RESTRUCTURING
A Progress

East meets West in Kuala Lumpur.

BANGKOK, THAILAND, MARCH 11, 1999 *An Australian executive working for Deloitte Touche Tohmatsu was shot dead here on Wednesday morning while on his way to a sugar mill which his firm is assisting in financial restructuring, police said. Michael Wansley, 58, was shot eight times by a gunman on a motorcycle and was pronounced dead on arrival at hospital. Wansley was travelling in a van driven by an employee of the sugar mill, an affiliate of Ruampol Industries, along with four Thais – two men and two women. Police said certain groups of people do not want the restructuring to succeed for fear of losing their interests.* —The Nation

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JEFFREY AARONSON/NETWORK ASPEN

EAST ASIA
Report

Somebody down there doesn't like us.

by Uwe Parpart

The murder of Michael Wansley, carried out by professional hit men, made headlines worldwide. And it prompted a Bangkok meeting of the "Big Five" international accounting firms to warn that debt restructuring in Thailand would not proceed if local authorities could not assure the safety of their personnel.

Fair enough, though the Deloitte Touche Tohmatsu country manager and local staff (numbering over 500) should have known that they were sending the locally inexperienced Wansley into a dangerous situation without taking precautions. These days, expertise in risk assessment – on which D.L.T. prides itself – cannot prudently be limited to financial risk.

This time, there really is light at the end of the tunnel.

Even in the boom years of the early 1990's, battles over market share or political rows over wealth distribution in East Asia were never pretty: The going price in Thailand for a drive-by killing was just $1,000. But now that the very existence of businesses is at issue, things have gotten really nasty: The price for assassinations is down 30 percent.

That's the situation on the ground – one playing out somewhat differently in Thailand and Indonesia than in Korea or Malaysia – as losses from some $300 billion in bad loans are being off-loaded in the process politely called "debt restructuring." The $300 billion figure, by the way, does not include losses in China or Japan, or an estimated $1 trillion in lost stock-market capitalization in East Asia.

After an initial spurt of activity that saw enactment of new bankruptcy laws and foreclosure procedures in most of the crisis economies, progress has been slow. And, ironically, recent gains in equity markets and stirrings of industrial recovery are adding to the inertia: Why restructure or sell when return of the good times is just around the corner?

Still, there can be no question that Asia must bite this bullet or be in danger of biting the dust. Should the financial and political systems prove as inept at deciding who will bear the losses as they previously were at passing out loans, recovery will be hard to come by.

On the other hand, it is clear that, once the debt logjam is broken, capital markets will be far friendlier to entrepreneurial initiative than in pre-crisis days. The dozen or so political/business cliques that have ruled the roost for decades in each East Asian country will not be left to beg for handouts. But their share of wealth – and influence – will be greatly reduced.

Meanwhile, each government's need to raise money for deficit spending and rehabilitation of its financial system is for the first time creating lively and liquid markets in debt securities – markets that will challenge the dominance of banks bred to a world of crony capitalism. Indeed, capital is being "democratized" on a scale unthinkable before the Asian crisis. As this drama plays out, capital markets are bound to become more efficient at channeling resources to profit-driven industries.

THE LOSERS – AND THEIR LOSSES

The businesses that Michael Wansley was attempting to restructure before he was shot had racked up some $450 million in debt – a respectable tally for a bunch of sugar mills in the boondocks. And sugar got only a modest piece of the action: The largely unrecoverable loans extended to political and business cronies by the Bangkok Bank of Commerce, Thailand's most notoriously corrupt bank, reached $2 billion before the institution was finally shuttered in November 1998.

But wait, the numbers get a lot bigger. The 56 finance companies closed by the Thai government in 1997 held some 900 billion baht ($25 billion) in assets, which are being auctioned by the country's Financial Restructuring Authority (F.R.A.) for 10 to 30 cents on the dollar. The non-performing loans held by Thailand's banking system are currently estimated at 2.7 trillion baht ($73 billion) and represent nearly 50 percent of all loans outstanding – not to mention 50 percent of Thailand's G.D.P. Some $50 billion in bank debt will likely go down the drain.

Those are scary figures. Some combination of investors and taxpayers, domestic and for-

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eign, will have to take a hit of $70 billion or more from bad loans, not to speak of the additional tens of billions of dollars in equity markets losses and real estate depreciation.

In Korea, Malaysia and Indonesia, credible estimates of net loan losses run around $200 billion. It is worth noting, though, that Korea and Malaysia have made better progress getting non-performing loans off the balance sheets of lenders.

As an aside, it is astonishing that, in the words of the Bank for International Settlements, European bank lending was "well sustained until the very last stage of the crisis." So, don't just blame Asian crony capitalism for the current malaise. Plenty of foreign banks now bewailing the need to take haircuts, lent with reckless abandon.

As loan losses are recognized on balance sheets, the impact on the wealth of the families that for decades have dominated business in East Asia is dramatic. When a Thai-Chinese media tycoon held a fancy lawn party in November 1994 to inaugurate his swank Bangkok corporate headquarters, superstar Chinese actor John Low and members of the Beijing Opera and Symphony were on hand to mark the occasion, and the beverage of choice was Chateau Margaux. Three years later, when Chatri Sophonpanich, the boss of the Bangkok Bank (Southeast Asia's largest), invited members of Thailand's best-known business families to a year-end party, the proffered drink was Coke. To rub in the point, the bank boss greeted his guests not as his fellow tycoons, but as "the millionaires of yesterday."

Stijn Claessens and Simeon Djankov of the World Bank, along with Larry H.P. Lang of the University of Chicago, have documented the concentration of wealth before the Asian crisis. They found, for example, that the top 15 families controlled well over 50 percent of business in Indonesia, the Philippines and Thailand. In Hong Kong and Korea the comparable figure was 35 percent; in Malaysia and Singapore, about 30 percent.

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BEVERLY BROWN/PHOTONICA

This is now rapidly changing as the result of bankruptcies, debt restructuring and bank recapitalization. Top family holdings have been diluted and ownership is becoming far more widely dispersed with foreign ownership, in particular, increasing rapidly.

In Thailand, the total wealth of the richest 20 business families is now no more than 20 percent of what it was in pre-crisis days. Two of the 15 commercial banks are in foreign hands and, by early next year, foreigners will control another four. Numerous surviving finance and securities companies have met the same fate, as have some of the large Thai-controlled manufacturers. In all, only two of Thailand's 20 wealthiest families (the ones operating hotel and telecommunications businesses) have emerged unscathed.

In Indonesia, the shift in wealth will likely

be even more drastic. The disenfranchisement of the Suharto family, which once controlled over 400 businesses, will make a big difference. And the fact that one of Indonesia's largest and once-proudest private banks, P.T. Bank Bali, is now passing into foreign hands (Standard Chartered) is an indicator of things to come.

In Korea, two of the country's top five banks (Seoul Bank and Korea First Bank) have been nationalized and are in the process of being sold to foreign investors. Even the big five *chaebol* (business conglomerates) are no longer immune to foreign inroads – though President Kim Dae-jung has yet to deliver on his avowed goal of cutting them down to size.

Only in Malaysia, where Prime Minister Mahathir Mohamad and his ruling UMNO. party have successfully resisted pressure to ease foreign access and have chosen bailouts as the preferred mode of dealing with insolvencies, has change in ownership been slow. Danaharta, the country's bank restructuring and asset management agency, has thus far purchased some $7 billion of the estimated $25 billion in non-performing loans at 50 percent or greater discounts. And it is beginning to sell them off – even to foreign investors. But key business groups with close ties to the ruling party remain politically protected and change will be far slower than in Thailand, Indonesia and Korea.

THE POLITICS OF CRISIS

Early this year, half a dozen members of the Thai Senate, an unelected body with substantial oversight powers, traveled to Washington to air their complaints. They had heard that Congress was highly critical of the role of the I.M.F. in Asian crisis management. And they expected a sympathetic hearing.

Their beef: The I.M.F. was imposing unreasonable conditions on both the content and speed of enactment of new bankruptcy legislation. That several of them were large debtors who stood to lose everything once the new rules were on the books went unmentioned. But they had misjudged Congressional sentiment, and returned to Bangkok red-faced and empty-handed. No one, it seems, had told them that United States legislators objected to the use of American taxpayer money to bail out the likes of the honorable Thai Senators.

Still, the fight over the bankruptcy law and proposals to liberalize foreign access to business and the real estate dragged on until April. All told, it took a full year to get the new laws passed. Thailand's first bankruptcy court put out its shingle in June with only 13 judges, though 60 are needed to handle the expected case load.

Meanwhile, rationalization of corporate debt, in the words of Financial Restructuring Authority chief Amaret Sila-on, has been "excruciatingly slow." Of nearly 400 major cases identified last October by the Bank of Thailand's Corporate Debt Restructuring Advisory Committee, less than 10 percent have been resolved.

The reason? Amaret offered the four C's in a speech in Hong Kong in May. Cronyism, collusion, corruption and complacency, he said, are the "four modern horsemen of the apocalypse" for Thailand. "Unless these perverse social aspirations are kept in check, bank restructuring – or any restructuring for that matter – will be ineffective and gains will be short-lived."

There are "strategic debtors" – debtors able but unwilling to pay – aplenty, and they include some of Thailand's largest corporations. But bankers are reluctant to call old business buddies on the carpet, preferring instead to wait things out and find new

sources of capital even at the expense of diluting their own holdings.

The biggest mistake both he and the Bank of Thailand made, explains Amaret, was to "underestimate the backlash" from vested interests. Indeed, the "nationalist" parliamentary opposition is accusing the reform government of Prime Minister Chuan Leekpai of selling the country to foreigners on the cheap.

In Indonesia, politics has opened since the May 1998 ouster of the repressive and corrupt regime of President Suharto. The parliamentary elections, held in June, have restored a degree of investor confidence in the country.

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But that doesn't mean an early resolution of the country's banking and corporate debt crisis is in sight.

Efforts to delay reform of the antiquated bankruptcy legislation going back to the Dutch colonial period were unsuccessful. The new law has been in place since September 1998, and a new commercial court was established soon thereafter.

But only 50 or so bankruptcy petitions had been filed as of March, and less than one-third have resulted in bankruptcy judgements. The rest were rejected on spurious grounds or are still pending. Indeed, not a single major debt-laden conglomerate has even faced bankruptcy petitions from its lenders. Two high-profile cases brought by foreigners against smaller companies were either thrown out by the Jakarta Commercial Court or later overturned by the country's Supreme Court.

As in Thailand, political collusion has prevented some cases from getting to court. In others, just plain inexperience with the new legal procedures has prevented satisfactory settlements. Business cultures don't change overnight.

Korea has had adequate bankruptcy laws for years. And enforcement, once a case is brought, is not a major problem. But as noted before, debt restructuring is a thorny political issue in Korea. A popular reform president is struggling to disentangle cross-shareholding among the *chaebol*, with financial institutions and bureaucrats colluding to keep it tangled. A year ago, Kim extracted a commitment from the five largest *chaebol* to bring their debt/equity ratios down to the 2:1 range. And guess what: They did.

TOM HALEY/SIPA PRESS

Or at least they claimed they did. On closer inspection, it turned out that their actual debt had not been reduced by a penny, but that creative accounting endorsed by the government bureaucracy had done the trick.

Foreign executives based in Korea have time and again warned that failure to reduce the debt load of the *chaebol* will make the current business recovery unsustainable. President Kim sees it the same way, and has both the popular backing and political will to see

the fight through. But it would be a huge mistake to assume that the family oligarchs controlling the *chaebol* will roll over any time soon.

On a recent assignment to Seoul, I had the opportunity for an off-the-record chat with a feisty *chaebol* chairman. "Debt is a political power issue," the man said. "Debt is leverage. We are too big to go under; Chrysler was too big to go under. Why should we convert debt to equity and dilute our holdings?" Doesn't that say it all?

There is an important point to add in Malaysia – not an excuse, but perhaps an insight into Malaysian leaders' reluctance to take on the corporate sinners.

We are too big to go under," explained the feisty chaebol chairman. "Why should we convert debt to equity and dilute our holdings?"

In 1969, the new Malaysian state was nearly destroyed by ethnic riots. It was a formative experience for Malaysia's current leaders – notably Prime Minister Mahathir Mohamad and his economic czar Daim Zainuddin. And, no doubt, memories were stirred in May 1998 when Indonesians rioted, Jakarta's Chinatown was ransacked and ethnic Indonesian Chinese refugees fled to Malaysia by the tens of thousands.

This is not the sort of stuff that I.M.F. officials or American institutional investors normally give much weight to. But it is the business of political leaders entrusted with the responsibility for keeping a volatile multiethnic society on an even keel.

Mahathir's claims that foreign hedge-fund operators caused the Asian crisis are patently silly. The harsh judicial treatment meted out to his former deputy Anwar Ibrahim was a travesty of justice. And capital controls did little or nothing to restore Malaysia to economic health.

But the country did stay in one piece and experienced little of the social disruption or hardship that hit Indonesia, Korea and Thailand last year. Capital controls allowed an easing of credit in Malaysia well in advance of the rest of East Asia. The controls also cushioned the fall of the Malaysian economy and prevented a bad economic situation from being transformed into an untenable social and political one.

Investors are well advised to take such political factors into account. One day soon, I predict, Mahathir will abandon capital controls with a flourish.

DEMOCRATIZATION OF ASIAN CAPITAL?

Reeling under the impact of currency devaluation, evaporating stock values, insolvent banks, collapsing corporations and skyrocketing unemployment, East Asian governments responded with alacrity in their first crisis year. Most liberalized markets and removed restrictions on foreign ownership. Indeed, a decade of "normal" development would not have brought the changes that one crisis year prompted with little opposition.

Meanwhile, substantial changes in wealth distribution and corporate control are breaking the stranglehold of a few oligarchical families. To date, foreigners are the main beneficiaries. At the onset of the crisis, there

were no foreign-owned financial institutions or securities firms operating in the crisis countries; next year, there will be dozens. By the same token, foreign holdings in East Asian industrial corporations will have increased nearly tenfold by the end of 2000.

Few analysts doubt that a recovery is under way – a conviction that is mirrored in both stock-market indices and GDP growth figures for the first half of 1999. Unfortunately, though, this has encouraged large numbers of local firms and politicians to believe that debt restructuring can be postponed indefinitely. And that is the current Achilles heel of the recovery process. Should complacency prevail, the good news will be buried in another decline.

In the end, the political will and savvy of the region's new reform-minded middle class will determine the outcome. And happily, betting on East Asia's middle class is looking like a good wager.

In Thailand, the government of Democrat Party Prime Minister Chuan Leekpai has weathered several storms. Next year's elections under the new, more liberal constitution enacted in early 1998 will either bring him back or see him replaced by the equally reform-oriented telecommunications tycoon, Thaksin Shinawatra.

In Indonesia, the leading candidate for president, Megawati Sukarnoputri, the daughter of first post-independence president, rode to parliamentary victory on the shoulders of the urban middle class. Whatever her political and economic policy shortcomings, she will not betray her reform mandate. Neither, I would argue, would any compromise candidate who gained the top office in Indonesia.

In Korea, President Kim is so firmly in the saddle that even his supporters worry about excessive presidential power. But he did not endure prison and years in exile just to turn around and ditch his reform agenda.

Malaysia's Mahathir, I predict, will prove that he can win one more election and then call it quits. His successor, no doubt from Mahathir's UMNO party, will cautiously embark on a reform course already mapped out by current economic advisers. Thus, while the guardians of the past may delay political and financial reform, that is all they will be able to do.

East Asia's new leaders will be greatly strengthened in their quest by two seemingly incidental developments in the region's finances. Governments, whether in Thailand or Korea, Indonesia or Malaysia, have been forced to issue bonds in unprecedented amounts in order to write down bank liabilities and to cover deficit spending. At the same time, corporations have discovered the advantages of bonds over bank loans at a time of contracting bank lending. Meanwhile, newly established (in Thailand) or existing secondary equity markets (in Korea and Malaysia) are making it easier for medium-size industries to raise capital.

Liquid markets in debt and equity will no doubt eclipse banks as financial intermediaries in Asia – just as they did in the United States. And that will lead to greater financial transparency, more reliable market valuation of corporate assets, and, ultimately, to capital access for deserving new ventures. Another serendipitous result: wider participation of households in capital ownership, along with mobilization of middle-class savings for sustained economic growth.

But perhaps the most important benefit of more efficient markets will be political. As the democratization of capital is increasingly perceived as a liberating force, the comeback paths for the oligarchs will be cut off and political democracy will take root. M