4
Thailand

Piman Limpaphayom[1]

4.1 Introduction

In May to July 1997, the Thai baht came under pressure from speculative attacks, heralding not only a financial crisis in the country, but also the stalling of East Asia's "economic miracle." After mounting an aggressive defense of the currency, the Thai Government conceded and adopted a floating exchange rate regime. Thailand's crisis exposed similar vulnerabilities in other East Asian economies, with the currencies of Indonesia, Republic of Korea (henceforth, Korea), Malaysia, and Philippines all depreciating significantly.

The crisis in Thailand stemmed directly from unsound macroeconomic policies and imbalances. But it also laid bare weaknesses in both the financial and corporate sectors. The banking system, poorly regulated and sheltered from competition, had been plagued with prudential problems for a long time. It was inefficient in financial intermediation. Instead of serving as a buffer between the large inflow of foreign capital and the corporate sector, the banking system merely validated the financial risks.

The corporate sector also contributed significantly to the crisis, with Thai corporations overutilizing short-term foreign currency-denominated loans. For the period 1994-1996, annual short-term capital inflows to Thailand were equivalent to 7-10 percent of gross domestic product (GDP). In the prelude to the 1997 crisis, short-term private debt obligations grew to about 60 percent of total private sector debts. The majority of these debts were not properly hedged. As a result, Thai corporations were collectively overexposed to exchange rate risks. The fixed exchange rate policy, coupled with financial liberalization and deregulation in the absence of an effective regulatory and supervisory system, magnified the impact of these problems on the economy when the crisis hit.

---

[1] Associate Professor, Faculty of Business, Asian University of Science and Technology, Chonburi, Thailand. The author wishes to thank Juzhong Zhuang, David Edwards, both of ADB, and David Webb of the London School of Economics for their guidance and supervision in conducting the study, the Stock Exchange of Thailand for its help and support in conducting company surveys, and Lea Sumulong and Graham Dwyer for their editorial assistance.

There is now a consensus that weak governance was partly responsible for the corporate sector's poor financing and investment practices. Key factors that led to weak corporate governance include the ineffectiveness of the regulatory framework, lack of transparency and adequate disclosure, and a family-based corporate ownership structure. This study examines these and other factors that might have weakened corporate sector governance in Thailand, focusing mainly on the companies listed in the Stock Exchange of Thailand (SET).

Section 4.2 discusses the development of the Thai corporate sector under the National Economic and Social Development Plans, its growth and financial performance, as well as its legal and regulatory framework. Section 4.3 looks at corporate ownership patterns that resulted in inadequate protection for minority shareholders and weak corporate governance in Thailand. Section 4.4 provides an overview of Thailand's financial markets and examines patterns of corporate financing and investment in the years prior to the 1997 crisis. Section 4.5 discusses how the corporate sector contributed to the financial crisis and looks at its impacts. The study then considers policy recommendations with emphasis on corporate governance improvement.

4.2 Overview of the Corporate Sector

4.2.1 Historical Development

The corporate sector has long been considered the engine of Thailand's economic growth, with government policy providing support but avoiding direct interference. The country initiated national economic development planning in 1961 when the economy was growing rapidly. The National Economic and Social Development Board was created to plan the country's economic and social development.

The First and Second Plans (1961-1971)

Under the first two plans, the Government implemented major infrastructure projects and modified its tax policy to encourage capital investment and savings. Import tariffs on machinery and heavy equipment were removed. To protect domestic industries, the Government increased tariffs on products that could be produced locally, while new industries were encouraged to reduce the need for imports.

During this period, gross national product grew by about 7 percent per year, with the agricultural sector the major contributor. Industrial sector growth was also rapid and many industries (tires, textiles, chemicals, canned foods, processed steel, and automobile assembly) emerged. But the sustained importation of heavy machinery and equipment resulted in large trade deficits. However, capital inflows, especially foreign aid from the United States, helped offset these deficits. Inflation levels were low, averaging 1.6 percent per year. Consequently, the value of the baht remained stable.

The Third, Fourth, and Fifth Plans (1972-1986)

An economic downturn at the end of the Second Plan led to an adjustment in policies. External factors, including a weakening of the dollar, and increases in world food and oil prices, resulted in increases in the current account deficit, leaving the Government no choice but to resort to overseas borrowings. Budget deficits also increased throughout the Fourth Plan. Thus, the government's debt burden escalated. Inflation reached 15.5 percent in 1973 and 24.3 percent in 1974, remaining high until 1981.

The Government had to shift emphasis to restoration of economic stability, using tax policy to control prices of consumer goods and implementing several price control measures to curb inflation. At the same time, it proceeded with its development plan for the industrial sector. As a result, the industrial sector grew at a faster rate than the agricultural sector. Unemployment, however, became a major problem as domestic investment declined.

The Government decided to embark on restructuring measures in the Fifth Plan (1982-1986) to rehabilitate the ailing economy. The focus shifted to export promotion, with the devaluation of the baht in 1984 a major step in this direction. The results were increased exports, an improved trade balance, and reduced current account deficits. The decline in imports was steady. In the wake of lower world oil prices and the rapid growth in income from the tourism and travel industry, the current account registered a surplus in 1986.

Budget deficits remained a major problem during the Fifth Plan, however. The average budget deficit reached an all-time high of $2.15 billion per year or 4.4 percent of GDP. To close the fiscal gap, the Government borrowed $6.4 billion from overseas and increased taxes on numerous items, including luxury goods. Average growth for the period was 4 percent per year, lower than anticipated due to a worldwide economic recession.

The Sixth Plan (1987-1991)

Industrial sector productivity improved gradually during the Sixth Plan period, while exports expanded considerably. From 1989, the Government successfully balanced the budget and even settled its foreign debt of $4 billion before this was due. Growth rates during 1987-1991 ranged from 9.5 to 13.2 percent per year, averaging 10.5 percent. The manufacturing sector became a dominant force in the economy, increasing its share in total export value from 42 to 76 percent. The country also attracted a large amount of foreign direct investments (FDIs), reaching an annual inflow of $2 billion in 1991. Most of the FDIs—originating mainly from Japan; United States; Singapore; Europe; and Hong Kong, China—went to export-oriented manufacturing industries. The exchange rate was steady at around B25 to the dollar.

The Seventh Plan (1992-1996)

The economy's performance from 1992 to 1996 generally met the targets of the Seventh Plan. Average annual growth in real GDP was 8 percent, compared with the 8.2 percent target. Private sector investment grew at an average annual rate of 7 percent, lower than the target of 8.8 percent. Growth of exports and imports averaged 14.2 and 13.6 percent, respectively, compared with the 14.7 and 11.4 percent targets. Inflation was 4.8 percent, better than the 5.6 percent target of the Seventh Plan.

Thailand's rapid growth up to the mid-1990s made the country one of the world's fastest-growing economies. Key to this growth performance was the government's adoption in 1993 of an aggressive program for attracting foreign capital to finance domestic investments. The country's high ratings in the international capital market, combined with its liberal financial policies, invited a deluge of capital seeking profitable investments. Thailand became a debtor's market, with private foreign debt reaching $92 billion by the end of 1996, from only $31 billion in 1992.

On top of its predominantly "borrowed" nature, the bulk of domestic investments went to speculative ventures such as real estate, property development, and the stock market, rather than to productive activities. By 1995, an oversupply of housing emerged. With loans increasingly becoming expensive and hard to come by due to a lending squeeze by the central bank and high interest rates, compounded by a slump in property sales, the property sector began to collapse in 1996.

Toward the end of the Plan period, the signs of an economy about to falter were there. Exports went into a tailspin, with growth shrinking from 23.8 percent in 1995 to 1.3 percent in 1996, on account of an overvalued baht that weakened export competitiveness. The country had a current account deficit of about 8 percent of GDP in 1995 and 1996. A series of increases in customs and excise taxes on luxury imports did little to stem rampant consumer spending. The deficits caused the Government to rely on even more external borrowing, which raised the debt service ratio.

4.2.2 Development of Capital Markets

Although the corporate sector has long been the government's main tool for economic development, the capital markets didn't play a significant role until 1975. Included in the Second Plan (1967-1971) was a proposal to establish the country's first authorized and regulated securities market. Its most crucial role was to help mobilize funds to support Thailand's industrialization and economic development. In 1969, a former Chief Economist from the US Securities and Exchange Commission, Sidney M. Robbins, prepared a comprehensive report entitled "A Capital Market in Thailand," which later became the master plan for the development of the Thai capital market. In his report, Robbins recommended an overhaul of the existing informal stock market established earlier by a group of local brokers in favor of a centrally regulated institution.

In 1972, the Government amended the "Announcement of the Executive Council No. 58 on the Control of Commercial Undertakings Affecting Public Safety and Welfare," extending its control and regulatory powers to the finance and securities companies operating freely at the time. In May 1974, the establishment of the Securities Exchange of Thailand (SET) was legislated and trading began on 30 April 1975. SET officially became "the Stock Exchange of Thailand" in 1991.

In 1978, the Government passed the Public Limited Company Act, placing all publicly listed companies under regulation. However, many companies considered the Act too restrictive and a hindrance to growth.

Before the capital market emerged, the corporate sector's main source of funding was the banks. And because the Government considered the banking system vital to the development of the economy, its policy had always been to protect domestic banks. Foreign banks were barred from competing directly with domestic banks, a policy that held throughout the first six economic development plans. Under the 1962 Commercial Banking Act, which was amended in 1979 and 1985, the Bank of Thailand and

the Ministry of Finance had full authority to supervise all commercial banks. At the end of the Sixth Plan, there were 29 commercial banks (15 domestic and 14 foreign banks) in Thailand.

With the liberalization of financial markets, Thai banks gained access to a variety of funding sources from around the world. The resulting availability of funds propelled the corporate sector's growth through the early part of the 1990s.

However, the financial and banking laws were generally ineffective. The regulatory measures were inadequately designed and poorly enforced. The banks and finance companies operated at insufficient levels of reserve capital and were overexposed in high-risk businesses such as real estate. While the Bank of Thailand had the regulatory power to influence business practices, it usually relied on "moral suasion." The Government also granted financial institutions overly generous bailouts, creating a moral hazard problem—the perverse expectation that imprudent bank behavior would be rewarded with forbearance and bailout.

In the 1990s, Thailand's capital market entered a new era with improved legislation and regulation, increased financial market activities, and new financial instruments. Laws were enacted to stimulate growth of the corporate sector. The Public Company Act of 1992 relaxed some of the rules and restrictions contained in the original laws, while the Securities and Exchange Act (SEA) the same year sought to improve capital market supervision.

The introduction of these two laws came just after the Government's signing of Article VIII of an Agreement with the International Monetary Fund (IMF) in May 1990 to deregulate and liberalize financial markets. Thailand discarded controls on foreign exchange transactions and capital flows—a turning point for the Thai corporate sector.

A number of internal and external factors contributed to the Thai Government's acceptance of the IMF's Article VIII agreement. Economic growth had been rapid and domestic savings could not keep up with the pace to support investments. Financial deregulation and liberalization allowed the country to attract foreign savings and investments that helped finance the growth of the economy.

Externally, the Government was under international pressure to deregulate the financial sector. Earlier, the World Bank had recommended such a move, and the General Agreement on Tariffs and Trade (GATT) meeting in Uruguay had the liberalization of financial services on its agenda. The pressure dovetailed with the Government's intention to make Bangkok one of the financial centers of the region, to cater specifically to its

fast-growing neighbors. Financial deregulation and liberalization were key to realizing that vision. The Bangkok International Banking Facility (BIBF) was thus established to facilitate international borrowings and encourage capital flows as a means of financing the current account deficit.

The stock market boom from 1991 until the financial crash of 1997 reflected international investors' response to Government policies. The result was a corresponding growth and development in Thailand's capital markets. Worldwide, the country became recognized as an economic development model for other emerging economies.

4.2.3 Growth and Financial Performance

Since the 1978 enactment of the Public Limited Company Act, about 661 companies with total registered capital of B2.1 trillion and paid-up capital of B1.3 trillion have been registered with the authority (Table 4.1). The majority of the companies are in manufacturing, finance, and wholesale/ retail trade and restaurant/hotel sectors, in that order. In terms of capital, however, the financial sector is the largest, with B1.4 trillion in registered capital and B791 billion in paid-up capital. The manufacturing sector is a far second with registered capital of B350 billion and paid-up capital of

Table 4.1
Public Companies Registered, 1978-2000

Type of Business	Number of Companies	Registered Capital (B billion)	Paid-up Capital (B billion)
Agriculture, Hunting, Forestry, and Fishing	5	1.9	1.2
Mining and Quarrying	6	16.6	11.9
Manufacturing	245	350.1	261.0
Electricity, Gas, and Water	5	30.9	19.6
Construction	13	34.5	23.3
Wholesale and Retail Trade, and Restaurants and Hotel	129	111.0	83.1
Transport, Storage, and Communication	22	110.9	78.5
Financing, Insurance, Real Estate, and Business Service	194	1,394.5	791.0
Community, Social and Personal Service	42	50.6	21.6
Total	**661**	**2,101.0**	**1,291.2**

Note: The data for 2000 is as of October 2000.
Source: Department of Commercial Registration, Ministry of Commerce, Thailand.

B261 billion. The preeminence of the financial sector is a direct result of financial deregulation and liberalization.

The development of the corporate sector closely followed the development of capital markets. After the passage of the SEA of 1992, the value of public offerings rose steadily, reaching a precrisis peak in 1996 (Table 4.2). Debt market activities also increased significantly with the establishment of the Bond Dealers' Club (BDC) in 1994. Domestic and offshore debt issues reached B54.7 billion and B27.8 billion, respectively, from only B20.5 billion and B1 billion the previous year.

Table 4.2
Public Offerings of Securities, 1992-1999
(B billion)

Type of Securities	1992	1993	1994	1995	1996	1997	1998	1999
Equity	1.2	34.0	82.1	64.6	65.2	15.7	136.4	277.2
Debt Instrument								
Domestic Offering	5.1	20.5	54.7	39.3	40.4	12.2	31.1	286.8
Offshore Offering	—	1.0	27.8	31.3	51.9	25.9	—	26.5
Hybrid Instrument								
Domestic Offering	—	1.6	7.5	8.7	5.7	0.3	6.7	9.1
Offshore Offering	—	39.3	22.4	7.9	37.8	2.5	—	—
Total Funds Raised	**6.4**	**96.3**	**194.6**	**151.8**	**201.0**	**56.6**	**174.1**	**599.6**

— = not available.
Source: Key Capital Market Statistics, Securities and Exchange Commission of Thailand.

The 1997 crisis battered the primary market for securities, reducing the value of offerings to a little more than a quarter of the previous year's level. While a rebound was apparent beginning in 1998, this was due to the recapitalization of commercial banks in compliance with the new loan provisioning requirement.

With the enactment of the SEA of 1992 that brought suppliers of finance services and their clients together, the capital market became instrumental in the rapid growth and development of the corporate sector. The signing of Article VIII with the IMF, moreover, allowed Thai financial institutions and corporations to obtain funds overseas. These peaked at B89.7 billion in 1996, the year before the crisis struck.

The stock market also became an invaluable source of funds for corporations. The number of listed companies and securities steadily increased until 1996 (Table 4.3). Market capitalization, meanwhile, reached

Table 4.3
Statistical Highlights of the Stock Exchange of Thailand, 1993-1999

Item	1993	1994	1995	1996	1997	1998	1999
Number of Listed Companies[a]	347	389	416	454	431	418	392
Number of Listed Securities	408	494	538	579	529	494	450
Market Capitalization (B billion)	3,325	3,301	3,565	2,560	1,133	1,268	2,193
Turnover Value (B billion)	2,201	2,114	1,535	1,303	930	855	1,610
SET Index	1,683	1,360	1,281	832	373	356	482

[a] Due to listing requirements and other reasons, not all public companies are listed on the SET.
Source: Securities and Exchange Commission of Thailand.

its high point in 1995 at B3.6 trillion. Foreigners accounted for an increasing proportion of SET's turnover value, their share rising from 17 percent in 1993 to 43 percent in 1997.

Side by side with this surge of financing for corporate growth, however, was the ominous deterioration in the key financial ratios of publicly listed companies. Throughout the 1990s, corporate profitability had been declining. But instead of shifting to a low gear, the highly liquid financial system continued offering cheap funds to sustain corporate sector investments.

The key financial ratios of all companies listed on SET bear this out (Table 4.4). Corporate profitability, as measured by return on assets (ROA), return on equity (ROE), and gross profit margin, had been on the rise throughout the 1980s. The upward trends for ROE and ROA continued through 1989, then stalled in 1990. Meanwhile, gross profit margin rose until 1991 before falling in 1992. By the early 1990s, the averages for all three profitability ratios took a downswing all the way until 1996. ROA dipped from 10.3 percent in 1989 to 3.4 percent in 1996. ROE similarly fell from 21.4 percent to 5.8 percent. While the decline in gross profit margin was not as sharp, in the end, the companies could not generate enough net returns from their assets and equity, resulting in their inability to fulfill debt obligations. From 10.5 at its peak in 1987, the average times interest earned (TIE) was down to 5.1 by 1996.

The financial leverage of all companies declined until 1994, pulled down by active public offering activities. The trend reversed in 1995, however, when long-term debt grew as Thai corporations began to borrow heavily to finance growth. The plunge in profitability and asset turnover—from 117 percent in 1985 to 65 percent in 1996 for the latter—cast doubts on the

Table 4.4
Key Financial Ratios of Publicly Listed Companies, 1985-1996

Year	Return on Assets (%)	Return on Equity (%)	Gross Profit Margin (%)	Times Interest Earned	Total Debt to Equity (%)	Long-Term Debt to Equity (%)	Total Debt to Assets (%)	Long-Term Debt to Assets (%)	Asset Turnover (%)
1985	3.7	7.6	25.4	3.4	242.2	59.4	63.1	14.4	117.4
1986	4.9	12.7	24.9	4.2	215.6	47.9	60.8	12.7	119.0
1987	8.1	15.7	27.2	10.5	168.2	39.6	54.7	12.3	125.1
1988	9.3	20.7	27.4	9.4	161.0	36.7	54.5	12.7	120.1
1989	10.3	21.4	28.0	9.8	139.9	35.4	51.5	12.8	114.3
1990	8.9	18.5	29.5	8.4	144.8	34.6	50.8	11.7	91.8
1991	7.2	15.8	30.2	5.9	151.6	41.7	51.4	12.7	88.7
1992	6.7	14.2	27.7	7.6	138.4	34.2	51.9	12.4	80.9
1993	5.8	10.2	27.6	7.4	139.6	35.5	51.2	12.9	77.9
1994	5.3	10.0	27.7	7.7	125.9	38.1	49.5	14.1	66.5
1995	4.4	7.7	27.4	5.8	140.0	44.4	52.1	16.1	63.2
1996	3.4	5.8	26.0	5.1	145.7	44.0	52.7	16.0	64.6

Source: Pacific-Basin Capital Markets Database compiled by the University of Rhode Island, US.

practice of heavy borrowing. Despite the availability of the equity market, these companies opted for debt. A major reason for this was the rapid rise in asset prices, resulting in higher collateral values for borrowers. It has also been argued that family-based controlling shareholders borrowed excessively to avoid diluting their control over their corporations.

The downtrend in corporate profitability, which was particularly significant in the two years preceding the crisis, was felt across industries, but was most severe in building and furnishing material industries as a result of the downturn in the real estate market. Severely affected by global competition throughout the decade, the textiles, clothing, and footwear industries also experienced losses. Hotels and travel showed the highest ROE of 15 percent while textiles, clothing, and footwear had the lowest at 11 percent.

Among the crisis-hit countries, Korea and Thailand had the highest debt-to-equity ratios. Thailand's ROE, which fell from 16 percent in 1991 to just under 6 percent in 1996, was also distinct in the region.

Overall, large companies (where size is reckoned in terms of assets or sales) were more profitable than small companies in terms of ROE (Table 4.5). They were generally more efficient in managing their assets and

Table 4.5
Average Key Financial Ratios by Company Size, 1985-1996

	Company Size by Assets			Company Size by Sales		
Item	**Small**	**Medium**	**Large**	**Small**	**Medium**	**Large**
Return on Assets (%)	6.5	6.2	5.9	5.1	6.8	6.7
Return on Equity (%)	12.6	12.8	13.3	10.1	13.6	14.9
Gross Profit Margin (%)	26.3	23.8	25.7	30.1	25.1	20.6
Times Interest Earned	6.5	7.2	6.3	5.4	8.2	6.3
Total Debt-to-Equity (%)	121.3	135.0	176.8	134.8	142.6	164.3
Long-Term Debt-to-Equity (%)	20.1	29.3	62.3	30.6	31.8	49.4
Total Debt-to-Assets (%)	43.3	49.6	52.2	47.0	48.6	52.3
Long-Term Debt-to-Assets (%)	7.7	10.5	18.0	10.2	10.6	15.4
Asset Turnover (%)	94.3	88.6	83.1	61.5	87.8	116.7

Source: Pacific-Basin Capital Markets Database compiled by the University of Rhode Island, US.

capital despite the higher gross margins of small companies. They also tended to use more financial leverage than small companies as their total DERs show.

During the 1990s, the overall activities of listed companies, measured by total asset turnover, also deteriorated. Although stable in the 1980s, total asset turnover declined after 1989. In sum, although the performance of listed companies in the late 1980s was strong, by the 1990s, weaknesses became evident. Increasingly heavy borrowings rendered the sector even more vulnerable to lower profitability and sales.

4.2.4 Legal and Regulatory Framework

Before 1992, the Public Limited Company Act of 1978 and its amendments regulated Thai publicly listed companies. However, some rules and regulations of this particular law were believed to be too restrictive and were discouraging companies from going public. For instance, the law disallowed cumulative voting. The argument was that having a Board of Directors whose members represented different groups of investors would create conflicts and hamper management effectiveness. Cumulative voting, it was thought, could lead to a high turnover in the board, which would be disruptive to company management. There were also concerns that the provisions governing the criminal prosecution and penalties of directors and management were harsh and inappropriate.

Another issue was the proportion of shareholding by top shareholders. The law prohibited the largest shareholders, as a group, from holding more than 50 percent of total outstanding shares and other shareholders from holding more than 10 percent of outstanding shares individually. The provision discouraged original family owners from registering their companies.

The Public Company Act of 1992, adopted to promote the development of publicly listed companies, relaxed the contentious provisions of the 1978 Public Limited Company Act. Cumulative voting was made optional, the limit on shareholdings by the largest shareholders was increased from 50 to 70 percent of total outstanding shares, and the punishment for management misconduct was also lightened considerably. The original company owners welcomed the changes and the number of publicly listed companies subsequently rose to more than 600.

However, the new legislation removed a number of incentives that would have kept public companies prudent and diligent in their operations. As the succeeding sections point out, the exit of these provisions appears to have contributed to the 1997 financial crisis. The legal and regulatory framework for the corporate sector also includes provisions related to insolvency. This will be discussed in Section 4.5.

4.3 Corporate Ownership and Control

Ownership and control of corporations in Thailand are highly concentrated, a feature that is believed to have impaired the effectiveness of existing regulatory mechanisms in the corporate sector. The protection of minority shareholders was inadequate under the Public Company Act of 1992, and external monitoring and control of corporations were also weak. An Asian Development Bank (ADB) survey conducted for this study shows, for instance, that creditors had generally little influence on the management of corporations.[2] The market for corporate control was not active and did not give managers strong incentives to perform efficiently. As it turned out, concentrated ownership, coupled with weak corporate governance, played an important role in bringing about the financial crisis.

---

[2] ADB survey questionnaires were sent to all Thai listed companies in early 1999. Forty-six companies responded, but not all questions were answered.

4.3.1 Patterns of Corporate Ownership

A World Bank study covering nine Asian countries finds that firms in Japan and Taipei,China have the least concentrated ownership, with the largest shareholder on average controlling 10.3 percent and 18.9 percent of shares of a company. In contrast, Thai; Indonesian; and Hong Kong, China firms have the highest single shareholder ownership concentration at 35.3 percent, 33.7 percent, and 28.1 percent of control rights, respectively.

Most large Thai corporations listed on SET started out as family businesses. The Public Company Act of 1992 allowed ownership and control of these companies to remain with the founding families even as they became increasingly dependent on nonfamily resources. In the past, these companies obtained funding solely from banks or from their own retained earnings. But with their increased reliance on new varieties of equity and debt instruments, one would expect the public, creditors, and minority shareholders to stake their claim in the control and regulation of these companies. Unfortunately, this was not the case.

Ownership Concentration

Between 1990 and 1998, the top five shareholders of each of publicly listed Thai companies held, on average, 56.4 percent of outstanding shares, with the top three shareholders accounting for almost 50 percent (Table 4.6). This implies that the top five shareholders enjoyed full control over the outcomes of shareholder meetings. Across industries, there were only slight variations in the pattern. Ownership was most concentrated in the packaging,

Table 4.6
Top-Five Ownership Concentration of Publicly Listed Companies in Thailand, 1990-1998

	Average[a]	1990	1991	1992	1993	1994	1995	1996	1997	1998
1st Largest	28.1	26.2	26.3	26.8	32.3	26.4	27.7	28.1	28.5	28.9
2nd Largest	12.0	11.4	11.4	11.0	16.5	10.7	11.3	11.7	11.7	12.1
3rd Largest	7.4	6.6	6.8	7.1	9.9	6.9	7.0	7.1	7.3	7.3
4th Largest	5.2	4.9	5.0	5.2	6.4	4.9	5.0	5.1	5.1	5.2
5th Largest	4.0	3.9	3.9	4.0	4.6	3.9	3.9	3.9	4.1	4.2
Top Five	56.4	52.4	52.4	53.8	68.9	52.6	54.3	55.6	56.6	57.5

[a] Average for 1990-1998 period.
Source: Comprehensive Listed Company Information Database, Stock Exchange of Thailand.

agribusiness, and building and furnishing industries, with a top-five ownership concentration of at least 60 percent. Other industries had their top five shareholders controlling at least 55 percent of outstanding shares.

Based on a regression analysis, there is no statistically significant relationship between ownership concentration (measured by percentage of shares owned by the top five shareholders) and profitability of Thai publicly listed companies (Table 4.7). On the other hand, results show a significant positive relationship between ownership concentration and financial leverage, as measured by debt-to-equity and debt-to-asset ratios. These are consistent with the hypothesis that companies with more concentrated ownership tend to engage in higher debt financing because their controlling owners do not want to dilute their control by bringing in new equity holders. Company size is significantly related to ROE and leverage.

Table 4.7
Statistical Relationships between Corporate Profitability, Leverage, Ownership Concentration, and Company Size

Item	ROA	ROE	Debt-to-Equity	Debt-to-Assets
Intercept	0.058*	(0.116)	(1.533)***	(0.072)
Top Five Ownership Concentration	(0.001)	0.001	0.005**	0.001***
Company Size	0.003	0.022***	0.169***	0.034***
Adjusted R-Squared	0.029	0.031	0.080	0.115
F-Statistic	3.037	3.090	6.800	9.647

Note: The regression included dummy variables for industry, year, and ownership types.
* Denotes significance at the 10 percent level; ** at the 5 percent level; *** at the 1 percent level.
Source: Author's estimation based on the Pacific-Basin Capital Markets Database compiled by the University of Rhode Island, US.

Composition of Controlling Shareholders

Affiliated corporations comprise the largest group among the top five shareholders of publicly listed companies, owning 26.7 percent of outstanding shares on average (Table 4.8). It is the practice of Thai corporate founding families to set up holding companies to own shares in affiliated companies or subsidiaries. Through these holding companies, founding families maintain effective control of entire groups, including those that are publicly listed

Table 4.8
Top-Five Shareholder Composition of Publicly Listed Companies in Thailand, 1990-1998

Year	Company	Bank	NBFIs[a]	Individuals	Government	Other
1990	28.3	2.1	6.9	13.9	0.7	1.1
1991	27.6	1.8	7.2	15.2	0.5	0.9
1992	25.4	1.6	7.5	18.0	0.8	0.7
1993	22.8	1.6	2.9	17.9	0.7	—
1994	23.3	1.4	6.5	18.9	1.3	1.3
1995	27.3	1.2	5.1	19.4	1.3	0.5
1996	27.8	1.5	4.7	20.0	1.2	0.5
1997	28.6	1.3	5.6	19.3	1.5	0.4
1998	28.5	1.6	5.2	20.0	1.4	1.0
Average	**26.7**	**1.5**	**5.5**	**18.5**	**1.1**	**3.3**

— = not available.
[a] NBFIs denotes nonbank financial institutions, including finance and investment companies.
Source: Comprehensive Listed Company Information Database, Stock Exchange of Thailand.

in SET. Although holding companies set up affiliate firms, the affiliate firms rarely hold shares of their parent companies, unlike in Japan where cross-shareholding is common. The ADB survey indicated that listed companies held shares in an average of 11 companies.

Individual family members also hold a significant amount of outstanding shares, averaging about 18.5 percent. These individuals usually hold important management positions in concerned companies. Typically, founding families and their relatives maintain control of many companies by jointly holding on to the most significant chunk of shares.

This practice is illustrated by Central Pattana, a company listed in the real estate sector of SET. Established in 1980 with a registered capital of B300 million, the company, a joint venture among three families, operates five of the most successful shopping malls in Thailand. In 1994, the company increased its registered capital and became a public company listed in SET. The roster of its major shareholders as of December 1997 illustrates the typical ownership concentration of a publicly listed company in Thailand. The largest shareholder is Central Holdings Company, owned by the Chirathivat family, one of the founding members, with 29.3 percent of outstanding shares. In addition, individual members of the Chirathivat family aggregately hold 25.6 percent of outstanding shares. The top 10 shareholders include a holding company owned by the Tejapaibul family,

another of the company's founding members. In effect, the top 10 shareholders consist predominantly of members of founding families and their holding companies. By owning 62 percent of voting shares, these shareholders are able to control the company.

Across industries, the predominance of individual family members and holding companies in the top shareholder list remains valid. Except in the hotel and travel service sector, holdings by individual family members and holding companies account for at least 50 percent of outstanding shares of an average listed company.

Although the list of top shareholders of publicly listed companies includes financial institutions, they exercise limited influence in operations because of the restricted size of their shareholdings. On average, commercial banks account for only 1.5 percent of total outstanding shares of listed companies. Moreover, only one tenth of listed companies have commercial banks on their top-five shareholder list. Nonbank financial institutions hold an aggregate 5.5 percent of total outstanding shares. About half of listed companies have nonbank financial institutions such as finance and investment companies in their top-five shareholder list.

The Government holds, on average, 1.1 percent of total outstanding shares of listed companies. Only a handful of companies have the Government among their large shareholders. In such cases, the Government owns the majority of the shares. For example, Thai Airways International Plc. has the Ministry of Finance as its only large shareholder with 92.9 percent of outstanding shares. Another example is Bangchak Petroleum Plc., where the top three shareholders are the Ministry of Finance, the Petroleum Authority of Thailand, and a state bank. Together, they account for 80 percent of total outstanding shares. There was a trend of rising government shareholdings throughout the period 1990 to 1998. However, with the envisioned privatization master plan, the Government's role in public companies is expected to decline.

4.3.2 Corporate Management and Control[3]

Board of Directors

The Public Company Act of 1992 stipulates the appointment process, qualification, roles, duties, and responsibilities of directors of public companies.

[3] Discussions in this section are based on results of company surveys by SET and ADB, both conducted in 1999.

Directors are required to meet minimum qualifications specified under the SEA of 1992 and the Listing Rules issued by SET. Unless stipulated in public companies' articles of association, directors shall be elected at the annual general shareholders' meetings (AGSMs).

In their business conduct, directors are required to act with care and honesty for the company's best interest, and to comply with the laws and articles of association. If found in violation of these provisions, directors may be imprisoned or fined. In addition, directors could be compelled to compensate the company for damages arising from their misconduct. Many companies have a formal policy on corporate governance and business ethics.

A survey by SET found that the majority (58 percent) of the 202 responding companies held their board meetings every quarter, while 30 percent of respondent companies held board meetings monthly. Almost all companies (98 percent) exceeded the minimum required five members in their Board of Directors. Most companies (83 percent) satisfied SET's requirement of having two independent board members, while 15 percent of respondents went beyond the requirement. Meanwhile, the ADB survey found that 31 companies (out of 46 responding) required outside directors to be present at all board meetings.

Chair of the Board and Chief Executive Officer

The SET survey showed that about 73 percent of listed companies had a separate executive (management) board. Generally, an executive board consists of senior management and some main board members. Some companies (36 percent) had five to six main board members holding seats in their executive boards.

The ADB survey indicated, meanwhile, that only in two of the 46 responding companies were the chair of the boards elected based on the extent of their shareholdings. Nineteen companies stated that selection was based on professional qualifications. In five other companies, selection was based on relationships with controlling shareholders. The appointment of the chief executive officer (CEO) needed approval during the AGSM in 11 of the responding companies, but not in 22 others. Three companies indicated that the CEO and the chair were close relatives. Although 28 percent of the chairpersons came from the ranks of independent outside directors, the majority (71 percent) had board chairs who were also members of top management teams.

Compensation of Directors, Chair, and CEO

The majority of company respondents to the SET survey provided similar compensation packages to internal and external directors. Where different, these were attributed to variations in the extent of duties and responsibilities assumed by those directors. Half of the companies in the SET survey had a separate remuneration committee. However, the work of this committee was often considered part of the executive board's responsibilities, not an independent assignment. Also, the majority of the companies (77 percent) did not have outside directors as members of their remuneration committees. These committees were mainly responsible for determining compensation for senior and regular staff. The directors' compensation was determined largely by the Board of Directors except in 19 percent of the companies surveyed where a remuneration committee was in charge.

The ADB survey indicated that 18 of the 46 responding companies compensated their chairpersons using a fixed-fee schedule. Fourteen other companies had profit-related incentive schemes in addition to fixed fees. In 25 companies, the remuneration packages had to be approved during AGSMs. Three companies allowed their management to determine the chair's compensation package.

Audit Committees and Accounting Standards

Since January 1999, all listed companies have been instructed to establish audit committees to be responsible for examining the quality and reliability of company financial statements. Directors with managerial responsibility or those related to major shareholders cannot be members of such audit committees. The SET survey found that the majority of listed companies (81 percent) still have no separate audit committee. Companies already with audit committees did not have independent outside directors as audit committee members.

SET's attempts to bring accounting practices to international standards have included requiring listed companies to consolidate all liabilities—including those on off-balance sheets—in their financial statements beginning June 1998. Twenty-five of the 46 respondents to the ADB survey declared adherence to all relevant international standards, while 19 companies observed only some of them. All respondents confirmed the use of external auditors, with 41 firms admitting the use of services of international auditing firms. In one company, however, the auditor is not

independent from the company. The majority of the companies (85 percent) require the appointment of external auditors during annual general meetings. Relationships between firms and external auditors are generally long-term, averaging about 14 years. However, the corporate sector lacks a strong self-regulatory body to compel compliance with these standards, although recently, the Securities and Exchange Commission (SEC) and SET were actively prosecuting violating firms.

Minority Shareholders and their Rights

Many different rights and entitlements of shareholders are laid out in the Public Company Act of 1992. SET's rules and regulations closely follow this Act. For instance, shareholders can claim compensation in cases of negligence or dishonesty by management. The Act also holds directors liable for any damage to shareholders, including false statements to conceal information about the financial condition and operations of the company during the sale of shares, debentures, or other financial instruments. The Act, likewise, stipulates the proper conduct of shareholder meetings, as well as the registration and holding of shares.

While safeguards are in place, there are also significant gaps in the system of shareholder protection. (i) No standards are enforced in the content and timing of notices for shareholder meetings. Proxy solicitation tends to be abused to the extent that shareholders are inadequately informed about matters to be taken up in shareholder assemblies. (ii) The prudential role of outside directors is limited by the noncompulsory character of their participation in key decision-making bodies such as the audit, remuneration, and executive committees. (iii) Because the chair is frequently also part of the top management team, there is the danger that top management may be capable of unduly influencing the board's decisions. (iv) The roles and responsibilities of the major government agencies regulating shareholder rights—the Ministry of Commerce, SEC, SET, and the Bank of Thailand—are not clearly defined. As a result, the institutional machinery is not fully responsive to complaints about violation of shareholder rights.

According to the ADB survey, most responding companies have rules and regulations intended to protect shareholders. In the majority of these companies (38 out of 46 respondents), shareholders have access to reliable information at no cost. Forty-four companies indicated that they had proxy voting in place, with 13 companies allowing proxy voting through mail. Shareholders are also entitled to call emergency meetings and present proposals at AGSMs. At least 28 responding companies had the following

mechanisms in place: mandatory shareholder approval of major transactions and interested or related party transactions; and mandatory disclosure of related interests and significant shareholders' transactions.

The SEA of 1992 and the listing rules also contain provisions for the protection of shareholders against transfer pricing, takeover of the company, and insider trading. On paper, minority shareholders are assured adequate legal protection. In practice, however, such protection has been insufficient.

Written law and its enforcement diverge partly because of a provision that shareholders who take action against erring directors must have at least 5 percent of the total number of shares. But with the ownership concentration of Thai companies, it would be difficult for minority shareholders to gather the shares needed to take action. In theory, minority shareholders may also appoint an outside inspector to examine the company's operations and financial condition, and call an extraordinary session. But the exercise of these rights requires even higher shareholding levels. In effect, the only group of shareholders that can exercise rights is the top five shareholders.

The difficulty minority shareholders have in exercising their rights can be seen from the ADB survey results. Only a small number of shareholders attended the latest AGSMs. Although the attendees held, on average, 66 percent of total outstanding shares, they comprised only 8 percent of total shareholders. Almost 82 percent of shareholders, representing only about 28 percent of shareholdings, did not vote in previous AGSMs. The ADB survey results reveal that the proposals presented by management were rarely rejected during the general meetings.

These problems appear to be partly a result of the relaxation of the rules and regulations in the original Public Limited Company Act of 1978. While stimulating the growth of the sector, the new Public Company Act of 1992 inadvertently weakened the governance of public companies by diminishing minority shareholder rights.

4.3.3 External Control

Control by Creditors

The fact that insider control in Thai companies is very strong should compel a search for alternative external control and monitoring mechanisms. Banks would be obvious candidates to implement these mechanisms, given their importance in providing finance and their stake in companies.

Historically, Thailand has relied on commercial banks and finance companies to channel funds to private enterprises. However, creditors do not always require project feasibility studies or business plans in granting loans. Only 28 of the responding companies in the ADB survey indicated that their creditors required such feasibility studies. Apparently, a company's reputation and its long-term relationship with creditors sufficed in many instances, as the ADB survey confirmed.

Seven of the companies responding to the ADB survey indicated that all their creditors required collateral, 17 indicated that only some of their creditors had such a requirement, while 18 said none of their creditors required collateral. Most companies reported that banks were more likely to require collateral, while loans for fixed investment were also more likely to be supported by collateral. The presence of collateral usually diminishes banks' incentives for screening project feasibility and monitoring project implementation.

The impact of the financial crisis on credit eligibility and supervision requirements has been significant. Among 16 companies in the ADB survey whose loan applications in the last three years were rejected, 11 experienced rejection after the crisis started. For 20 of the 46 responding companies, creditors' collateral requirements were tightened after the crisis. Fifteen of the 20 companies that had to renegotiate loan repayment with creditors in the last five years did so after the crisis. In the end, however, the majority believed that creditors had little influence on company management and decision making. Only three companies thought otherwise. Eleven companies stated that creditors usually exercised whatever influence they had on management through covenants regarding the use of loans.

Normally, when insiders want to expand their company's operations without losing control, they resort to borrowing. Leverage allows the assets and operations of the company to grow without diluting corporate control. One tempering mechanism that could inhibit the excessive use of borrowing is the threat of losing control in the event of bankruptcy. Under a weak bankruptcy system, such as that seen in Thailand before the crisis, borrowers seldom lose control to creditors even when they default and become insolvent. The old bankruptcy law in Thailand also made it difficult for creditors to obtain payment against bankrupt borrowers. There were many options, other than losing control, to solve debt repayment problems. Debtors had many handles to stall the bankruptcy process, including procedural disputes, which could cause a delay by at least a year. Actual bankruptcy proceedings took more than five years on average.

The financial crisis has presented a unique opportunity for reinventing the framework for corporate bankruptcy and for creating regulatory and judicial precedents. Such efforts would serve to strengthen external discipline on controlling owners. It will take years, however, before the extent to which the bankruptcy framework has been strengthened becomes clear.

The Market for Corporate Control

The SEA of 1992 was the first legislation that stipulated rules and regulations regarding the market for corporate control. SEC was later made responsible for regulating corporate takeovers.

According to the SEA of 1992, there are two categories of merger and acquisition activities with associated regulatory measures. The first category is the acquisition of shares in the open market. In this case, a person who acquires more than 5 percent of issued shares must file a report with SEC one day after the date of acquisition, if the purchase of shares implies a change in the directors or business activities.

The second category is the tender offer, which is a general offer made to shareholders of a company to acquire at least 25 percent of outstanding shares. There are detailed requirements regarding such notification, whether directly or indirectly, of shareholders: (i) all shareholders must receive tender offers; (ii) an advertisement regarding the tender offer must be placed in major newspapers for at least three consecutive days; and (iii) tender offers will be effective 30 days after the report has been filed with the SEC.

The company has 21 days to evaluate the tender offer and submit a report to SEC and all shareholders. SEC has no authority to either approve or reject tender offers; its main role is to ensure transparency and fairness. Recently, the minimum tender offer was reduced to 10 percent and some procedural modifications have also been introduced.

The market for corporate control has not been active in Thailand, and failed to provide managers with strong incentives to perform efficiently. Since the introduction of the Public Limited Company Act of 1978, only a limited number of successful mergers of public companies have taken place. In 1994 and 1995, there were 41 cases of tender offers, with a total tender offer value of B42.3 billion (Table 4.9). In 1996, there were only six tender offers, with a significantly lower total tender offer value of B8.3 billion. The situation remained sluggish in 1997 at nine tender offers and a further decline in total offered value. The dearth of tender offers before the crisis suggests that the Thai capital market did not offer a venue for imposing market discipline on corporate management. Although merger and acquisi-

Table 4.9
Merger and Acquisition Activities, 1993-1999

Year	Tender Offer Value[a] (B billion)	Purchase Value		Number of Companies
		B billion	% of Tender Offer Value	
1993	5.4	4.6	84.1	8
1994	23.1	17.3	75.1	27
1995	19.2	11.2	58.1	14
1996	8.3	6.9	84.0	6
1997	6.2	3.5	55.8	9
1998	7.7	6.2	81.3	13
1999	11.0	6.7	60.8	23

[a] Tender offer value refers to the minimum offer value.
Source: Securities and Exchange Commission of Thailand.

tion activities increased after 1997, most of these were forced mergers or related to rescue packages.

The number of domestic institutional investors rose after the mutual fund industry was established in 1991. But instead of opting for an active role in the market for corporate control, they have mostly been concerned with short-term gains. While the Thai mutual fund industry compares well to those in other developing countries in the region, it remains small. Since 1994, trading by mutual funds in SET represented less than 10 percent of total trading. Pension funds are perhaps even weaker in Thailand. Provident funds for government workers and workers in public enterprises have been established only recently.

Employee Participation in Corporate Governance

There has been little, if any, employee participation in corporate governance in Thailand. Few companies offer employee stock option plans (ESOPs). Even when companies offer ESOPs, employees regard the plans as monetary incentives, not with a view to becoming involved in actual management. Because of the current crisis, employees are even less willing to accept common shares as a form of compensation or benefit. Eleven of the 46 responding companies in the ADB survey offer ESOPs, but employees have never been represented in the board of directors since their shareholdings are minimal. Twenty-nine firms indicated that employees held shares of their companies, but the average shareholding is smaller than 1 percent of total outstanding shares.

4.4 Corporate Financing

4.4.1 Overview of the Financial Sector

A breakdown of the Thai financial sector for the period 1992-1999 (Table 4.10) shows that Thailand is a highly bank-dependent economy. The total values of loans from financial institutions and commercial banks were consistently larger than the market capitalization of SET. The bond market played only a marginal role in corporate financing, although its role increased in the wake of the crisis.

Table 4.10
Size and Composition of the Thai Financial Sector, 1992-1999
(B billion)

Year	Outstanding Loans from All Financial Institutions	Outstanding Loans from Commercial Banks	SET Market Capitalization	Domestic Debt Securities Outstanding
1992	2,906.1	2,161.9	1,485.0	215.2
1993	3,663.4	2,669.1	3,325.4	262.0
1994	4,775.1	3,430.5	3,300.8	339.0
1995	5,979.6	4,230.5	3,564.6	424.4
1996	6,912.0	4,825.1	2,559.6	519.3
1997	8,171.1	6,037.5	1,133.3	546.8
1998	7,360.5	5,372.3	1,268.2	941.4
1999	6,477.5	5,119.0	2,193.1	1,390.4

Source: Stock Exchange of Thailand, Thai Bond Dealing Centre, and Bank of Thailand.

The Banking System

Until recently, the banking sector was highly concentrated; there were 29 commercial banks, 15 of which were domestic banks. Competition from foreign banks was limited as they were not allowed to engage in full branch operations. In 1996, total assets of commercial banks amounted to B5.5 trillion. The share of domestic banks in the banking system's total assets was 80 percent. The country's largest bank, Bangkok Bank Ltd., accounted for 28 percent of the banking sector's total assets; the next four largest banks accounted for 63 percent. Many large commercial banks had affiliates among the 93 finance companies that served the high-risk market.

The Government was also a major figure in the banking system, owning 70 percent of the country's second largest bank.

Banking activity peaked in the mid-1990s. The Government removed controls on capital and dividend repatriation in 1991, and almost all capital account transactions were deregulated. In 1993, the Government established the BIBF to expand the banking sector and reduce the borrowing costs of Thai companies. Licenses were granted to 15 Thai banks, 12 existing foreign banks, and 20 new foreign banks. Banks under the BIBF scheme were allowed to mobilize funds from abroad and lend to Thai companies in foreign currency. Because borrowers carried the exchange rate risk, the liberalization of interest rates and capital account transactions stimulated a credit expansion through short-term borrowings in foreign currency. BIBF banks also enjoyed tax incentives on their operations and profits. In contrast, hardly any progress was made in lowering the cost of domestic financial intermediation or in developing new financial instruments for corporations.

The Equity Market

During the first few years of its operations, SET was not very active. Many company founders did not want to release even a small portion of corporate ownership and refused to go public. Easy access to commercial bank loans by family business groups, due to their close ties, also made it unattractive to raise capital from the equity market. The lack of supply of quality shares was a big problem for SET at that time. SET is organized into 32 major industries. Through the years, banking, finance, and property have accounted for the bulk of trading volumes.

Benefiting from rapid economic and industrial growth, the stock market entered its first boom period in 1986. Despite the worldwide market crash in 1987, SET immediately recovered due to the strength of the Thai economy. Stock prices tripled in the next three years until the market experienced its first crash as a result of the Gulf Crisis in 1990. After that, the market rose steadily and reached a record high in the fourth quarter of 1993. Turnover value reached B2.2 trillion. The number of listed companies also quadrupled between 1981 and 1993. Some 347 companies were listed in the same year with a total market capitalization of B3.3 trillion. In the following years, the SET index declined, reaching 355.8 in 1998.

In 1995, an over-the-counter market, the Bangkok Stock Dealing Center (BSDC), was set up by 74 members with an initial capital of B500 million. BSDC is a nonprofit, self-regulatory organization under the

jurisdiction of SEC. Its main role is to serve as a secondary market for unlisted companies trying to raise capital. Only one security was listed in BSDC in 1995 and two more in 1996. Turnover value was B1.8 billion in 1996, but dropped the following year to B122 million. In 1998, turnover value was negligible and the BSDC Index remained flat throughout 1996-1998. Consequently, the BSDC was dissolved in 1999.

The SEA of 1992 installed the legal and regulatory framework for Thai capital markets. It separated the primary and secondary markets to promote more flexible and effective supervision of both. The primary market is supervised by SEC, which has a legal mandate to examine a company's financial status and operations before allowing it to issue securities to the public. After initial public offerings, securities can be traded in the secondary markets, which consist of SET and BSDC.

According to the SEA of 1992, SET's primary functions are to serve as a center for the trading of listed securities and to provide the essential systems needed to facilitate securities trading. SET, however, also acts as a clearinghouse, securities deposit center, and securities registrar, among other functions approved by SEC.

Before 1993, there were two kinds of companies in SET—"listed" and "authorized" companies, with each facing different listing requirements. Listed companies were those that had (i) paid-up capital of at least B20 million, and (ii) a minimum of 300 shareholders, each holding no more than 0.5 percent and collectively owning at least 30 percent of paid-up capital. Authorized companies were those with a minimum of 200 shareholders owning collectively at least 25 percent of paid-up capital.

In 1996, the two classifications were merged, so now only listed companies are traded in SET. Proposed changes in capital must be submitted for approval to SET accompanied by a detailed memorandum outlining the use of proceeds, financial projections, and *pro forma* balance sheet and income statements.

In July 1990, SET established new requirements for initial public offerings. A company wishing to qualify for listing in SET must file an information booklet (prospectus) with SEC and SET. Company applicants must have an established history of operating under substantially the same management. The company should then appoint a financial adviser, approved by SET, to assist in the public offering process. The listing application should be submitted concurrently to SEC and SET. If approved by SEC and the SET Board of Governors, stock trading can commence within five days. The allocation procedure is nondiscretionary. If the issue is oversubscribed, lottery drawing must be used to ensure fairness.

The Bond Market

The Thai bond market has played a marginal role in corporate financing until recently. In 1996, it accounted for a small share of the entire financial sector, at about 11 percent of the total value of outstanding loans extended by commercial banks and 20 percent of total equity market capitalization. To gain some perspective of the size of the bond market in Thailand, in 1994, it represented only 9 percent of GDP, compared to 110 percent in the US and 74 percent in Japan in the same year. The Thai bond market was also smaller than that of Malaysia (56 percent of GDP) and the Philippines (39 percent of GDP) in that year.

The bond market in Thailand started in 1933, the year the Ministry of Finance first issued government bonds to finance infrastructure projects and economic development. Upon its founding in 1942, the Bank of Thailand assumed responsibility for regulating the bond market. Beginning 1961, the Government issued more bonds to finance industrial development projects and perennial deficits. The budget surpluses of the 1990s eliminated the need for new bond issuance, and the Government did not issue new bonds during 1990-1997. The recent financial crisis, however, led to the renewed issuance of Government bonds to finance the resurgent budget deficit and support cash-strapped financial institutions.

State-owned enterprises became active issuers of bonds since 1993 because the Government constrained their borrowings (Table 4.11). However, the market for these bonds has been slow owing to the change in the Government's original policy of requiring the use of state-guaranteed bonds as legal reserves.

The corporate sector played a limited role in the bond market in the early years because of the complicated rules and regulations in effect at that time. Companies generally issued short-term debt instruments like promissory notes or bills of exchange. Investors had limited knowledge of debt instruments. A turning point of the corporate debt market was the enactment of the SEA of 1992, which encouraged limited companies and public companies to issue debt instruments. Four years after the passage of the SEA, the size of the corporate debt market rose to B132.9 billion. The Thai Rating Information Services, the first bond rating agency in Thailand, was also instrumental to the growth of the corporate debt market.

A breakdown of domestic offerings of corporate debt securities from 1992 to 1996 shows that unsecured debts accounted for about 60 percent, while secured debt instruments accounted for just above 10 percent. The proportion of domestic convertible debt instruments increased until 1995,

Table 4.11
Offerings of Debt Securities, 1992-1999
(B billion)

Item	1992	1993	1994	1995	1996	1997	1998	1999
Government Bonds	—	—	—	—	—	—	400.0	333.7
Treasury Bills	—	—	—	—	—	—	—	77.0
State Enterprise Bonds	27.0	60.4	57.1	55.2	57.4	49.3	46.7	95.2
Guaranteed	—	—	50.8	55.2	43.1	41.3	46.7	90.1
Nonguaranteed	—	—	6.3	—	14.3	8.0	—	5.1
Other Government Bonds	—	—	—	29.5	138.8	191.5	55.0	—
Corporate Bonds	5.1	61.4	110.0	86.7	132.9	40.9	37.1	315.9
Domestic	5.1	21.1	59.8	47.5	43.1	12.5	37.1	289.3
Secured	—	—	3.5	5.5	10.7	0.0	0.0	33.7
Unsecured	5.1	10.8	31.9	30.3	29.7	7.3	13.1	107.4
With Warrant	—	9.6	19.3	3.5	—	0.0	17.3	140.6
Convertible	—	0.7	5.1	8.2	2.7	0.3	6.0	7.7
Short-Term	—	—	—	—	—	4.9	0.7	—
Offshore	—	40.3	50.2	39.2	89.7	28.4	—	26.5
Secured	—	—	—	3.1	6.0	5.4	—	—
Unsecured	—	1.0	26.2	28.2	45.9	20.5	—	—
With Warrant	—	—	1.6	—	—	0.0	—	26.5
Convertible	—	39.3	22.4	7.9	37.8	2.5	—	—
Total	**32.1**	**121.8**	**167.1**	**141.9**	**329.0**	**281.7**	**538.7**	**821.8**

Source: Securities and Exchange Commission of Thailand and the Thai Bond Dealing Centre.

then declined substantially in 1996 and 1997. The domestic debt market declined after 1994 because corporations could borrow offshore at lower costs. A sharp rise in unsecured offshore debt offerings can be noted all the way through 1996. The decline in total domestic debt offerings in 1996 can be ascribed to the increase in offshore convertible debts. Total offshore debt offerings peaked in the run-up to the financial crisis. However, by the end of 1997, the year the crisis unraveled and the baht was floated, total offshore debt offerings had plunged by 68 percent to a mere B28.4 billion.

BDC was established in November 1994 by 50 securities companies based on the provisions of the SEA of 1992. The club was considered the first organized secondary bond market in Thailand to serve as the wholesale market for debt securities. By 1995, turnover value had reached B51.5 billion. The following year, this had climbed to B200.6 billion, a surge attributed to capital inflows encouraged by high returns on Thai bonds,

compared with investment in equities. In 1997, turnover value plummeted to B106.2 billion as a result of the default of debentures due to the Asian crisis. The closure of 58 finance companies affected the BDC significantly since half of its members were suspended as a result. Turnover fell further to B72.1 billion in 1998. In the same year, BDC was renamed "the Thai Bond Dealing Centre" following its status upgrade to a bond exchange.

4.4.2 Patterns of Corporate Financing

An examination of financing patterns among Thai companies listed in SET shows that on the asset side, listed companies experienced liquidity problems with declining reserves of cash and marketable securities during the period 1990 to 1996 (Table 4.12). The proportion of accounts receivable also declined steadily. The ratio of net working capital to total assets decreased from a peak of 31 percent in 1993 to 28 percent in 1996. The overall trend is consistent with the decline in profitability observed in the analysis of corporate sector performance earlier. In any case, overall asset quality and liquidity of listed Thai companies deteriorated throughout the period.

Thailand's publicly listed companies rely mainly on loans from commercial banks and financial institutions to finance their growth. At lower than 5 percent of total liabilities, the use of debentures remains minimal even though the trend was generally upward until the 1997 crisis. From 1990 to 1996, short-term loans accounted for more than 40 percent of total liabilities, a trend most apparent in the leap between 1991 and 1992. Long-term loans accounted for about 20 percent of total liabilities, steadily easing up between 1990 and 1996.

Equity financing remains an important part of listed companies' long-term financing, with equity levels remaining high despite an increase in debt. Retained earnings accounted for about 30 percent of total equity financing. There was also little change in the trend in retained earnings within the seven-year period.

Across industries, significant variations can be noted. Construction and property development industries tended to have high proportions of long-term loans and debentures. For the construction industry, these accounted for 33 percent of total liabilities, while for the property development industry, these comprised 31 percent. The average for all industries was only 22 percent. Companies in construction and property development seemed unable to generate internal funds, judging by their relatively low levels of retained earnings, cash balances, and marketable securities holdings. In addition, they also had a relatively small proportion of equity and

Table 4.12
Common-Size Statements for Companies Listed in SET, 1990-1996
(percent)

Item	All Years	1990	1991	1992	1993	1994	1995	1996
Assets								
Cash	2.3	2.2	3.2	2.9	2.4	2.2	1.7	1.9
Marketable Securities	0.8	3.3	1.6	0.5	0.7	0.6	0.6	0.3
Accounts Receivable	12.9	16.2	15.0	13.6	13.1	13.0	10.9	12.0
Inventories	15.2	17.9	14.6	15.9	14.9	14.7	14.9	15.0
Other Current Assets	12.4	6.8	9.0	10.2	12.0	14.6	14.8	14.2
Total Current Assets	43.8	46.4	43.5	43.2	43.2	45.2	42.9	43.6
Net Fixed Assets	36.1	36.5	37.8	37.6	38.8	34.2	34.3	34.8
Other Assets	20.2	17.1	18.8	19.3	17.9	20.6	22.6	21.6
Total Assets	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Liabilities and Equity								
Accounts Payable	6.9	10.8	9.8	6.9	6.1	5.9	6.3	6.2
Short-Term Loans	22.2	17.6	18.8	25.3	25.4	21.8	21.3	21.8
Other Current Liabilities	7.8	10.5	9.4	8.0	7.4	7.6	6.7	7.7
Total Current Liabilities	36.9	38.8	37.9	40.3	38.8	35.3	34.2	35.6
Long-Term Loans	10.1	7.8	8.5	9.6	8.7	9.6	11.6	12.0
Debentures	2.2	2.2	1.6	0.2	2.1	2.9	3.2	2.5
Other Liabilities	1.5	1.3	1.6	2.0	1.8	1.2	1.5	1.3
Total Liabilities	50.7	50.1	49.7	52.0	51.4	49.1	50.6	51.4
Capital Stock	17.3	18.3	18.2	17.9	17.1	17.7	16.2	16.8
Paid-In Capital	17.7	16.7	17.7	18.2	16.9	18.4	17.9	17.4
Retained Earnings	14.3	14.9	14.5	11.9	14.5	14.7	15.3	14.4
Total Equity	49.3	49.9	50.3	48.0	48.6	50.9	49.4	48.6
Total Liabilities and Equity	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Pacific-Basin Capital Markets Database compiled by the University of Rhode Island, US.

were highly leveraged. The agribusiness industry relied more heavily on short-term loans at 56 percent of the industry's total liabilities, compared with the 44 percent general average. Printing and publishing companies had lower financial leverage than companies in other industries.

Analysis of common-size statements by ownership concentration (based on the levels of top-five ownership concentration classified as high, medium, and low) also underscores that companies with high ownership concentration had high levels of long-term loans (Table 4.13). The level of total liabilities for the group characterized by high ownership concentration

Table 4.13
Common-Size Statements of Public Companies by Ownership Concentration, 1990-1996

	Degree of Ownership Concentration		
Item	**High**	**Medium**	**Low**
Assets			
Cash	2.6	2.3	1.9
Marketable Securities	0.6	1.2	0.7
Accounts Receivable	14.6	11.9	12.4
Inventories	15.5	16.5	13.8
Other Current Assets	11.1	13.2	13.0
Total Current Assets	44.4	45.1	41.9
Net Fixed Assets	35.7	36.0	36.5
Other Assets	19.9	19.0	21.6
Total Assets	100.0	100.0	100.0
Liabilities and Equity			
Accounts Payable	7.2	6.6	6.9
Short-Term Loans	22.2	22.9	21.4
Other Current Liabilities	8.4	7.8	7.3
Total Current Liabilities	37.8	37.3	35.6
Long-Term Loans	12.2	8.6	9.4
Debentures	0.9	2.4	3.3
Other Liabilities	2.1	1.4	1.1
Total Liabilities	53.0	49.7	49.5
Capital Stock	16.3	17.1	18.4
Paid-In Capital	16.0	18.2	18.8
Retained Earnings	14.6	14.9	13.4
Total Equity	47.0	50.3	50.5
Total Liabilities and Equity	100.0	100.0	100.0

Source: Pacific-Basin Capital Markets Database compiled by the University of Rhode Island, US.

was 53 percent of total assets compared with 49.7 percent for medium ownership concentration companies and 49.5 percent for low ownership concentration companies. For the high ownership concentration group, common equity accounted for a smaller proportion of total assets (47 percent) than companies with lower ownership concentration. This is consistent with the observation that majority shareholders try to maintain their control by utilizing debt as a major source of funds. Companies with medium ownership concentration tended to have a higher proportion of short-term loans.

Results from the ADB survey reveal that Thai companies preferred to use reserves and retained earnings as their first choice of financing, followed by bank loans, bond issues, and rights issues. After the crisis, however, bond issues overtook loans from commercial banks as the second preference. Generally, the choice of financing is determined by the company's liquidity considerations, minimization of transaction and interest costs, and maintenance of the existing ownership structure.

An overall picture of SET-listed companies' financing and investment patterns in the 1990s shows a steady rise in the use of financial leverage (Table 4.14). The ratio of total debt to total assets increased from 50.8 percent in 1990 to 52.7 percent in 1996. Short-term debt accounted for most of the increase, especially from 1994 to 1996. Public companies relied more on short-term debt financing in the period before the financial crisis. More important, however, was the headlong deterioration of firms' ability to meet their interest payment obligations. The TIE ratio declined from its peak of 7.7 in 1994 to 5.1 in 1996. Such deterioration of financial positions during the period was a common feature of listed companies.

Table 4.14
Financial Ratios of All Listed Firms, 1990-1996

Ratio	1990	1991	1992	1993	1994	1995	1996
Times Interest Earned	8.4	5.9	7.6	7.4	7.7	5.8	5.1
Total Debt to Equity (%)	144.8	151.6	138.4	139.6	125.9	140.0	145.7
Long-Term Debt to Equity (%)	34.6	41.7	34.2	35.5	38.1	44.4	44.0
Total Debt-to-Assets (%)	50.8	51.4	51.9	51.2	49.5	52.1	52.7
Long-Term Debt-to-Assets (%)	11.7	12.7	12.4	12.9	14.1	16.1	16.0
Net Working Capital-to-Assets (%)	25.1	23.7	28.1	31.3	31.1	31.0	28.9
Operating Capital-to-Assets (%)	63.3	61.7	66.2	68.8	65.8	65.1	64.3

Source: Estimated from the Pacific-Basin Capital Markets Database compiled by the University of Rhode Island, US.

The direct relationship between the degree of leverage and the degree of ownership concentration is apparent in Table 4.15. The financing patterns indicate that companies with high ownership concentration were more highly leveraged than companies with medium and low concentration. While further detailed investigations are necessary, it would seem that firms with concentrated ownership and associated links to the banking system have easier access to debt financing. As a result, these firms more easily increased their leverage, thus rendering them more vulnerable.

Table 4.15
Financial Ratios of Listed Companies by Ownership Concentration, 1990-1996

Ratio	Degree of Ownership Concentration		
	Low	Medium	High
Times Interest Earned	6.5	7.2	6.5
Total Debt to Equity (%)	126.5	124.6	148.3
Long-Term Debt to Equity (%)	34.2	30.8	42.4
Total Debt-to-Assets (%)	49.4	49.6	52.8
Long-Term Debt-to-Assets (%)	13.4	11.8	14.8
Net Working Capital-to-Assets (%)	27.4	29.8	28.0
Operating Capital-to-Assets (%)	63.8	66.1	64.3

Source: Estimated from the Pacific-Basin Capital Markets Database compiled by the University of Rhode Island, US.

4.5 The Corporate Sector during the Financial Crisis

4.5.1 Impact of the Financial Crisis on the Corporate Sector

The financial crisis came after a period of rapid growth in the Thai economy. The corporate sector contributed significantly to the crisis because of its rising levels of leverage, unhedged foreign exchange liabilities, and a preponderance of short-term debt liabilities. The proportion of nondebt-creating capital flows, such as direct equity and portfolio investment, continued to slide from 1985 to 1997. Their average annual growth rate declined from 28.5 percent between 1985 and 1990 to 8.7 percent from 1991 to 1996. This decline was accompanied, on the other hand, by a remarkable growth in the proportion of debt-creating capital inflows in the wake of the development of the debt market and the establishment of the BIBF. From 45 percent of total net capital movements in 1985, debt-creating capital inflows rose to 65 percent in 1990, peaking in 1994 at 84 percent.

The proportion of external debt as a percentage of GDP consequently increased from 42.2 percent in 1986 to 251.9 percent in 1997. The composition and term-structure of this debt, however, is even more telling. From only 34 percent in 1986, private debt accounted for 84.5 percent of external debt in 1996 (Table 4.16). Nonbank private debt increased from 27.4 percent to 46 percent during the same period. Additionally, the proportion of short-term debt increased from 15.8 percent in 1986 to 52 percent in 1995.

Table 4.16
External Debt, 1986-1999
($ billion)

Year	Government		Private Nonbank		BIBF		Commercial Bank		Total
	Long-Term	Short-Term	Long-Term	Short-Term	Long-Term	Short-Term	Long-Term	Short-Term	
1986	12.0	0.1	3.1	1.9	—	—	0.3	0.9	18.3
1987	13.9	0.1	2.8	1.7	—	—	0.3	1.2	20.0
1988	13.0	0.3	3.0	2.3	—	—	0.3	2.2	21.1
1989	11.9	0.2	4.6	2.9	—	—	0.3	2.8	22.9
1990	11.3	0.3	7.3	6.2	—	—	0.3	3.9	29.3
1991	12.1	0.7	10.0	10.5	—	—	0.3	4.1	37.9
1992	12.5	0.6	11.5	12.8	—	—	0.7	5.5	43.6
1993	14.2	—	12.7	12.3	1.4	6.4	1.3	4.0	52.1
1994	15.5	0.2	13.7	7.4	3.0	15.1	3.5	6.4	64.9
1995	16.3	0.1	23.9	18.6	3.8	23.7	4.4	10.0	100.8
1996	16.7	0.1	31.2	18.8	10.7	20.5	2.3	8.4	108.7
1997	24.1	0.0	32.1	13.9	10.9	19.2	3.9	5.2	109.3
1998	30.9	0.2	34.8	10.9	6.9	14.9	3.9	2.5	105.1
1999	35.9	0.1	31.6	10.4	5.3	7.8	3.0	1.6	95.6

Source: Bank of Thailand.

This shows that although banking and finance companies suffered most because of their short-term exposure, nonfinancial companies also experienced severe liquidity problems as a result of the baht's devaluation. With easy access to foreign funds, large Thai companies had actively borrowed at low interest rates from foreign financial institutions. The ADB survey conducted for this study confirms this: 35 of the 46 respondents indicated that they took out foreign-denominated loans mostly from foreign banks. On average, foreign currency-denominated debts constituted 55 percent of their total debt portfolio. Most of these foreign debts were not properly hedged, exposing the companies to disaster when the baht started tumbling on 2 July 1997.

The severity of the impact of the crisis on the corporate sector was apparent from (i) the decline in the volume of public offerings; (ii) the rise in the nonperforming loan (NPL) ratio and consequent tightening of credit even for viable firms; and (iii) bankruptcies, closures, and drastic decline in the number and capital of newly registered companies.

The value of public offerings sank in 1997 to B56.6 billion from the 1996 level of B201 billion. The proportion of NPLs as a percentage of outstanding loans demonstrates the liquidity problem experienced by the corporate sector. NPLs spiraled from 12 percent in the second quarter of 1997 to almost 40 percent in the third quarter of 1998, reaching 45 percent of total outstanding credit in December, based on the three-month past due definition. Aside from the problem of NPLs, according to the Bank of Thailand, outstanding credit also declined throughout the second half of 1998. If lending rates remained high, banks would be recording more of such NPLs. Similarly, the liquidity problems faced by the corporate sector are likely to continue for some time.

Due in part to liquidity problems on the one hand, and poor business confidence on the other, the numbers of bankruptcies and company closures reached all-time highs in 1998 (Table 4.17). Meanwhile, from its peak in 1995, the number of newly registered companies dropped to a 10-year low in 1998. The effects of the crisis were felt across all industry sectors.

SET's dismal performance is indicative of the extent of the setback suffered by the Thai capital market. Foreign investors retreated from the market, leaving domestic investors with large capital losses. Even before the crisis, trading activity at SET had been on the downturn. At the end of 1994, the SET Index stood at 1,360. After that, the index declined to 1,281 in December 1995 and to 831.6 in December 1996. It hit a 10-year low in the second quarter of 1998. Trading volume has since been thin, suggesting that serious investors have not returned to the market.

Table 4.17
Number of Newly Registered and Bankrupted/Closed Companies, 1985-1999

Year	Newly Registered	Bankrupted/Closed
1985	10,777	2,797
1986	11,095	4,410
1987	14,066	5,105
1988	19,096	4,307
1989	22,312	4,902
1990	25,933	3,218
1991	25,052	3,224
1992	36,134	4,334
1993	31,288	4,112
1994	35,915	9,695
1995	37,410	3,792
1996	37,407	7,080
1997	28,904	9,925
1998	20,201	12,409
1999	24,677	6,977

Source: Department of Commercial Registration, Ministry of Commerce, Thailand.

The price-to-earnings (P/E) ratio deteriorated from 19.5 at the end of 1994 to 12 in 1996 and further to 6.6 in 1997. The increase of the P/E ratio in 1998 was mostly a result of a decrease in earnings for most listed companies. A steady price decline over the past few years has dragged down the ratio of market price to book value. It also explains the higher dividend yield ratio.

4.5.2 Responses to the Crisis

Initially, the Thai Government was lukewarm to the idea of obtaining IMF assistance because of the requirements and conditions attached to the financial package. But when assistance from other sources did not materialize, the Government was left with no choice. The IMF financial package was a credit facility of $17.2 billion for balance of payments support and buildup of the country's reserves. As part of the assistance package, IMF required Thailand to meet a set of performance criteria and implement various restructuring measures. The first Letter of Intent was cosigned by the Minister of Finance and the Governor of the Bank of Thailand on 14 August 1997.

The terms of the agreement required the Government to maintain tight monetary and fiscal policies. In early 1998, IMF relaxed these key conditions.

The core of the IMF conditionalities was the restructuring of the banking and financial sector to regain investor confidence, increase profitability, and restore solvency. The Financial Sector Restructuring Authority was established in October 1997 to address the problems of 58 finance companies that were suspended in 1997. As it turned out, only two companies emerged intact from the suspension. The assets of the other companies were liquidated by auctions.

The Bank of Thailand also improved banking standards. Strict loan classifications, loan provisioning, and income recognition were implemented. The Government required all remaining financial institutions to recapitalize and instituted closer monitoring measures to ensure full compliance with this requirement.

Regulatory Response by the Government

The IMF program, drawn up with World Bank and ADB assistance, also aimed at institutionalizing legal and regulatory reforms. Several changes in the banking and financial policy environment have been effected in line with the restructuring program. These include repeal of the Commercial Bank Act, the Civil and Commercial Code, and the Act Regulating the Finance, Securities, and Credit Foncier Businesses. The Government also passed the Bankruptcy Act and Foreclosure Act Amendments, and worked on revisions to the Secured Transaction Law.

Under the old bankruptcy laws, creditors seldom succeeded in obtaining payment against bankrupt borrowers. There were many options for solving debt repayment problems. Creditors could negotiate to reschedule debt repayments, and if necessary, follow through with a civil or bankruptcy suit. They could seek civil action through the courts and could also use criminal sanctions to enforce debt repayments. The old law allowed only creditors to file bankruptcy suits, and did not recognize debtor-initiated bankruptcy declarations. While no definition for "insolvency" could be found in the bankruptcy law, it was widely interpreted as "having debts more than assets." Creditors thus bore the burden of proving a debtor's insolvency before the courts. By invoking procedural loopholes, however, debtors could drag out the process for many years.

Many believed that the process was inefficient. For example, secured creditors had to obtain the court's approval before starting proceedings

for the recovery of debt through the realization of any collateral. Foreign secured creditors had to go through the motions of establishing that their country of domicile granted Thai creditors similar rights. To make matters worse for creditors, any new loan to a company extended after the creditor discovered the insolvency would not be eligible for repayment.

In 1999, the National Assembly passed an amended Bankruptcy Act and approved the establishment of special bankruptcy courts. The amendment added reorganization provisions to the Bankruptcy Act of 1940, thereby allowing court-supervised corporate restructuring. The original Bankruptcy Act dealt only with liquidation and composition. The amended legislation also includes voluntary bankruptcy as a new feature.

Under the old Bankruptcy Act, creditors always had to contend with the threat of disruptions in a delinquent borrower's business. The new law is designed to prevent bankruptcy due to temporary liquidity problems by allowing an insolvent debtor to file a reorganization plan with the court. The amended law also introduced the concept of automatic stay, which means that a debtor could continue in business while the reorganization program was being implemented. In effect, a remedy beneficial to borrowers and creditors is made possible through a business reorganization that should improve the borrower's debt position and ensure its continued operations.

The reorganization process is successful if (i) the debts shall have been discharged; (ii) management of the company reverts to the borrower; (iii) shareholders regain their legal rights; and (iv) the debts shall have been settled within a five-year period. If the process fails to revive the business, the company shall be declared bankrupt and liquidation of assets shall follow.

The model for Thailand's amended bankruptcy law was the US Chapter 11, the main purpose of which is to assist in the rehabilitation process so that a company can repay its debt and still retain its assets while remaining in business. Chapter 11 is the main tool in restructuring bankrupted companies in the US, but it is a complicated, time consuming, and expensive process. Chapter 11 cases account for only 5 percent of bankruptcy suits in the US but consume 90 percent of the courts' time. In Thailand, the judges and court officers have yet to learn and master the new bankruptcy procedure. Enforcement of the new law is bound to be ponderous and lengthy.

There are other potential problems. For one, the amended law limits the rights of secured creditors. But more important, it covers only the court-supervised reorganization of distressed companies. Companies need

to solve the problems (e.g., corporate governance) that caused the bankruptcy in the first place. Without the necessary corporate restructuring, the Bankruptcy Amendment will just prolong the problems of nonviable borrowers. Under the new law, the test for insolvency still uses the balance sheet criterion, namely "liabilities exceed assets," as opposed to the more appropriate criterion of "ability to pay when the debt falls due."

The Foreclosure Act Amendment was likewise passed in 2000. The amendment seeks to revise old rules and procedures that tended to delay foreclosure proceedings. Procedural delays give borrowers an advantage because they can refuse to pay back their loans even though they can meet their obligations. The new foreclosure law cuts short the procedures required under the Civil and Commercial Code for petty or simple cases dealing with mortgage defaults: (i) submission by the drafting committee of a default judgment bill within a week, and (ii) processing of default cases within four to six months of filing of a court claim. The amendment also remedies the slow process of executing or disposing of assets in a public auction.

Still pending Parliament approval is the amendment to the Secured Transaction Law, which aims to increase liquidity in the domestic economy by allowing businesses to use both tangible and intangible assets in securing credit. In the past, only tangible assets were the norm. The proposed new law seeks to expand the type of assets that a borrower can use as collateral.

SEC also examined the possibility of an amendment to the Public Company Act of 1992. Replacing the Public Limited Company Act of 1978, the 1992 Act relaxed some of the original restrictive rules and regulations to encourage public company registration. The result, however, has not been satisfactory. Most important, minority shareholders' rights are not adequately protected. The minimum shareholding requirement is too high for any individuals or groups of minority shareholders to take action against controlling shareholders. Minority shareholders also have to absorb the costs related to their actions because the 1992 Act does not allow them to be reimbursed by the company. Consequently, questions have been raised regarding the appropriateness of the 1992 Act.

There have been proposals to lower the minimum shareholdings required for a minority group to request the board of directors to call an extraordinary general meeting at any time. In case the board of directors does not comply, the court, after determining the legitimacy of the request, shall have the power to call the extraordinary general meeting. The proposed amendment also includes a provision for the company to reimburse minority shareholders for expenses related to calling such a meeting.

Another issue is the assumption in the 1992 Act that there is a separation of ownership and control functions. This may be true in countries where publicly traded companies are widely held. But as demonstrated, this is not so in publicly traded companies in Thailand. Because of high ownership concentration, the controlling shareholders have the exclusive domain to appoint or exercise management, and determine voting results on virtually any matter. The textbook separation between owners who sit in the company's board and professional managers who run the company does not apply in Thailand. But because this is the assumption embedded in the regulation, the main problem is overlooked, i.e., the dominance of controlling shareholders, who are also the managers, vis-a-vis the minority shareholders. Consequently, there are few provisions in the Act that deal with related or connected transactions that potentially reduce shareholders' value.

The 1992 Act also allows directors to engage in business activities that may directly or indirectly affect the company, subject only to approval by the board of directors. In addition, it permits directors, with the approval of the board, to borrow from the company without consideration to the fairness of the transaction or transparency of the approval process. Directors enjoy unusual protection under the 1992 Act in that they can be pardoned by shareholders in the annual general shareholders' meeting for any violation of fiduciary duties. The only reason Thai investors placed their money in stock issues despite these legal cracks was the rapid increase in stock prices in the 1990s.

In the absence of such a stock market boom now, minority shareholders are likely to be wary of increasing their equity without corresponding control mechanisms at their disposal. Where equity will come forward, it will probably be expensive because of the higher risk that comes with weak accountability mechanisms. The radically changed circumstances after 1997 offer the possibility that firms and their controlling shareholders will be under greater pressure to concede to the exercise of minority rights. Otherwise, they face the prospect of being unable to compete for the scarce funds available in the equities market. The regulators are drafting a proposal to amend the provisions on related transactions. The proposal clearly delineates duties of care and loyalty for directors of public companies.

The 1992 Act only prescribes—not requires—the use of the cumulative voting procedure. Most companies decide against cumulative voting, claiming that it creates fragmentation in the board of directors, which, in turn, disrupts the company's management and decision making. However, without cumulative voting, minority shareholders have no chance of being represented in the board. The proposal for the amendment of the Public

Company Act of 1992 includes a recommendation to require all public companies to use cumulative voting to ensure that the board of directors consists of representatives from all groups of shareholders.

Corporate Debt Restructuring and Bankruptcy

The 1997 crisis led to a severe liquidity problem in the economy, contributing to the unprecedented rise in the corporate sector's bad debt. In response, the Government introduced debt restructuring-related measures to help resolve bad debts.

The Bank of Thailand issued guidelines in 1998 encouraging financial institutions to specify their own policies, methods, and procedures for debt restructuring. Considerable progress has been achieved on this front. By October 2000, 322,764 debt restructuring cases involving B1.8 trillion had been completed. Commercial banks initiated 74 percent of these cases, accounting for B1.1 trillion of outstanding credit. Another 77,068 cases involving B475 billion are undergoing restructuring.

In addition, a Corporate Debt Restructuring Advisory Committee (CDRAC) was established in 1998 to map out debt restructuring measures in support of efficient negotiations between the private sector and financial institutions. As of November 2000, CDRAC's target debtors comprised 10,767 cases involving outstanding credit of B2.6 trillion. However, only 7,147 cases (B1.6 trillion) have agreed to cooperate with CDRAC's restructuring process. Some 82 percent of these cases have been successfully restructured, accounting for B1.1 trillion in outstanding credit, with the majority of the debtors coming from the commerce, personal consumption, and manufacturing sectors. Another 5 percent of cases (B70 billion) are undergoing restructuring negotiations. Cases for which negotiations were unsuccessful, as well as those that did not cooperate with CDRAC's restructuring process, will be settled by the courts.

The first bankruptcy court in Thailand opened on 18 June 1999. Within three months, the court had more than 80 cases for disposition, although since then, the number of cases has abated. The reason is that bankruptcy law amendments appear to facilitate settlements outside the court.

Reforms in bankruptcy procedures should be seen not only in the context of crisis resolution. Equally important is the contribution of effective and reliable bankruptcy procedures for improved corporate governance. In particular, where bankruptcy procedures are swift and effective, the mere threat of external control alters the incentives faced by managers and controlling shareholders significantly. This point is crucial because compared with

Malaysia, Philippines, and even Indonesia, Thailand is coming from a situation where excessively high leverage became the norm because firms could obtain finance without having to concede a measure of control to outsiders. Weak bankruptcy procedures were part and parcel of the perverse set of incentives that led firms to build up unsustainable levels of debt.

Reforms through SET and Improved Disclosure

The financial crisis prompted SET to introduce a range of improvements to its operation and regulation. It required listed companies to establish their own audit committees by the end of 1999. Financial information from listed companies will also soon be required to conform to International Accounting Standards. The exchange has already required that listed companies' quarterly reports be directly comparable with annual statements.

Such improvements in disclosure standards are part of the efforts of SET and SEC, despite the weakness of their disciplinary powers, to push companies to harmonize their accounting with international standards.

4.6 Summary, Conclusions, and Recommendations

4.6.1 Summary and Conclusions

This study has provided an overview of the corporate sector and governance in Thailand. Emphasis was on the structure of corporate governance and patterns of corporate ownership and financing of publicly listed companies. The study covers the period 1985 to 1996, a time span that includes the onset of financial liberalization—the turning point of Thai economic development in the last decade—and represents the decade preceding the Asian financial crisis of 1997. Examination of corporate ownership, behavior, and performance during this period helps understand the causes of the crisis.

The economic development of Thailand took off with the implementation of a series of National Economic and Social Development Plans beginning with the first medium-term plan for 1961 to 1966. In the next three decades, the Thai Government managed its economy with the corporate sector as the main engine of growth and development. For this reason, the Government protected certain corporate sectors through tariffs and regulation, and promoted key industries through incentives. The banking industry played a key role in the early stages of economic development because it represented the only avenue for funding Thai corporations. The

importance of bank financing continued throughout the 1990s, even after the development of capital markets. In 1992, the corporate sector entered a new era with the enactment of two major pieces of legislation, the Public Company Act of 1992 and the SEA of 1992. Subsequently, there was a marked increase in the number of public corporations.

The SEA of 1992 also marked the beginning of an active bond market in Thailand. After 1992, the number and value of public offerings of securities accelerated. The financial performance of the corporate sector remained satisfactory up to the years before the outbreak of the financial crisis. Profitability increased throughout the 1980s but began to decline in the first half of the 1990s. In 1995 and 1996, the profitability of publicly listed companies abruptly declined and their financial leverage increased. Financial liberalization apparently encouraged companies to borrow overseas to finance investments that were not productively employed.

At the onset of the 1997 financial crisis, the overall corporate sector was seriously affected. The number of newly registered companies in 1997 dropped by almost 10,000 from the previous year's level. At the same time, the numbers of bankruptcy cases and company closures reached all-time highs. Meanwhile, the number of listed companies in SET fell from 454 in 1996 to 392 in 1999. The impact of the crisis was felt across all industries.

One of the principal causes of the crisis was the excessive use of foreign debt by the corporate sector. During 1992-1997, foreign debt in the Thai corporate sector increased continuously, reaching its peak in 1996. Nonbank private corporations accounted for most of the increase. Although there was a decline in short-term foreign debt, the increase in long-term debt more than compensated for the drop. Because most of these debts were not hedged, Thai companies were vulnerable to exchange rate risks. Consequently, the devaluation of the baht that began on 2 July 1997 affected the financial condition of Thai corporations, at a time when most of them were already experiencing declining profits and high leverage.

The study examined the impact of ownership structure on corporate governance and financing patterns. One of the major findings is the high ownership concentration among Thai companies listed on SET. On average, the top five largest shareholders hold about 56 percent of total outstanding shares. Although there are some variations across industries, the overall pattern of ownership concentration seems to have been stable for the past 10 years. This implies that the control of an average Thai company is typically in the hands of a few persons (founders or their associates) who own a majority of total outstanding shares. Minority shareholders,

although larger in number, hold only a small portion of total outstanding shares. Consequently, they have little influence over management decision making and control.

Among the five largest shareholders of Thai companies listed on SET, holding companies and affiliated corporations hold the largest proportion at 27 percent of total outstanding shares. Individuals and insiders hold the second largest proportion at about 19 percent. Financial institutions hold a very small proportion; commercial banks hold only about 2 percent of total outstanding shares while nonbank financial institutions hold about 6 percent. The Government holds about 1 percent of total outstanding shares but these holdings represent majority shares of a few companies. The investing public holds the rest of the outstanding shares, averaging 46 percent.

An analysis of the corporate ownership structure in Thailand suggests that founders and management continue to own and control publicly listed Thai companies, through the use of holding and affiliated companies. The implications of ownership structures that are concentrated to such a high degree are serious. The absence of external market controls on the management of publicly listed corporations is dangerous. With financial institutions playing limited roles in the capital market, there is a clear lack of outside monitors for these publicly listed but family-controlled companies.

Institutional investors in Thailand, foreign and domestic, are not active. In the past, the government pension fund was the only major institutional investor. Recently, the mutual fund industry has entered the picture but with limited roles and activities. Most foreign institutional investors invest only on a short-term basis and aim for short-term trading profits. All these, along with a highly concentrated ownership structure, contribute to the lack of external controls on the corporate sector through the capital markets. Thus, publicly listed and unlisted companies in Thailand are equally subject to the consequences of the risk-taking behavior of controlling owners. It remains to be seen how reforms in bankruptcy procedures—including the increased threat of creditor control—could shift the incentives of controlling shareholders toward greater acceptance of equity finance and its consequent accession of control to new shareholders.

The highly concentrated ownership structure weakens the protection of minority shareholder rights. Nominally, the existing legal and regulatory framework suggests otherwise. The key laws, the Public Company Act of 1992 and the SEA of 1992, protect the interests of all shareholders of public companies. These laws stipulate rules and regulations concerning the activities of all public companies. The rules in both Acts governing

minority shareholders' participation in decision making and in initiatives against management conform to international standards. However, the high ownership concentration of many listed Thai companies inhibits the effectiveness of these provisions, because there is no separation between ownership and management.

In view of this, the main challenge is not how the board can control management to maximize shareholder value. Rather, because there are shared interests between the controlling shareholders and key management personnel, the main challenge is in protecting minority shareholders from the possibility of expropriation by the majority. For instance, before the crisis, laws did not provide minority shareholders sufficient safeguards in cases of transactions involving companies where the controlling shareholders had related interests.

Certain provisions, moreover, posed formidable barriers in the minority shareholders' exercise of their rights. For example, the Public Company Act of 1992 allows shareholders to act only when they hold a minimum proportion of shareholdings, a requirement impossible to meet due to the concentrated shareholdings of founding family members and management. The Government has been moving to amend the Public Company Act of 1992 to increase minority shareholders' protection in this regard.

The ownership structure of Thai listed companies also significantly affects company behavior. Ownership concentration appears to have little impact on corporate profit performance, but is significantly related to financing patterns. Specifically, the degree of ownership concentration has a statistically significant positive relationship to the degree of financial leverage. It appears that founding family members use debt extensively to finance investments because they want to preserve control of their firms. Consequently, these companies tend to become overleveraged, making them vulnerable to economic shocks.

4.6.2 Policy Recommendations

There are three major policy issues and recommendations that could improve corporate governance in Thailand. The first issue involves the development of a comprehensive supervisory framework and the strengthening of the capacity of supervisory agencies. The second issue involves the protection of shareholder rights, an aim that can be achieved mostly through legal reforms. The third issue involves creating external market controls through better regulation and development of the capital markets. In this third area, key reforms that will strengthen the regulation of financial institutions,

encourage market competition, activate the market for corporate control, and increase the participation of institutional investors are imperative.

Development of a Comprehensive Supervisory Framework

There is a need for the Government to establish a comprehensive supervisory framework for the corporate sector. Under the current system, three major government organizations (the Ministry of Commerce, SET, and SEC) are involved in corporate supervision. This is due to the historical development of the Thai corporate sector: before 1975, the Ministry of Commerce had the sole supervisory responsibility; in 1975, SET was mandated to supervise listed companies; and after the enactment of the SEA in 1992, SEC was established as another supervisory agency. Consequently, the supervisory system is fragmented and not as effective as it should be. It is important that the roles and responsibilities of each agency are clearly defined to the public. The Government must develop an overall framework for corporate sector supervision and redefine the regulatory jurisdiction of each agency along functional lines. Only then will these agencies be able to act promptly and effectively. The best approach may entail establishing a single, unified supervisory agency or a permanent regulatory division consisting of supervisory units from the three agencies. Once the roles and responsibilities are clearly defined, the supervisory agencies also need to be empowered to enforce the laws.

Protection of Shareholder Rights

The common assumption is that publicly traded corporations are widely dispersed in terms of ownership. There is also supposed to be separation of ownership and control, with control delegated to professional managers. The owners of a firm rely on a board of directors to supervise the managers, voting only on major decisions. If this were the situation, the key issue in corporate governance would then be to ensure that managers act in the best interests of the shareholders. The board therefore plays a pivotal role.

In reality, in most of Thailand's publicly traded firms, the principal shareholder typically plays a key role in management and often serves as the chief executive officer. If the principal shareholder is in fact chair of the board, he/she often has the decisive vote. In this setting, the key issue in corporate governance is how to prevent insiders from expropriating assets of minority shareholders. As in other crisis economies in the region, this is a problem in Thailand.

There is a need to recognize the unique ownership structure in Thailand and its effects on corporate investment and financing behavior. Current laws allow a high degree of ownership concentration and provide inadequate safeguards against possible conflict-of-interest transactions and their impact on minority shareholders. The current ownership structure leads to ineffective corporate governance and inadequate protection of minority shareholders. The situation prompts two specific recommendations.

The first recommendation involves the repeal of current legislation to allow minority shareholders to have greater influence over management decision making. This includes prescribing ways to empower minority shareholders without disrupting the company's operations. SEC is exploring the possibility of amending the law toward this direction. Some of the legal reforms under consideration concern settling conflict-of-interest situations with significant effects on minority shareholders, increasing penalties for directors engaged in misconduct, requiring cumulative voting for the election of directors, and a prohibition of connected transactions by directors or management. The Ministry of Commerce is conducting a study on proposed amendments to the Public Company Act of 1992.

The second recommendation is to dilute ownership concentration through the use of regulatory power. Through an amendment in the Public Company Act, the Government can change the shareholding limit for controlling shareholders. This move is expected to be unpopular among founding family members and original owners. There is also a need for legislation dealing with nominee or holding companies because they are the institutional means that founding family members use to maintain control. The Government does not have an effective way of monitoring the financial activities of these companies even as it is widely believed that a large amount of funds is being channeled through them. Because these holding companies control a number of large public companies in Thailand, they should be monitored and regulated.

To ensure a level playing field, regulators must increase transparency and step up enforcement. Since the Asian financial crisis, there has been much progress in this area. Both SET and SEC are taking an active stance in improving the transparency and efficiency of Thai capital markets. But weaknesses in accounting and auditing practices have been inhibiting the development of capital markets. The slow improvement in the legal framework has likewise obstructed progress in this area.

SEC has been trying to lay the foundations of good corporate governance by espousing fairness, transparency, accountability, and

responsibility among companies. However, the SEC's disposition toward a largely voluntary approach for adoption of these characteristics has resulted in uneven compliance among public companies. Accounting standards have also been under review.

Capital Market Development and Regulation

Another important issue concerns the development of capital markets. Without a strong and efficient capital market, it will be difficult to improve corporate governance in Thailand. In the stock market, for instance, there is a need to increase market disciplinary power through market competition. In an environment of highly concentrated ownership, the power of the capital market to discipline inefficient management is almost nonexistent. One way the Government can improve the current situation is to require publicly listed companies to trade a higher proportion of outstanding shares in the secondary market. The promotion of active roles for domestic institutional investors should also improve corporate governance in Thailand.

There will be no incentive for companies to raise capital in the equities market if they can obtain funds at a lower cost elsewhere. The Bank of Thailand's enforcement of prudent lending practices among Thai financial institutions, aimed at ensuring that banks finance only creditworthy projects, will incidentally close off easy sources of finance for companies that have been practicing regulatory arbitrage. The same goes for improvements in the bankruptcy system.

Because the financing of Thailand's corporate sector is predominantly bank-based and will remain so for a long while yet, it is important to explore reforms that can lead to the enhanced role of banks in monitoring enterprises. This may not be possible without reforms in the banking sector itself, especially in the area of connected lending.

Thailand should develop a strong public debt market to supplement the banking system in financing corporate investments. The first step is to establish an active secondary Government bond market, which, in turn, will lead to the emergence of a reference yield curve. The variety of debt instruments available to the corporate sector and investors should be increased and longer-term sources of bond finance actively promoted. A well-developed domestic debt market will provide corporations with an alternative to bank financing, while a strong domestic debt market will also offer protection from foreign exchange risk. Further, a well-developed secondary market will pave the way for market disciplinary forces to act against poorly managed companies.

References

Annual Report. 1997. The Securities and Exchange Commission of Thailand.

Bank of Thailand Monthly Bulletin. 1995-1999. Bank of Thailand.

Bank of Thailand Quarterly Bulletin. 1995-1999. Bank of Thailand.

Bond Market Development in Thailand. 1998. The Thai Bond Dealing Centre.

Department of Commercial Registration Database, Ministry of Commerce, Thailand.

Fact Book. 1995-1999. The Stock Exchange of Thailand.

Key Capital Market Statistics. 1997-1999. The Securities and Exchange Commission of Thailand.

PACAP-Thailand Database, Pacific-Basin Capital Markets Research Center, The University of Rhode Island, Kingston, US.

Thai Accounting Standards. 1995. The Stock Exchange of Thailand.

The Stock Market in Thailand. 1997. The Stock Exchange of Thailand.