be a rocket scientist to know that if inflation in one country is higher than inflation in another country, the country with the higher inflation will have a weaker exchange rate over the long term. And that was what was happening in Thailand. They had a higher inflation rate, and therefore their currency had to get weaker. But the Central Bank kept on saying, "No, no, we'll support the currency at this fixed rate," and of course they were shelling out the U.S. dollars to protect the currency. So their foreign reserves were dwindling, and of course any hedge fund manager looking at that would say, "Hey, these guys are going to be in trouble, and I'm going to short the Thai baht."

And then they went one step further. They went to the Central Bank, and they said, "Now, are you sincere about the Thai baht being kept at 20-1?," or whatever the rate was at that time. And so the Central Bank said yes. "Then if you're so sure, why don't you sell your dollars to us forward?" In other words, "We'll just buy it forward, and you give us dollars." And the Thai bank stupidly did that, and very soon there were no U.S. dollars left, and as soon as that point was reached, then the currency went to hell, because everybody was shorting the currency because they knew they had to. They didn't have any more dollars to protect the currency. That's the real nexus of the crisis in Thailand. Sure, there was careless lending from banks, but what country doesn't have careless lending? But the nexus was the Central Bank, which is why I am a believer in the elimination of central banks. I think central banks should be eliminated in all countries, and currency boards should be adopted, where there is a fixed rate administered by an independent currency board that has no discretion whatsoever, whatever you want to fix it against, another currency or against gold or whatever. I think it's the only answer in the long run.

Do Fund Managers Help Emerging Markets?

INTERVIEWER: And what do you say to critics of people like you, who say you come in and, you know...

MARK MOBIUS: Oh, yeah. Well, that's the next point, this hot-money idea. When I put money... Now you've got to make the distinction between loans and equity. If somebody makes a loan, they are guaranteed their money back, okay? There's no question about it. You make a loan, it is a fixed contract, and you say you're going to get your money back on a certain day, and if you don't like the country at that date, you exit; you get out. In the case of equity, by definition it's a long-term investment, because once I buy equity in a company, there's no way I can exit unless I sell it to somebody else, and then that guy becomes a long-term investor. So this idea that it's hot money is totally erroneous, because as soon as we make an equity investment by definition we're a long-term investor, because there's no promise from anyone to give us our money back. We are putting our faith in that company and in that country. And this is I think a very, very important distinction to be made, and probably one of the reasons why I understand the Koran prohibits loans. The concept is very good, because if you make a loan, it means that there's a guarantee you'll get your money back. In the case of equity there is no guarantee, and therefore the person that puts equity in is committed and becomes a partner with the company in which they're putting that money.

There's another factor which I think is very important, and I think that is between direct strategic investors and portfolio investors. We are portfolio investors; we are passive. For the most part we're passive investors. And in the case of the direct investors—who are the major multinationals who come in, build a plant, and take majority control—we're quite different, because we are actually empowering the local management. We're telling them: "Look here's money; you do with it whatever you will. As long as you make this company prosperous we will be happy, because we are partners with you." In the case of the strategic investor, they say: "Look, get out of here. We're taking control. We will run this company, and we will do whatever we want, and if we don't want local people around we can do so; we can throw the local people out." So there's another very important distinction to make, which is the reason why very often we're in conflict with strategic investors is because their interest may not be aligned with the domestic companies' interest.

The Need for Corporate Governance: Out with the "Feudal System"

INTERVIEWER: I want you to talk about this idea of corporate governance, because we're interviewing Bill Crist of CalPERS, and he was talking about when he first realized that his fund had a fair amount of money invested particularly in Japan in the early '90s. He sort of started going over to Japan and thinking, "Hey, they're not actually running this company in the interest of the shareholders."

MARK MOBIUS: Right.

INTERVIEWER: But when he started talking about changing that, he met a lot of resistance, and now he's doing the same thing in France, where they've got big investments, and he's also meeting a lot of resistance. And there's a sense that they feel like they're trying to impose the American way on these companies. What's your sense about that?

MARK MOBIUS: Well, I was mentioning, you know, the power structures within these countries have been developed over thousands of years in many cases, or at least hundreds of years in the younger countries, and there is tremendous resistance, because basically you're taking power away from people, and in many of these countries like France, you basically have a feudalistic system where a few families control these large companies and they want to pass that on. They want to pass it on like the divine right of kings, and that's why this whole concept of equity... you know, "equity" means "equal." That means each share has an equal vote, or it's supposed to mean that. But in many, many countries like France, that doesn't mean that. You have special classes of shares which have more voting power, and if you go into this subject a little more deeply, you're talking about human rights. That's basically what you're talking about—human rights and the ability of people to be equal in a company structure. And that is not the case in Thailand, in France. In almost every country in the world you're going to find this, this problem of controlling shareholders who have more power with less money, if you know what I mean. In other words, you have a situation where a family has 10 percent of the stock of a company, but yet it controls over 50 percent of the votes.

INTERVIEWER: I think that's very common in Asia as well.

MARK MOBIUS: It's very common in Asia, yes. And that's the kind of thing we would like to see changed, but that involves threatening some of the very powerful people in the country, because they are powerful because they have this control, and they don't want to give it up. This is the problem you're facing. (laughs)

INTERVIEWER: During the boom there was a lot of talk about Asian values, and you know this system working in this area. You know last week in Singapore [it came up]: "You can't impose this on us."

MARK MOBIUS: Yes, but if you look at the behavior of the Singapore companies, you'll see they're moving in that direction. They are now beginning to... The government is beginning to give up control of the companies reluctantly, but they are gradually giving up control, and the reason is they want to become global. They want to become global leaders. The only way they're going to do that is by adopting egalitarian structures where the best people rise up to the top and where there is no nepotism, where someone does not get a position because their father was in that position but where the most capable people rise up to the top. So, you know a lot of this is about global competition, and that's the reason why a lot of people are against the so-called globalization, because it threatens the basic power structures that are in place. It threatens a lot of people who would have had a very comfortable life and don't want to give that up.

INTERVIEWER: But if they want to be part of the global system, they have to change?

MARK MOBIUS: Yeah, I mean eventually they have to change in order to compete, because globalization implies a level playing field. If you have a level playing field, then the best man will win, not necessarily a man who's had a father who had the title.

INTERVIEWER: We started off by talking about why some countries are more rich and some countries are poor, and you think that if ultimately trade and globalization are on a level playing field, that would help the average guy on the street in the developing country?

MARK MOBIUS: Exactly. The idea of globalization is that you have a level playing field, and you allow the most capably equal people to rise to the top. And what is the result of that? The poor guy on the streets of an emerging country has the ability to come up to the top, and he has a better chance. Why? Because chances are he's a harder worker; he's hungry; he wants to get more; and he will most likely become one of the global leaders. He will move up to the top. But you've got to let him out of his cage, so to speak. Right now most of these countries have structures which don't allow the guy on the street to come up to the top.

The Short Term Takes Over: "The Mob Is Often Wrong"

INTERVIEWER: We were talking before about the monthly and the quarterly demands. And you know, some of that puts a lot of pressure on companies in emerging markets to meet the expectations of shareholders that might be involved. Talk about that relentless of demand to constantly show profits.

MARK MOBIUS: There is in our business more and more of a tendency to look short term and to demand returns on a short-term basis. Now what has happened is that a lot of the institutional investors and even the retail investors have fallen back on indexing, because the theory the efficient market, the famous efficient-market theory, has taken hold, and a lot of people say, "Well, over the long run a management portfolio cannot beat an index portfolio." So everybody now is measuring themselves against the index on daily, weekly, monthly, yearly basis, and if you are underperforming the index, then everybody's unhappy. The problem with that is, what is the index? The index is the mob. It's the emotional mob that goes after the most popular thing of the day, which as we've learned in the case of the tech crisis, the dot-com crisis, is very often wrong. The mob is often wrong. And then you get this vulnerability, because if everybody is following the index and wants to at least be in line with the index and not perform the index, then you have this mob instinct in the clothes of vulnerability being enhanced, because everybody's following the same pattern. Then you have greater vulnerability, and that's where we are now.

That's a very dangerous phenomenon, because if you're looking at the normal life cycle of the company and the normal planning cycle of the company, it's not one week; it's not one month; it's not one year. It's more like three or four or five years. If a managing director of a company has to meet his profit targets on a monthly or quarterly basis, there's no way that this company is going to be able to plan long term for the future. It'll be a very difficult thing to do. And that's where we are now, is that everybody's running after these short-term results. It's very difficult to do long-term planning.

Are Emerging Markets Still Viable Today?

INTERVIEWER: One last question: After the crisis, a lot of people thought they had gone, emerging markets; "we don't want to go there anymore." What's your sense of the future of investment in the emerging markets?

MARK MOBIUS: Well, it's true. I mean, given what we've seen—the Asian crisis, the Russian crisis, and so forth—a lot of people have questioned the viability of emerging markets. Is it a viable category?—and particularly since you've seen the rise of hedge funds and so-called alternative investments. People are saying: "Hey, do we need emerging markets? Do we need all this corruption?," and so forth and so on. But the bottom line is that the initial premise of emerging markets is still valid, and that's growth. The rapid growth of these countries still is valid. If you go back 10 years and you track an emerging market's growth and the U.S. growth, or the market's growth, you'll see emerging markets have always outperformed. Even during the crisis time, by the way, emerging markets have been faster growing. So, I mean, if given that situation, given the fact that people are now much more aware of corporate governance, there is no reason for you not to believe that things are going to get better, because there's going to be improvements on a number of fronts. And at the same time you're going to see this growth, this rapid growth which will be reflected in the stock market. It has to be.