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Large-Scale Post-Crisis Corporate Sector Restructuring

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Abstract

This paper summarizes the objectives, tasks, and modalities of large-scale, post-crisis corporate restructuring based on nine recent episodes with a view to organizing the policy choices and drawing some general conclusions. These episodes suggest that government-led restructuring efforts should integrate corporate and bank restructuring in a holistic and transparent strategy based on clearly defined objective and including sunset provisions.

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I. INTRODUCTION

Corporate restructuring on a large scale is possibly one of the most daunting challenges faced by economic policymakers. Large-scale restructuring arises in the aftermath of a financial crisis amplified into a historically severe recession by pervasive corporate distress (Krugman, 1999; Stone, 2000). The successful completion of restructuring requires that the government take a leading role to establish restructuring priorities, address market failures, reform the legal and tax systems, and, perhaps most important, deal with obstructions posed by powerful interest groups.

This paper summarizes the objectives, tasks, and modalities of large-scale, post-crisis corporate restructuring with a view to organizing the policy choices and drawing some general conclusions. The modesty of these goals reflects the shortfall of literature on the principles and cross-country experience with large-scale corporate restructuring.[2] This shortfall can be attributed to the relatively recent vintage of crises with important corporate sector dynamics, the country specificity of the issues, and limited data.

This paper is based mainly on evidence collected from nine systemic financial crises where the corporate sector played a key role (Table 1). Real GDP over the course of these episodes contracted by an average of 6 percent, reflecting high levels of corporate leverage (Stone, 2000). This list is not meant to be comprehensive and excludes episodes with less successful restructuring efforts (Romania and Russia in the early 1990s), and does not

[2] The general principles of corporate restructuring are discussed in Begg and Portes (1992), Fries and Lane (1994), and van Wijnbergen (1994). Rare examples of theoretical analyses include Aghion et al., (1994) and Aghion et al., (1996). Cross-country experiences with corporate restructuring are in Carlin and Landesmann (1997), World Bank (1996), Stone (1998), Claessens et al. (1999), World Bank (1999), and BIS (1999).

encompass small countries. Rather, these nine episodes seem to be particularly important, and data and documentation on them are more readily available.

Table 1. Large-Scale Post-Crisis Corporate Restructuring Episodes

Country	Crisis trough	Country	Crisis trough
Chile	January, 1983	Indonesia	May, 1998
Mexico	October, 1983	Korea	July, 1998
Hungary	July, 1992	Malaysia	November, 1998
Poland	October, 1991	Thailand	November, 1998
Mexico	July, 1995		

1/ Trough month is that of the lowest value of the level of seasonally adjusted industrial production during the crisis episode.

Source: Stone (2000).

This paper is organized as follows. The objectives and tasks of large-scale corporate restructuring are set forth in Section II and Section III, respectively. The modalities of government-led corporate restructuring are examined in Section IV; the reduction of the role of government is evaluated in Section V; and Section VI concludes. Details of the modalities of restructuring for the nine episodes examined in this paper are summarized in an appendix.

II. Objectives

Corporate restructuring on a large scale is made necessary by a systemic financial crisis, which can be defined as "a severe disruption to financial markets that by impairing their ability to function has large and adverse effects on the real sector" (IMF, 1998). The intertwining of the corporate and financial sectors that defines a systemic crisis requires that the restructuring effort must address both sectors together. Since the complexity of this effort necessitates that government take the lead in post-crisis restructuring, the underlying strategy must also include the winding down of the role of the government after restructuring is completed.

Against this background, the *broad policy objectives* of corporate restructuring in the context of a systemic financial crisis can be reduced to:

- restructuring viable corporations and liquidating nonviable corporations;
- restoring the health of the financial sector; and,
- creating the conditions for long-term economic growth.

Although these objectives are rather general, they do help organize the overall restructuring effort, as well as provide benchmarks for assessment of the effectiveness of the restructuring strategy and for the timing of the shutting down of restructuring institutions.

III. TASKS

The tasks for attainment of these objectives encompass the entire spectrum of economic policies(Figure 1). Some tasks are prerequisites for others, but this chronological order is loose and in practice will reflect the unique circumstances of each country.

A. The Foundation

Successful restructuring is not possible without a strong foundation established by government actions that span the entire spectrum of economic policies. First, *macroeconomic stability must be entrenched to provide the confidence needed for debt restructuring transactions*. Stable prices, interest rates, and exchange rates are needed for debtors, creditors and potential investors to have enough certainty to value and close transactions. Delays in the

Figure 1. Tasks of Large-Scale Corporate Restructuring

I. The Foundation

- Entrench macroeconomic stability (Government).
- Identify scale and nature of corporate distress (Government).
- Formulate holistic strategy for restructuring corporate and financial sectors (Government, restructuring director).
- Establish legal, regulatory, and accounting environment (Government).
- Improve corporate governance (Government).
- Offset social costs of crisis and restructuring (Government).

II. Financial restructuring

- Separate out viable from nonviable financial institutions (Government, BRA).
- Shut down nonviable banks (Government, BRA).
- Recapitalize viable bank (BRA).
- Shift bad bank assets to AMC. (Government, BRA, AMC).

III. Corporate restructuring

- Separate out viable from nonviable Corporations (Banks, AMC).
- Establish new liquidation mechanisms for nonviable corporations (Government).
- Restructure balance sheets of viable corporations (Banks, AMC).

IV. Reduction in role of government

- Dispose assets of liquidated corporations (AMC, market players).
- Reprivatize government-owned financial institution assets (Government).
- Close restructuring institutions (Government).

attainment of macroeconomic stability slowed progress toward restructuring in Chile and Indonesia.

The scale and nature of corporate distress must be quickly assessed by the authorities, banks and advisers to determine whether or not the problems are systemic and thus whether the government should take a leading role The assessment of corporate distress can be based on back of the envelope calculations of the debt servicing capacity of the aggregate corporate sector, the demand for bank credit, increases in nonperforming loans, and bankruptcies (Stone, 2000). Assessment of corporate distress in every one of the case study episodes was complicated by poor corporate balance sheet data, and by the uncertain macroeconomic environment.

A holistic strategy for restructuring encompassing both the corporate and financial sectors should be formulated as soon as possible after the crisis is judged to be systemic in scope. The involvement of all interested parties in the formulation of the strategy enhances its credibility, as does transparent presentation of its objectives, tasks and modalities. Sweden, during its banking crisis of the early 1990s, and Korea benefited from the early formulation of comprehensive restructuring strategies. (Ingves and Lind, 1996 and Stone, 1998).

A supporting *legal, regulatory and accounting environment* is a necessary condition for successful corporate restructuring. Important legal aspects of restructuring include foreclosure standards, foreign investment rules, and merger and acquisition policies. Regulations governing debt-equity conversions and asset sales often need to be changed to make possible novel and complex restructuring transactions, as in Thailand. Financial disclosure standards should be raised to international levels and enforced to promote transparent restructuring transactions. In Hungary, the enactment in 1991–1992 of new loan provisioning laws furthered bank restructuring, and contributed to the gradual tightening of corporate budget constraints. Typically, groups of individuals whose interests could be hurt by restructuring transactions try to stop the establishment of a supporting environment, as in East Asia (World Bank, 2000).

Corporate governance must be brought up to international standards to provide incentives for viable firms to restructure their balance sheets and maximize their surplus value. Improved governance is needed not only to push managers to restructure the existing debt stock, but also to operate profitably and improve future profit flows (Johnson et al., 1999). Often liberalization of foreign investment can promote good governance through the importing of international best practices. Russia (Aghion et al., 1994) and Romania (Begg, 1996) are vivid examples of how corporate distress can persist without improvements in corporate governance. Korea and Thailand have enhanced the rights of minority shareholders, but there is room for further progress generally in East Asia (Claessens et al., 1999 and World Bank, 2000).

The closing of nonviable corporations will incur *social costs that necessitate offsetting government actions* in order to help sustain continued political support for restructuring over the long haul. Hungary and Poland took measures to reduce income disparities in the mid-1990s, which reflected more than just corporate restructuring, albeit with mixed success (World Bank, 1996). In East Asia, rudimentary social safety nets at the time of the crisis were expanded to offset the impact of the crises on the poor through income transfers, unemployment limiting measures, and measures to maintain access by the poor to social services (Gupta et al., 1998). Social measures during these episodes were often formulated with the cooperation of corporations and unions.

B. Financial Sector Restructuring

Even after the foundation has been laid, corporate restructuring cannot begin in earnest until substantial progress has been made in restructuring the financial sector. The draining of bank capital brought on by the crisis will usually lead to a sharp cutback in lending to viable and nonviable corporations alike, exacerbating the aggregate contraction. Moreover, banks must have the capital and incentives to play a role in restructuring.

Only the aspects of financial sector restructuring that pertain directly to the corporate sector are addressed here.[3] The first task of financial restructuring is separating out the viable from the nonviable institutions to the extent possible. Financing and technical assistance from international financial institutions can be helpful, as in Indonesia. Thereafter, nonviable banks should be closed down and their assets sold or shifted to an asset management corporation (AMC), while viable banks should be recapitalized. Banks need to be directly recapitalized for normal operation or else, in the absence of strong competitive pressures, they may impede recovery by recapitalizing themselves indirectly through wide interest rate spreads. There is a degree of circularity here in that the separation of viable from nonviable banks is facilitated by completion of the same task for corporations, which itself is aided by financial restructuring. The best way to close this circle seems to be rapid restructuring of the banks because a cutback in bank financing to corporations amplifies the aggregate

[3] For overviews of bank restructuring see Sundararajan and Baliño (1991), Dziobek and Pazarbasioglu (1997), Alexander et al. (1997), and BIS (1999).

contraction, and has irreversible consequences such as underpriced asset sales (Kim and Stone, 1999). Financial reform accelerated restructuring in Mexico in the 1980s and in Poland, in contrast to the experience in most transition countries. In East Asia, financial restructuring has made substantial progress but is as yet incomplete (World Bank, 2000).

C. Corporate Restructuring

Corporate restructuring can begin in earnest only when banks, AMCs, and market players are willing and able to participate. The first task is *distinguishing viable from nonviable corporations*. Nonviable firms are those whose liquidation value is greater than their surplus value as a going concern, taking into account potential restructuring and at the "equilibrium" exchange rate and interest rates. The timely exit of nonviable firms ensures that they do not absorb credit or worsen bank losses. However, the identification of nonviable corporations is complicated by the poor overall performance of the corporate sector during and just after the crisis. Viable and nonviable firms can be identified using profit simulations (World Bank, 1999) and balance sheet projections (Gray, 1999), as well as best judgement.

Liquidation of nonviable corporations in the setting of a systemic crisis usually requires the establishment of *new liquidation mechanisms that bypass standard court-based bankruptcy procedures*. The bankruptcy code of the United States can be taken as the standard minimal government involvement approach. However, in practice this code has a strong liquidation bias—some 90 percent of cases end in liquidation (Aghion, Hart and Moore, 1994), and reorganization takes a long time (Bebchuk, 1998). The welfare loss arising from the liquidiation bias and prolonged period of reorganzation (i.e., the surplus value over the liquidation value of all the viable firms that are liquidated) can be very large in the wake of a systemic crisis. Moreover, courts are usually unable to handle a large volume of cases, lack expertise, and may be subject to the influence of vested interests. Giving debtors protection from bankruptcy during mediation proceedings allows corporations that are later judged to be viable to remain operating and promulgates the orderly liquidation of nonviable corporations. However, if debtors are protected from bankruptcy, monitoring of the corporations is needed to ensure that incumbent managers do not hive off the most profitable assets. Liquidation can be expedited by special courts (Kenya) or new bankruptcy laws (Thailand). Hungary introduced a tough "bankruptcy" law of 1991 under which firms in arrears were required to submit reorganization plans to creditors; if agreement was not reached, firms were liquidated. Also, a standstill on payments to banks during negotiations allows cash-strapped corporations to continue operation while their viability is being decided. Without effective bankruptcy procedures, restructuring can be significantly slowed down, as happened in many transition countries in Mexico in 1995, and especially in Indonesia.

The government must also decide on *disposal of the assets of liquidated corporations.* Delays in asset disposal tie up economic resources, slow economic recovery, and impede corporate restructuring. The decision regarding asset disposal entails the trading off of asset recovery values, the speed of resolution, and financial sector recovery (Woo, 2000). The choice of the asset disposal procedure must of course fit within the overall strategy. Banks can take the lead if they are in charge of corporate restructuring, or disposal can be left to the markets in more limited crises. Otherwise, as is more often the case in recent years, the government must set up a special asset management corporation, which has its own risks, as discussed below.

Next is *restructuring of the balance sheets of the viable corporations.* Restructuring will involve private domestic and foreign creditors, newly state-owned creditors, and asset management corporations, as well as stakeholders such as unions and governments. Usually, balance sheet restructuring takes place through the reduction of debt or debt-to-equity conversions. Often minority creditors slow debt restructuring by threatening to liquidate the debtor to force majority creditors to buy them out on favorable terms. This coordination problem can be avoided by rules that allow less-than-unanimous creditor approval of reorganization plans, which can be enforced by government moral suasion, by prior creditor agreement to a set of principles, or through bankruptcy proceedings.

Early completion of relatively clear-cut transactions can jump-start the restructuring program. Restructuring is often delayed by difficulties in valuing transactions due to macroeconomic instability and unreliable corporate data. For example, in Indonesia, foreign creditors were reluctant to enter into restructuring agreements before the rupiah settled down, and in many countries unreliable corporate balance sheet data have slowed restructuring. Despite the uncertainties, the momentum for restructuring can be established by early liquidation of the "least" viable firms, as in Korea.

Long delays in implementing bankruptcy reforms have greatly slowed the large-scale corporate restructuring efforts of the mid- and late 1990s. By early 2000, Mexico had still not completed bankruptcy law reform, even though there had been a sharp drop in bank claims on the private sector since the country's 1995 crisis. In East Asia, ineffectual bankruptcy laws have stymied corporate restructuring by allowing nonviable firms to stay afloat, which not only precludes banks from collecting the underlying collateral, but also acts as a disincentive for viable firms to repay their debt—further hurting the banks (World Bank, 2000). Delays in bankruptcy reform are mainly due to pressures from groups and individuals who would be hurt by the liquidation of nonviable firms, as well as by the time needed to bring up to speed legal systems faced with a sudden increase in bankruptcy cases. Transparency is one positive suggestion for bankruptcy reform: regular government disclosure of all the aspects of restructuring can make clear the impediments put forth by vested interest groups, and thus lead to public pressure to accelerate reform.

IV. Corporate Restructuring Modalities

Experience has shown that large-scale corporate restructuring requires the government to take a leading role so as to establish priorities, mitigate the economic and social costs of crisis, address market failures, and deal with the obstructions posed by powerful interest groups. The government's role in corporate restructuring is highly country-specific owing to its complexities, social consequences, and involvement of different elements of society. Thus, there are relatively few overarching operational principles or obvious ways to organize the policy choices, especially in comparison to other structural policy areas such as capital account liberalization and labor market reform. The approach taken here is to examine five government-led corporate restructuring modalities in ascending order of government involvement based on the nine episodes examined in this paper Appendix).

A. Government Mediation

Government mediation between corporations and banks or between banks is warranted if there are *factors that inhibit creditors from leading corporate restructuring*. Such factors include a lack of bank capital, excessive negotiating power by either debtors or creditors, or a lack of incentives for banks or corporations to work out debt usually arising from poor supervision and bad governance. These factors can prolong restructuring, resulting in avoidable costs and even the unnecessary liquidation of debtors. To avoid these pitfalls, the government can mediate informally or in a more structured framework.

The best known form of government mediation is the "London approach" which is implemented in the United Kingdom under the aegis of the Bank of England. The London approach is based on the following principles: (i) if a corporation is in trouble banks keep credit facilities in place and do not press for bankruptcy; (ii) decisions about the debtor's future are made only on the basis of comprehensive information shared among all banks and parties; (iii) banks work together; and (iv) seniority of claims is recognized but there is an element of shared pain. Although the term London approach has been applied to the restructuring efforts underway in several East Asian countries, governments in these countries have come to play a larger role, owing to the systemic consequences of corporate distress as well as the absence of a supporting microeconomic environment as in the United Kingdom.

The government mediation framework is appropriate if corporate restructuring is limited in scope and the environment supportive. This approach offers flexibility and adaptability, but requires a credible government mediator, macroeconomic stability, and the appropriate regulatory setting—all of which are attributes of the United Kingdom where the London Approach has been successful. This approach has proven to be less useful when there are great many creditors, especially foreign creditors, as in Indonesia.

B. Government-Financed Incentive Schemes

Financial incentives through a preset government-financed scheme can be useful if *corporate distress is systemic and market or regulatory failures inhibit restructuring.* These schemes usually involve insurance or subsidy incentives that are made available to creditors and debtors on a voluntary basis. Incentives include compensation to creditors for lengthening debt maturities and grace periods, interest rate and exchange rate guarantees, and equity injections. The government must trade off the fiscal costs of the plan against the systemic benefits of alleviating corporate distress. Government strategies were employed by Mexico (FICORCA in the early 1980s and UCABE in the mid-1990s), and Chile. Today, government incentives are offered in Indonesia (INDRA). Of course, government schemes have important pitfalls, including politicization and overly generous and long-lasting incentives, as in Chile.

C. Recapitalization of Banks

Bank recapitalization is warranted if *corporate debt problems are pervasive enough to undermine the health of the banking system, and banks are willing and able to restructure corporations on their own.* The widespread interruption of corporate loan payments, which usually reflects macroeconomic instability, will reduce and can even wipe out bank capital. If new capital is all that banks need to restructure debt, (i.e., they have the incentives and capacity for working out loans), and if new private capital sufficient to restore the banks to normal operation is not forthcoming, then public financing is needed to restore bank capital.

A new bank-restructuring agency (BRA) is typically established to help coordinate the policies needed to ensure the success of recapitalization (Enoch et al., 1999). The BRA must gauge carefully the potentially very large fiscal costs of bank recapitalization against the benefits. Existing shareholder equity should be written down before public funds are used to recapitalize banks to ensure that taxpayers do not bear more than their fair share of the burden. Requirements for the BRA to unwind its equity positions upon the meeting of prespecified conditions accelerate the return of banks to private control. Finally, the BRA in most cases will play a key role in deciding whether banks should manage their own impaired assets or spin them off into an asset management corporation or other entity.

Bank recapitalization was undertaken in all nine of the episodes examined here. Recapitalization costs tended to be higher than for the average banking sector crisis, given the severity of systemic financial crises examined here. Bank resolution costs in a typical bank crisis tend to be around 7–14 percent of GDP (Frydl, 1999) whereas the recapitalization of banks in the nine corporate crisis episodes reviewed in this paper averaged 23.5 percent of GDP (Table 2).

Table 2. Fiscal Cost of Bank Recapitalization 1/
(Percent of GDP)

Country	Period	Cost
Chile	1981-83	41.2
Hungary	1991-95	12.2
Indonesia	1997-present	56.3
Korea	1997-present	26.5
Malaysia	1997-present	16.4
Mexico	1981-2	2.0
Mexico	1995-99	20.0
Poland	1993	5.7
Thailand	1997-present	32.8
Average		23.5

Sources: Frydl, 1999; Claessens et al., 1999; Oxford Analytica; World Bank, 2000.

1/ These costs are overstated in that they are not discounted back to the base period for GDP in the denominator, and that revenues from asset recovery and bank reprivatization are not netted out.

Bank recapitalization is warranted under similar conditions as for government schemes but where banks are better qualified to work out debt. However, recapitalization creates a fresh moral hazard problem: banks may have incentive to gamble the new capital on risky loans with the expectation that they will again be recapitalized if these loans do not pay off, as in Bulgaria and Hungary (Aghion, et al., 1994; Begg, 1996). Further, newly recapitalized banks holding large equity shares in restructuring corporations may face conflicting objectives, as in Korea. To avoid this moral hazard problem, recapitalization should be complemented by measures that improve bank supervision and governance, as did Poland, especially if banks end up owning a large share of the corporate sector. Tying bank recapitalization to specific bank measures to restructure corporate debt, again as in Poland and as in Thailand, can be helpful.

D. Asset Management Corporation

A new government-financed AMC is called for *if the number of troubled corporations is large and there are microeconomic factors which severely inhibit restructuring* (Woo, 2000).[4] The most important of these factors are decapitalized and poorly managed banks, a shortfall of bank debt workout expertise, an uneven balance of power between banks and corporations, a lack of corporate capacity and willingness to provide reliable financial information, and, again, adverse systemic consequences. A government-financed AMC can buy bad loans, provide equity to banks and corporations, negotiate with debtors, and take an active financial and operational role in restructuring. If bankruptcy

[4] Alternatively, asset management and resolution can be led by newly created bank subsidiaries, as in Thailand.

courts are ineffective an AMC can also serve as an out-of-court bankruptcy mechanism, since the passing of legislation and the building of institutional infrastructure for effective bankruptcy procedures can take time (Wijnbergen, 1992). The debt taken on by the AMC can be converted to equity and eventually sold to the public. The AMC realizes economies of scale in the specialized area of corporate debt restructuring and can develop secondary debt markets. Banks benefit from higher capital, while corporations can expect to have their debt restructured more quickly.

AMCs were utilized in Hungary, Indonesia, Korea and Malaysia. In East Asia, AMCs have taken on large amounts of debt, ranging from the equivalent of 10 to 35 percent of GDP (Table 3). However, disposal and resolution of the assets have proven to be quite slow.

Table 3. East Asia, Asset Management Company Results, 1999

	Indonesia	Korea	Malaysia
Value of assets held by AMC (Percent of GDP)	38	11	15
Assets disposed (Share of total assets transferred)	1	6	1

Sources: World Bank, 2000.

An AMC is appropriate if bank-led debt restructuring is infeasible, but they also carry their own risks. To be successful, an AMC should have clear and predefined goals and aim at maximizing loan recovery, remain clear of politicization, and be sufficiently funded. The government should avoid recapitalizing banks through an AMC by paying above-market prices for bad loans, as occurred in Chile and Mexico in 1995–97, because this approach is nontransparent. Marking-to-market the debts of firms taken over by an AMC will assure potential buyers that they will not have to pay off the face value of these debts, which was a problem in FYR Macedonia. Another potential problem is that AMC managers may be reluctant to undertake assets sales and put thenselves out of a job. This problem can be addressed by a built-in sunset provision that closes down the AMC after a preset period, as was done in Poland. An AMC may be a better vehicle for liquidating nonviable corporations, where other corporate stakeholders must be taken into account, but is a less appropriate means for leading restructuring.

E. Restructuring Director

The complexities of the corporate and financial restructuring efforts of many of the recent corporate crisis countries have led to the appointment of a restructuring director to accelerate the pace of reform. A director can clearly and transparently define the goals of restructuring, overcome excessive leverage by creditors or debtors, marshal and prioritize government financial support, and establish a place at the table for elements of society that might otherwise be excluded. Typically, restructuring directors are appointed by and report to the country's chief executive and oversee mediation efforts, corporate restructuring committees, AMCs, and BRAs.

Restructuring directors are a relatively recent development. None of the crisis episodes of the 1980s and early 1990s appear to have had such a director. In Korea, financial restructuring has been directed since early 1998 by the Financial Supervisory Commission (FSC). The FSC chairman is a member of the cabinet and reports to the President. In Indonesia, where progress has been relatively slow, the Financial Sector Policy Committee (FSPC) was established in January 2000 to give clear political leadership and direction to the restructuring efforts. The FSPC is chaired by the Coordinating Minister for Economic, Finance, and Industry, who reports directly to the President. The financial crisis in Sweden in the mid-1990s led to the immediate establishment of the Bank Support Authority which helped establish political consensus in support of restructuring including through the inclusion of members of the opposition political parties on its board (Ingves and Lind, 1996). In other episodes, the central bank has taken on some of the responsibilities of a restructuring director, for example, Mexico in the early 1980s and Thailand and Malaysia in the 1990s.

A restructuring director can help accelerate the pace of restructuring when there are *a large number of players with conflicting interests and systemic consequences increase the costs of delays.* Naturally, there are potential problems with centralizing supervision of restructuring, including excessive politicization and the absence of market incentives to guide decision-making. However, as restructuring becomes ever more complicated and the systemic consequences of corporate crisis remain severe, directors may become a more regular feature of large-scale restructuring efforts.

V. Reduction of the Role of Government

The need for the government to first expand then shrink its role helps explain the long time needed to complete restructuring. The new restructuring institutions are subject to economic and political constraints that force the government to weigh difficult tradeoffs, especially between restructuring's short-term costs (e.g., unemployment, undershooting of asset prices, learning curve of new corporate managers) and long-term benefits (improved resource allocation, and safer balance sheets). Initially, the crisis atmosphere quells disagreements between interest groups brought on by unemployment and the removal of corporate owners. However, after the crisis passes and economic activity recovers, broad support for reform often wanes. Crucially, the influence of vested interest groups can delay bankruptcy reform and reprivatization that would dilute their ownership.

The completion of restructuring is marked by the sale of most or all of the government's ownership of the private sector, which can grow to large levels after a crisis (Table 4). Government ownership of the corporate sector can be direct as a resulting of debt-equity conversions, or indirect via government-owned AMCs and government recapitalization of banks. Successful privatization requires a transfer of control not only from the government, but also from current management, unlike in Russia. The introduction of a strategic investor who, in a small or medium sized economy, is more likely than not going to be a foreign financial institution, is usually needed to improve corporate governance.

Table 4. Corporate Crisis Countries, Government Ownership of Financial System Assets, mid-1999

	Indonesia	Korea	Malaysia	Thailand
As share of total Financial System assets	78	58	18	45
As share of GDP	79	124	62	127

Source: Claessens et al. (1999)

The successful completion of large-scale corporate restructuring can often take a long period of time—a minimum of perhaps five years. In Chile, the initiation of restructuring can be marked by the takeover of ailing financial institutions in late 1981, while the last takeovers and debt restructuring programs took place in 1986; the bank privatization and upgrading of the institutional framework was not finished until 1989 (Barandiaran and Hernandez, 1999). By 1998, government ownership of banking sector capital in Poland had been reduced to one-third and foreigners owned 40 percent of bank capital, while for Hungary government ownership was down to 20 percent, with most of the remaining share owned by foreigners (Bonin and Wachtel, 1999). In Mexico, aggregate growth has recovered strongly since the 1995 crisis, but the recapitalization of banks continues, including through the establishment of the Instituto de Protección al Ahorro Bancario (IPAB) in May 1999 (Oxford Analytica, 2000). Much restructuring remains to be done in East Asia (World Bank, 2000).

Delays in restructuring can be costly. The perpetuation of government ownership can inhibit restructuring and long-term growth prospects by obstructing the market forces needed to promote efficiency. In addition, a slow pace of restructuring will lead foreign investment to other competing countries—a process that may be difficult to reverse. Finally, there are fiscal costs to delaying restructuring especially from inefficient state-owned banks and corporations.

The time needed to complete restructuring can be shortened by proper design of the strategy. As noted earlier, early and transparent formulation of an overall strategy can build public support, mitigate the obstructions of vested interest groups, and improve policy effectiveness. Rapid establishment of a supporting legal environment is essential. A clear statement of the restructuring goals makes it plain later on when the government should pare back its role and shut down restructuring institutions. Sunset provisions for government restructuring institutions can help limit their lifespans, as in Poland.

VI. Conclusion

Large-scale corporate restructuring has proved to be one of the most daunting challenges faced by economic policymakers. The government is forced to take a leading role, even if indirectly, by the need to prioritize restructuring policy goals, address market failures, reform the legal and tax systems, and deal with the obstructions posed by powerful interest groups.

In this setting, the objectives of corporate restructuring can be reduced to restructuring viable corporations and liquidating nonviable corporations, restoring the health of the financial sector, and creating the conditions for long-term economic growth. The first set of tasks involves macroeconomic and legal policies to establish the foundation for successful restructuring and formulation of a holistic strategy. Thereafter, financial restructuring must commence to establish the proper incentives for banks to take a role in restructuring and get credit flowing again. Only then can corporate restructuring begin in earnest, which involves separating out viable from nonviable corporations, and restructuring the former and liquidating the latter. Upon attainment of the goals of restructuring the government must cut back the large role in the economy that it took on by necessity. The main government-led corporate restructuring modalities are mediation, incentive schemes, bank recapitalization, asset management companies, and restructuring directors.

Some general lessons regarding large-scale corporate restructuring that can be drawn from the experience of the countries examined here are as follows:

- Governments should be prepared to take on a large role as soon as a crisis is judged to be systemic.

- A supporting macroeconomic and legal environment is essential.
- Measures should be taken quickly to offset the social costs of crisis and restructuring.
- Restructuring should be based on a holistic and transparent strategy encompassing corporate and financial restructuring.
- Restructuring goals should be stated at the outset, and sunset provisions embedded into the enabling legislation for new restructuring institutions based on these goals.
- A determined effort to establish effective bankruptcy procedures in the face of pressures from vested interest groups is essential.
- The government should pare back its role in the economy after the attainment of its restructuring goals in order to set the stage for higher growth in the long run.
- Large-scale post-crisis corporate restructuring seems to take a minimum of five years to complete.

The limited scope of this paper makes clear the need for further analytical work on large-scale corporate restructuring. The formulation of conceptual models of restructuring would enhance understanding of the tradeoffs between conflicting objectives. The development of cross-country data bases covering the institutional approaches, fiscal costs, and economic benefits of corporate restructuring would make possible in-depth analyses of the different restructuring modalities, and help in the formulation of best practices for corporate workouts.

Finally, the successful completion of corporate restructuring can boost long-term growth prospects above the pre-crisis level. Indeed, it has been argued that crisis actually enhances growth in the long run by weakening special interests that had previously blocked restructuring (Rodrik, 1996). In Chile productivity has grown strongly after the crisis, and in Hungary and Poland growth and productivity have improved following large-scale restructuring (Carlin and Landesmann, 1996). The jury is still out on the crisis episodes of the late 1990s.

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Corporate Crisis Countries, Corporate Restructuring Modalities

	Government-financed scheme			Bank recapitalization	
	Entity	Incentives	Loans restructured	Entity	GDP Share
Chile, 1983	Ministry of Finance	Discounts; fixed interest rate; grade period; extended maturity	21 percent of total domestic credit	Central bank	41.2
	Central bank	Subsidies to banks		CORFO	
Mexico, 1983	FICORCA	Government-guaranteed exchange rate; grace period; extended maturity	$12.5 billion		
Poland, 1992				Enterprise and Bank Restructuring Program (EBRP)	5.7
Hungary, 1992				Government	12.2
Mexico, 1995	UCABE	Small equity injections; working capital loans	$2.6 billion		20.0
Indonesia, 1998	INDRA	Protects against exchange rate risk		Indonesian Bank Restructuring Agency	56.3
Korea, 1998				Korean Deposit Insurance Corporation	26.5
Malaysia, 1998				Danamodal	16.4
Thailand, 1998				Financial Institution Development Fund	32.8

Corporate Crisis Countries, Corporate Restructuring Modalities (Concluded)

	Asset management corporation			Corporate Restr. Comm./Agency	
	Entity	Holdings	Government Director	Entity	Responsibility
Chile, 1983					
Mexico, 1983			Banco de Mexico		
Poland, 1992				Bank-led committees under EBRP	
Hungary, 1992				Government trustee. State Property Agency	Supervised reorganization plans—5,000 firms reorganized
Mexico, 1995	FOBAPROA and IPAB.	15 percent of GDP	National Banking Commission and FOBAPROA	UCABE, UDI, FINAPE, FOPYME	
Indonesia, 1998	Asset management unit (part of IBRA)	38 percent of GDP 66 percent of bank NPLs	Financial Sector Policy Committee	Indonesian Bank Restruct. Agency; Jakarta Initiative Task Force	Oversees bank and corporate restructuring; Oversees voluntary corporate debt restructuring.
Korea, 1998	KAMCO	11 percent of GDP 26 percent of bank NPLs	Financial Supervisory Commission	Corporate Restructuring Coordinating Committee	Debt-creditor restructuring agreement
Malaysia, 1998	Danaharta	15 percent of GDP 50 percent of bank NPLs	Bank Negara Malaysia	Corporate Debt Restructuring Committee	Oversees voluntary corporate debt restructuring
Thailand, 1998	Financial Restructuring Agency and AMC for intervened banks; private AMCs for other banks		Bank of Thailand and Financial Restructuring Advisory Committee	Corporate Debt Restructuring Advisory Committee	

Sources: Stone (1998), Kawai (1999), Enoch et al (1999), Dasri (1999), and World Bank, 2000.