Corporate Governance and Restructuring in East Asia: An Overview

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After the 1997-8 Asian financial crisis, Asia's turnaround in 2000 appears spectacular. To aid corporate restructuring, East Asian economies have passed new laws and regulations for more efficient bankruptcy procedures and improved bank-supervisory standards. Foreign Direct Investment (FDI) has also poured into East Asia in 1999 and 2000. This paper provides an historical overview of corporate restructuring in Indonesia, Korea, Malaysia, the Philippines and Thailand since the outbreak of the financial crisis. It also explores the implications of growth and economic dependency, needs for transparency and increased FDI on corporate restructuring in East Asia.

Keywords: Asian crisis, Financial reform, Structural reform, FDI

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I. Introduction

After the 1997-8 Asian financial crisis, Asia's turnaround in 2000 appears spectacular. The region's ravaged economies grew three

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TABLE 1

REAL GDP PERCENT CHANGE IN EAST ASIA

	Actual				Projection	
	1996	1997	1998	1999	2000	2001
East Asia 5						
Indonesia	8.0	4.5	-13.7	0.2	4.0	4.0
Korea	6.8	5.0	-5.8	10.7	8.5	6.5
Malaysia	8.6	7.5	-7.5	5.6	8.0	6.0
Philippines	5.8	5.2	-0.4	3.3	4.0	4.5
Thailand	5.5	-1.3	-10.0	4.2	4.5	4.5
Transition Economies						
China	9.6	8.8	7.8	7.1	8.0	7.5
Vietnam	9.3	8.2	5.8	4.4	5.0	4.5
Small Economies						
Mongolia	2.4	4.0	3.5	3.5	4.0	4.5
Cambodia	7.0	1.0	1.0	5.0	5.5	5.5
Lao PDR	6.8	6.9	4.0	7.3	6.0	6.0
PNG	3.5	-4.6	2.5	4.2	3.4	2.7
Fiji	3.4	-1.8	-3.7	7.8	-15.0	4.0
Solomon Islands	0.6	-0.5	-7.0	-0.5	-20.0	2.0
East Asia NIEs						
Hong Kong SAR	4.5	5.3	-5.1	3.1	8.7	4.4
Singapore	7.5	9.0	0.3	5.4	8.1	6.4
Taiwan (China)	5.7	6.8	4.8	5.4	6.6	5.9
Japan	5.0	1.4	-2.8	0.3	1.9	2.0

Sources: World Bank for EA5, Transition and Small Countries; World Bank DECPG for Japan; Consensus Forecast September 2000 for Hong Kong (SAR), Singapore, Taiwan (China)

times faster than analysts' forecasts of a year ago (*The Economist* 2000a; and World Bank 2000). South Korea's GDP rose by almost 11 percent in 1999 and now exceeds pre-crisis levels. Malaysia experienced 6 percent of GDP growth in 1999 and by the end of 2000, along with Thailand, will have clawed back to pre-crisis output levels. Indonesia has lagged, yet its GDP still grew at an annual rate of 6 percent in the fourth quarter of 1999 (Asian Development Bank 2000). Much of the growth in GDP has come from exports of electronics, particularly to the USA (Government of Japan 2000). Table 1 sketches percent of GDP changes in East Asia.

To aid corporate restructuring, East Asian economies have passed new laws and regulations for efficient bankruptcy procedures and improved bank-supervisory standards. Governments have closed many insolvent institutions, recapitalized weak banks and created public-asset-management companies to sell non-performing loans. As needs for transparency and corporate governance have grown, international auditors have acquired more power and influence (Crispin 1999).

Foreign Direct Investment (FDI) has also cascaded into East Asia in 1999 and 2000. FDI has always provided an important source of external financing in developing Asia. Historically and presently, FDI has also resulted in new expectations from foreign partners and demands for changes in labor and managerial practices (Haley 2000a).

This paper provides an historical overview of the corporate restructuring efforts in Indonesia, Korea, Malaysia, the Philippines and Thailand since the financial crisis. It also explores the implications of growth and economic dependency, needs for transparency and increased FDI on corporate restructuring in East Asia. Section II indicates stakeholders' goals behind corporate restructuring. Section III highlights national differences in corporate-restructuring strategies. Section IV explores the offshoots of some post-crisis strategies of restructuring and resurgence on corporations and managerial environments in Asia.

II. Goals for Corporate Restructuring

Analysts, researchers and policy makers widely attributed poor governance for the weaknesses in East Asia's financial and corporate sectors and urged restructuring for their effective functioning (see Backman 1999; and Haley 2000a). Symptoms of rot included intricate formal and informal relationships between governments, financial institutions, and corporations; inadequate disclosure requirements; and widespread corruption and favoritism. Reform and restructuring efforts aimed to improve market discipline and corporate governance through introducing anticorruption and competition policies. Broader goals included transforming corporate cultures. With the assistance of multilateral financial institutions, notably the Asian Development Bank (ADB), the International

Monetary Fund (IMF), and the World Bank, the crisis countries endeavored to increase the transparency of economic and financial data, to strengthen corporate disclosure requirements, to enhance accountability to shareholders, to bolster competition laws, to privatize state-owned enterprises, to dismantle state-supported monopolies and cartels, and to restructure opaque corporate relations.

At least three broad strategic approaches exist for corporate-sector restructuring: centralized, decentralized, and London. Governments play prime roles in centralized approaches; these strategies prove more effective with small debts, simple corporate structures and high-levels of stakeholders' confidence in governments (*e.g.* Sweden in the early 1990s and Hungary in the mid-1990s). At the other end of the spectrum, relevant stakeholders reach voluntary restructuring agreements with decentralized approaches; these strategies prove more effective with large debts and complex corporate structures (*e.g.* the United States in the 1990s).

An intermediate strategic approach, the London approach, evolved in the United Kingdom in the early 1990s when creditor financial institutions and about 160 British indebted firms worked closely with a government institution, the Bank of England, outside formal judicial processes. The London approach includes: a) full information sharing between all parties; b) collective decision-making among creditor banks on corporate financial lifelines; c) standardized agreements between debtors and creditors; d) clear timetables for resolution; e) binding agreements between banks and corporations to honor the restructuring agreements; f) equal treatment for all creditors of a single category; and g) penalties for broken agreements. This approach demands strong confidence in the official mediating institutions; in the British case, all relevant stakeholders had strong confidence in the Bank of England.

Corporate-debt workouts, under government coordination in Indonesia, Korea and Thailand, superficially resemble the London approach. All the crisis-hit East Asian countries followed broadly similar strategies. For example, all the countries developed new out-of-court systems to restructure large corporations' debts. Indonesia set up the Jakarta Initiative, Korea and Malaysia set up corporate debt-restructuring committees, and Thailand established a corporate debt-restructuring advisory committee. Tax incentives encouraged out-of-court workouts, while policy makers strived to remove regulatory obstacles that hindered mergers and debt-equity swaps. Simultaneously, the countries strengthened domestic bankruptcy laws to resolve bankruptcy cases speedily, to protect creditors' rights, and to discipline managers. Policies to improve corporate governance included attempts to reduce ownership concentration, to increase market competition, to reduce government monopolies, to strengthen minority shareholders' rights, and to increase the transparency of financial reports and transactions (Asian Development Bank 2000).

However, the Asian countries lacked the equivalent of the Bank of England, a government institution with high credibility. They also suffered a lack of mutual trust and confidence between financial institutions. Consequently, many debt negotiations failed, leading to protracted discussions and corporate bankruptcies. Presently, a gradual change is seeping through the debt workouts as both financial institutions and corporations become more confident in governmental abilities to oversee corporate debt restructuring (Asian Development Bank 2000).

Restructuring costs have also proven far larger than anticipated, dampening corporate and organizational restructuring efforts. One estimate suggests that total financial restructuring costs for the four worst hit countries will reach 58 percent of GDP in Indonesia, 16 percent in Korea, 10 percent in Malaysia, and 32 percent in Thailand (Asian Development Bank 2000). South Korea serves as post-crisis East Asia's star performer having made great strides to strengthen and to diversify its financial system. The government has struggled to reduce net leverage: net lending to the *chaebol* for instance shrank last year despite the country's phenomenal growth. Yet, even in South Korea, corporate reform has barely begun, despite the much-publicized restructuring of Daewoo, one of the country's biggest *chaebol*. At the other extreme, Indonesia has barely started on reform.

Undercapitalized banks, with enormous quantities of non- performing loans (NPLs), still hesitate to lend to corporations. Table 2 identifies NPLs in East Asia. Saddled with heavy debt burdens, insolvent companies cannot undertake the financial burden of restructuring. Private sector financial analysts estimate that NPLs constitute about 60-85 percent of loans in Indonesia as compared with 20-30 percent in Korea and Malaysia and 50-70 percent in Thailand.

TABLE 2

NPLS OF CRISIS-AFFECTED COUNTRIES

(Percentage of total loans)

	1997	1998	1999				2000	
	Dec.	Dec.	Mar.	Jun.	Sept.	Dec.	Mar.	Jun.
Indonesia[a]	-	-	-	-	-	-	58.4	58.7
excl. IBRA	9.3	19.8	58.6	-	-	-	41.5	39.7
Korea[b]	6.0	7.4	8.7	8.7	6.2	8.3[c]	14.0[d]	12.2
Malaysia[e]	6.0	22.6	22.7	23.4	23.6	23.6	23.3	23.2
excl. Danaharta	-	18.9	18.2	18.1	17.8	16.7	16.7	-
Philippines[f]	4.7	10.4	13.2	13.1	13.4	12.5	14.4	14.6
Thailand[g]	-	45.0	47.0	47.4	44.7	41.5	39.8	34.8
excl. AMCs	-	45.0	47.0	47.4	44.7	38.9	37.2	32.0

Notes: (a) The first line uses the "stringent" definition of an NPL; the second line excludes transfers to IBRA.

(b) Figures include commercial and regional banks only, excludes specialized banks, and excludes KAMCO holdings of impaired assets.

(c) Figures starting in December 1999 reflect the application of the new Forward Looking Criteria (FLC) to the valuation of assets.

(d) Figures starting in March 2000 reflect the application of the FLC to restructured loans, including loans to all workout companies and companies under court receivership.

(e) Figures include commercial banks, finance companies, merchant banks, and Danaharta.

(f) Figures are for commercial banks.

(g) First line includes commercial banks, finance companies, and the estimated amount of NPLs transferred to wholly-owned private Asset Management Corporations (AMCs).

Source: World Bank, East Asia and Pacific Region.

Overall, the NPLs reflect the poor health of companies in East Asia. However, generally, export-oriented companies fared better than those that produced nontraded goods and services; and, except in Korea, small firms were hit harder than large firms. In Malaysia, for instance, companies in the nontradable sector accounted for about 75 percent of the NPLs. In Thailand, small companies and households accounted for 50 percent of the NPLs. As bankruptcies and strained financial circumstances pervaded the East Asian economic landscape, the paucity of social safety nets became evident. Concomitantly, a variety of stakeholders, including financial institutions, business corporations, labor unions, and politicians have exerted pressure to hinder corporate restructuring.

Though the broad principles of financial and corporate restructuring appear similar in the crisis countries, the particulars and rates of progress have varied considerably across individual countries. Generally, corporate governance has improved. For example, post-crisis East Asian corporations appear to disclose more accurate, and timelier information on finance, performance, and ownership structures. In Korea, corporations must provide consolidated financial statements. In Malaysia, individuals can hold a maximum of ten directorships in publicly listed companies, and companies have to provide quarterly financial statements. Yet, as the next section details, effective corporate governance remains mostly elusive in East Asia.

III. National Differences in Corporate Restructuring Strategies

Corporate restructuring strategies and impediments have varied enormously across Indonesia, Korea, Malaysia, the Philippines and Thailand. This section explores some of these differences.

A. Indonesia

As indicated in the previous section, corporate restructuring in Indonesia has barely begun and has not progressed much beyond creating new institutions and improving legislation on paper. First, the government set up the Indonesian Bank Restructuring Authority (IBRA) in January 1998 to restructure troubled banks and the Indonesian Debt Restructuring Agency (IDRA) in July 1998 to restructure foreign debt. IDRA allows debtors and creditors to insure themselves against exchange risks, once they have reached rescheduling agreements. Indonesia then created the Jakarta Initiative for out-of-court corporate settlements (Asian Development Bank 2000). Legislation to improve corporate governance included new bankruptcy and anticorruption laws. In August 1998, the Indonesian government introduced a new bankruptcy law that modernized the legal infrastructure for bankruptcy and facilitated the rapid resolution of commercial disputes. Subsequently, in 1999, the Indonesian government adopted a law against corruption, collusion, and nepotism.

Despite this comprehensive legal and institutional framework, the progress of corporate restructuring seems disappointing. The IDRA has registered little debt. By the end of June 1999, the IDRA had registered only 80 bankruptcy cases, although almost half of Indonesian corporations experienced insolvency and increased difficulties in meeting debt-service obligations (Asian Development Bank 2000).

One big impediment to restructuring includes the lack of financial-system reform. Weak, undercapitalized banks lack the resources or technical skills to resolve corporate debts within the Jakarta Initiative's framework. Indonesia's huge foreign debt provides another impediment. Without relief from foreign creditors, including Japan, Indonesia probably cannot service this debt, in particular the $36 billion owed to foreign banks.

A third impediment includes chronic corruption and nepotism among top policy makers and unjustifiable decisions by top managers (Backman 1999). Decisions by IPTN, the state-owned Indonesian aircraft manufacturer launched under the patronage of ex-President Suharto, indicate some of the hurdles in corporate restructuring (Ranawana and Caragata 2000). Created and run by B. J. Habibie, then Research and Technology Minister and, in 1998-9, President, IPTN aimed to transform Indonesia into Asia's leading plane manufacturer. Today, it owes $245 million to the IDRA, and approximately another $130 million to other creditors. IPTN dropped plans for a regional jet and a sophisticated turbo-prop as a condition for the IMF's assistance to Indonesia at the outset of the crisis; however, the company continues to turn out small turbo-props and some helicopters. IPTN's President, S. Paramajuda, in a recent media interview insisted that the company is adapting to market realities (Ranawana and Caragata 2000). Yet, IPTN's huge debt indicates that the government will need to come to its rescue and to convert its giant debt to equity out of dwindling public funds.

Problems surrounding IBRA epitomize restructuring problems in Indonesia. Superficially, IBRA is advancing towards the IMF's target of 18.9 trillion rupiah from asset sales by the end of December 2000. However, IBRA has sold less than 20 percent of the assets under its control and the original owners still operate their companies. Much of the restructuring has focused on debt-to-equity swaps, loan extensions and debt discounts rather than asset sales.

Foreign interest in the companies appears negligible as the Master Settlement and Acquisitions Agreement (MSAA), IBRA's chief vehicle for restructuring, favors the original owners. Although the MSAA places the burden of ownership on IBRA, it yields operational control to the owners. Neither does the MSAA force the owners to surrender all their assets. So long as the owners have operational control of their companies and maintain access to other resources, they can decide how well a business does. An owner who wants to hinder foreign buyers can adjust the company's performance and hinder due diligence. Former Finance Minister Mar'ie Muhammad serves as chairman of IBRA's newly formed oversight committee. "It looks nice and sounds good," he said, "but this kind of restructuring is an accounting exercise" (Vatikiotis 2000).

B. Korea

As indicated in the previous section, Korea has made the greatest strides toward corporate restructuring, following active governmental participation. First, the government mobilized the restructuring of the Big Four *chaebol* through specific plans to improve capital structure. These plans required the four largest *chaebol* to reduce their debt-equity ratios to below 200 percent by the end of 1999, to remove existing cross-guarantees between subsidiaries in different lines of business, and to consolidate businesses by exchanging non-core businesses with other *chaebol*, a process known as "Big Deals." Second, the medium sized *chaebol* and other large corporations engaged in out-of-court workouts with their designated lead creditor banks. Third, the government postponed the restructuring of small and medium-size enterprises (SMEs) by leaving this process to the creditor banks. To prevent insolvency and preserve employment, SMEs could easily access working capital loans. In Korea, compared with other crisis countries, SMEs account for a relatively small fraction of outstanding bank loans. While their small numbers justify the delays in restructuring SMEs, the government needs to propose a comprehensive program to resolve their debts and to obviate future societal pain (Asian Development Bank 2000).

Notwithstanding timely policies, Korean corporate restructuring has made uneven progress. The lead banks appear to include hemorrhaging companies that they should have liquidated. Given their own financial fragility, the banks have continued to keep many terminally ill firms on their balance sheets. The lead banks also could not devise a comprehensive set of criteria including debt-equity swaps, debt write-downs, and debt rescheduling raising concerns about the fairness and effectiveness of differential measures across companies and industries. Disagreements over loan-loss provisioning, disputes over asset valuation, and managerial resistance to losing control have complicated restructuring (Asia Recovery Information Center).

The government has already spent about 100 trillion won to recapitalize the banks, through buying their bad debts and bailing out depositors. A few banks have closed down and a third of employees in the financial sector have lost their jobs. At the end of June 2000, the 17 big commercial banks had combined bad loans of 55 trillion won or 11 percent of their total loans and had made provisions against only one-third of these. The average rate of return on equity (ROE) for these 17 banks was -21.5 percent in the twelve months to the end of March 2000 (*The Economist* 2000b).

Inadequate transparency makes the *chaebol*'s operations murky and hinders attempts at gauging the adequacy of corporate restructuring attempts. For example, despite the Big Deals, excess capacity problems that plagued Korea's *chaebol* may continue. Evidence also appears mixed on whether the Big Four have fulfilled their commitments to improve corporate governance and to pare down to a few core businesses.

The *chaebol*'s aggressive management led to their becoming global players in their industries, yet contributed to their financial problems. As with other efforts to alter character traits, efforts to amend managerial styles have led to suffering and bloodletting. Ssangyong's restructuring indicates some of the pain. Founded by the father of group chairman Suk Won Kim, Ssangyong evolved into a household name in Korean cement and housing construction and became a high-profile contractor in Asia. In the 1980s the *chaebol* started many new ventures, from the Yongpyong Ski resort to an oil-refining joint venture with Saudi Arabia's Aramco, and a car alliance with Germany's Daimler-Benz. Ssangyong Motor already assembled four-wheel-drive vehicles, but Kim's goals included luxury vehicles too, which required bank loans and Mercedes-Benz technology. But when the first Chairman sedan rolled off the assembly lines, the auto manufacturer's debt had piled high with no hope of a profit. By late 1996, a year before the Asian crisis hit Korea, Ssangyong Motor's debt reached 17 times its equity.

In May 1998, Ssangyong submitted a restructuring plan, promising to sell assets, to repay more than $5 billion, to reduce its debt-equity ratio to 1.59 by 2002, and to refocus on cement and construction. It sold its stock brokerage in October 1998 to a group led by Hambrecht & Quist Asia-Pacific. An Aramco consortium bought the *chaebol*'s stake in Ssangyong Oil. This year, UK- based Pan-Pacific Resort Investment assumed a half-stake in the Yongpyong resort for $100 million. America's Lonestar is closing a deal to buy land, buildings and other assets, valued at more than $500 million. A $450-million stake in Ssangyong Information & Communications and the luxury car-manufacturing unit have also made their way to the auction block (Nakarmi 2000).

As the public hacking of prominent *chaebol* continues to create shock waves through the Korean economy, the deluge of FDI indicates major restructuring ahead for the Korean economy in key sectors (Asia Pulse 2000a, b). Unprecedented mergers and buyouts have left Daimler-Chrysler and Renault of France in control of South Korea's debt-ridden auto manufacturers. This FDI will necessarily recast corporate restructuring in Korea as new management methods and expectations clash with traditional ones.

Yet uncertainties and complications still remain as the halting sale of Daewoo Motors reveals (Watts 2000). In 1999, when the huge Daewoo *chaebol* collapsed with debts of $709 billion, parts of the group were offered for sale. As a sign of Korea's willingness to embrace globalization, Ford was chosen as the preferred buyer for Daewoo Motors. But, Ford suddenly pulled out of negotiations in September 2000 amid rumors that it found Daewoo's liabilities far worse than it had originally believed. As of October 2000, creditors are looking to General Motors (GM), which is reportedly offering a third of the $7 billion bid by Ford. The government wants a deal by the end of the year, but analysts say the process of due diligence may take months. One or two banks would rather pull the plug on the company, but given the crisis that would follow such a move, the main creditor, the government-run Korea Development Bank, will probably approve new funds on a short-term basis. With the value of the company falling by the day, GM and its partner Fiat appear in no hurry to close a deal. At least one creditor has already written off all debts owed by Daewoo

Motors, suggesting that the company may sell for far below its worth. GM is reportedly in favor of a part purchase of Daewoo's assets, which would leave creditors with the bill for liquidating the company's least profitable operations. Daewoo's main union fiercely opposes this breakup of the firm and is demanding a large-scale injection of public money to put the company back on its feet.

C. Malaysia

Malaysia's experience of financial and corporate restructuring differs from the other Asian economies in two crucial aspects. First, Malaysia began with a stronger financial sector because of relatively more effective bankruptcy and foreclosure laws and stronger supervisory capacities. Capital-asset ratios in the banking sector appeared strong, exceeding 10 percent. Second, in September 1998, Malaysia chose to impose capital controls rather than to accept an IMF rescue package with attendant IMF scrutiny. Rather than close ill financial institutions as in Korea and Thailand, Malaysia encouraged mergers. The central bank approved ten new banking groups and the selection of the anchor banks and their respective partners in January 2000. The government will consolidate 54 domestic banking institutions—reduced from 88 at the end of 1997.

Before the crisis, Malaysia's corporations carried less debt than companies in other crisis-hit East Asian countries. Consequently, corporate distress in Malaysia appeared less acute than elsewhere, although a rise in interest rates hurt most corporations with their heavy dependence on bank financing. Malaysia's troubled corporations appear concentrated in the real estate, construction, and infrastructure sectors.

Debt workouts and operational restructuring through the Corporate Debt Restructuring Committee has been slow, partly because of a lack of adequately trained staff. To address the problems, the government has established agencies to manage corporate restructuring: the Loan Monitoring Unit of the central bank assists small corporate borrowers in restructuring, a rehabilitation fund helps viable SMEs restructure, and the Finance Committee on Corporate Governance works on reforming corporate governance.

Yet, without outside supervision or audits, Malaysian companies, especially those that stoke national pride, have continued to make the Napoleonic mistakes that characterized so many companies in pre-crisis Asia. For example, for years, the Proton, a pet project of Prime Minister Mahathir Mohamad, was little more than a Mitsubishi with Malaysian characteristics. Its manufacturer, Hicom, recently unveiled a new model, the Waja, largely designed and engineered in Malaysia. Hicom, suffered a net loss of $41.5 million last year and its holding company, DRB, lost $55 million. Yet, state-owned, cash-rich Petronas has come to rescue this well-connected company. Petronas will buy Proton for $263.2 million, a decision to nourish an over-protected car manufacturer in an industry marked by overcapacity (Ranawana and Caragata 2000). Protected Proton will likely lose half its domestic market share when barriers come down in 2005.

Despite managerial rumblings, key Malaysian policy makers have continued their strong support of Proton's mission to manufacture the Malaysian car. For example, Proton recently announced the abrupt resignation of a Japanese board member, Fumio Yoshimi. Yoshimi had publicly questioned Proton's chances of survival without protective tariffs as a small car manufacturer in an industry of giants (*Business Times* 2000). Yoshimi candidly told reporters at a seminar of Japanese car manufacturers in Kuala Lumpur last month that "[Proton gets] a profit under the special protection of the government. Without protection, our estimate is that Proton would have less than 30 per cent market share. With protection, it's about 60 per cent" (*Business Times* 2000). Raising quality, lowering costs and doing so with relatively low production of 240,000 units a year (when the big car manufacturers produce millions of units) formed the company's main problems, Yoshimi told reporters before he abruptly left Proton (*Business Times* 2000).

D. Philippines

The Philippines, though affected by the Asian crisis, suffered significantly less than the other four crisis economies. No broad banking crisis occurred and the country received no emergency rescue assistance from the IMF. The country's resilience stemmed from virtually no short-term foreign-currency borrowings, well-capitalized banks and a smaller less-leveraged manufacturing sector than the other economies. The mildness of the Philippines' crisis, and the lack of outside supervision or demands for transparency, have affected the scope and nature of the country's corporate reforms. The Philippines has followed a market-led reform process with less government involvement.

Without pressing demands for organizational restructuring, few corporations have revised old methods of doing business, despite an often-glaring imperative to do so. For example, the Philippine National Bank (PNB) like many other regional financial institutions did not always back loans with properly secured collateral (Haley, Tan and Haley 1998). The corporate culture promoted sweet deals to well-connected people and other misuses of capital. The boom times fuelled indiscriminate borrowings of US dollar funds. When the crisis hit, borrowers defaulted, local currencies plummeted against the dollar and foreign debt ballooned. The PNB, a major financial player in the Philippines, suddenly faced the prospect of death. Lucio Tan, the beer, tobacco and airline tycoon, mysteriously acquired a controlling stake in the bank, preventing the Manila government, previously the PNB's largest shareholder, from overhauling or selling the bank. A joint auction in June turned into farce when the highly priced shares—almost three times the real value—resulted in only one qualified bidder. Tan has promised much-needed, and much-delayed, action. He has proposed an eight-point rehabilitation program that includes cost reduction, continuous personnel training, aggressive generation of deposits, sales of non-performing assets and bans on political loans. Yet, without insistent stakeholders, the reforms have not materialized. International brokerage house, Salomon Smith Barney, labeled the PNB "high risk" in its June 2000 report (Caragata and Lopez 2000).

E. Thailand

Thailand's strategies for corporate restructuring, like those of the other countries, consisted of forming new institutions, offering better incentives, and improving the legal framework. In August 1998, the government created the Corporate Debt Restructuring Advisory Committee. It also tried to create an effective legal framework for recovering debt through bankruptcy legislation, and provided tax and other incentives to encourage corporations and banks to restructure bad debt.

Progress has occurred, and corporate restructuring accounts for about 25 percent of NPLs. However, the growth of NPLs has outpaced the completion of corporate-restructuring programs. SMEs account for more than two-thirds of this aggregate corporate debt, which makes restructuring complex: the SMEs, scattered around the country, engage in small, costly and diffused transactions. Banks would also rather not deal with SME's debts, preferring instead to reduce lending to them.

International and auditors' scrutiny have resulted in successful restructuring of some large companies such as Siam Cement. In the manner of Overseas Chinese companies (Haley, Tan and Haley 1998), Thai blue-chip company Siam Cement's highly-diversified holdings reach well beyond construction materials to include paper, petrochemicals, tires and an agricultural machinery business in China. Before the crash, Siam held about $4.2 billion of its $5 billion consolidated foreign debt in US dollars. Consequently, the baht's devaluation in 1997 dealt the company a devastating blow. Siam posted a loss of about $1.53 billion in 1997, a profit of $467 million in 1998 and a loss of nearly $124 million in 1999. Yet, Siam worked stringently to reduce its offshore debt. When the economy declined, the company sought counsel from outside experts such as McKinsey, undertaking a cold evaluation of all its businesses to assess cuts. Top managers identified core businesses that Siam made more autonomous and focused on profitability rather than market share. The company simultaneously cut costs, encouraged younger managers' endeavors and pruned deadwood with early retirement. To manage investor relations, rather than liquidate shareholdings in joint ventures with strong partners, Siam reduced their shares—thereby reserving a stake in any economic upturn and winning many international investment analysts' plaudits (Faulder 2000).

IV. Implications

Corporate restructuring in East Asia has had some intended and unintended effects. This section explores the implications arising from needs for transparency, foreign capital and increased output. These requirements have resulted in the increased power of outside auditors, globalization of managerial practices and the hitching of East Asia's growth engine to the USA's growth.

A. The Increased Power of Auditors

The Asian crisis created a requirement for transparency and symbolic adoption of best managerial practices (Haley 2000b). Consequently, accounting firms, such as PwC, have increased their visibility and reach. Much of the Big Five's work in Asia now involves auditing suspicious governmental agencies and restructuring indebted companies. Indeed, PwC's stamp of approval on corporate financial statements appears necessary for many of Asia's beleaguered corporations to shake their pariah status with outside investors and creditors. "It's almost a prerequisite now," said Nigel Cornick, General Manager of Raimon Land in Bangkok that hired PwC to devise his debt-ridden company's rehabilitation plan for creditor shareholder approval (Crispin 1999).

PwC has emerged as far and away the region's dominant accounting firm with $1.7 billion in Asia-Pacific revenues in 1998, up from $1.5 billion in 1997 and nearly double the revenue of its nearest competitor, Deloitte Touche Tohmatsu. PwC expanded its staff in the region to more than 23,000, up from a combined 19,700 in 1997 for its pre-merger halves (Price Waterhouse and Coopers Lybrand). In Indonesia, PwC's well-publicized recent efforts include tracing nearly 70 percent of the $70 million diverted from Bank Bali to the re-election campaign of then President B. J. Habibie. PwC has also recommended improving operations at the state oil company, Pertamina, after estimating that inefficiency and corruption cost the company $4.7 billion during 1996-8. In Thailand, investors and IMF officials have credited PwC with tackling some of the tougher debt-restructuring cases, including the tangle of alleged misappropriation of funds surrounding Alphatec Electronics. A PwC audit in 1997 found evidence to support the allegation that former Chief Executive Officer Charn Uswachoke embezzled 3.6 billion baht ($93 million) in company funds (Crispin 1999).

The World Bank has endorsed the accounting companies' supporting roles in restructuring, thereby increasing their symbolic powers. "The bank views the Big Five as partners in the reform process," said Jayasankar Shivakumar, country manager in Thailand for the World Bank, which is working with the government to improve accounting standards (Crispin 1999). Shivakumar also noted that the accounting companies could not set higher standards unilaterally and that bringing about real change would take years.

Sometimes the auditors make mistakes and sometimes they appear highhanded ruffling stakeholders' feathers. For example, the failing Thai Bank Krung Thai's board hired PwC to identify problems in credit procedures. PwC estimated NPLs at 84 percent, rather than the 53 percent that bank management reported. Krung Thai's President Singh Tangtawatas called PwC's methods as "unscientific" and said the accounting company failed to follow the Bank of Thailand's criteria for classifying NPLs. Nor did PwC consult management during the review, leading to misunderstandings of the bank's operations and to faulty conclusions without seeing all the relevant files (Crispin 1999). The Thai government launched several investigations into Krung Thai's books and PwC's report. The Finance Ministry hired Credit Lyonnais Securities in mid-August to use statistical models to verify PwC's figures. Credit Lyonnais calculated that if indeed NPLs consisted of 84 percent of Krung Thai's loans, then the bank's interest income would necessarily have been lower than reported. However, Credit Lyonnais did not propose an alternative figure for the NPLs. Sukont Kanjana-huttakit, Chief Executive Officer of PwC in Thailand, refused to respond to criticism of PwC's work at Krung Thai on the basis of client privilege. Yet, PwC did not classify loans as it should have and did not consult management, as auditors generally do.

Post-crisis governance laws have also resulted in tougher scrutiny over corporate performance and structures. In Thailand, for example, the Corporate Debt Restructuring Advisory Committee allows creditors to tell debtor firms which auditors to hire—auditors who may already be advising the creditors on restructuring their debts! Thai Telephone and Telecommunications, the largest fixed-line phone company in Thailand's rural areas, attempted to resist such an arrangement. Its Vice-President, Prasitchai Kritsanayunyong, said creditors forced his company to hire PwC to monitor cash flow; but PwC already worked for the creditors in the debt-restructuring talks. Prasitchai said this arrangement created a conflict of interest, offering PwC an incentive to make very conservative cash-flow projections to bolster the creditors' demands for more collateral. Western countries have standards boards, and ultimately courts, to enforce rules against conflicts of interest; Thailand and other Asian countries generally let companies monitor themselves. Frictions over the dual roles that accounting firms are playing in many debt-restructuring talks appear to be slowing progress (Crispin 1999).

B. The Influx of FDI

FDI can serve important roles in financial and corporate restructuring. By investing in, or acquiring, distressed companies or banks, foreign investors provide crucial new capital as well as managerial resources. In 1998 and 1999, net FDI flows into the five worst-hit countries, Indonesia, Korea, Malaysia, the Philippines and Thailand, slightly increased from the 1997 level of $17.5 billion. However, individual countries fared differently. FDI inflows into Korea approximated $2.8 billion in 1997, $5.5 billion in 1998, and $8.5 billion in 1999. FDI inflows into Malaysia for the same years approximated $5.1 billion, $3.7 billion, and $3.8 billion. This difference, in large part, reflects the crisis-affected countries' different attitudes toward the role that FDI should play in corporate and financial reforms (Asian Development Bank 2000).

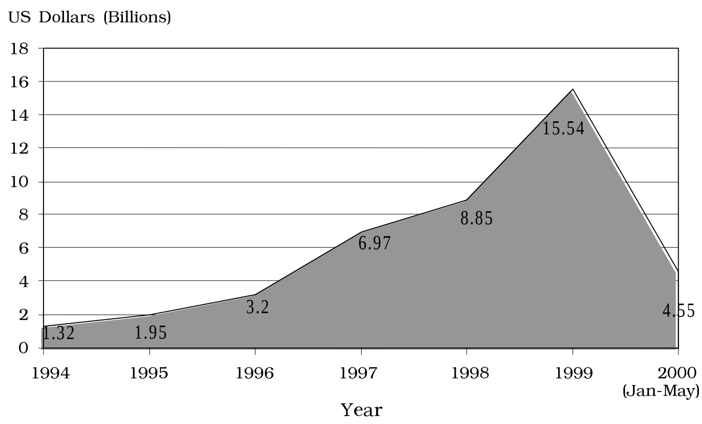
Many countries in the region, especially Korea and Thailand, have made specific efforts to attract FDI. Korea has opened up several sectors to foreign investors, including property, securities dealing and financial services. The government has abolished restrictions limiting foreign ownership of equity, thereby allowing foreign investors to buy as much as 100 percent of local companies. The Foreign Investment Promotion Act provides comprehensive legal protection for foreign investors in Korea. Thailand also allows foreign investors to hold as much as 100 percent equity in domestic banks and finance companies for as long as ten years; the government has opened 39 industrial sectors to increased foreign investment. Majority foreign-owned companies (with the foreign investors holding more than 50 percent of the voting securities) can now distribute their products domestically. In Malaysia, the government has suspended restrictions on foreign holdings in new export-oriented manufacturing projects until 2000 and relaxed foreign-ownership limits. Indonesia has just begun implementing new incentives to attract foreign investors, increasing the maximum foreign ownership of banks to 99 percent, while the authorities have provided a clearer legal framework for the conversion of bonds issued locally into equity.

Since the financial crisis, cross-border mergers and acquisitions, as opposed to green-field investments, have become the most important mode of FDI in the five crisis-affected countries. Opportunities for cheap acquisitions and more liberal business environments for FDI have attracted foreign investors. In addition to strengthening foreign investors' rights, the crisis-affected countries have tried to simplify procedures for mergers and acquisitions, revamped their bankruptcy laws, introduced short-term tax measures to facilitate asset transfers, and improved accounting standards to ease asset valuations.

Dramatic results have followed. Foreign companies announced 162 acquisitions in Korea in 1999 and 111 in 1998—up from 24 in 1997 and 27 in 1996 according to Thomson Financial Securities Data. Korea was number one in Asia for overall mergers and acquisitions in 1998 and 1999: More than $25 billion worth of deals were announced in 1999 and $12 billion in 1998 (Thomson Financial Securities Data). FDI including acquisitions, investments in plants and joint ventures with Korean firms shot up 76 percent in 1999 to $15.5 billion from the year before; FDI increased an additional 31 percent for the first 5 months of 2000 (Ministry of Finance, Korea). Inward flows of FDI to Korea continue despite the faltering sale of Daewoo Motors outlined earlier.

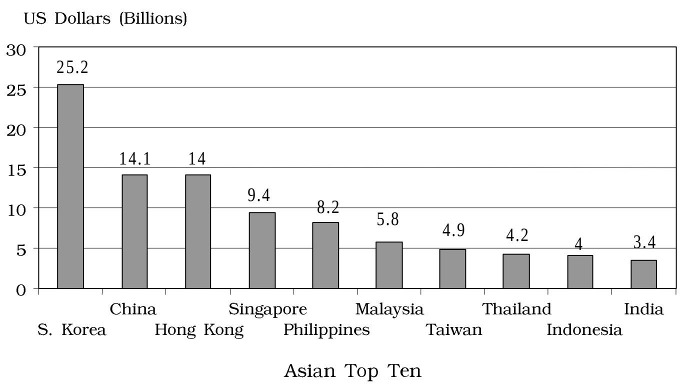
Figure 1 indicates FDI flows into Korea. Figure 2 indicates the dollar amounts of mergers and acquisitions in Asia; while Figure 3 indicates the number of deals these entailed. Figure 4 shows the dollar amounts specifically of foreign acquisitions in Korea. Figure 5 reveals the relatively small numbers of these acquired companies and highlights that in Korea, the foreign acquisitions centered on the giant *chaebol*.

Foreign companies and their managers are changing Korean businesses. For example, the local press expressed amazement at the US-style annual compensation of $3 million given to Korean-born investment banker Tom Kang, 38, when he became CEO of Seoul Securities; financier George Soros acquired Seoul Securities in 1999. Foreign companies have also wanted more standardized book-keeping practices, especially to gauge companies' values. In 1998, Bowater, a Greenville, S. C. paper company spent $201 million to buy a state-of-the-art paper mill from the Halla *chaebol*. Bowater had to haggle individually with 22 banks, some of which hesitated initially to admit that the paper mill's worth amounted to considerably less than the loans they had made to finance it (Wiseman 2000). US FDI is also driving acquired Korean companies to new markets. For example, US investment firm,



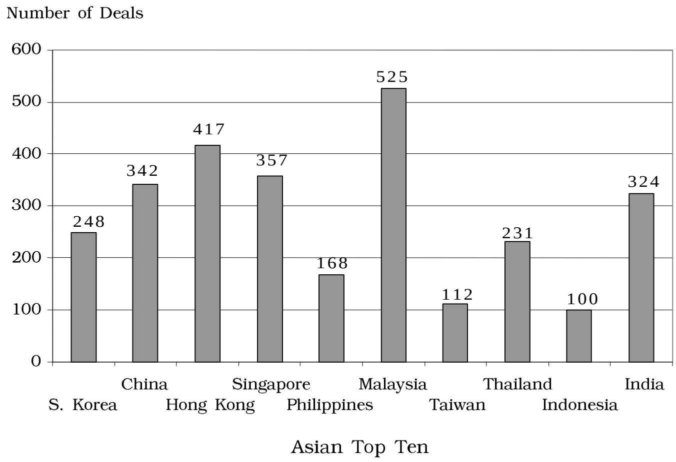
Source: South Korean Finance Ministry

FIGURE 1
FDI IN SOUTH KOREA



Source: Thomson Financial Securities Data

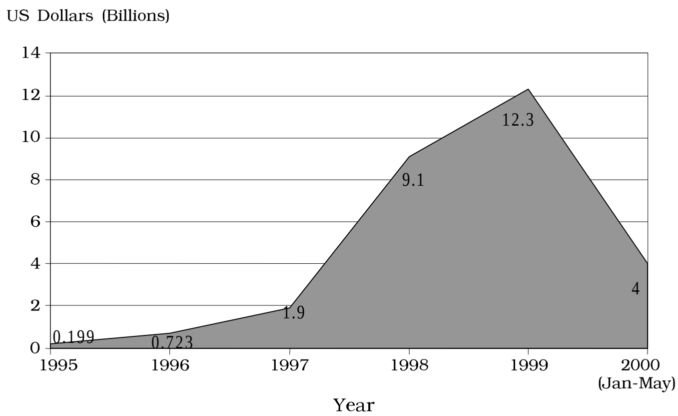
FIGURE 2
M&A IN ASIA: 1999



Source: Thomson Financial Securities Data

FIGURE 3

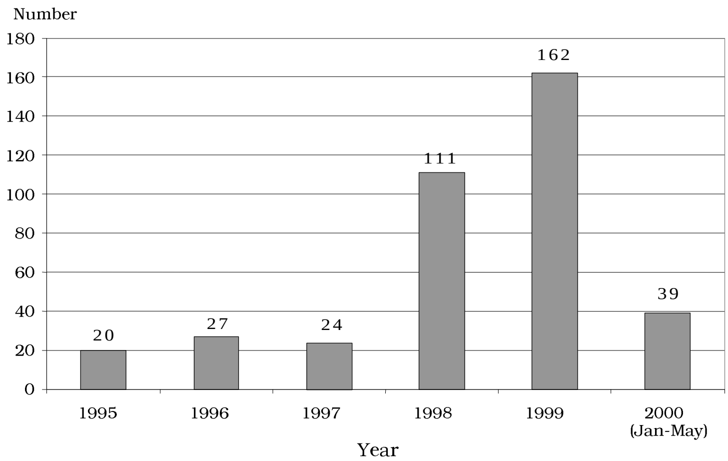
NUMBER OF ASIAN M&A DEALS: 1999



Source: Thomson Financial Securities Data

FIGURE 4

SOUTH KOREAN ACQUISITIONS BY FOREIGN INVESTORS



Source: Thomson Financial Securities Data

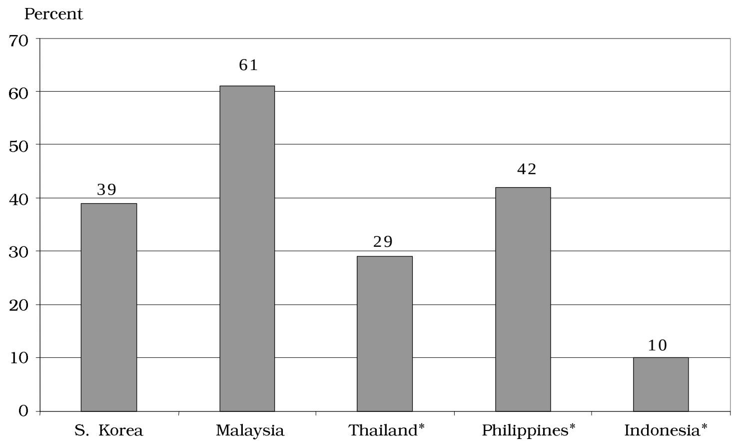
FIGURE 5

NUMBER OF SOUTH KOREAN ACQUISITIONS BY FOREIGN INVESTORS

Newbridge Capital, that acquired Korea First Bank, is taking the bank into consumer banking and small-business lending. Korea First that had concentrated on servicing the *chaebol*, largely ignored these markets. Entering new markets often means retraining old workers, hiring new ones and changing corporate cultures. Foreign buyers especially endeavor to change management culture and management styles. At Korea First for example, 231 veterans left this spring on an early retirement program, not always voluntarily. The new US management wished to hire "young blood" and hired new recruits more tailored for the bank's new strategies (Wiseman 2000).

C. The Growth of Information Technology (IT)

As indicated earlier, exports in dollar terms from East Asia as a whole, which had declined sharply in 1998, began recovering at the beginning of 1999 and propelled growth in the second half of the year. This favorable export performance laid the foundation for the



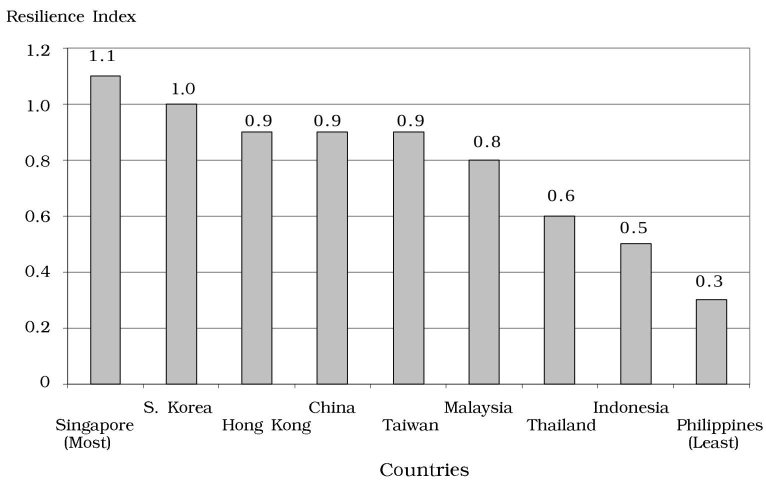
Source: Economic Planning Agency, Government of Japan

FIGURE 6

ELECTRICAL/ELECTRONICS AS SHARE OF ASIAN EXPORTS: 1998(*)/1999

faster-than-expected recovery of the East-Asian economies. In particular, strong exports of electrical and electronic equipment and active intraregional trade, contributed greatly to enhanced export performance (Government of Japan 2000). Figure 6 indicates the relative share of electronics and electrical equipment as a percentage of Asian exports.

Increasing worldwide demand led by the United States for IT-related equipment and the broad network of production among East Asian economies appears to have fuelled the increases in exports (Government of Japan 2000). Asia appears to be rehitching itself to the US bandwagon of growth (Haley 2000a) and a downturn in the USA's abnormally high current growth (approximating 5 percent) will affect Asian growth. Some Asian economies depend more on the USA than others. Figure 7 sketches a recent attempt to evaluate dependency on the US by SG Securities in Singapore through a dependency index. The index gauges the resilience of several Asian economies in the light of a downturn in the US economy. The index incorporates a country's direct exposure



Source: SG Securities, Singapore

FIGURE 7

RESILIENCE INDEX OF ASIAN ECONOMIES TO US DOWNTURN

to the USA and its other sources of growth. Thailand and the Philippines emerge as two of the most troubled economies with deep structural problems and heavy reliance on exports to the USA. While Indonesia has a low correlation with the US economy, its teetering financial system exposes it to even a small shock. Singapore and Korea that rely more on US trade have fewer disturbing imbalances and therefore fewer worries about dependence on the USA.

Another disturbing trend synchronizing with the importance of IT concerns the diversion of funds from manufacturing to dot com enterprises. These Asian dot com enterprises also get most of their investment from US venture capitalists, thereby increasing the influence of outside investors and markets on Asian economies and starving traditional economic sectors of funds badly needed for restructuring.

The economic preeminence of IT will also affect human-resource functions in Asian corporations. The worldwide shortage of capable, IT personnel will probably continue in the future, benefiting Indian and Philippine companies with globally competitive software industries but having poorer manufacturing facilities (see "India and IT" at http://www.asia-pacific.com/issue2.htm for a fuller discussion of this issue). The shortage of qualified personnel may also impel the development of public and private educational programs and specialized institutes as corporations and governments strive to promote IT literacy (as in Singapore) and to reduce the digital divide between various sections of the population (as in Korea). Governmental IT operations have also started outsourcing IT to domestic and overseas companies, signifying direct alliances between public funds and private enterprises (see Haley 2000a for a more complete discussion of Singapore's investments in IT).

Investments in IT do affect organizational restructuring: expanded network externalities create virtuous cycles between the proliferation of IT and corporate structures through reduced costs and increased consumption and production. The IT revolution in Asia consequently has the potential to affect organizational and industrial restructuring for effective performance (Haley 2000a). IT has relatively rapid diffusion and inexpensive labor costs. Intellectual property and information have high values and experience significantly higher returns on investment; these aspects have largely been ignored in traditional Asian organizations (Haley, Tan and Haley 1998) but can no longer be relegated to subservient strategic positions as Asian corporations restructure themselves in the new post-crisis environment.

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