

Capital Markets, Corporate Governance, and Long-term Financing for Development

Chalongphob Sussangkarn

Thailand Development Research Institute

Importance of Financing Structure for Stable Development

- **Lesson from the 1997 crisis. Reliance on foreign short-term debt to finance saving-investment gap creates high risks. Thailand, Indonesia and South Korea had very high ratios of short-term foreign debt to reserves.**
- **Saving-investment gap caused mainly by Private Sector (Public Sector in surplus for 9 consecutive years from 1988-1996)**
- **Bank lending was main source of finance for Private Sector. Role of capital market was limited. Average Debt-Equity ratio about 4.0 before crisis.**
- **Foreign bank borrowing mostly short-term due to Basel Capital Accord's rule of provisioning.**

Structure of Sources of Financing for Non-Financial Private Real Sector

	Change in Loans from Financial Institutions	New Stocks	New Debt Instruments
1992	83.7%	14.0%	2.2%
1993	82.7%	9.2%	8.2%
1994	75.1%	14.3%	10.6%
1995	83.1%	13.3%	3.6%
1996	75.5%	13.5%	11.0%
1997	85.3%	10.6%	4.1%

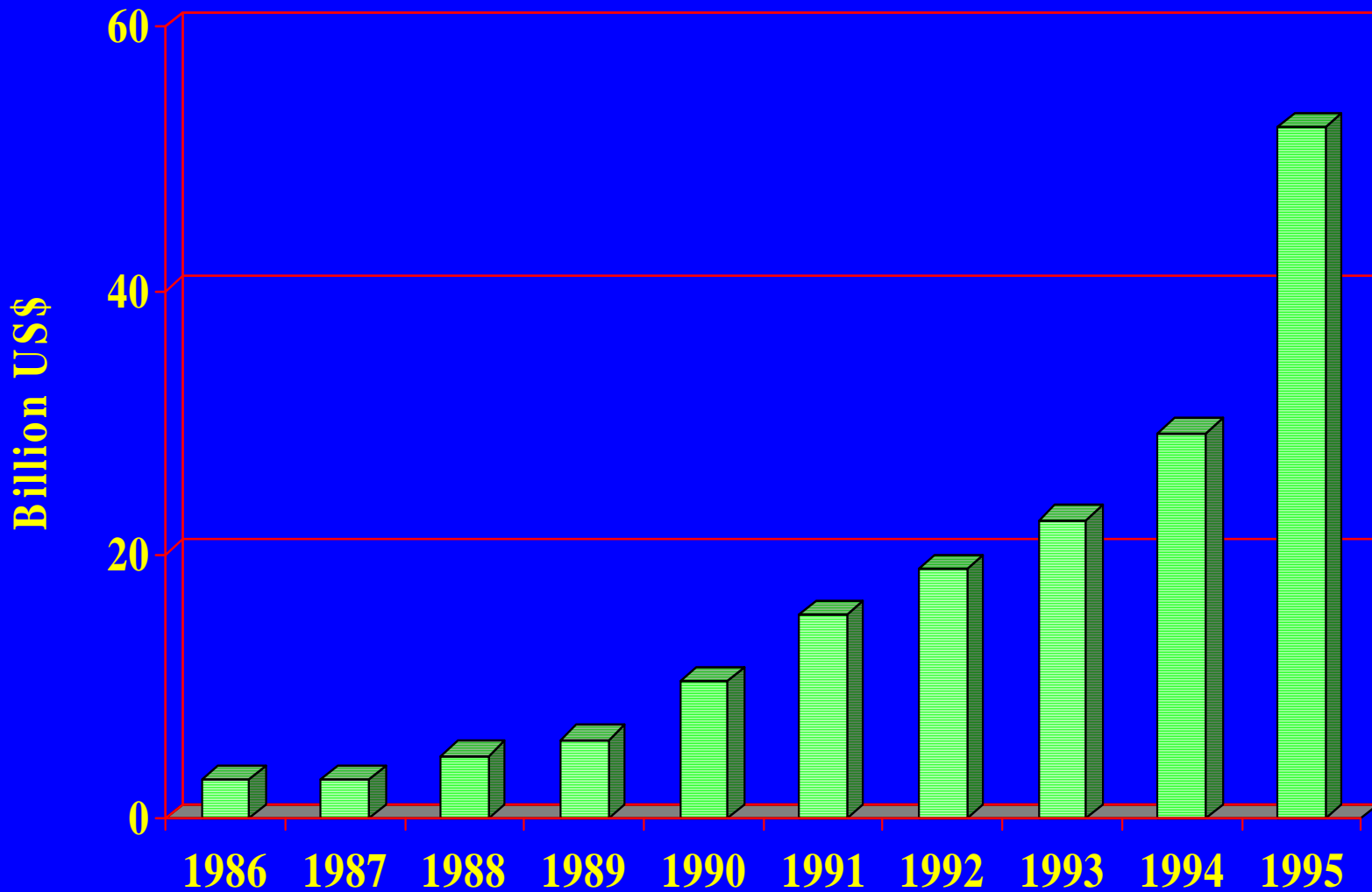
Source: Bank of Thailand

Note: Includes foreign sources of finance.

Basle Capital Accord Risk Weights

	Risk Weight
Claims on or guaranteed by banks outside OECD with a residual maturity of up to ONE year	20%
Claims on or guaranteed by banks outside OECD with a residual maturity of more than ONE year	100%

Short-term External Debt



Ratio of Short-term Foreign Debt to Official Reserves

	1990	1993	1996	1999
China	30.8%	66.5%	23.6%	11.2%
Indonesia	130.7%	145.6%	167.2%	73.5%
Malaysia	19.3%	25.4%	40.8%	24.6%
Philippines	216.2%	85.0%	67.9%	38.3%
South Korea	72.9%	60.2%	195.4%	46.9%
Thailand	58.3%	89.0%	110.3%	67.3%

Source: Asian Development Bank, Key Indicators 2001.

Toward a More Stable Financing Structure

- **Development of Domestic Bond Market, with impetus from the increase in Public Sector Debt.**
- **Promotion of good Corporate Governance to generate confidence.**
- **Need for financial cooperation in East Asia to promote the development of an efficient Regional Bond market.**

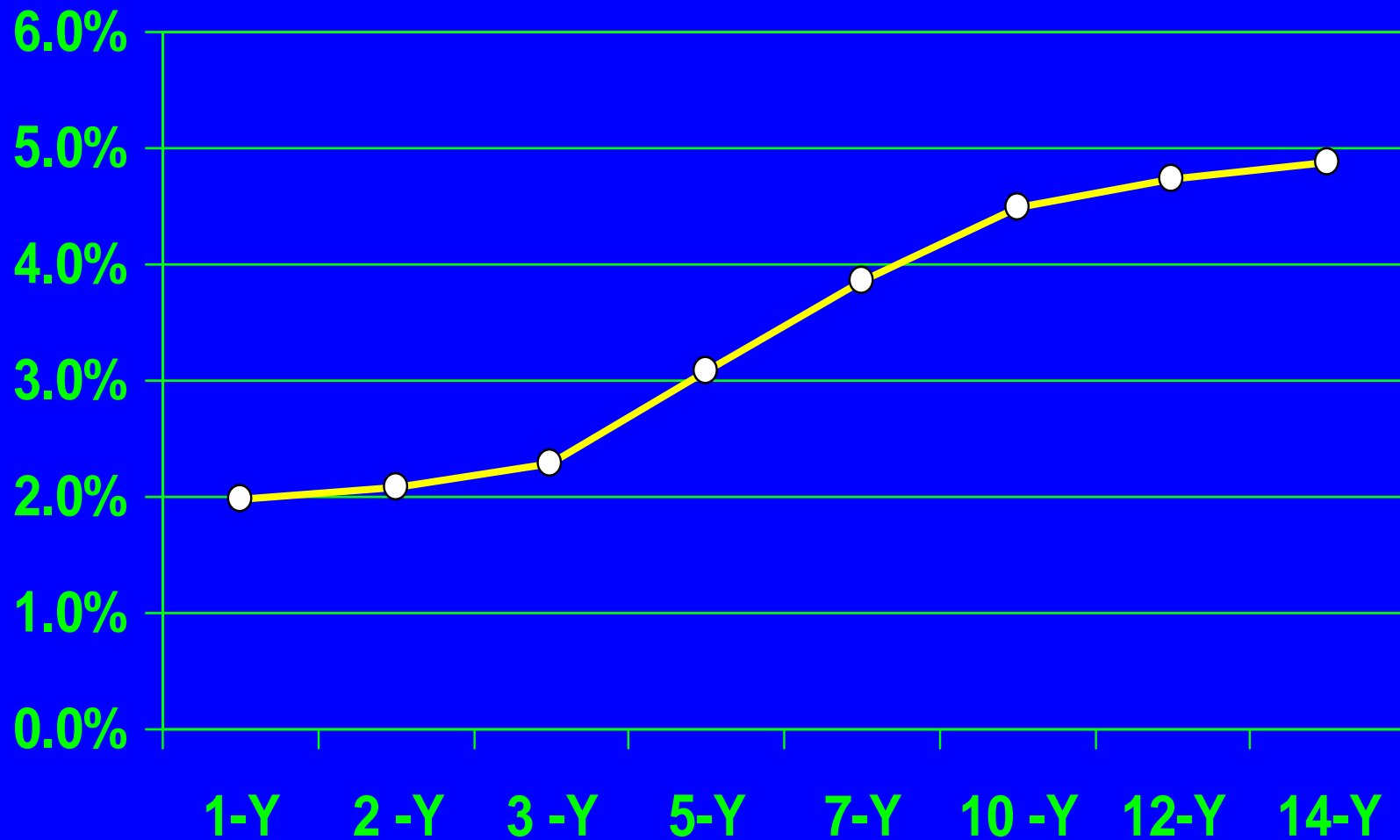
Stock and Bond Market Trends

(Million Baht)

	1995	1996	1997	1998	1999	2000	2001
Stocks	3,423,486	2,457,931	1,097,436	1,239,669	2,148,409	1,279,224	1,607,310
Bonds	370,473	426,611	440,115	838,375	1,118,537	1,267,110	1,363,824
Government Bonds	42,966	18,054	13,755	411,928	587,371	658,935	706,689
State Enterprise Bonds	238,279	278,368	293,769	300,606	351,780	398,292	405,415
Private Corporate Bonds	89,228	130,189	132,591	125,841	179,387	209,883	251,720
Bond Trading Value	51,528	200,608	106,190	72,098	431,197	1,357,121	1,592,219

Source: Bank of Thailand

Government Bond Yield Curve: August 30, 2002



Measures to Improve Corporate Governance

- **As an outcome of crisis, much attention paid to poor corporate governance in crisis affected countries (crony capitalism).**
- **Unsound lending and business practices and siphoning.**
- **Many developments to improve corporate governance.**
 - **Board members of banks cannot sit on boards of more than 3 other companies (In the past, some directors sat on more than 10 other boards).**
 - **Audit Committee for publicly listed companies.**
 - **Institute of Directors (training and information exchanges for directors), and public education.**
 - **Rules and regulations to improve accountability of directors, protect minority share holders, increase transparency, improve corporate accounting and asset valuations.**
- **However, *business ethics* is still crucial as witnessed by recent corporate governance scandals in the U.S.**

Corporate Governance Rating Initiative

- **Initiative of Securities Exchange Commission to be carried out by the Thai Rating and Information Services (TRIS), starting about September 2002.**
- **Rating Based on:- Structure and Role of Board of Directors; Transparency of Information to Investors; Share Holding Structure; Shareholders' Rights and Protection; Corporate Governance Culture.**
- **Direct Benefits such as:- public awards; fee reduction; faster and less costly new share issues.**
- **Indirect Benefits include:- good public image; possible premium on share prices; possible lower borrowing cost.**

Corporate Governance Rankings: Thailand

	1999	2001
1. Rights and Responsibilities of Shareholders well defined	43	44
2. Corporate Credibility	32	34
3. Corporate Board can prevent improper practices	43	32
4. Generation of Shareholder value	42	39
5. Insider trading	45	34
6. Social Responsibility	40	36
8. Customer orientation	31	22
Average ranking	39.4 (47)	34.4 (49)

Source: IMD, The World Competitiveness Yearbook, 1999 and 2001

Development of Regional Long-term Financing for Development

- **Need to develop alternative to short-term borrowing.**
- **BIS standard encourages short-term bank lending to developing countries.**
- **East Asia's saving surplus before crisis, about US\$ 100 billion/year, currently about US\$ 200 billion/year.**
- **Regional bond market could recycle surplus savings in the region as long-term financing for development.**
- **Precondition is the existence of efficient and active domestic bond markets. This is rapidly developing.**
- **Need financial cooperation to provide the required infrastructure, such as a regional regulatory framework, credit rating, settlement systems, borrowing and lending system etc.**

Development of Regional Long-term Financing for Development (2)

- **As market develops, the role of regional credit rating agencies will become more and more important compared to agencies from outside the region.**
- **Issue of internationalization of regional currencies has to be sequenced properly, as this can lead to more ammunition for speculators.**
- **Now, most countries are in current account surplus, but eventually deficits will reappear, therefore need to develop the infrastructure so that long-term financing will be available when the need arises.**