

# FINANCIAL STABILIZATION AND INITIAL CORPORATE RESTRUCTURING IN EAST ASIA: APPROACHES, INITIAL RESULTS, AND LESSONS

*By*

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## *Emerging Markets in the New Financial System: Managing Financial and Corporate Distress*

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## **Introduction**

1. Almost three years after the crisis began, it is reasonable to offer some summary of (i) the role of companies in Korea, Thailand, Indonesia, and Malaysia in helping cause the crisis and the crisis' impact of the corporate sector; (ii) the effectiveness of each country's framework for resolving corporate distress; (iii) corporate restructuring results achieved to-date; and (iv) major lessons to be learned from this experience. Lessons include the importance of "contextual" factors in shaping each country's corporate restructuring approaches and results; detailed recommendations on crisis prevention, crisis response, and crisis resolution; and the ongoing need for government support to facilitate ongoing corporate restructuring. Our assessment of each country's corporate restructuring framework proceeds from a notional set of international "best practices." Departures from best practice tend, as shall be seen, to reflect contextual factors.

### **I. Development of the Crisis and Its Effects**

2. Well before the onset of acute liquidity problems and full-blown crises in the second half of 1997, the financial position and performance of East Asian companies were deteriorating as a result of over-investment and over-leverage. Companies increasingly diversified away from core competencies into highly competitive sectors (e.g, property, construction, environmental, financial services) and long-payback emerging markets. These debt-financed excursions were abetted by poor standards throughout the region for financial disclosure, corporate governance, and supervision of financial institutions. Corporate finance practice featured elaborate capital structures and cross-shareholdings within conglomerates, cross guarantees among related companies and personal guarantees never expected to come due, and improper transactions between related companies – often to the disadvantage of public shareholders. The more problematic corporations – in terms of interest coverage and leverage – began showing signs of distress well before the onset of acute liquidity crisis. As a result of interest and currency shocks, distress spread beyond the most problematic sectors and companies. Companies in some countries – depending on the legal protections available to creditors – engaged in wholesale self-financing through the suspension of debt service.

#### **A. Korea**

3. Warning signs were evident by late 1996. For instance, profitability for the Top 30 chaebols in 1996 was just 0.2%. Returns on equity for the Top 5 chaebols (Hyundai, Daewoo, Samsung, LG, and SK) declined from an average of 10.7% for 1987-88 to 6.2% for 1989-96. At year-end 1996, cumulative liabilities/equity (L/E) for the thirty largest chaebols was 363%. Ten of the largest thirty had L/E ratios above 500% – and as high as 3075% in one case.

4. Korea experienced three waves of corporate distress. Chaebol insolvencies in 1997 constituted the first wave. Five chaebols with cumulative debts of KRW 8.6 trillion

defaulted during the first half of 1997 and were placed under court supervision. Kia followed in July 1997 with cumulative debts of KRW 6.6 trillion (Table 1). By the end of 1997, 13 chaebols with debts of KRW 28 trillion had entered court-supervised insolvency. During 1997, L/E ratios for Korea's thirty largest chaebols rose from 363% to 519%. The second wave was acute distress among the second-tier ("6-64") chaebols. By end-1997, 18 additional chaebols from the thirty largest were deemed at medium or high risk of insolvency (SBC Warburg, 1998). Small and medium enterprises (SMEs) began failing in large numbers – 8,200 in 1997 and 10,500 in 1998. While not themselves over-leveraged, SMEs fell victim to cash-conserving payment delays by their chaebol customers. Between September 1998 and mid-1999, 16 chaebols and 38 standalone companies went through organized workouts. The Daewoo crisis, which threatened both viable business operations and the stability of local capital markets,<sup>1</sup> constituted a third wave of corporate distress

5. Accounting for up to 30 percent of real sector output, 50 percent of exports, and 25 percent of financial sector loans, the Top 5 (Hyundai, Daewoo, Samsung, LG, and SK) stood alone in terms of size, importance, access to resources, and influence. In mid-1998 it appeared that the Top 5 were not in immediate jeopardy because of their ability to generate cash from core operations, tap local and global capital markets, and provide cross-affiliate support. However, the Top 5 chaebols presented longer-term issues as a result of questionable intra-group transactions, expansion into highly competitive businesses and emerging markets, high leverage (averaging 479 percent at year-end 1997), and their potential to absorb a disproportionate share of new capital that might otherwise go to help restructure second-tier chaebols and support SMEs. Indeed, overall profitability and returns on investment had been declining since 1988-89.<sup>2</sup> Core businesses generated healthy cash flows, but substantial resources were being used to expand into competitive businesses and emerging markets.<sup>3</sup> Intra-group sales accounted for 30 percent of 1997 revenues and cross-support in the form of guarantees, financing, and use of resources between affiliates was common. The Top 5 were slow to sell assets in response to the crisis, but adept at accessing local and global capital markets.<sup>4</sup> It appeared that the Top 5 might be able to float over Korea's corporate carnage without undertaking real restructuring measures necessary for their long-term competitiveness.

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<sup>1</sup> Daewoo companies represented 5% of GDP, 10% of exports, and 10% of holdings by investment trust companies.

<sup>2</sup> Among the Top 5, the average ratio of pre-tax earnings to sales declined 3.9 percent for 1988-89 to 2.6 percent for 1990-1996. Average returns on equity declined from 10.7 percent for 1987-88 to 6.2 percent for 1989-1996.

<sup>3</sup> A comparison between publicly listed affiliates and non-listed affiliates for 1997 indicates that the ratio of cash flows (EBITDA) to assets was 11.9 percent at the public affiliates but only 4.3 percent at the non-public affiliates. Many of these public affiliates were tempting cash cows. Indeed, Korea's Fair Trade Commission has brought a number of actions against chaebols for transactions wherein more established (often publicly listed) affiliates provided all manner of support (e.g., cheap loans) for non-listed affiliates within the chaebol.

<sup>4</sup> The Top 5 accounted for 57 percent of the year-end 1997 assets of all chaebols, but only 34 percent of asset/affiliate sales during the first 9 months of 1998. In contrast, the 6-64 chaebols held 43 percent of chaebol assets but accounted for 66 percent of asset sales during the period. During the first 9 months of 1998, the Top 5 absorbed about 80 percent of the proceeds for bond and equity issues.

## **B. Thailand.**

6. For 350 publicly listed non-financial companies, between 1993 and 1996, returns on assets decreased from 4% to 2% (Phatra Securities, 1998). This reflected a three-year increase of 110% in assets versus just 16% in profits. Mismatches were particularly evident in the property sector (assets up 115%, profits down 69%) and construction/building materials (assets up 107%, profits down 16%). Other sectors – agribusiness, electronics, household, healthcare, communications, pulp/paper, and textiles – suffered from declining returns on assets as well. Among a smaller set of 280 publicly-listed non-financial companies, the ratio of operating cash flows (EBITDA) to interest expense declined from 6.3x for 1994 to 3.4x for 1996. High levels of debt financing, with perhaps a quarter of it foreign denominated, left Thai companies vulnerable to interest spikes and devaluation of the Baht. Of 356 publicly traded non-financial companies, those unable to generate enough operating cash flow to cover interest expense increased from 18 in 1994, to 34 in 1995, to 49 in 1996. During the third quarter of 1997, 114 of 356 publicly traded non-financial companies could not cover interest expense. Fifty-one property, chemical, and construction companies accounted for three-quarters of the liabilities of all such distressed public non-financial companies.

7. Non-performing loans (NPLs) grew to Baht 2.7 trillion by year-end 1998 – or 48% of systemwide credits. Some 600 large companies accounted for half these NPLs. The other half were owed by 400,000 SMEs and 50,000 individual debtors. Motivations for “strategic defaulting” ranged from self-preservation to malevolent intent – e.g., concerns about access to working capital and loss of competitiveness, desires to improve one’s bargaining position with creditors, or hopes of postponing debt repayment indefinitely by driving one’s creditors out of business. The decision early on to suspend 56 finance companies and transfer their assets for eventual sale by the Financial Sector Restructuring Agency (FRA) and disposition by loan purchasers (who might include the original debtors buying back loans at deep discount) – *without providing for ongoing loan collections or extraordinary powers by the FRA to enforce its creditor rights* – probably encouraged strategic defaulting. While individual NPLs did not necessarily indicate corporate distress, they cumulatively wrought severe distress on the financial sector.

## **C. Indonesia.**

8. The roots of Indonesia’s crisis stretch back as far as 1982, when the government allowed free access by domestic corporations to international capital markets. Subsequently, in 1988, the government deregulated the financial sector, which expanded the number of commercial banks without commensurate improvements in transparency and supervision. By 1993, NPLs were estimated at 14% of total loans. Increasing borrowing from foreign banks by Indonesian companies increased the exposure of Indonesia’s economy. By end-1997, domestic private companies had borrowed \$53.6 billion from foreign banks, which left the corporate sector (as well as Indonesian banks exposed to these corporates) highly vulnerable to sudden depreciation. By late 1998, corporate indebtedness was estimated to total \$118 billion. Of this, nearly 60% was to foreign creditors and about half was foreign denominated. Risk (mis)management

practices appear to have severely aggravated the situation, as a number of corporations ended up on the wrong side of very disadvantageous derivative contracts.

#### ***D. Malaysia***

9. Unsustainable debt-financed asset growth also appears to have been the main culprit in Malaysia. While asset growth between 1992 and 1996 averaged 31% for non-financial corporations, asset growth exceeded 40% on average for companies in construction, diversified holdings, trade, services, and property. L/E ratios averaged 163% for non-financial corporations as a whole, but averaged 200-300% for industrial and construction companies and over 500% for diversified holding companies.

10. One analysis of publicly listed companies for 1995-1998 showed a decrease in net profit margins from 12% in 1995 to 6.9% in 1997. The proportion of firms whose interest expenses exceeded operating cash flows steadily increased from 3% in 1995 to 6% in 1996 to 17% in 1997 (Claessens et al, 1999). An analysis by Goldman Sachs indicated that non-performing corporate loans increased from 8% in 1996 to 11% in 1997 to 18.5% in 1998.

11. Several measures indicated the extent of corporate distress. The number of companies wound up under the Companies Act for an inability to satisfy debts coming due increased from 681 in 1996 to 1,898 in 1997 to 4,800 in 1998. In 1998, 32 companies sought court protection from their creditors under Section 176 of the Companies Act. Other indicators included increases in corporate defaults disclosed per Kuala Lumpur Stock Exchange requirements and in corporate downgrades by rating agencies.

## **II. Frameworks for Corporate Restructuring**

12. Before examining the corporate restructuring frameworks adopted by the East Asian countries in detail, it is useful to establish some benchmarks for comparison. Box 1 suggests a set of best practice standards for corporate restructuring, either under normal conditions or in a systemic crisis.

## Box 1. Suggested Best Practice Standards for Corporate Restructuring

- An prompt ability by unsecured creditors to appoint a receiver to liquidate a company for a general failure to service debts on time;
- A prompt ability by secured creditors to seize and sell collateral;
- A court-supervised reorganization framework that protects debtors from asset seizures; provides priority for new lending; gives a debtor and its creditors an opportunity to work out a mutually satisfactory restructuring plan; allows a majority of creditors to “cram down” a reorganization plan on a holdout minority of creditors; and converts the case into a court-supervised liquidation if interim milestones and reasonable deadlines are not met;
- Substantial institutional capacity, in terms of experienced judges, receivers, and insolvency professionals;
- Agreed standards among financial institutions for out-of-court workouts, including appointment of a lead creditor and steering committee; development and sharing of information; priority for new lending; apportionment of losses among creditor classes; thresholds for creditor approval of proposed workouts; and means for the resolution of inter-creditor differences;
- A strong regulator who can encourage financial institution creditors to resolve differences among themselves on their own;
- A well-developed secondary market for corporate debt, including distressed debt;
- No legal barriers to the debt/equity conversions or the swift re-deployment of corporate shares, real estate, and productive assets – including through foreign investment, hostile takeover, or merger;
- A legal presumption, which can be altered in negotiation, that the equity interests of all shareholders – including minority shareholders – are wiped out in case of corporate insolvency;
- No immediate taxation of non-cash corporate reorganizations, e.g., mergers, share swaps;
- A strong financial regulator able and willing to force banks to take immediate losses on corporate restructuring and to take over banks whose risk-weighted capital adequacy ratio falls below an acceptable level;
- Adequate public resources to re-capitalize banks to make up losses from corporate restructuring combined with systematic monitoring by the financial supervisor of corporate restructuring transactions to ensure the adequacy of proposed operational restructuring, financial restructuring, and provisioning;
- If a public asset management company (AMC) is needed (e.g., to provide liquidity through purchases of NPLs or take over failed institutions), its operations should be based on best commercial and market principles – including uninterrupted efforts to collect loans and enforce creditor rights and maximum prompt use of bulk sales of small NPLs, outsourcing, and use of outside professionals (compensated on an incentive basis) to work out large corporate NPLs;
- Reliance on market participants to structure and negotiate out-of-court workouts based on available information and the participants’ commercial interests;
- Opportunities and encouragement for banks to set up professionally managed private asset management companies for distressed corporate debt and converted equity;
- Except in extreme cases when the government may need to create a public AMC, government involvement limited to eliminating of legal/regulatory impediments to corporate restructuring, providing necessary incentives, and maintaining a sound financial sector.

13. Responses by East Asian government to crisis in their corporate sectors varied widely in terms of the enforcement and reform of legal protections for creditors, the development of voluntary workout regimes and asset management companies, supporting legal reforms, and linkages between corporate restructuring and overhaul of highly distressed financial institutions.

A. Legal Frameworks and Reform Efforts

14. In a systemic crisis where many hundreds of large corporations and tens of thousands of SMEs experience simultaneous distress, the great majority of restructuring efforts must proceed on an out-of-court basis. Otherwise the capacity of local courts, administrators, and other insolvency professionals would be overwhelmed and restructurings delayed. Out-of-court restructuring occurs, however, in the shadow of the law. While some debtors might voluntarily cooperate out of the goodness of their hearts, more often the success of out-of-court efforts ultimately depends on the ability of creditors to impose losses on debtors – through the seizure of assets, foreclosure, or liquidation. In East Asia, the “shadow” cast by legal regimes for secured lending, foreclosure, and bankruptcy was relatively robust in Korea and Malaysia. In Thailand and Indonesia, however, the shadow remains rather attenuated – even after efforts at reform. Thailand illustrates the important point that uncooperative debtors will have no incentive to seek protection through a court-supervised reorganization if creditors have no prompt ability to seize assets or force a debtor company into liquidation or receivership.

15. ***Korea.*** The existence of a credible threat of foreclosure and court-supervised receivership has distinguished Korea’s approach to corporate restructuring. As indicated in Table 1, 13 chaebols went under court supervision in 1997. Eleven of these were placed under receivership, entailing a complete loss of ownership and management control. Korea has streamlined its processes for composition, reorganization, and bankruptcy and some large companies have emerged from reorganization (e.g., Kia). Court supervised insolvencies in Korea would benefit, however, from further streamlining (e.g., prepackaged reorganizations) and greater flexibility on the part of receivers to respond to the commercial/financial needs of companies under reorganization. Indeed, the Financial Supervisory Commission recently concluded that half the chaebol affiliates under court supervision had made insufficient progress on reorganization. Concerns that receivership would strangle viable Daewoo Corporation business segments led the authorities to make extraordinary efforts to facilitate a buyout of foreign creditors by Korean lenders. These procedural shortcomings aside, repeated demonstrations of an ability by Korea’s courts and creditors to seize ownership and control of a debtor company must have encouraged others to cooperate with voluntary workout efforts. While voluntary workouts typically resulted in close ongoing supervision by creditors, debt/equity conversions, and substantial dilution, controlling shareholders usually retained management control and a significant equity share. Half a loaf apparently seemed better than nothing.

16. ***Malaysia.*** Two traditional remedies available to creditors are “winding up” (i.e., liquidating) a company or reorganizing the company as a going concern (as described by Thillainathan, 2000)

17. According to the 1965 Companies Act, Sections 212-318, creditors can petition the High Court to “wind up” a company for failure to pay its debts. The Act provides for appointment of a liquidator/receiver, defines the powers of the receiver, and establishes priorities between and within classes of creditors. From the perspective of an unsecured creditor, commencement of liquidation proceedings is often the best way to pressure a distressed debtor to pay its debts and preserve the debtor’s assets from seizure by other creditors. Secured creditors can enforce their security outside liquidation proceedings. In Malaysia, a receiver can even be appointed without court involvement if the underlying legal document is a mortgage or debenture that entitles the mortgage or debenture holder to appoint a receiver.

18. According to Sections 176-181 of the Companies Act, the High Court can enforce a reorganization or compromise plan that attracts support from 75% of a company’s creditors – debt-weighted. The court can also issue orders temporarily restraining creditors from proceeding against a company. While Malaysia lacks guidelines for the rehabilitation of troubled companies through judicial management, the reorganization process is cumbersome, and the courts have limited experience, the Companies Act provides incentives for debtors to seek the protection of a court-supervised reorganization or to cooperate with out-of-court restructuring efforts.

19. *Thailand* has undertaken extensive reforms of its insolvency/foreclosure regime and made progress, but significant gaps remain. Reforms include amendment of Thailand’s 1940 Bankruptcy Act to permit court-supervised reorganization as an alternative to liquidation (passed April 1998); further amendments to streamline court-supervised reorganizations (passed March 1999); amendments to the Code of Civil Procedure to expedite foreclosures (passed March 1999); and establishment of a Central Bankruptcy Court (opened June 1999).

20. Whereas it could formerly take 10+ years to seize and sell collateral, local lawyers now suggest that the process could be completed in about 2 years. The process, however, is still too long and uncertain. Thus, debtors have felt insufficient pressure to cooperate with voluntary restructuring efforts or to seek protection through court-supervised reorganization.

21. Introduction of an option for court-supervised reorganization has provided a useful means for a super-majority of creditors (representing at least 75% of debts) to cram down a reorganization on dissenting creditors. In cases where there is insufficient agreement between creditors and the debtor, however, debtors and creditors remain reluctant to petition for court-supervised reorganization because of three uncertainties. First, an uncooperative debtor who has generally failed to pay debts as they come due may rebut the presumption of insolvency, by claiming that assets (possibly inflated) exceed liabilities, as happened in the infamous Nikko Hotels case.<sup>5</sup> Second, because selection of the outside

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<sup>5</sup> In March 2000, Thailand’s Bankruptcy Court ruled that the TPI reorganization case could proceed, despite the debtor’s claims of solvency. While this indicates that the reorganization chapter in Thailand’s Bankruptcy Act can be used to forcibly reorganize a recalcitrant debtor with positive equity, it does not create a strong precedent in a civil law system. A debtor’s acceptance of insolvency and a

planner – who develops a company’s reorganization plan – is so important to controlling the company and shaping its reorganization, a debtor may be reluctant to seek reorganization without support from 1/3 of outstanding credits while creditors may be similarly reluctant to seek reorganization without controlling a 2/3 block of credits. Lastly, provisions for exit from court-supervised reorganization or conversion would benefit from further clarification.

22. Some cases have emerged from court-supervised reorganization (e.g., Alphatec) and the pace of reorganization petitions has increased since the Bankruptcy Act’s reorganization chapter received additional improvements in March 1999. Reorganization petitions averaged Baht 7 billion a month April 1998 through April 1999, and then increased to an average of Baht 34 billion for the period May-December 1999. While insolvency/foreclosure reforms have expedited consensual cases, recalcitrant debtors still face little or no immediate consequences for failing to service their debts or cooperate with voluntary restructuring efforts.

23. **Indonesia.** A new revised bankruptcy law, together with a special Commercial Court, became effective in August 1998. Important changes include more efficient and transparent procedures; an opportunity to appoint receivers and administrators from the private sector; greater protections against preferential or fraudulent transfers; limits to the ability of secured creditors to foreclose on collateral during proceedings; and recognition of out-of-court settlements approved by just 50% of unsecured creditors so long as they represent 2/3 of outstanding claims. The consensus among local creditors is that Indonesia’s insolvency law is workable, but that its credibility has suffered from uneven and uncertain implementation. The threat of imposing loss on recalcitrant debtors remains too low to induce cooperation with voluntary restructuring efforts.

#### B. Voluntary Workout Regimes

24. All four countries introduced procedures and institutions for facilitating out-of-court workouts. Approaches have differed, with Korea focused on arbitration of inter-creditor differences; Thailand’s central bank promulgating and enforcing a contractual approach to corporate restructuring; Indonesia attempting to rely on a set a principles and active facilitation; and Malaysia using a loose process overseen by its central bank.

25. **Korea.** The FSC assigned specific Lead Banks to oversee the development of workout agreements for the most troubled smaller chaebols from among the “6-64.” Recognizing that differences among creditors would quickly come to the fore (e.g., between banks and non-bank financial institutions), the FSC encouraged 210 Korean financial institutions to sign a Corporate Restructuring Agreement in June 1998, which provides for the following: (i) creation of a 7-person Corporate Restructuring Coordination Committee (CRCC) empowered to advise on the viability of corporate restructuring candidates, arbitrate inter-creditor differences, provide guidelines for workout plans proposed by creditors, and enforce substantial fines for failure to implement CRCC

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reorganization petition may remain largely discretionary, weakening incentives for debtors to cooperate with voluntary restructuring efforts.

arbitration decisions; (ii) an initial standstill of 1-3 months, which may be extended for an additional 1-2 months; (iii) a 75% voting threshold – credit-weighted – for creditor approval of a proposed workout; and (iv) CRCC arbitration if creditors cannot achieve 75% agreement after three attempts. The CRCC also provided extensive guidelines on the organization, structuring, and documentation of workout agreements.

26. The CRCC provided arbitration decisions in 21 cases involving 6-64 chaebols or other standalone companies, and played a major role in the Daewoo matter. The CRCC arbitrated among CRA signatories (all of which were Korean financial institutions) on the development of workouts for two Daewoo affiliates. More strikingly, the CRCC intermediated between foreign creditors and Korean creditors in agreement on a proposal by the latter to buy out \$4.8 billion debt held by the former in Daewoo Corporation, Daewoo Heavy, Daewoo Motors, and Daewoo Electronics.

27. *Thailand* initially took a purely consensual approach to out-of-court restructuring. A Corporate Debt Restructuring Advisory Committee (CDRAC) was formed in June 1998, consisting of representatives from debtor and creditor interest groups – e.g., the Federation of Thai Industries, Thai Bankers' Association, and Foreign Bankers' Association – and chaired by the Bank of Thailand (BOT) governor. CDRAC members identified priority cases, promulgated a set of principles for voluntary workouts based on the London approach (the “Bangkok rules”) in September 1998, and endeavored to facilitate negotiations and identify legal or regulatory impediments.

28. As it became clear that a purely consensual approach to corporate restructuring was not producing sufficient timely progress, the BOT stepped up its efforts and became the main champion for corporate restructuring. In January 1999, the BOT created a CDRAC Office within the BOT to track progress on 700+ large high-priority cases. The BOT's CDRAC Office also encouraged the development of two contracts – the Debtor-Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA). DCA signatories agree to defined procedures for acceptance of a case, a 6-8 month schedule for developing and agreeing on a workout plan, information sharing, and thresholds for creditor approval. Approval by 75% of the creditors (credit-weighted) is necessary to finalize a restructuring – the same threshold as for a court-supervised reorganization. In cases of just 50-75% creditor approval, an issue or proposed plan must be submitted for ICA arbitration. If fewer than 50% of creditors approve of the plan, the DCA obliges creditors to petition the court for collection of debts, foreclosure, or insolvency. Violation of DCA obligations exposes financial institution signatories to reprimands or fines by the BOT. Inter-creditor differences are to be arbitrated, according to the ICA, by a 3-person panel which can vary from case to case. Since March 1999, 84 Thai and foreign financial institutions have acceded to the ICA and to company-specific DCAs.<sup>6</sup> As of end-1999, over 400 large debtors have acceded to DCAs. The BOT/CDRAC has recommended, and creditors have pursued, court sanctions (e.g., collection of debts, foreclosure) against debtors who have

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<sup>6</sup> Notably, an ICA signatory can opt out of ICA application in any case where debts total Baht 1 billion. This escape clause responds to concerns that some creditor groups – e.g., unsecureds, foreign creditors might be systematically disadvantaged in arbitration decisions.

refused to sign a DCA. The CDRAC Office has attempted to smooth corporate restructuring by identifying individuals who could serve as mediators and encouraging parties at interest to avail themselves of mediation, to be paid for by the debtor companies. The CDRAC Office has also promoted a simplified “lite” version of the DCA for resolution of SME debts.

29. **Indonesia.** The September 1998 Jakarta Initiative included a set of principles to guide corporate restructuring and creation of a Jakarta Initiative Task Force (JITF) intended to facilitate negotiations between debtors and creditors and to obtain necessary regulatory approvals for deals. While 320 companies with \$23 billion in debts have registered with the JITF, only 6 cases representing less than \$1 billion in debt have been resolved. Uncertain enforcement of laws to protect creditors has given debtors little incentive to agree to restructuring deals likely to result in debt/equity conversions and substantial dilution of their shareholdings. In an effort to energize the JITF, the government has recently approved time-bound procedures for JITF mediation of its cases and agreed that the JITF may refer cases of uncooperative debtors to the government’s Financial Sector Policy Committee for action by the Attorney General’s Office in Bankruptcy Court.

30. **Malaysia.** In August 1998, a Corporate Debt Restructuring Committee (CDRC) was established, with support from Bank Negara Malaysia (BNM), to provide a framework for out-of-court workouts for complex cases involving debts of RM50 million or more and 3+ creditors. Key principles governing CDRCs approach include efforts to preserve viable businesses; establishment of creditors committees representing at least 75% of outstanding debts; full information disclosure and sharing; appointment of independent consultants; a 60-day standstill, which can be extended; and continuation of existing credit lines. Workouts can apparently be approved with 75% creditor support. Danaharta – one of Malaysia’s public AMCs – has been used to buy out dissenting creditors. In addition, the BNM has been willing to persuade hold-out banks who oppose workouts supported by a majority of creditors. CDRC acts as an advisor and mediator between debtors and creditors. Once an application is made to CDRC by either debtor or creditors, an independent consultant is appointed to develop a restructuring program. Applications for 62 cases have been made to CDRC, and 45 were accepted. The others were rejected, transferred to the Danaharta AMC, or rejected for failure to meet Danaharta’s viability test (Thaillainathan, 2000).

### C. Role of Asset Management Companies

31. Public AMCs can play many roles, including provision of liquidity support through purchases of NPLs and resolution of failed financial institutions. Elsewhere, public AMCs have enjoyed greater success at bundling and selling loans or working out real estate-backed assets than at attempting to restructure operating companies (Klingebiel, 1999). While Korea and Thailand’s public AMCs have so far focused on on-selling bad loans, Malaysia’s and Indonesia’s public AMCs are positioned to play a major role in corporate restructuring. Malaysia’s Danaharta AMC has enjoyed some success, but it is too early to

assess the Indonesia Bank Restructuring Agency (IBRA). It is fair to say, however, that IBRA has many obstacles to overcome before it can function effectively.

32. **Korea.** As of end-January 2000, the Korea Asset Management Company (KAMCO) had purchased loans with a total book value of KRW 74.5 trillion, including KRW 18.5 trillion of Daewoo debts. By late 1999, KAMCO had sold only about 5% of the assets it had acquired. While KAMCO is exploring joint venture liquidation and restructuring funds with potential investors, so far it has not actively engaged in corporate restructuring.

33. **Thailand.** The Financial Sector Restructuring Agency (FRA) took over loans with a book value of Baht 600 billion from 56 failed financial institutions and auctioned these relatively quickly. By November 1999, the FRA had obtained Baht 152 billion from the sale of these loans, about 25% of book value. In addition, as of September 1999, the FRA had auctioned non-core assets of finance companies (e.g., automobiles, securities) valued at Baht 65 billion from auction for about 53%. The FRA has been commended for its speed and thoroughness in on-selling the assets of failed financial institutions. But the FRA was not set up or given extraordinary powers to collect on debts or enforce its rights as a creditor. This probably encouraged “strategic defaulting” by other debtors in the belief that they could drive additional creditors out of business. Otherwise, the FRA has not been active in corporate restructuring.

34. Significant FRA assets were sold to a public AMC, which was set up to prevent assets from being sold for “too low” a price to private investors. The public AMC has not been active in corporate restructuring. In addition, private AMCs are being set up by some private banks (notably Thai Farmers) and by some of the state-owned banks, including Krung Thai. Thai Farmers has retained Goldman Sachs and GE Capital to work out the Baht 80 billion book value of loans transferred to its private AMC at 50% of book value. Some observers worry, however, that this valuation is still too high to encourage Thai Farmers’ AMC to take necessary losses on restructuring. In general, it is unclear whether these private AMCs will focus more on loan sales/liquidations or on working out the underlying assets and companies.

35. **Malaysia.** Danaharta was established in August 1998 to acquire NPLs or assets of distressed borrowers from banks to provide liquidity, facilitate an orderly resolution of distressed debt and underlying assets, and restructure or liquidate distressed companies with outstanding debts of RM 50 million or less.

36. As noted in one assessment (Thillainathan, 2000), at the onset of the crisis Malaysia’s Companies Act did not provide for the rapid acquisition and disposal or smooth management of a distressed company. The necessary legal framework to engage in these activities was provided in the September 1998 Danaharta Act and in amendments to the National Land Code. This legislation empowered Danaharta to acquire title to assets while preserving existing registered interests in the assets and to foreclose/sell the assets through public auction, public tender, or direct negotiation without consent of the borrower so long as the sale was at market value and 30 days’ notice was provided. Danaharta is also empowered to appoint special administrators to manage the affairs of distressed

companies. Under the Companies Act, practically speaking, such an appointment could be made only by a debenture holder. Enabling Danaharta to appoint a special administrator seeks to compensate for the lack of well-defined procedures for judicial management of corporate insolvency cases.

37. Danaharta's approach to resolution of corporate NPLs seeks to restructure viable companies, sell its interest in distressed companies in viable sectors, and sell the underlying assets in cases where neither the company nor its industry appear viable. If Danaharta cannot reach agreement on a loan workout within 3 months, the loan is deemed non-viable, presumably setting the stage for a liquidation. Danaharta's loan workouts are supposed to follow certain principles – e.g., (i) the debtor's shareholders should bear most of the loss; (ii) the debtor's management has only one opportunity to implement an agreed workout, with no opportunities for revision; and (iii) the debtor's business operations must be closely monitored. Danaharta has also developed non-binding guidelines for corporate workouts – e.g., (i) restructured debt should provide a yield commensurate with cash flow, rather than be of a zero-coupon variety; (ii) the repayment period for restructured loans should not exceed five years; (iii) existing shareholders should be prevented from diluting shareholdings obtained by creditors through debt/equity conversions; and (iv) the workout agreement should include monitorable covenants regarding inter-company lending, disposal or transfer of assets, dividend payments, and additional borrowing.

38. **Indonesia.** Progress on corporate restructuring will depend on the Indonesia Bank Restructuring Agency (IBRA), which has acquired extensive corporate sector assets. IBRA includes two asset management units: Asset Management Credits (AMC) – established to workout or sell NPLs; and Asset Management Investments (AMI) – established to manage company shareholdings acquired in satisfaction of related-party lending violations and liquidity support provided by Bank Indonesia (BI) to commercial banks that later failed.

39. IBRA/AMC manages a loan portfolio of more than Rp 207 trillion. While these monies are owed by about 170,000 debtors the credits are concentrated: 1,339 debtors each owing more than Rp 50 billion account for 83% of the portfolio, and another 1,572 with loans of Rp 1-50 billion account for 12.4%, while almost 168,000 borrowers account for just 4.8% of the portfolio. Moreover, many of the large debtors are related and can be grouped under single obligors. Thus, the 50 largest obligors account for 54% of IBRA/AMC's portfolio. While smaller loans are to be sold, outsourced, or settled (including discounts on accrued interest), IBRA/AMC is itself attempting to restructure loans larger than Rp 50 billion to 1,339 debtors. While initially adamant in refusing to take "haircuts" on debt rescheduling, IBRA is now seeking indemnification of its staff and government approval for circumstances in which IBRA could agree to debt writeoffs or discounts. Unfortunately, IBRA is vulnerable to charges of KKN (i.e., corruption, cronyism, and nepotism) which has not been helped by the Bank Bali affair. It appears that IBRA staff are sensitive to the possibility of unfounded KKN allegations for proposing any transaction that involves a loss to IBRA. This could have a chilling effect on IBRA's ability to resolve its large caseload on reasonable commercial terms in any timely manner.

40. Of 760 major debtors that IBRA/AMC has categorized, 31% are considered cooperative and viable; 53% cooperative but questionable; 3% uncooperative but viable; and 13% uncooperative and questionable. Since mid-1999, IBRA has been gauging cooperation by requiring its largest obligors to sign letters of commitment. While it may use bankruptcy proceedings against uncooperative or non-viable debtors, IBRA faces the same uncertainties as any other creditor in going through the court system. To compensate, IBRA has been given extraordinary powers (the so-called PP17 powers) to seize the assets of uncooperative debtors, which became effective in October 1999. In an attempt to send a message, IBRA used its PP17 powers for the first time in December 1999, seizing two properties – including 14 hectares of land in Jakarta from a firm owned by a Suharto family member. IBRA had earlier announced that it would sue a number of other debtors, and is continuing to fight several lower court decisions that have impeded its debt collection efforts.

41. Meanwhile, IBRA/AMI has taken equity positions (mostly convertible rights issues) with a face value of Rp 112 trillion in about companies in settlement by eight commercial banks of violations on affiliated lending and BI liquidity support. Over half the assets are in agribusiness and real estate. These stakes or organized in up to eight holding companies. IBRA/AMI plans to rely on private sales and public offerings to exit from these equity positions. IBRA/AMI is seeking to raise Rp 12.8 trillion in 1999 and plans to sell its 40% stake in car-maker Astra, on which three financial investors have expressed an intention to bid. IBRA/AMI dispositions of its equity positions could effect significant changes in corporate ownership. IBRA/AMI's effectiveness will ultimately depend on its ability to achieve adequate monitoring and governance over its holdings and to exit from these holdings in a timely manner without depressing share prices.

#### D. Segmentation and Prioritization

42. In systemic distress among many hundreds of large corporations and tens of thousands of SME's, an efficient response requires some segmentation of the problem and establishment of priorities. As noted above, IBRA/AMC is segmenting its treatment of the 170,000 debtors in its credit portfolio – focusing its efforts on the 0.8% that account for 82.8% of its portfolio and designating the rest for sale, outsourcing, or standardized settlement. Danaharta's approach to its cases is based on its assessment of company and industry viability.

43. Following initial dalliances with ill-conceived “bankruptcy avoidance” loans,<sup>7</sup> the Korean government eventually settled on an effective crisis-segmentation strategy that included court supervised insolvency for the most difficult companies; an immediate focus on the most-distressed 6-64 chaebols; multiple efforts to impose financial discipline on the Top 5 chaebols, and a systemic response to SME distress. As indicated in Table 1, 13 chaebols were allowed to go under court supervision. No additional large bankruptcies occurred during 1998. Between June and September 1998, however, the CRA/CRCC

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<sup>7</sup> Between October 1997 and May 1998, Korean creditors with government encouragement provided KRW 1.9 trillion in “bankruptcy avoidance” loans to 9 chaebols. These were accompanied by little or nothing in the way of chaebol commitments to undertake serious restructuring. Eight of the 9 chaebols subsequently entered court-supervised insolvency or CRA workouts.

framework was put in place and Korean creditors agreed on workouts for 16 highly distressed mid-tier chaebols and about 38 standalone companies between September 1998 and mid-1999. While not in *immediate* danger in mid-1998, the Top 5 posed longer-term problems because of problematic business investments and high leverage (479% at end-1997) and because these chaebols threatened to absorb a disproportionate share of new capital that might otherwise go to help finance mid-tier chaebols and SMEs. In response, the FSC attempted to impose financial discipline by requiring chaebols to implement capital structure improvement programs (CSIPs) and bringing a host of legal and regulatory pressures to bear (described below) to forestall avoidance of greater financial discipline by the Top 5. The government also brought various pressures to bear to encourage the Top 5 to conclude various “big deals” – acquisitions, mergers, or joint ventures designed to rationalize capacity in sectors suffering from overcapacity.<sup>8</sup> For SMEs, the financial supervisor adopted several support schemes: (i) banks were required to roll over SME loans due by December 1998; (ii) commercial banks were required to cancel compensating balances for SMEs between January and November 1998 to all credit flows to SMEs; and the relatively larger and stronger commercial banks were required to provide additional loans to SMEs. In addition, the government made working capital and trade finance available to SMEs through a number of facilities and established four investment funds, which were mostly to provide debt and equity financing to SMEs.

#### E. Supporting Legal/Regulatory Measures

44. Governments took a wide variety of legal/regulatory initiatives to encourage corporate restructuring. These included both “carrots”(i.e., positive incentives and elimination of disincentives or obstacles) and “sticks” (i.e., disciplinary procedures and punishments for failure to restructure adequately. Many of these measures appear to have been useful or perhaps necessary. But the following measures are generally not sufficient to induce corporate debtors to sell cherished assets, accept equity dilution, or hand over management control. The measures listed below nonetheless provide a checklist of useful actions for future crises.

45. *Taxes.* Some countries provided tax relief for debt restructuring, typically limited to debt restructuring by financial institutions so that the relief might not be abused through debt restructuring transactions between related parties. Typically, the creditor could deduct the debt-restructuring loss from its taxes and the offsetting gain to the debtor would not be taxed. Thailand attempted to strengthen this incentive by limiting its duration from 1 January 1998 until 31 December 1999. This incentive had no noticeable effect on debt restructuring. Recently extended through end-20001, this tax incentive may yet prove useful as debtors and creditors become more ready to restructure corporate debt. Some countries have also provided relief on various registration, stamp, and transfer taxes. Other measures have included exemptions from SMEs on capital gains on the sale of real estate used to repay debt and for real estate transferred in M&A transactions. Tax treatment of M&A transactions remains a sticking point in Thailand, where non-cash transactions (e.g.,

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<sup>8</sup> “Big deals” have been agreed for semiconductors (i.e., Hyundai Electronic’s acquisition of LG Semiconductor), oil refining, rolling stock, aircraft, power generation, and ship engines. A petrochemical deal is still under consideration. The proposed swap of Samsung Motors for Daewoo Electronics has been scuppered by court receivership for the former and Daewoo’s mid-1999 crisis.

mergers, share swaps) create an immediate tax liability. One tax “stick” has been Korea’s move to limit or eliminate deductibility on interest on “excessive” debt

46. *Foreign investment and ownership.* After a series of liberalizations, Korea has essentially eliminated restrictions on foreign ownership of Korean companies. Thailand has amended its Alien Business Law and somewhat eased restrictions on foreign ownership of land or condominiums.

47. *Corporate takeovers.* Korea has made it possible for outside investors to acquire larger blocks of a company’s shares without approval from the company’s board..

48. *Corporate reorganizations.* While it has not been a problem in Thailand, debt/equity conversions are legally considered a two-part transaction between the debtor and the converting creditor, which could give rise to challenges from other creditors as a preferential transfer to converting creditors. The law also provides requires 6 months before concluding a merger to enable creditors to object. Lastly, in several countries, it appears that minority shareholders of insolvent companies continue to enjoy substantial rights and are unreasonably positioned to block restructuring transactions that disadvantage them.

49. *Labor.* Korea changed its Labor Standards Act to allow companies involved in restructuring or a M&A transaction to lay off employees. In addition, Korea somewhat broadened and extended its program of unemployment insurance.

50. *Corporate governance.* Several countries have moved to improve financial disclosure through adoption of international accounting standards and other shareholder protections. Korea, for instance, is requiring chaebols to provide consolidated financial statements for 1999; appointment of independent directors to one-quarter of board seats; and lower thresholds for inspections and lawsuits by minority shareholders. In recognition of the issue of weak corporate governance (e.g., inadequate safeguards of minority shareholders, connected party transactions, inadequate financial disclosure, and lack of independent oversight at the board level) the Malaysian government formed the Finance Committee on Corporate Governance in March 1998. Its recommendations have been published and implementation begun

51. *Losses by state-owned banks.* State-owned banks may be legally constrained from taking losses on debt restructuring. For instance, Article 157 of Thailand’s act on state-owned enterprises – which holds employees personally liable for losses caused to the SOE – has probably made it more difficult for Krung Thai or other state-owned banks to agree to debt writeoffs or restructurings that pose a present value cost. Similar strictures have applied to IBRA. The Indonesia government, however, has moved forward with a policy specifying conditions under which IBRA may agree to haircuts/discounts and with indemnification for IBRA employees.

52. *Limits on bank shareholdings.* Recognizing that Korea’s massive corporate debt overhang made debt/equity conversions inevitable, the government amended the banking law to increase the percentage of a corporation’s shares that a bank could hold – from 10%

to 15%, or more with FSC permission. In Thailand, the banking law has been amended to allow private AMC's to hold assets other than debt instruments. This issue apparently remains to be addressed in Indonesia, where banks are required to sell converted equity within a few months.

53. *Competition policy.* The practice of having stronger affiliates in a chaebol cross-guarantee debts by weaker start-up affiliates complicated the liability structure of Korean chaebols, often worked to the disadvantage of public shareholders, encouraged chaebols to make imprudent over-leveraged investments, and made it more difficult to jettison non-viable affiliates. In response, in early 1998, the government prohibited new cross guarantees and required existing cross guarantees to be eliminated by March 2000. In addition, the Fair Trade Commission (FTC) has conducted three rounds of investigations into improper transactions between related affiliates within major chaebols. These included purchases of commercial paper, subordinated debt, and real estate at above-*Exposure limits*. More stringent loan exposure limits have served to reduce lending by Korean banks to the Top 5 chaebols.<sup>9</sup> A July 1998 rule limited the ability of a chaebol's financial affiliate to hold the commercial paper of related affiliates. At end-October 1998, bondholdings in a single group were limited to 15% of their total for investment trust companies and 10% for banks – still high enough to threaten a bond market meltdown when Daewoo came under stress.

54. *Mandated exits.* At the FSC's direction, Korean banks identified 55 non-viable chaebol affiliates in June 1998 and forced their sale, merger, or liquidation.

55. *Capital structure improvement programs (CSIPs).* In Korea, since April 1998, the FSC has required each chaebol seeking new credits or a credit rollover to agree on a CSIP with its lead bank. Each CSIP was to identify measures to enhance management transparency, focus business operations on core competencies, reduce L/E ratios to 200% by end-1999, and eliminate cross guarantees. Following an uneven start-up, quarterly reviews of CSIP implementation have provided a useful means for disciplining at least four of the Top 5. Daewoo's migration from the Top 5 to near bankruptcy represented a "too little too late" lapse in the government's ability to impose greater financial discipline on Korea's largest chaebols. If CSIPs provided the "anvil" for restructuring Korea's largest chaebols, more stringent exposure limits for their lenders, mandated elimination of cross guarantees, and fines for improper intra-chaebol transactions served as the "hammer."

#### F. Linkages to the Financial Sector

56. If corporate debtors are likely to suffer loss from corporate restructuring – through forfeiture or sale of cherished assets and businesses, equity dilution, and diminution or loss of management control – their bankers can expect to suffer as well – through credit write-

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<sup>9</sup> Banks have been required to (1) include in their calculation of a single borrower and group exposure limits all off-balance exposures, including guarantees; (2) reduce their exposure to a single borrower or group from 45% to 25% of their equity by end-1999; and (3) reduce single-group exposure to large shareholders and affiliates from 45% to 25% of their equity by January 2000. Net lending, including guarantees, from commercial banks to the Top 5 dropped from KRW 81 trillion at end-1997 to KRW 58 trillion at mid-1999.

offs; allowance of grace periods, rate reductions, term extensions; or conversions of debt into equity or quasi-equity for which there may be no market. Recognition of the present value effects of these concessions and provisioning to reflect the future likelihood of repayment can reduce a bank's capital below acceptable levels. Capital shortfalls may prompt government seizure of the bank or necessitate recapitalization of the bank from private or public sources, the latter of which would dilute existing shareholders and threaten the loss of management control. Thus, the controlling shareholders and managements of banks will be reluctant to take corporate restructuring initiatives that threaten their equity position and control. Bankers are also reluctant to offer concessions on debt restructuring out of concern for moral hazard. Forcing asset/business sales and acquiring a controlling equity interest in the debtor's company, however, should mitigate such concerns.

57. To ease the reluctance of bankers to take losses on corporate restructuring, governments may provide various types of forbearance. For example, a government could give banks more time to reduce their capital to reflect losses on corporate restructuring (forbearance on provisioning) or require full provisioning immediately but allow banks to operate for some time with inadequate capital (forbearance on capital adequacy).

58. If a government ends up taking ownership and control of financial institutions, the dilemmas faced by private bankers convey to the government. For example, what losses on corporate restructuring can state-owned banks absorb and how much additional recapitalization must be funded by the taxpayers? How can state-owned banks make concessions on debt restructuring without creating moral hazard? The cases of Thailand, Indonesia, and Korea illustrate the dilemmas for private and state-owned banks and the consequent effects for corporate restructuring.

59. **Thailand.** The crisis led to the government taking over a large additional portion of the country's financial sector assets. This included the assets from 56 finance companies closed in June and August 1997, 4 medium-sized banks intervened in January-February 1998, and 2 additional banks intervened in August 1998. As noted earlier, the decision to close the finance companies and transfer their assets to the FRA for auction – which took a year to complete and was unaccompanied by either extraordinary powers or normal loan collection efforts – may have encouraged “strategic defaulting” by debtors convinced that they could thereby drive their creditors out of business and escape repayment. NPLs quickly rose to 45-48% of outstanding loans and remained at that level for over a year. This represented an ongoing drain on bank capital and a continuing source of frustration for the government (as well as for the World Bank and IMF). The government did not want to force the banks to recognize all capital losses – e.g., from any debt restructuring – immediately, for to do so might have resulted in nationalization of most or all of Thailand's financial system. As noted earlier, the foremost impediment to corporate restructuring was the inability of Thailand's legal system to impose losses on non-viable or recalcitrant debtors. It would have been unfair and ill-advised to force Thailand's banks to take all of the loss from corporate restructuring. Thai banks may have engaged in imprudent lending, but they were not responsible for the Thai legal system's weak protections for creditors. Nationalizing Thailand's large banks in a rush to resolve

NPLs could have politicized the resolution of distressed corporates and created huge moral hazard risks for the future.

60. Instead, the government responded by giving forbearance on the recognition of losses from corporate restructuring and offering public funds – linked to progress in corporate restructuring and new business lending – for bank recapitalization. In early 1998, BOT regulations required banks to upgrade their provisioning to international best practice but gave banks more than 2-1/2 years to decrease their capital to reflect losses from corporate restructuring. Banks could take capital decreases in five semi-annual increments – of 20% each – starting year-end 1998 and finishing at year-end 2000. Restructured loans could be reclassified as performing once the debtor resumed consistent debt service (e.g., 3 consecutive months). Risk-weighted capital adequacy standards remained at 8%.

61. In August 1998, the government followed up with a program for financial sector restructuring, which would provide up to Baht 300 billion in public funds for bank recapitalization. For Tier 1 recapitalization (preferred stock), the government would recapitalize the institution up to 2.5% if, following immediate write-off of NPLs and full provisioning, an institution's Tier 1 capital adequacy ratio fell below 2.5%. Beyond 2.5%, the government would match Tier 1 capital raised from private investors. The government would not necessarily change the bank's management, but reserved the right to do so. Tier 2 capital (subordinated debt) would be provided at 100% of losses from BOT-approved corporate restructuring transactions and 20% of increases in business lending.

62. The response of Thailand's private banks revealed their determination to avoid additional state ownership, control, or influence. Thai banks aggressively raised capital from private sources including preferred shares, subordinated debt, and conversion of deposits.<sup>10</sup> Between January 1998 and October 1999, Thailand's private banks raised Baht 305 billion in Tier 1 capital and Baht 53 billion in Tier 2. Only Baht 45 billion came from public sources – Baht 42 billion in Tier 1 and Baht 3 billion in Tier 2. While avoiding acceptance of public capital except to avoid being intervened, it appears the banks have also carefully staged their losses from corporate restructuring so as to keep their capital write-downs under control. Observers suggest that as banks have become more fully provisioned, they have become more willing to conclude corporate restructuring transactions that include loss-making concessions on debt. This raises some key policy questions – would corporate restructuring have moved faster in Thailand (or elsewhere) if the government had allowed capital adequacy to drop below 8% for some period (e.g, 2 years) but required immediate full provisioning for all loans? Or would such forbearance merely have encouraged banks to take bigger risks and ultimately raised the cost to Thailand's taxpayers?

63. **Indonesia.** Moves in the financial sector have included the closure of 16 banks in July 1997, the transfer of 54 distressed banks to IBRA in February 1998, IBRA's closure

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<sup>10</sup> Deposits were converted into capital through instruments referred to as SLIPS and CAPS. Deposits converted into capital earned interest of 11-22% and had first call on bank profits until redeemed. This is a temporary solution, as these instruments will need to be refinanced in five years.

of 7 banks and takeover of another 7 in March 1998, and the government's announcement in March 1999 of plans to close 38 additional banks, nationalize 7, and help recapitalize 9. As announced in September 1998, a bank could qualify for joint recapitalization if, after full provisioning of its impaired loans, its capital adequacy ratio was anywhere between 4% and *minus* 25%. In a joint recapitalization, current owners and the government would share 20/80 in contributions of new capital, related-party NPLs would have to be repaid, the bank's management would have to submit a business plan to achieve viability, and the bank would have to comply with prudential regulations. While requiring immediate full provisioning, the government would give banks until end-2001 to achieve 8% risk-weighted capital adequacy ratios.

64. While Indonesia's remaining private banks may thus have some grace period within which to complete corporate restructuring transactions, many of these deals will necessarily involve IBRA. IBRA's mandate, however, focuses on maximizing collections. Indeed, IBRA is expected to collect and contribute Rp 17 trillion to the government budget for fiscal 1999/2000. IBRA has also been adamant in resisting debt write-downs or loss-making reschedulings. Underlying this has been an insistence that flight capital be brought back to Indonesia to satisfy debts. While there is a good moral hazard rationale for insisting that capable debtors make good on their debts, IBRA's own analysis raises questions about the business prospects of two-thirds of the major debtors it has analyzed. Especially for such cases, IBRA needs the flexibility to make concessions on debt restructuring, take losses on necessary debt restructuring, and resolve differences on an equitable basis with other creditors.

65. **Korea.** By end-May 1999, four of the lead banks in Korea were more than 90% state-owned (Seoul, Korea First, Hanvit, and Chohung). In theory, this might have enabled the government to be more aggressive in restructuring corporations – e.g., seizing assets, changing management at debtor companies, writing off debts, or converting additional debt into equity. Several factors, however, worked against this: e.g., depressed asset values; limited numbers of qualified corporate managers; hopes of leaving existing managers with enough of an equity incentive to turn their companies around, regulatory limits on holdings of corporate equity; and a the reluctance of banks to consolidate the financial results of distressed corporates with their own. Perhaps most importantly, the government did not want to exceed the KRW 64 trillion ceiling on public sector liquidity and capital support for the financial sector that had been agreed with the National Assembly. Indeed, as resolution of the crisis progressed, officials responsible for financial sector restructuring looked for ways to “recycle” the KRW 64 trillion. Throughout the crisis, the government displayed two approaches toward its banks – at times directing solutions (e.g., mandated exits, “Big Deals”) and at other times taking a relatively hands-off attitude and expecting bank managers to negotiate corporate restructuring transactions based on their best commercial judgement.

### III. CORPORATE RESTRUCTURING RESULTS

66. The magnitude of corporate restructuring activity in Korea – reorganizations and workouts underway and transactions completed – probably represents the most that can

reasonably be expected in terms of a short-term response to a systemic crisis. Despite the weak legal incentives there for debtors to cooperate with voluntary restructuring efforts, corporate restructuring is progressing in Thailand and Indonesia and the main agents for corporate restructuring – the Bank of Thailand’s CDRAC Office and Indonesia’s IBRA – have each identified a pipeline of transactions in process and time-bound goals for their completion. Malaysia has made progress through combined use of court-supervised processes, the Danaharta AMC, and CDRC.

67. As many discussions on East Asia corporate restructuring distinguish between financial restructuring and “real” operational restructuring, and allege lack of progress on the latter, it is important to provide some definitions and perspective. Subsequent discussion distinguishes between corporate “self help” and concessionary debt restructuring. Corporate self-help includes sales of businesses or non-core assets, cost reductions, and capital infusions through equity contributions from existing owners or outside investors. Given the time needed to sell businesses or real estate and other assets for more than “fire sale” prices, to shed marginal business lines and employees, and to focus on core competencies, operational restructuring can easily take 18-36 months. Concessionary debt restructuring – which includes grace periods on interest or principal, rate reductions, term extensions, or conversion of term debt into equity or convertible bonds (CBs) – can be accomplished almost immediately.

A. Korea

68. Large corporation restructuring efforts amounting to at least KRW 187 trillion are proceeding via several tracks:

- (1) KRW 33 trillion in the debts of 13 chaebols are being resolved through court-supervised insolvencies. Some major reorganizations have been completed (e.g., Kia) and other negotiations for significant asset transfers are underway.
- (2) Workouts for KRW 44 trillion in debt at 16 second-tier (“6-64”) chaebols and other large companies have been agreed. These workouts contemplate a 4:1 mix of debt restructuring and “self-help.” Self-help asset/affiliate sales, new equity investment, and cost reductions amounting to KRW 3 trillion have been achieved. Controlling shareholders have been diluted and some managements replaced.
- (3) The Top 4 chaebols (Hyundai, Samsung, LG, and SK) appear to have completed about KRW 20 trillion in asset/affiliate sales and KRW 27 trillion in new equity issues by YE1999.
- (4) The Daewoo case provides warning that no chaebol is “too big to fail.” Complete changes in ownership and control are underway at the 12 workout affiliates. Domestic creditors have agreed on restructuring KRW 63 billion in Daewoo debts. Assuming a proposed buyout of debts owed to foreign creditors is completed, strategic sales, spin-offs, operational restructuring, and liquidation of non-viable operations can proceed.

69. *CRA Workouts.* By 30 September 1999, CRA workout plans had been agreed for 41 affiliates of sixteen 6-64 chaebols and for 38 large/medium standalone companies (a

total of 79 companies, excluding Daewoo affiliates). These plans represent over KRW 44 trillion in planned restructuring (see Table 2), of which 21% is to come from “self-help” (e.g., asset sales and new equity) and 79% from debt restructuring. Given pre-workout debt levels and the potential glut of assets and equity issues on offer, this mix of self-help and debt restructuring is not surprising. Of the KRW 34.9 trillion in proposed debt restructuring, 81% is to come in the form of rate reductions and/or payment deferrals and 12% in conversions of debt into equity or convertible bonds (CBs). In most if not all cases, debt/equity conversions have substantially diluted existing shareholders and given financial institutions a controlling equity interest. So as to ensure needed operational restructuring and maximize share values, these financial institution shareholders will need to exercise effective corporate governance. Payment deferral periods range from 2-5 years and average 4 years. Operational restructuring/self-help is to continue during this period. Thus, the 34% implementation of planned self-help achieved by end-September 1999 represents reasonable progress. In addition, the 16 chaebols involved in workouts have committed to disposing of 237 affiliates through sale, liquidation, merger, or court-supervised processes. As of end-September 1999, 113 affiliates had been disposed of.

70. *Top 4 Chaebols.* As part of their CSIPs, the Top 4 (Hyundai, Samsung, LG, and SK) committed to over KRW 20 trillion in asset/affiliate sales and over KRW 27 trillion in new equity issues for 1998 and 1999. These amounts were intended to produce liabilities/equity ratios of 200% by year-end 1999. As Table 3 indicates, the Top 4 completed KRW 13.6 trillion of asset/affiliate sales and new equity issues in 1998 and KRW 26.7 trillion during the first 9 months of 1999. As of 30 September 1999, it appeared that Samsung, LG, and SK were well on their way to full implementation of their CSIPs. While questions were raised about Hyundai’s ability to raise KRW 5.9 trillion during the fourth quarter of 1999, the company’s management announced in December 1999 that it had also achieved a 200% liabilities/equity ratio for 1999. Liabilities/equity ratios must be viewed with caution and the Top 4 will warrant continued regulatory attention. While the FSS has eliminated the effects of asset revaluations from the calculation of liabilities/equity ratios, a significant amount of new equity was sold within these chaebols to related affiliates. Once group-wide financial statements prepared according to international accounting standards become available in mid-2000, a fresh assessment of the financial position of Top 4 chaebols and longer-term reform requirements should be undertaken.

71. *Daewoo.* While the other Top 5 chaebols seemed to make steady progress in de-leveraging, the ratio of liabilities/equity steadily increased for Daewoo companies from YE1997. Despite the availability of analyses indicating that Daewoo experienced a KRW 12.2 trillion *negative* cash flow from operations during 1998 and increasingly onerous credit terms during 1999, it appears that many local and foreign creditors were surprised at the onset and magnitude of Daewoo’s distress. Despite the extraordinary complexity of the Daewoo case – involving more than 100 individual companies in 65 countries, with almost 200 foreign lenders and \$54 billion in debt – only 6-8 weeks was allowed for preliminary due diligence. This reflected the urgency of stabilizing local capital markets and preserving viable but vulnerable business operations among Daewoo companies. Notably, 8 of the 12 workout affiliates were deemed insolvent and 3 affiliates – Corp, Motors, and Electronics – were estimated to have negative equity of KRW 23 trillion.

With support from the CRCC, CRA signatories agreed on workout plans for all 12 affiliates by December 2<sup>nd</sup>. These plans provided for the restructuring of KRW 63 trillion in debt. As indicated in Table 4, KRW 27 trillion (42% of the total) of this restructuring would come from conversion of debt into equity or basically zero-yield CBs. Especially after ongoing due diligence indicated that Daewoo Corp had transferred \$7.5 billion offshore to support other operations, foreign creditors agitated for additional due diligence and those most exposed to Corp sought substantive consolidation of the 4 biggest cases in hopes of larger recoveries.

72. On January 22<sup>nd</sup>, the CRCC, the steering committee of foreign creditors, and Daewoo representatives announced agreement on an offer to purchase up to \$4.8 billion in loans made by foreign creditors to the four major Daewoo affiliates (Corp., Motors, Electronics, and Heavy). Although the prices offered vary according to the debtor and guarantor, proposed purchase prices average about 40% of the face value of the debt. This is substantially more than earlier estimates of liquidation value and estimated returns from CRA workouts. In addition, tendering creditors will be entitled to receive out-of-the-money warrants, the terms of which remain to be finalized. Foreign creditors can either participate in the agreed CRA workouts or sell their claims for the aforementioned discount. For this buyout to go forward, over 90% of foreign claims should be committed to the buyout arrangement or to the CRCC workout. The CRCC is seeking decisions by individual foreign creditors by mid-March 2000 and to complete the debt buyout by early April. Assuming this buyout is completed, local creditors can proceed with plans for strategic sales (e.g. of Daewoo Motors), spinoffs, transfers of dubious assets and investments into “BadCos” for liquidation, and more complete operational restructuring. At the end of this process, it is expected that Daewoo will have undergone a complete ownership change and substantial restructuring of its operations.

73. Agreed data on the 1999 financial performance of Top 30 chaebols and their year-end financial position is not expected from the FTC until April and consolidated financial statements for 1999 may not be available until July 2000. The Top 4 (Hyundai, Samsung, LG, and SK) appear to have floated over Korea’s corporate carnage by virtue of their size, cash generation capacity, opportunities for cross-affiliate support, and access to local and global capital markets. The Top 4 reduced their debt from KRW 178 trillion at end-1997 to KRW 160 trillion at 30 June 1999 and – by one means or another – improved their L/E ratios from 350-575% at end-1997 to 200% at end-1999.

74. The picture is less rosy among the second-tier chaebols and other companies that went through CRA workouts. As a group, the 37 workout affiliates of the 16 chaebols that went through CRA workouts achieved 89% of their sales targets for the first half of 1999, while the 33 standalone companies that went through workouts achieved 99% of their revenue goals. While actual “current income” losses (i.e., earnings before extraordinary items and taxes) for the 33 standalone companies were 6% better than plan, actual current income losses for the 37 workout affiliates from the 16 chaebols were 2.5x larger than expected. Given Korea’s macroeconomic turnaround, such under-performance suggests unrealistic business plans and/or failure to implement necessary cost reductions. The viability of CRA workout chaebols, which remain heavily indebted, when grace periods expire in 1-4 years is uncertain. Eight chaebols have reportedly already entered a second-

round CRA workout. It would not be surprising to see 10 of the 16 workout chaebols forced into second-round CRA workouts or court-supervised reorganization/receivership over the next 6-18 months.

## B. Thailand

75. Through December 1999, the BOT reported that Baht 1,015 billion in corporate restructuring transactions had been completed. (Table 5). The pace of corporate restructuring has accelerated somewhat. Completed transactions averaged Baht 63 billion a month from end-December 1998 through June 1999 and Baht 80 billion a month from June through end-December 1999.

76. CDRAC and BOT's CDRAC Office are separately tracking progress on about 700 large and 1,000 medium-sized restructuring cases, which together account for Baht 2.1 trillion in debt. As indicated in Table 6, 271 of these cases (representing Baht 704 billion, or 33% of outstanding debt) are complete or essentially complete – either by recovering to normal status, achieving resolution under the old CDRAC/Bangkok rules framework, or under the Debtor-Creditor Agreement framework. Another 1,229 cases representing Baht 983 billion (46% of the CDRAC total) are in process. These include 357 cases that are proceeding according to Debtor-Creditor Agreements. *If* DCA timetables are adhered to and enforced, these cases should be resolved by mid-2000 – through agreement on a restructuring plan or court petition for collection of debts, foreclosure, or insolvency. In another 872 cases, the debtor has not yet signed a DCA. Some 227 cases representing Baht 462 billion (21% of the total) are destined for legal action. These include 35 cases where debtors have failed to sign DCAs or are otherwise uncooperative and 192 cases where creditors failed to agree on a restructuring plan after a second vote. In the latter cases, CDRAC recommends legal action and creditors are obliged within 60 days to seek court-sanctioned remedies.

77. Restructurings to date – both CDRAC and purely self-directed – have included a mix of concessionary debt restructuring (e.g., forgiveness, term extensions/rate reductions, and conversions of debt into equity) as well as “self help” (e.g., refinancings through debtor bond issues, capital increases, and asset sales). These efforts are expected to total Baht 221 billion (see Table 7 for details) and involve a 30:70 mix of concessionary debt restructuring and self-help. The favored self-help techniques are debt refinancings (e.g., via bond issues) and capital increases (e.g., through issues of new equity) – only Baht 6.3 billion in asset sales are involved.

78. Court-supervised reorganizations have not yet played a major role. By end-1999, Thailand's Bankruptcy Court had approved reorganization plans for just seven companies.

79. Table 11 presents both interest coverage (EBITDA/interest expense) and leverage (liabilities/equity), by sector, from 1996 through 30 September 1999 for 280 non-financial companies listed on the Stock Exchange of Thailand. Even though some sectors (agribusiness, electronics, food, pharmaceuticals, and printing) show favorable trends in cash flow and de-leveraging, others remain distressed and vulnerable. Communications, energy, packaging, textiles, and transport show reasonable interest coverage but high debt

levels. Another cluster of companies in chemicals, electrical products, health care, household products, property, and miscellaneous suffer both from an inability to cover interest costs with operating cash flows and high debt.

### C. Indonesia

80. Corporate restructuring in Indonesia is mostly a work in process. Some significant restructurings have occurred, mostly outside official structures.<sup>11</sup> Over 300 cases have registered with the JITF. IBRA's AMC and AMI have debt and equity positions in, respectively, about 950 and 200 large companies.

81. *Jakarta Initiative.* At end-1999, 323 firms with combined external debt of \$23 billion and about Rp 15 trillion in local debt had registered with the JITF (Table 9). Modest increases in JITF's caseload occurred during the second half of 1999. JITF has restructured the debts of only 6 companies, with total indebtedness of less than \$1 billion. Another 58 cases have reached either a formal standstill agreement, agreement in principle, or final agreement presumably awaiting documentation. Thus, resolution of the remaining 259 are presumably in a very preliminary stage. In hopes of giving JITF more teeth, the government recently agreed that JITF would adopt time-bound mediation procedures and that JITF mediators could refer recalcitrant debtors to the Financial Sector Policy Committee for consideration and possible referral by the Attorney General to the Bankruptcy Court.

82. *IBRA.* Through end-1999, IBRA's AMC had collected Rp 4.5 trillion on its Rp 207 trillion loan portfolio, from 8,450 debtors – mostly small.<sup>12</sup> Table 10 shows IBRA/AMC's pipeline of 959 large cases, which represent \$6.9 billion in foreign-denominated debt and Rp 60 trillion in local debt. Only about 5% of these cases were complete or close to finalizing a restructuring proposal at end-1999. Another 40% were in the middle stages of a workout (assignment of advisors, due diligence underway, initiation of restructuring negotiations), while 55% were still in the preliminary stages (initial meetings or agreement on a standstill). IBRA's resolution of these cases on more or less satisfactory terms will depend on (i) its ability to use the courts or its own special administrative powers to enforce creditor rights; (ii) insulation of IBRA from political pressure – including unfounded KKN allegations; and (iii) flexibility to take losses if so warranted by the debtor company's asset base and operating cash flows.

83. IBRA's AMI is in the process of acquiring equity interests in about 200 companies (Table 11). IBRA/AMI is planning to exit these positions through public offerings or private sales. Presently, IBRA is discussing sale of its 40% stake in Astra – acquired from Bank Central Asia (BCA) – with three potential financial investors. In theory, IBRA/AMI could be in a position to use these shareholdings to promote corporate restructuring. In

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<sup>11</sup> Included are the restructuring in \$1.1 billion debt of car-maker Astra, restructuring of \$289 million debt of PT Ariawest International, and restructuring of \$219 million debt of pharmaceutical company PT Kalbe Farma. In addition, Bakrie Brothers has reached preliminary agreement w to restructure \$1.2 billion in debt, including with IBRA.

<sup>12</sup> Twenty large debtors accounted for just Rp 587 billion in settlements.

practice, its ability to do so will depend on a host of factors – its ability exercise governance and monitor companies to preserve the value of its assets, its rights as a (typically) minority shareholder, interest from institutional investors and the ability of local equity markets to support public offerings, readiness to open ownership and control to foreign investors, and political pressures on IBRA – including for ongoing contributions to the state budget.

#### D. Malaysia

84. More than 40 companies have filed for reorganization under Section 176 of the Companies Act. In 13 cases, schemes of reorganization have been proposed and in another 3 cases the schemes of reorganization have been approved. However, court-based workouts have proceeded relatively slowly in comparison to CDRC- or Danaharta-led restructuring. Amendments to Section 176 and opportunities for creditors to sell their loans to Danaharta have been helpful. The ability of debtor firms to ask for extensions of stay orders against their creditors, however, continues to hamper some restructuring efforts.

85. By end-1999, Danaharta's portfolio included NPLs, from 2,345 borrowers, with a book value of RM 45.5 billion. As Table 12 indicates, RM17.4 billion of these loans (i.e., 38% of Danaharta's portfolio) had undergone loan restructuring, asset restructuring, or disposal as of end-1999. By end-February 2000, Danaharta had appointed special administrators to 53 companies.

86. The CDRC had received applications from 62 corporations with over RM36 billion in debt by December 1999. Of these, 16 cases with cumulative debts of RM13.1 billion have been resolved. Another 29 cases with total debt of RM16.9 billion were in process at end-1999. Seventeen cases were withdrawn, transferred to Danaharta, or rejected for failure to meet CDRC's viability test.

87. Of RM 13.3 billion in corporate debt restructured by CDRC as of end-1999, 87% was through conversion of loans into bonds (see Table 13). Debt/equity conversions accounted only for 5%, with other methods accounting for less. As noted in Thillainathan's analysis, the prominence of bond re-financing is largely due to the restructuring of Renong and UEM whereby RM 16 billion of zero coupon bonds were issued. Excluding Renong and UEM, CDRC restructuring is more balanced. Conversions into bonds decrease to 64.5% of total restructured debt, while debt/equity conversions rise to 14%.

88. According to Thillainathan, CDRC has been criticized for approaching each workout on a case-by-case basis and for failing to adopt Danaharta's approach of providing guidelines (e.g., on use of zero-coupon bonds) for its workouts. Given BNM's preeminence in the CDRC process, Thillainathan questions whether participating financial institutions were acting freely. His review of major CDRC restructurings, especially Renong and UEM, concludes that there has been a bailout of creditors – especially foreign creditors – and perhaps of existing management, although not of

shareholders and that the fear of systemic risk was used to justify a government-facilitated and –financed restructuring rather than a market-based approach. He questions the extent to which the CDRC-sponsored restructuring of Renong and UEM meets Danaharta’s viability criteria. Danaharta’s approach is driven first by what new capital shareholders can provide, and only secondarily by a debtor’s cash flow debt-service capacity.

## V. LESSONS LEARNED

89. “Contextual” factors powerfully affect a country’s corporate restructuring approach and results. Even so, it is reasonable to make detailed recommendations on crisis prevention, crisis response, and crisis resolution. Clearly, there is a need for effective government responses to any systemic crisis. Once some financial stabilization of the corporate sector has been achieved, as has occurred in East Asian, ongoing efforts – with government support – at operational restructuring of distressed companies is almost certainly needed.

### A. Contextual Factors

90. Six factors had an overwhelming influence on the extent and nature of corporate restructuring in the East Asia crisis: (1) the speed of the macroeconomic recovery; (2) political cohesion within each country; (3) institutional capacity; (4) the magnitude of the corporate debt overhang; (5) differences across countries in the ability of each legal regime to impose losses on debtors; and (6) the willingness or ability of creditors – or governments – to recognize losses from corporate debt restructuring.

91. *Macroeconomic recovery.* The crisis surprised most observers – in terms of both the depth of the crisis and the speed of the recovery. As indicated in Table 14, economic growth resumed in 1999. This has been attributed to several factors, including restocking of inventories, resumption of consumer demand, fiscal stimulus programs, global liquidity, and judicious actions by the US Federal Reserve. While the prompt macroeconomic turnaround benefited the citizenry in East Asia crisis countries, the recovery may have saved corporations from having to undertake more fundamental operational restructuring – e.g., employee layoffs, closure of loss-making or non-competitive businesses, sales of non-core assets, greater acceptance of foreign equity ownership – needed for short-term survival. Thus, concerted efforts by government regulators (e.g., financial supervisors, securities commissions, tax authorities, competition authorities) will be needed in lieu of the discipline that might otherwise have been provided by the marketplace. Unfortunately, surviving East Asian corporate managers may have concluded that – rather than undertaking needed operational restructuring – they can rely on rapid macroeconomic upsurge in any future crisis to “re-float” their companies.

92. *Political cohesion.* In Korea, a new government committed to reform shepherded a host of legislation through the national assembly in February 1998 which provided a more conducive legal/regulatory environment for corporate restructuring. As noted earlier, Korea’s legal environment going into the crisis already provided strong protections for creditors. While Korea’s approach to economic management has sometimes been

criticized in the past as overly *dirigiste*, this hands-on approach facilitated relatively crisp responses when action was called for – e.g., taking over the six largest banks, organizing a workout process to stabilize the most-distressed 6-64 chaebols, orchestrating government efforts to impose financial discipline on the Top 4, and facilitating a financial restructuring by local creditors and their buyout of foreign creditors in the Daewoo case. By contrast, corporate restructuring elsewhere has been hampered by an inability to achieve sufficient strengthening of legal protections for creditors or to enforce available protections through the courts in a timely and dependable manner.

93. *Institutional capacity.* To varying degrees, all these countries need to develop their capacity for dealing with court-supervised insolvencies. More experienced judges, receivers, and insolvency professionals are needed to develop sensible solutions in a timely manner. While banks have gained useful experience, a lack of experience with corporate restructuring experience – for example, among Korean banks – led to superficial “cookie cutter” restructurings. While Danaharta shows some promising results, the operation of a large-portfolio AMC can be daunting. Public AMCs would be well advised to follow the lead of Thai Farmers’ private AMC in outsourcing case management to experienced professionals operating on an incentive compensation basis. Korea’s government showed good coordination in using available powers – e.g., prudential regulation, fair trade investigations, tax authority – to impose more financial discipline on its largest conglomerates. It might be difficult for other crisis countries to develop a similarly coordinated government program.

94. *Magnitude of corporate debt.* It was unrealistic to expect that East Asia’s corporate crisis could be addressed in a timely manner without massive restructuring of corporate debts – e.g., through rate/term adjustments, grace periods, and conversions of debt into equity. The corporate debt overhang at the start of the crisis was massive. In Korea, for instance, liabilities/equity for the thirty largest chaebol (including their financial affiliates) was 604% at year-end 1997. There were not enough investment bankers and not enough of an opportunity for immediate operational restructuring to reduce corporate leverage to a reasonable level (e.g., the 200% mandated by the Korean government) through incremental improvements – e.g., from asset/business sales, issuance of new equity, or increases in retained earnings from improvements in operational efficiency – within a reasonable time period (e.g., by year-end 1999). Under normal circumstances, it can easily take 18-36 months to restructure a large corporation. The difficulty in East Asia was greatly compounded by the fact that hundreds or thousands of large corporations were simultaneously exploring the possibility of asset/business sales or equity issues to strengthen their financial position – creating the potential for an asset glut and fire sale prices. Thus, the corporate debt overhang had to be dealt with – either through conversions into equity or through concessionary debt restructuring. An analysis from May 1998 (Table 15) indicated that even using optimistic assumptions about de-leveraging through increases in retained earnings, court-supervised insolvency, asset sales and foreign investment relative to historical norms (e.g., as a percentage of GDP), new equity issues relative to historical norms (e.g. as a percentage of market capitalization), and debt/equity conversions up to the 15% regulatory limit, Korea’s thirty largest chaebols would still be 343% leveraged at end-1999. In fact, Korea has probably exceeded expectations at the start of the crisis for asset/business sales and new equity issues. An immediate focus on

the financial stabilization of most distressed corporates (e.g., 6-64 chaebols in late 1998 and Daewoo in late 1999) and a 4:1 ratio of debt restructuring to “self help” in a corporate debt crisis of Korea’s magnitude is hardly surprising. Financial stabilization of distressed corporations, however, must be promptly followed with more basic operational restructuring.

95. *Imposition of losses on debtors.* Multiple demonstrations in Korea of an ability to wipe out the equity interests of controlling shareholders through court-supervised reorganization and replace existing management with a receiver played a key role in encouraging other corporate debtors to cooperate with voluntary restructuring efforts. Because debtors did not face comparable threats of court-imposed loss in Thailand and Indonesia, debtors there had little or no incentive to agree to corporate restructuring transactions that would cause some loss to them – e.g., forfeiture or sale of assets or cherished businesses, equity dilution, or diminution or loss of management control. Mediation and workout contracts, even those enforced by the financial supervisor, are at best a weak substitute for a robust regime for creditor protection.

96. *Readiness of creditors (or governments) to take losses.* Even if losses can be imposed on debtors, the managers and controlling shareholders of private banks must be prepared to take losses – voluntarily or at the behest of financial supervisors. If major portions of the financial sector are nationalized, the extent of corporate restructuring (and accounting for it by state-owned banks) will depend on the government’s willingness to use public monies to recapitalize banks. If a weak legal framework makes it difficult to impose losses on debtors, forcing banks to take a disproportionate share of the losses could jeopardize their controlling shareholders/managements.

## B. Lessons on Structural Responses to Systemic Crisis

97. Contextual factors aside, the recent crisis indicates that governments can do more in terms of crisis prevention, crisis response, and crisis resolution.

98. *Crisis prevention.* In a world of free access to international capital, a financially disciplined corporate sector is required so as to avoid excessive risky borrowing. Sustainable leverage and a comfortable excess cushion of cash flow over interest expense are needed for corporations to weather exchange rate and interest rate shocks. This requires prudent financial management and a transparent governance structure for the corporate sector. It also requires effective monitoring of corporations by creditors and financial supervisors. As noted below (items 1 and 8), governments should also be prepared to take countervailing steps when monitoring indicates the development of unsustainable over-investment by corporations. It is also important to create and stimulate markets for distressed assets, especially including debt and real estate. Lastly, it is important to stimulate the development of local capital markets and equity financing. An active market for corporate bonds and other debt can serve both as a warning and exit/redeployment mechanism, while equity financing is obviously needed to cushion against currency and interest rate shifts.

99. *Crisis response:* Upon the development of a systemic corporate crisis, a government needs to ensure that a coherent framework for resolving corporate distress is put in place. This framework needs to include court-based measures for reorganization, liquidation, and protection of secured and unsecured creditors; a well-structured out-of-court process for corporate restructuring; and an enabling tax, legal, and regulatory environment. Governments also need to segment the crisis and prioritize their responses – e.g., to the most-distressed large corporates and to SMEs. If governments are forced to create public AMCs, these should be insulated from political pressure and operated according to best commercial and market principles (items 2,3,4,5,7, and 9).

100. *Crisis resolution.* In addition to an effective legal, regulatory, and institutional framework, governments must actively “work the problem” until the crisis eases. Macroeconomic stabilization is essential, including restoration of confidence in the currency and financial markets. Resolution of external debt may be needed early in the crisis. Throughout, as noted below (item 6), governments will need to ensure that major financial institutions remain reasonably sound and conclude necessary corporate restructuring transactions in a timely manner.

1. *It being possible to see systemic corporate crises developing, governments should monitor the financial health of major corporate sectors and respond to early warning sign of over-investment and distress.* Indications that large corporations and sectors were over-investing and over-borrowing were available in Indonesia by 1993, Thailand by 1995, and Korea by 1996. Assuming that financial disclosure standards for listed companies are adequate, it should be possible to anticipate a crisis by monitoring such measures of financial position and performance as returns on assets, returns on capital employed, profitability, leverage, and operating cash flows relative to interest expense. Governments – especially financial supervisors – should monitor these indicators and make precautionary responses to signs of widescale over-investment. Possible responses include more stringent exposure limits, additional provisioning for loans to over-invested sectors, tougher tax treatment (e.g., non-deductibility of interest on “excessive” debt), and requirements for banks to require capital structure improvement programs from large borrowers.
2. *In a systemic crisis, governments need to segment the crisis and prioritize responses, both by the government and by the banks.* Financial regulators should require banks to identify non-viable companies early on, exit from these companies, (e.g., by forcing their sale or liquidation ), and take the loss. For highly distressed but viable corporations, standardized workouts may be needed. Notwithstanding longer-term opportunities for asset/business sales and improvements in operating efficiency, a company’s short-term debt capacity depends on its operating cash flow. Debts in excess of this debt service capacity will need to be restructured. While financial restructuring is thus likely to figure prominently in responses to a systemic corporate crisis, financial stabilization needs to be followed closely by on-going operational restructuring to eliminate marginal businesses, assets, and – with appropriate safety nets – redundant employees. For problematic corporations that are not necessarily in immediate peril, concerted government actions (e.g., CSIP requirements, tighter exposure limits, fair trade

investigations) may be needed to encourage these companies to embrace greater financial discipline. Lastly, in a systemic crisis banks will not have the institutional capacity to resolve distress among tens of thousands of SMEs one by one. Systemic responses to SME distress are needed. These may include, for instance, regulatory forbearance to encourage banks to rollover SME debts for 6 months.

3. *Resolution of a systemic corporate crisis depends on out-of-court processes, preferably formal, well-organized, and purposeful.* In a systemic crisis involving many hundreds of large corporations, frequent resort to court-supervised processes would overwhelm the capacity of courts and insolvency professionals. Thus, efficient resolution of the crisis must rely on out-of-court processes. An informal unstructured processes, however, is not enough. Notably, Thailand abandoned its initial soft approach of relying on a set of principles (“Bangkok rules”) modeled after the London approach. Korea dallied with government-sanctioned “bankruptcy avoidance” loans, which did not give creditors sufficient access to do due diligence and develop restructuring plans and which merely postponed the problem. These initial efforts were abandoned in favor of the more structured CRA/CRCC process in Korea and CDRAC Office/DCA process in Thailand.

Corporate restructuring in Thailand has increased since the BOT’s promulgation of formal restructuring contracts (i.e., Debtor/Creditor Agreements). Experience suggests that such contracts should provide for (i) a time-bound standstill (e.g., 3 months); (ii) complete creditor access to all records for due diligence; (iii) joint management-creditor teams to monitor performance, develop cash flow projections, and control asset disposals; (iv) priority for fresh working capital; (v) interim milestones for completion of due diligence, development of a restructuring plan, and creditor votes; (vi) voting thresholds for creditor approval of a reorganization plan; (vii) mediation or arbitration of inter-creditor differences; (viii) conversion of the case into court-supervised insolvency for failure to meet interim milestones; and (ix) penalties for non-compliance by financial institution signatories – including failure to petition the court for debt collection, foreclosure, or insolvency if interim milestones are not met. The financial supervisor could serve to enforce workout contracts, including penalty provisions, as has been done by Thailand’s BOT and Korea’s FSC.

4. *Some mechanism is needed to resolve inter-creditor disputes.* The willingness of creditors to agree to debt restructuring and provide new money will vary – e.g., depending on whether they are secured or unsecured and on their provisioning and capital adequacy. Inter-creditor differences may be particularly sticky when foreign creditors are involved. On the one hand, the foreign creditor may feel particularly disadvantaged (e.g., by language barriers, access to information, or comfort with the local business culture) and “hang tough” so as to make a point. In other circumstances, well-provisioned foreign creditors with a strong offshore capital base may be more willing to agree to a debt restructuring discount. While a given loss might be painful for a foreign creditor, the same-sized loss could be life-threatening for a local creditor. While the CRCC arbitration mechanism worked in

Korea, it applied only to Korean financial institutions. When foreign creditors became heavily involved, in the Daewoo matter, they were unwilling to expose themselves to CRCC arbitration. Similarly, Thailand's Inter-Creditor Agreement allows any financial institution signatory to opt out of the ICA in any case involving total debts of Baht 1 billion. In the Daewoo matter, issues with foreign creditors will likely be resolved through a buyout by local creditors of foreign creditor claims. In general, centralized buyouts or secondary trading in claims may be the most expeditious way for resolving differences between local and foreign creditors. To make it easier to deal with future crises, countries should facilitate the development of secondary markets in corporate debt.

5. *To be effective, an out-of-court process for corporate restructuring needs to be backed up by effective court-supervised processes for seizure of assets, foreclosure, liquidation, receivership, and reorganization.* Without the threat of court-imposed loss, there is not enough incentive for corporate debtors to cooperate with voluntary efforts and agree to the asset/business sales, equity dilution, and diminution of management control that may be part of a fair deal. Ideally, corporate debtors should face a continuum of threat – beginning with the possibility of prompt seizure of assets. Debtors should feel encouraged to seek protection in court-supervised reorganization, as an alternative to liquidation or foreclosure. Without a strong “shadow” of creditor protections, an emphasis on reform of court-supervised reorganization will produce only limited results. In Thailand, for instance, efforts by recalcitrant creditors to avoid court-supervised reorganization (e.g., in Nikko Hotels and TPI) indicates that the legal regime for collection of debts is too weak. Court-supervised reorganization needs to be a serious option for restructuring distressed but viable companies – and not just a forum for a reorganization plan “cram down” on dissenting creditors in cases where the debtor happens to be cooperative.

As it can be extremely difficult to reform legal regimes for protection and enforcement of creditor rights during a crisis – when the personal “downside” to parliamentarians and other powerful persons may be all too obvious and imminent – necessary reforms should be implemented in good times, i.e., before a crisis.

6. *Financial institutions need some breathing room to support real corporate restructuring and take losses, without necessarily threatening current controlling shareholders.* Financial sector restructuring is outside the purview of this paper, but the motivations of the controlling shareholders and bank managers need to be considered in developing a response to systemic crises. Unless it is prepared to nationalize all or most of a country's financial sector, the government will need to give banks an opportunity to take necessarily steps in corporate restructuring – loss recognition – without necessarily exposing these banks to a state takeover or government control. The experience of Thailand indicates that banks will sequence corporate restructuring deals so as to avoid threats to their own ownership and control. Real corporate restructuring – including debt restructuring down to sustainable levels – will require banks to take losses. Banks will resist these losses

without some regulatory forbearance. Thailand's experience suggests consideration of forbearance on capital adequacy rather than on loss recognition. Admittedly, governments would have to consider the risk that forbearance might just lead to a higher eventual cost to the public for financial sector recapitalization.

7. *Supporting legal/regulatory measures – to eliminate obstacles and provide positive incentives – are necessary but will not in themselves induce corporate restructuring.* Real corporate restructuring involves losses for the controlling shareholders and managers of corporations – e.g., through sale or forfeiture of cherished businesses and assets, diminished scope of business operations, equity dilution, and diminution of control. Similarly for financial institutions, corporate restructuring will lead to losses from concessionary debt restructuring, diminution of capital, and possible dilution and diminution or loss of control. Legal and regulatory “carrots” – e.g., an ability by banks to deduct debt restructuring losses and exclusion of the debtor's gain from taxation – will not be enough to get debtors and creditors to take real losses. Hence, the timely resolution of a large volume of distressed companies ultimately depends on the availability of legal coercion.
8. *It can be useful for governments to marshal available powers – both before and during crises – to encourage large corporations to restructure themselves to improve their long-term competitiveness.* Korea provides useful examples, both of ill-advised corporate diversification and a coordinated government campaign to reimpose financial discipline. Debt financed expansion and diversification – whereby Korean chaebols departed from core competencies for ill-advised diversifications (e.g., into luxury automobiles and financial services for one basic materials producer) – were not sustainable. While deeply distressed 6-64 chaebols had to submit to CRA workouts, in mid-1998 the Top 5 were not in imminent danger but posed a longer-term problem. As noted earlier, the government orchestrated its various powers – e.g., prudential regulation of financial institutions, tax administration, investigation of unfair trade practices – to impose greater financial discipline on its largest conglomerates. This longer-term approach is worth considering for conglomerates in other countries.
9. *Public asset management companies are not a panacea for resolution of corporate distress.* KAMCO and the FRA are not good test cases, as the former is more oriented toward providing financial institution liquidity while the latter focused on bundling and selling assets taken over from failed finance companies. Indeed, the wholesale closing of 56 finance companies in Thailand and transfer of their assets to the FRA for eventual disposition may have hurt the development of a credit culture in Thailand, as creditors came to believe that they could escape repayment by driving their creditors out of business. Experience elsewhere on public AMCs is mixed (Klingebiel, 1999). They have not proven adept at restructuring operating companies.

101. While Malaysia's Danaharta has achieved some success, it is uncertain how effective IBRA will be as an agent for corporate restructuring. IBRA's effectiveness at

corporate restructuring will depend on its ability to enforce creditor rights (either through the courts or through use of its extraordinary PP-17 powers); on insulation from political pressure (e.g., to protect well-connected debtors); and on its ability to restructure corporate debts on purely commercial considerations. IBRA must be able to give debt discounts or write-offs without worrying about legal liability or allegations of KKN. If the Indonesian government can muster the institutional capacity, IBRA's efforts would benefit from the orchestrated use of existing government powers against recalcitrant corporate debtors.

102. Political pressures may mount and IBRA's ability to do deals may well erode over time. Thus, for IBRA to function effectively in its role as the principal restructurer of Indonesia's corporate sector, it needs to resolve its caseload quickly and to greatest commercial advantage through bulk sales of loans, marginally cleaning up loans and conveying them back to commercial banks as quickly as possible, and outsourcing debt restructuring negotiations to outside advisors working on an incentive compensation basis.

### C. Remaining Agenda

103. The crisis countries have been reasonably successful in achieving financial stabilization for their most-distressed corporations. Some operational restructuring is underway. Much more operational restructuring is needed, however, to assure long-term viability and competitiveness.

104. A key problem is how to move forward from the emphasis so far on financial restructuring to the needed emphasis on operational restructuring. In Korea, for example, local financial institutions are faced with the task of how to manage converted equity, convertible bonds, and rescheduled loans with a face value of about \$80 billion for the 16 chaebols and smaller companies and for the Daewoo affiliates that went through CRA workouts. Strategic buyers will be found for some. In most cases, however, the creditor/shareholders will need new structures to induce ongoing corporate restructuring and maximize the value of their holdings of corporate debt and equity. Since banks in the region do not have experience in the operational aspects of corporate turnarounds, they would do well to enter into joint ventures with foreign partners who can provide this experience. It is encouraging to see that some banks (e.g., Thai Farmers) have entered into such arrangements with foreign partners.

105. While much more such partnering is needed, Korea's experience suggests that several issues will first need to be addressed. In many cases, banks will need to take a loss when overvalued corporate equity or debt is conveyed – to the private AMCs, JV, corporate restructuring company, etc. The equity may be overvalued because of an illiquid market, agreements among creditors not to sell converted equity except by unanimous agreement, and artificial premiums for minority public shareholders. Local banks will need to negotiate fair valuations with foreign partners. Governments can promote this second-phase of corporate restructuring by permitting special-purpose corporate restructuring corporations, providing tax neutrality for these, and encouraging banks to transfer corporate debt and equity at real values through tax incentives or some forbearance on loss recognition.

**Table 1: Chaebols Under Court-Supervision(Borrowings in KRW billions)**

| <b>Group</b>    | <b>Default Date</b> | <b>Leverage</b> | <b>Net Borrowings</b> | <b>Status</b>                     |
|-----------------|---------------------|-----------------|-----------------------|-----------------------------------|
| Hanbo           | 1/23/97             | 1896%           | 4,091                 | Court receivership; sale underway |
| Sammi           | 3/19/97             | (3324%)         | 875                   | Court receivership                |
| Jinro           | 4/28/97             | 4231%           | 1,917                 | Composition; sale being finalized |
| Daenong         | 5/28/97             | (2806%)         | 1,172                 | Court receivership                |
| Hanshin Constr. | 6/2/97              | 649%            | 502                   | Court receivership                |
| Kia             | 7/15/97             | 411%            | 6,624                 | Sold to Hyundai; reorg complete   |
| Ssangbangwool   | 10/15/97            | 711%            | 595                   | Court receivership                |
| Taeil Media     | 10/24/97            | 334%            | 588                   | Composition                       |
| Haitai          | 11/1/97             | 658%            | 3,046                 | Court receivership; sale underway |
| Newcore         | 11/4/97             | 1222%           | 1,215                 | Applied for court receivership    |
| Soosan Heavy    | 11/26/97            | 476%            | 639                   | Court receivership                |
| Halla           | 12/5/97             | 2066%           | 6,453                 | Court receivership                |
| Chunggu         | 12/27/97            | 484%            | 728                   | Court receivership                |
| Sungwon         | 4/12/99             | n.a.            | 545                   | Composition                       |
| Samsung Mtrs.   | 6/30/99             | n.a.            | 4,170                 | Court receivership                |
| <b>Total</b>    |                     | <b>822%</b>     | <b>33,160</b>         |                                   |

**Table 2: Summary of CRA Workouts**

|                                       | <u>Agreed Amounts</u><br>(in KRW billions) | <u>Actual Implementation</u><br>(at 9/30/99) |
|---------------------------------------|--|--|
| <b><i>Self-Help:</i></b>              |  |  |
| Real estate sales                     |  | 23%  |
|                                       | 3,956                                      |  |
| Affiliate sales                       |  | 7%   |
|                                       | 1,047                                      |  |
| Other asset sales                     |  | 46%  |
|                                       | 995  |  |
| Foreign capital                       |  | 58%  |
|                                       | 1,650                                      |  |
| Rights issues                         |  | 53%  |
|                                       | 433  |  |
| Cost reductions/capital contributions |  | 44%  |
|                                       | 1,262                                      |  |
|                                       | <b>9,343</b>                               | <b>34%</b>                                   |
| <b><i>Debt Restructuring:</i></b>     |  |  |
| Rate reduction & deferral             |  | 96%  |
|                                       | 23,302                                     |  |
| Deferral                              |  | 93%  |
|                                       | 4,857                                      |  |
| Conversion to equity or CBs           |  | 78%  |
|                                       | 4,329                                      |  |
| Other*                                |  | 105%   |
|                                       | 2,412                                      |  |
|                                       | <b>34,900</b>                              | <b>94%</b>                                   |
| <b>Total</b>                          | <b>44,243</b>                              | <b>81%</b>                                   |

Source: FSS

\*Includes repayment and writeoffs.

**Table 3: Implementation of Capital Structure Improvement Plans**  
(in KRW trillions)

|                       | <u>Actual</u> | <u>Actual</u>   | <u>Required</u> | <u>Expected</u> |
|-----------------------|---------------|-----------------|-----------------|-----------------|
|                       | <u>1998</u>   | <u>99:1Q-3Q</u> | <u>99:4Q</u>    | <u>1998/99</u>  |
| <b>Hyundai</b>        | <b>2.6</b>    | <b>10.3</b>     | <b>5.9</b>      | <b>18.8</b>     |
| Asset/affiliate sales | 0.9           | 2.7             | 1.2             | 4.8             |
| Equity issues         | 1.7           | 7.6             | 4.7             | 14              |
| <b>Samsung</b>        | <b>4.5</b>    | <b>5.8</b>      | <b>-0.5</b>     | <b>9.8</b>      |
| Asset/affiliate sales | 2.1           | 1.9             | 0.5             | 4.5             |
| Equity issues         | 2.4           | 3.9             | -1.0            | 5.3             |
| <b>LG</b>             | <b>5.5</b>    | <b>7.3</b>      | <b>1.4</b>      | <b>14.2</b>     |
| Asset/affiliate sales | 3.1           | 5.2             | 0.8             | 9.1             |
| Equity issues         | 2.4           | 2.1             | 0.6             | 5.1             |
| <b>SK</b>             | <b>1.0</b>    | <b>3.3</b>      | <b>0.1</b>      | <b>4.4</b>      |
| Asset/affiliate sales | 0.3           | 1.2             | 0.2             | 1.7             |
| Equity issues         | 0.7           | 2.1             | -0.1            | 2.7             |
| <b>Total</b>          | <b>13.6</b>   | <b>26.7</b>     | <b>6.9</b>      | <b>47.2</b>     |
| Asset/affiliate sales | 6.4           | 11.0            | 2.7             | 20.1            |
| Equity issues         | 7.2           | 15.7            | 4.2             | 27.1            |

*Source: FSS*

**Table 4. Overview of Proposed Daewoo Workouts**  
(in KRW billions)

|                     | <i>Debt Deferral</i> |                    | <i>Debt Conversion</i> |               |              | <i>*</i>      | <b>Total</b> | <b>New Money</b> |
|---------------------|----------------------|--------------------|------------------------|---------------|--------------|---------------|--------------|------------------|
|                     | <b>Reduced Rate</b>  | <b>Normal Rate</b> | <b>Equity</b>          | <b>CBs</b>    | <b>Other</b> |               |              |                  |
| D. Corporation      | 6,044                | -                  | 2,000                  | 16,700        | 251          | <b>24,995</b> | 1,909        |                  |
| D. Heavy            | 7,556                | -                  | 1,349                  | -             | -            | <b>8,905</b>  | 148          |                  |
| D. Motors           | 6,751                | -                  | 1,470                  | 1,878         | -            | <b>10,099</b> | 2,154        |                  |
| Ssangyong Motors    | 1,587                | -                  | 130                    | -             | 19           | <b>1,736</b>  | 264          |                  |
| D. Telecom          | 1,054                | -                  | 200                    | 1,145         | 18           | <b>2,417</b>  | 318          |                  |
| D. Motor Sales      | -                    | 539                | -                      | -             | -            | <b>539</b>    | -            |                  |
| D. Electronics      | 3,689                | -                  | 395                    | 1,065         | 1,144        | <b>6,293</b>  | -            |                  |
| D. Electronic Comp. | 117                  | 36                 | -                      | -             | -            | <b>153</b>    | 5            |                  |
| Orion Electronics   | 1,230                | 121                | -                      | -             | -            | <b>1,351</b>  | 38           |                  |
| Kyungnam Ent.       | 92                   | 85                 | 134                    | -             | 218          | <b>529</b>    | 10           |                  |
| D. Capital          | 4,757                | -                  | 40                     | 138           | -            | <b>4,935</b>  | -            |                  |
| Diners Club         | 1,238                | -                  | -                      | -             | -            | <b>1,238</b>  | -            |                  |
| <b>Total</b>        | <b>34,115</b>        | <b>781</b>         | <b>5,718</b>           | <b>20,926</b> | <b>1,650</b> | <b>63,190</b> | <b>4,846</b> |                  |

*Source:* FSS

\*Includes monies already on deposit and available to offset *claims*.

**Table 5.: Completed Debt Restructuring in Thailand:  
(amounts in Baht millions)**

|                  | <b>Dec-98</b>  | <b>Jun-99</b>  | <b>Increase</b> | <b>Dec-99</b>    | <b>Increase</b> |
|------------------|----------------|----------------|-----------------|------------------|-----------------|
| Agricultural     | 2,573          | 11,887         | 9,314           | 23,841           | 11,954          |
| Mining           | 1,911          | 3,840          | 1,929           | 6,309            | 2,469           |
| Manufacturing    | 51,088         | 181,698        | 130,610         | 318,422          | 136,724         |
| Commercial       | 29,446         | 108,856        | 79,410          | 211,044          | 102,188         |
| Construction     | 2,869          | 14,922         | 12,053          | 33,144           | 18,222          |
| Real estate      | 33,733         | 81,480         | 47,747          | 166,478          | 84,998          |
| Public utilities | 4,728          | 12,613         | 7,885           | 40,430           | 27,817          |
| Services         | 20,086         | 80,707         | 60,621          | 131,796          | 51,089          |
| Consumption      | 7,721          | 38,811         | 31,090          | 83,448           | 44,637          |
| <b>Total</b>     | <b>154,155</b> | <b>534,814</b> | <b>380,659</b>  | <b>1,014,912</b> | <b>480,098</b>  |

*Source:* Bank of Thailand

**Table 6 Pipeline of Large/Medium-Sized CDRAC Cases**

|   | <b>Number<br/>of Cases</b> | <b>Outstanding<br/>Debt<br/>(Baht million)</b> | <b>% of<br/>Debt</b> |
|---|----------------------------|--|----------------------|
| Awaiting documentation/signature          | 91                         | 281,370  | 13%                  |
| <b>Completed</b>                          | <b>271</b>                 | <b>704,002</b>                                 | <b>33%</b>           |
| Cases underway (e.g., per DCA)            | 357                        | 436,904  | 20%                  |
| Cases awaiting DCA accession              | 872                        | 545,715  | 25%                  |
| <b>Voluntary cases underway</b>           | <b>1,229</b>               | <b>982,619</b>                                 | <b>46%</b>           |
| CDRAC recommendation for legal action     | 192                        | 366,860  | 17%                  |
| Independent legal action by creditors     | 35                         | 94,973   | 4%                   |
| <b>Troublesome cases for legal action</b> | <b>227</b>                 | <b>461,833</b>                                 | <b>21%</b>           |
| <b>Total</b>                              | <b>1,727</b>               | <b>2,148,454</b>                               | <b>100%</b>          |

**Table 7: Selected Restructuring Cases in Thailand: Allocation of Techniques  
(in Baht millions)**

| Sector             | Debt Restructuring |               |               | Self Help          |                  |                 | TOTAL          |
|--------------------|--------------------|---------------|---------------|--------------------|------------------|-----------------|----------------|
|                    | Forgiven           | Rescheduled   | Converted     | Debt Refinanc<br>e | Capital Increase | Sales of Assets |                |
| Agribusiness       | -                  | -             | 100           | -                  | 3,200            | 120             | 3,420          |
| Automotive         | -                  | -             | 1,200         | -                  | 5,400            | -               | 6,600          |
| Building materials | -                  | 46,410        | 2,310         | 50,000             | 28,037           | 4,000           | 130,757        |
| Chemical           | -                  | -             | -             | -                  | 10,200           | -               | 10,200         |
| Computers          | *                  | -             | 1,700         | -                  | 1,700            | -               | 3,400          |
| Contractors        | 6,033              | 1,722         | 1,060         | -                  | 3,082            | 1,186           | 13,083         |
| Electronics        | 738                | -             | -             | -                  | 1,573            | -               | 2,311          |
| Energy             | -                  | -             | -             | -                  | -                | -               | -              |
| Entertainment      | 292                | -             | -             | -                  | 3,238            | -               | 3,530          |
| Hotels             | -                  | -             | 369           | -                  | 1,885            | -               | 2,254          |
| Household          | -                  | -             | -             | -                  | -                | -               | -              |
| Manufacturing      | -                  | -             | 300           | -                  | -                | -               | 300            |
| Property           | 1,400              | -             | 3,834         | 5,000              | 20,714           | 1,088           | 32,036         |
| Transport          | -                  | -             | -             | -                  | 25               | -               | 25             |
| Telecoms           | -                  | -             | -             | -                  | 13,530           | -               | 13,530         |
| Total              | <b>8,463</b>       | <b>48,132</b> | <b>10,873</b> | <b>55,000</b>      | <b>92,584</b>    | <b>6,394</b>    | <b>221,446</b> |

Source: SEAMICO

The emphasis on financial self-help reflects that fact that the list includes some good and proactive companies. For instance, while not a CDRAC case Siam Cement's planned Baht 50 billion debt refinancing, Baht 400 million capital increase, and Baht 12 billion debt rescheduling are included in the table. Notably, TPI is not included.

**Table 8: Thai Corporate Interest Coverage and Leverage By Sector, 1996-1999**

|                  | EBITDA / Interest expense   |             |             |             | Liabilities/Equity          |             |             |             |
|------------------|-----------------------------|-------------|-------------|-------------|-----------------------------|-------------|-------------|-------------|
|                  | <u>1999:9-</u><br><u>mo</u> | <u>1998</u> | <u>1997</u> | <u>1996</u> | <u>1999:9-</u><br><u>mo</u> | <u>1998</u> | <u>1997</u> | <u>1996</u> |
| Agribusiness     | 4.51                        | 2.67        | 2.24        | 2.94        | 1.25                        | 1.51        | 2.68        | 1.72        |
| Building         | 1.37                        | 0.89        | 0.56        | 3.01        | 3.72                        | 3.14        | 5.14        | 2.78        |
| Chemicals        | 0.89                        | 1.37        | 0.92        | 3.53        | 3.89                        | 2.08        | 5.49        | 1.74        |
| Commerce         | 3.54                        | 1.54        | 1.97        | 5.78        | 1.52                        | 1.49        | 2.58        | 1.38        |
| Communication    | 2.04                        | 1.60        | 1.03        | 3.52        | 5.08                        | 4.43        | 9.22        | 1.99        |
| Electrical Prod. | 0.77                        | 0.11        | 1.03        | 2.74        | 42.89                       | N/M         | 8.38        | 2.41        |
| Electronics      | 12.29                       | 3.71        | 6.54        | 7.45        | 0.68                        | 0.90        | 1.30        | 1.27        |
| Energy           | 4.27                        | 3.33        | 2.91        | 3.28        | 2.05                        | 1.78        | 2.80        | 1.52        |
| Entertainment    | 1.98                        | (4.87)      | 9.30        | 18.20       | 0.74                        | 0.49        | 0.54        | 0.29        |
| Foods            | 10.58                       | 3.64        | 2.29        | 4.49        | 1.01                        | 1.10        | 1.71        | 1.39        |
| Health           | 0.72                        | 0.33        | 1.01        | 3.55        | 14.76                       | 5.14        | 4.92        | 1.42        |
| Hotel            | 2.42                        | 2.82        | 1.68        | 5.37        | 1.12                        | 1.06        | 1.14        | 0.91        |
| Household        | (0.97)                      | 0.93        | 1.09        | 3.08        | 77.43                       | 3.76        | 3.44        | 1.73        |
| Packaging        | 2.70                        | 1.11        | 2.07        | 4.58        | 4.75                        | 2.84        | 3.24        | 1.52        |
| Pharmaceutical   | 7.22                        | 2.16        | 1.73        | 4.41        | 0.45                        | 0.48        | 0.76        | 0.64        |
| Printing         | 4.08                        | 1.53        | 2.18        | 5.04        | 0.96                        | 0.29        | 1.52        | 0.89        |
| Property         | 0.50                        | (0.40)      | 0.36        | 3.73        | 10.43                       | 3.52        | 3.17        | 1.88        |
| Pulp & Paper     | 2.57                        | 1.94        | 1.51        | 1.11        | 2.02                        | 1.81        | 3.13        | 2.79        |
| Textiles         | 1.47                        | 1.15        | 1.72        | 1.86        | 2.96                        | 2.04        | 3.33        | 1.70        |
| Transportation   | 2.59                        | 6.08        | 8.09        | 3.77        | 6.32                        | 7.36        | 14.71       | 2.77        |
| Vehicles         | 3.58                        | 1.94        | 2.89        | 5.75        | 1.82                        | 1.98        | 4.64        | 1.78        |
| Miscellaneous    | 0.66                        | (2.36)      | (0.07)      | 1.79        | (8.04)                      | (24.19)     | 27.39       | 1.44        |
| <b>Total</b>     | <b>1.69</b>                 | <b>1.25</b> | <b>1.66</b> | <b>3.42</b> | <b>3.58</b>                 | <b>3.16</b> | <b>4.34</b> | <b>1.93</b> |

*Source:* Merrill Lynch

**Table 9: Jakarta Initiative Task Force: Registered Restructuring Cases**

| Industry Sector                   | Number of Cases (a)<br>(of which standstill or agreement in principle) |          | Debt Estimate(b) |          |                |           |
|-----------------------------------|--|----------|------------------|----------|----------------|-----------|
|                                   |  |          | US\$ billion     |          | Rupiah billion |           |
|                                   | June 1999  | Dec.1999 | June 1999        | Dec.1999 | June 1999      | Dec. 1999 |
| Agribusiness                      | 5 (1)  | 5 (1)    | 0.4              | 0.4      | 6.9            |           |
| Basic Industry                    | 27 (3)   | 34 (6)   | 5.5              | 6.8      | 3,104.0        | 3,980.8   |
| Chemicals                         | 10 (2)   | 10 (2)   | 3.5              | 3.5      | 604.0          | 604.0     |
| Consumer Goods                    | 4 (3)  | 6 (3)    | 0.4              | 0.4      | 65.9           |           |
| Textile and Garment               | 21 (1)   | 22 (2)   | 2.9              | 3.0      | 2,680.0        | 2,683.1   |
| Finance                           | 12 (1)   | 16 (2)   | 1.3              | 1.3      | 1277.0         | 1290.0    |
| Infrastructure and Utilities      | 9 (2)  | 10 (3)   | 0.5              | 1.0      | 386.0          | 386.0     |
| Mining                            | 5 (0)  | 5 (0)    | 0.5              | 0.5      | 0.5            |           |
| Property and Real Estate          | 62 (1)   | 76 (7)   | 1.2              | 1.3      | 3,668.0        | 3,797.7   |
| Trading, Services, and Investment | 43 (7)   | 63 (13)  | 3.6              | 3.7      | 731.0          | 763.0     |
| Transportation                    | 4 (0)  | 4 (0)    | 0.8              | 0.8      | 613.0          | 613.0     |
| Various                           | 49 (3)   | 72 (19)  | 0.7              | 0.7      | 469.0          | 533.0     |
| Total                             | 251 (24)   | 323 (58) | 21.4             | 23.4     | 13,605.3       | 14,666.7  |

Cases that either reached a final binding restructuring agreement between parties, a standstill agreement in principle, or an agreement in principle. Cases in parentheses include the latter two.

Aggregate indebtedness as reported by companies and their creditors. These numbers could be overstated or understated given the existence of undisclosed recent additional or paid debt.

*Source:* JITF

**Table 10: Indonesian Bank Restructuring Agency AMC:  
Active Debt Restructuring Cases(December 1999)**

| Restructuring Stage              | Number of Cases | Debt Estimate |                |
|----------------------------------|-----------------|---------------|----------------|
|                                  |                 | US\$ billion  | Rupiah billion |
| Initial Negotiation              | 515             | 1.85          | 19,553.8       |
| Standstill Agreement             | 16              | 0.0           | 1,239.0        |
| Advisory Assignment              | 199             | 1.82          | 17,071.3       |
| Due Diligence Underway           | 141             | 1.5           | 13,196.0       |
| Start Restructuring Negotiations | 46              | 0.4           | 6,777.5        |
| Finalize Restructuring Proposal  | 35              | 1.2           | 2,445.7        |
| Implement Restructuring Proposal | 7               | 0.1           | 65.0           |
| Total                            | 959             | 6.9           | 60,348.3       |

*Source:* IBRA

**Table 11: IBRA/AMI Shareholdings**

| <u>Bank</u>         | <u>Holding Company</u> | <u>CRI/PN</u><br><u>(In Rp-bns)</u> | <u>#</u><br><u>Companies</u> | <u>Status</u>                     |
|---------------------|------------------------|-------------------------------------|------------------------------|-----------------------------------|
| BCA                 | PT Holdiko Perkasa     | 52,726                              | 108                          | Holding Co<br>staffed/operational |
| BDNI                | PT Tunas Sepadan I     | 28,408                              | 12                           | Holding Co<br>staffed/operational |
| BUN-Hassan<br>Group | PT Kiani Wirudha       | 5,340                               | 30                           | 8 transfers complete(1)           |
| BUN-Ongko<br>Group  | PT Arya Mustika MA     | 8,347                               | 20                           | Final closing due 21<br>MAR 00    |
| Danamon             | PT Bentala Kartika A   | 12,533                              | 26                           | Completed                         |
| Modern              | PT Cakrawala Gita P    | 2,663                               | 10                           | Completed                         |
| Surya               | Direct                 | 1,886                               | 5                            | 4 completed                       |
| Hokindo             | TBT                    | 331                                 | 12                           | Closing in progress               |
| <b>Total</b>        |                        | <b>112,234</b>                      | <b>223</b>                   |                                   |

*Source: IBRA*

(1) 10 conditional and 9 to be replaced with cash

**Table 12: Danaharta's Pipeline of Workout Companies, at end-1999  
(amounts in RM billion)**

| <u>Stage of Process</u>                      | <u>Borrowers</u> |            | <u>Debts</u>  |            |
|--|------------------|------------|---------------|------------|
|  | <u>Number</u>    | <u>%</u>   | <u>Amount</u> | <u>%</u>   |
| Process not yet started                      | 686              | 29         | 5.7           | 12         |
| Awaiting submission of proposal              | 182              | 8          | 4.1           | 9          |
| Proposal submitted for evaluation            | 585              | 25         | 15.8          | 35         |
| Proposal evaluated and awaiting finalization | 103              | 4          | 2.5           | 6          |
| Workout proposal finalized                   | 582              | 25         | 12.6          | 28         |
| Fully settled                                | 68               | 3          | 1.7           | 3          |
| Performing                                   | 139              | 6          | 3.1           | 7          |
| <b>Total</b>                                 | <b>2,345</b>     | <b>100</b> | <b>45.5</b>   | <b>100</b> |

*Source: Thillainathan, 2000*

**Table 13: Summary of Restructuring Approaches for Completed CDRC Cases  
(amounts in RM billions)**

| <u>Method</u>             | <u>All Cases</u> |              | <u>Excluding Renong and UEM</u> |              |
|---------------------------|------------------|--------------|---------------------------------|--------------|
|                           | <u>Amount</u>    | <u>%</u>     | <u>Amount</u>                   | <u>%</u>     |
| Rescheduling              | 277              | 2.1          | 277                             | 5.8          |
| Debt/Equity conversion    | 661              | 5.0          | 661                             | 13.8         |
| Conversion into term loan | 185              | 1.4          | 185                             | 3.9          |
| Conversion into bonds     | 11,632           | 87.3         | 3,083                           | 64.5         |
| Equity injection          | 110              | 0.8          | 110                             | 2.3          |
| Debt write-off            | 71               | 0.5          | 71                              | 1.5          |
| Sale of assets            | 211              | 1.6          | 211                             | 4.4          |
| Capital reduction         | 183              | 1.4          | 183                             | 3.8          |
| <b>Total</b>              | <b>13,330</b>    | <b>100.0</b> | <b>4,781</b>                    | <b>100.0</b> |

*Source:* Rajandram, 2000, cited by Thillainathan

**Table 14: GDP Growth Rates, 1995-1999**

|           | <b>1995</b> | <b>1996</b> | <b>1997</b> | <b>1998</b> | <b>1999</b> |
|-----------|-------------|-------------|-------------|-------------|-------------|
| Indonesia | 8.2         | 7.8         | 4.7         | -13.5       | 0.2         |
| Korea     | 8.9         | 6.7         | 5.0         | -5.8        | 9.0         |
| Malaysia  | 9.4         | 8.6         | 7.7         | -7.5        | 5.4         |
| Thailand  | 8.8         | 5.5         | -0.4        | -10.2       | 3.9         |

**Table 15: Options for 1997-1999--De-Leveraging of the 30 Largest Chaebols  
(in KRW billions)**

| <b>Balances</b> | <b>Liabilities</b> | <b>Equity</b>  | <b>L/E Ratio</b> | <b>Resolution Method</b>                         |
|-----------------|--------------------|----------------|------------------|--|
| At 12/31/97     | 456,308            | 75,592         | 604%             |  |
|                 | (48,647)           | (1,947)        |                  | Court-supervised insolvency                      |
|                 | (12,000)           |                |                  | Foreign investment/asset sales                   |
|                 |                    | 1,200          |                  | Normal increase in retained earnings             |
|                 |                    | 2,500          |                  | Increase in retained earnings from restructuring |
|                 | (8,250)            | 8,250          |                  | Domestic equity issues                           |
|                 | (5,250)            | 5,250          |                  | Offshore equity issues                           |
| <b>Subtotal</b> | <b>382,161</b>     | <b>90,845</b>  | <b>421%</b>      |  |
|                 |                    | 0              |                  | Asset revaluations                               |
|                 | (16,031)           | 16,031         |                  | Debt/equity conversions (to 15% of equity)       |
| <b>Subtotal</b> | <b>366,130</b>     | <b>106,876</b> | <b>343%</b>      |  |
|                 | (76,190)           | 38,095         |                  | Other – to be determined                         |
| At 12/31/99     | 289,940            | 144,971        | 200%             |  |

*Source:* World Bank staff estimates, based on SBC Warburg Dillon Read, May 1998

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