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POST-CRISIS RESTRUCTURING OF MALAYSIAN CORPORATIONS

Case Studies of Corporate Restructuring in Malaysia in the aftermath of the Asian Financial Crisis

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ABSTRACT

This paper attempts to demystify the little-studied subject of corporate restructuring, which has received a lot of interest since the onset of the Asian financial crisis. This would be done by providing some definitions and then taking the reader through broad restructuring trends – as perceived by the macroeconomist – as well as through three benchmark case studies of corporate restructuring, the intricacies of which are otherwise only known to corporate financial advisors. Having familiarised the reader with the "why"s and "how"s of restructuring for each of the three cases, the paper then invites the reader to step into the shoes of the financial analyst to firstly evaluate the possibility of avoiding the problems that led to the restructurings, and secondly to evaluate the effectiveness of the restructuring approaches adopted in the three cases. The various restructuring issues discussed in the evaluation section are summarised into 13 lessons for corporate managers, bankers and policy-makers. While the mainstay of this paper is "applied" corporate restructuring using actual case studies, there are two "theoretical" conclusions that form the final recommendations of this paper, namely the notions that distress leading to financial restructuring is avoidable with proper debt management, and that business/operational restructuring is the key to corporate and economy-wide competitiveness.

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Key to Abbreviations on this page

YCS = Pembinaan YCS Bhd
Renong = Renong Bhd
TNB = Tenaga Nasional Bhd

CR = Corporate Restructuring
FR = Financial Restructuring
BR = Business Restructuring

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Key to Abbreviations on this page

YCS = Pembinaan YCS Bhd
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CR = Corporate Restructuring
FR = Financial Restructuring
BR = Business Restructuring

POST-CRISIS RESTRUCTURING OF MALAYSIAN CORPORATIONS

Case Studies of Corporate Restructuring in Malaysia in the aftermath of the Asian Financial Crisis

Motivation and Overview

This paper aims to achieve three objectives. The first objective is to consolidate the various facets and complexities surrounding the phenomenon of Corporate Restructuring seen in Malaysia since the outbreak of the Asian financial crisis. The second objective of the paper is to conduct firm-level case studies or micro analysis of Corporate Restructuring, thereby filling a gap in the literature on Corporate Restructuring which often focuses on the macroeconomic aspect of the subject. The third objective of the paper is to derive lessons from the recent restructuring experience, founded on the belief that these lessons could serve as valuable guidance for corporate managers, bankers and policy-makers in riding through future upswings and downswings of the business cycle.

To ensure focus and in keeping as close as possible to the three objectives of this paper, the paper has been divided into three corresponding sections; Sections 1, 2 and 3 of this paper are dedicated towards achieving the aforementioned objectives 1, 2 and 3 respectively. The introductory Section 1 consists of some definitions and recent restructuring trends. Section 2, which contains three selected Corporate Restructuring case studies, is broken further into two parts. Section 2a *describes* the problems the companies faced and the restructuring solutions adopted. Meanwhile, Section 2b *evaluates* the possibility of avoiding these problems, and then evaluates the effectiveness of the restructuring solutions. The three selected case studies in Section 2 are on ***Pembinaan YCS Bhd*** ("YCS"), *the* ***Renong Group of companies*** ("Renong") and ***Tenaga Nasional Bhd*** ("TNB"). The concluding Section 3 then summarises the findings made throughout the paper in the form of lessons, which are condensed further into two final recommendations.

Section 1

INTRODUCTION
TO
CORPORATE RESTRUCTURING

SECTION 1: INTRODUCTION TO CORPORATE RESTRUCTURING

1.1 CLASSIFICATION AND DEFINITION

Corporate Restructuring (CR) could be divided into **Financial Restructuring (FR)** and **Business Restructuring (BR)**[1]. BR in turn could be broken into Portfolio, Organisational and Process Restructurings. The table below summarises the different types of CR, the reasons for them, how they are usually done, and the cases under which they will be discussed in this paper:

Table 1: Corporate Restructuring (CR) Classification and Definition

WHAT Type of CR		WHY Need for CR	HOW CR is Done	CR CASE		
Financial/Debt Restructuring (FR)		in order to: • ↓ Financial Distress • ↓ Forex / Interest Rates Exposure	• Debt refinancing		Rng	
			• Debt rescheduling	YCS	Rng	
			• Debt to equity conversion	YCS		
			• Equity issuance/injection	YCS		
			• Debt waiver (write-off)	YCS		
			• Capital reduction	YCS		
			• Currency / int. rate swap			TNB
			• Debt novation[2]			
Business Restructu-ring (BR)	Portfolio	• ↓ Financial Distress • ↑ Competitiveness • ↓ Risk	• Asset disposal	YCS	Rng	TNB
			• Liquidation			
			• Merger and acquisition	YCS		
	Organiza-tional	• ↑ Competitiveness	• Change of co. structure		Rng	
			• Subsidiarization			TNB
			• Change of management			
	Process	• ↓ Financial Distress • ↑ Competitiveness	• Cost-cutting/Down-sizing	YCS		
			• Business Process Re-engineering.			TNB

Note: YCS = Pembinaan YCS
Rng = Renong
TNB=Tenaga Nasional

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[1] No standard terms for restructuring exist in the literature. The International Monetary Fund, the World Bank and Pengurusan Danaharta Nasional Bhd have used the terms *debt* restructuring and *operational* restructuring in place of the terms *financial* restructuring and *business* restructuring used in this paper. The author has opted to use the latter two to tie them closely to the firm's *financial* strategy and *business* strategy.

[2] Refers to the assumption of debt by a third party, usually a related firm.

Financial Restructuring and the 3 types of Business Restructuring are defined briefly here:

- **Financial Restructuring (FR)** involves rearranging the firm's financial commitments to match its underlying cash flows, and is intended to preserve the company as an on-going concern, and maintain or enhance stakeholder value. Such arrangements include refinancing debt (e.g. issuing bonds to new subscribers to pay off bank loans), rescheduling debt payments with the existing creditors over a longer period, and debt to equity conversion. The mechanism adopted for FR may be formal (court protection) or informal (voluntary workouts) depending on the financial distress level of the firm.
- **BR: Portfolio Restructuring** typically involves a (parent) company divesting lines of businesses (subsidiaries) which are unproductive, lack competitive advantage or non-core, and transferring the resources released in that way to the lines of businesses which create value where it would be more profitable for the company to invest in. The latter may involve investing in *existing* core areas where a company's current competitive advantage lies, or acquiring *new* businesses where the company's future competitive advantage may lie. At a more micro level, the asset disposal and acquisition concept could be applied by replacing unprofitable or old land, plants and machinery with profitable new ones.
- **BR: Organisational Restructuring** involves changing the organisation structure or the management team, typically to support a new corporate strategy.
- **BR: Process Restructuring** involves down-sizing or improving operational effectiveness and efficiency (e.g. via business process re-engineering, automation and information technology) with the ultimate aim of reducing cost and increasing quality.

1.2 RESTRUCTURING TRENDS IN MALAYSIA

This subsection provides a preview of Financial Restructuring and Business Restructuring trends in Malaysia, thereby providing the context for the case studies in Section 2.

1.2.1 Trends in Financial Restructuring (FR)

It is the first type of Corporate Restructuring, namely Financial Restructuring (FR), which has been dominating the headlines since the outbreak of the financial crisis. In Malaysia, the standard framework under which highly distressed firms conduct FRs is outlined by the **Section 176(10) of the Companies Act 1965**, whereby distressed companies are given a specified period of time to design an FR scheme with the help of their financial advisors, after obtaining a temporary restraining order from the High Court against their creditors in respect of their debt. Such restructuring under the Section 176 framework will be examined in this paper in the first case study on Pembinaan YCS.

However, due to the severity of the recent financial crisis in Malaysia, the Government had also established an **alternative FR framework for large companies**, namely a framework for out-of-court private workouts between companies and creditors through the intermediation of the **Corporate Debt Restructuring Committee (CDRC)**. The CDRC framework was based on the "London Approach" which has been successfully implemented in other countries to complement the formal legal insolvency arrangements[reference 7][11]. A study of restructuring under the CDRC framework will be done in the second case study on Renong. The CDRC is in fact only one of three restructuring agencies established by the Government during the financial crisis to facilitate FR by the private sector[3]. The other two are Pengurusan Danaharta Nasional Bhd, assigned to remove the non-performing loan (NPL) problem from the banking institutions, and Danamodal Nasional Bhd, assigned to undertake the recapitalisation of the banking institutions as well as act as a catalyst to guide bank mergers (see Appendix 1 on Restructuring Agencies).

FRs are also done outside both the Section 176 and CDRC frameworks. While these FRs are voluntary and may not be due to clear cut financial distress, they may be associated

with reducing funding costs or concerns over the possibility of *future* financial distress. We examine one such FR in the third case study on TNB.

1.2.2 Trends in Business Restructuring (BR)

The prevalence of Business Restructuring (BR) in the post-crisis environment is often due to BRs being conducted by companies concurrently or soon after the completion of their FRs. One reason for this is that the FRs that aim to restructure the liability/equity side of the balance sheet (e.g. debt reduction) would often require some corresponding BR that would restructure the asset side of the balance sheet (e.g. asset disposal). Having said that, BRs could indeed be done independent of FRs, and FRs could be done without requiring BRs. It is the likelihood of the second scenario (FR without BR) which is raising concerns among economists and academics, as reflected in various articles and reports (see Appendix 2: Selection of Reports and Views on BR). In particular, BR to reverse the pre-crisis trend towards diversification is lacking. **Overdiversification** into areas where companies do not have competitive advantage has in fact been argued to be the **other main problem** among crisis nations **other than overgearing**[4]. The two problems are inter-related and reinforce each other – overdiversification could lead to overgearing, and the ability to overgear could lead to the tendency to overdiversify. The consequence of overdiversification include slow decision-making due to an extended bureaucratic structure, and insufficient marketing or research and development (R&D) efforts due to parent companies' resources being spread thin among associated companies. The lack of "focused" effort in developing individual subsidiaries results in the multiple subsidiaries becoming small-time players making meagre profits in their respective industries. While these small companies may do well during good times, they would be the first victims of a credit crunch and demand contraction during a slowdown. In view of this risk, BR in the

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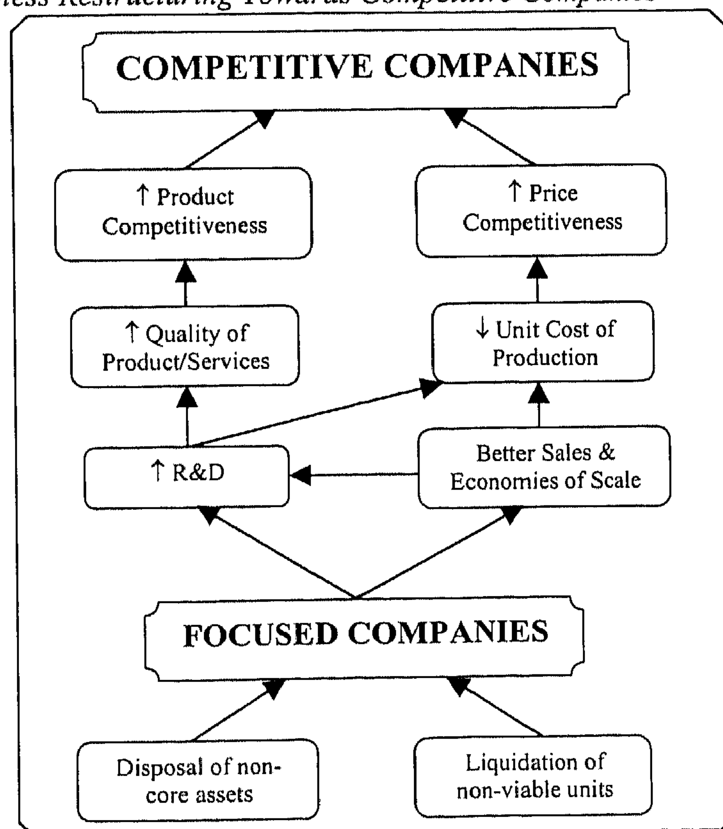
[3] Other Government measures to facilitate FR by the private sector include the stamp duty exemption and tax deductability of expenses related to FR.

[4] In fact, overdiversification and conglomeration have also been quoted as being responsible for the recent lack of competitiveness of Japanese and German corporations.

form of asset disposal and refocusing (i.e. Portfolio Restructuring) is important to ensure the long-term **survival** of companies through both economic upturns *and* downturns.

In actuality, the benefits of Portfolio Restructuring and "deconglomeration" go beyond survival, since "focus" has been used by many corporations as a **competitive** weapon. This is evidenced by the fact that the world's most competitive companies tend to be among the most focused companies, which had concentrated their resources in their core businesses to become large enough players in their respective industries. In principal, Portfolio Restructuring would enable companies to free up resources and direct them towards the companies' core businesses where their competitive advantages lie. Unlike diversified companies, focused companies are better able to concentrate their marketing efforts towards ensuring higher sales and therefore the achievement of economies of scale, lower unit cost and **price competitiveness**. In addition, focused companies could devote more resources to research and development (R&D), which would result in quality improvement and **products competitiveness**. The argument on how **competitive companies** could be built through BRs (via the creation of **focused companies**) is diagrammatized below:

Diagram 1: Business Restructuring Towards Competitive Companies



The two bottom-most boxes in the diagram in fact represent two out of the three methods of Portfolio Restructuring, as listed in Table 1 on CR Classification (page 2). As shown in Table 1, the method of Asset Disposal would be examined under all three case studies in the next section. As shown in Table 1 also, the third method of Portfolio Restructuring, namely Merger and Acquisition, would be studied under the case of Pembinaan YCS.

Besides Portfolio Restructuring, BR in the form of **Process Restructuring** is also important. In fact, in the case of the United States, BR through investment in communication and information technology in the late 80s and most of the 90s has been argued as one of the main reasons for the 9-year boom the US is currently enjoying. As far as this paper is concerned, a brief survey of the Process Restructuring of TNB will be made. The final form of BR, **Organizational Restructuring**, will also be briefly discussed by looking at Renong's and TNB's BRs.

1.3 FORMAT OF CASE STUDIES

In order to facilitate the derivation of some lessons on CR for the concluding part of the paper, all three case studies in this paper would be approached using a standard format:

Format of Case Studies in Section 2

	Section 2a – Description	**Section 2b - Evaluation**
Co. Overview	Company OVERVIEW	
PROBLEMS	Analysis of PROBLEMS	Possibility of Avoiding PROBLEMS
SOLUTIONS	Restructuring SOLUTIONS	Effectiveness of Restructuring SOLUTIONS

Based on the above format, value judgements on the possibility of avoiding problems, and value judgements on the effectiveness of the restructurings would be analysed in Section 2b after all three CRs have been described in Section 2a. The separation is intended to facilitate objectivity in the **description** of the background and the implementation of the CRs, as well as to facilitate a cross-case-study comparison in the **evaluation** section.

Section 2a

THREE CASE STUDIES
OF
CORPORATE RESTRUCTURING
IN MALAYSIA

(Description)

SECTION 2a: THREE CASE STUDIES OF CR IN M'SIA - Description

2a.1 CASE 1: PEMBINAAN YCS – RESTRUCTURING UNDER SECTION 176

2a.1.1 Case Overview

While not a headline CR like Renong, the case of YCS is discussed first in this paper before the case of Renong since YCS' CR represents a standard CR under Section 176, as compared to Renong's CR which benefited from the intermediation of the CDRC. In addition, compared to Renong's CR, YCS' CR is also a more comprehensive one, covering at least 8 different methods of CR outlined in Table 1 on CR Classification (page 2).

YCS was established in 1976 as a private limited company under the name Yap Choh Seng Sdn Bhd. The company changed its name to Pembinaan YCS Sdn Bhd in 1987, and subsequently to Pembinaan YCS Bhd upon conversion into a public company and listing on the KLSE's Second Board in 1993. The company's principal activities are investment holding and the undertaking of earthworks, foundation and construction contracts.

YCS' corporate structure is fairly straightforward, as shown in Appendix 3. In addition to the parent company, there are five active subsidiaries and five dormant ones, all of which are fully owned by the parent, whether directly or indirectly through another subsidiary. The five active subsidiaries are also involved in areas much like the parent company, namely investment holding, property development and property investment holding.

2a.1.2 Analysis of Problems

YCS' financial problems were associated with the company's high growth and high leverage strategy. In the four years prior to the economic downturn, namely between end-1992 and end-1996, YCS' total assets grew at a compounded rate of 45.0% per annum (see YCS' balance sheet in Appendix 4). YCS' financial strategy was to support its business

growth through **short-term debt financing**. YCS' tremendous growth since 1993 could also be attributed to the company's greater access to bank financing once the company got listed on the Second Board of the KLSE in 1993. Consequently, YCS' ratio of total borrowings to shareholders funds averaged 6.2:1 in the four years prior to the crisis, with short-term debts making an average of 87% of total debts[5].

As a result of this financing strategy, when the crisis struck, the financial situation of YCS deteriorated significantly especially when liquidity in the banking system tightened and YCS' short-term credit facilities were withdrawn. In addition, YCS also suffered in terms of operational performance as a result of the severe contraction in demand for property. Prior to the crisis, YCS had a turnover of RM202.7 million and profit after tax of RM4.0 million for the financial year (FY) ended 31 December 1995. YCS' profit after taxation increased to RM19.3 million with a turnover of RM163.3 million for the FY ended 31 December 1996. However, for the 18-month period ended 30 June 1998, YCS suffered a loss after tax of RM194.3 million, from a turnover of RM351.9 million (see YCS' turnover and profit/loss in Appendix 5). The accumulated losses of YCS stood at RM170.9 million and RM270.4 million as at end-June 1998 and end-June 1999 respectively.

As a result of the losses, YCS' capital structure also became increasingly leveraged. Earlier, on 31 December 1996, YCS' ratio of total borrowings to shareholders funds was approximately 3.2:1[6]. However, YCS' gearing became infinitely large when YCS' shareholders funds turned negative as YCS' accumulated losses grew to supersede the combined size of YCS' share capital and share premium account. As at 31 August 1998, total borrowings stood at RM288 million while there was negative shareholders funds of about RM70 million.

[5] Figures refers to the average of four end-year ratios of total debt to shareholders funds and of short-term debt to total debt respectively.

Faced by very weak operational prospects, YCS did not have the sustainable cash flow for it to procure sufficient working capital for continuing operations at acceptable levels and was under constant pressure from creditors for repayment of amounts due and payable. YCS subsequently defaulted on the principal and interest repayment on the borrowings from the financial institutions. By 20 August 1998, several legal proceedings had been initiated and were under way against YCS, primarily demanding payment of amounts due and payable by YCS. In addition, on 18 August 1998, PAB Trustee Bhd, the trustee for the YCS' Redeemable Secured Bank Guaranteed Bonds 1995/2000 (RSBG Bonds) bondholders, had exercised their option against the RSBG Bonds Guarantors to fully redeem the Bonds. The redemption was made because of the downgrading of the Bonds to below the rating of BBB3[7] and YCS' default in payment of principal and interest. The payment for the redemption was made by the RSBG Bonds Guarantors on 15 September 1998, and as a result, YCS has payments immediately due (to the Bonds Guarantors) in 1998, two years ahead of the original maturity date of the Bonds.

Given the situation, on 20 August 1998, YCS applied to the High Court for a restraining order under Section 176(10) of the Companies Act. On 3 September 1998, the High Court issued the restraining order, which restrained creditors of YCS from initiating or prosecuting legal proceedings against YCS for a period of six months from the date of the order, subject to the liberty of YCS to apply for an extension. Since the time of the restraining order, YCS' financial position has continued to weaken. On 14 December 1998, the trading of YCS' shares on the second board of the KLSE was suspended[8]. Subsequently on 2 March 1999, the restraining order had to be held over by the High Court for a further two months up to and including 4 May 1999. The said restraining order had been further

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[6] The ratio of total borrowings to shareholders funds was lower at end-1996 (3.2:1) compared to end-1995 (8.4:1) due to a rights issue, conversion of warrants and ESOS in 1996.

[7] Rating by Rating Agency of Malaysia (RAM).

[8] YCS' shares was suspended at the request of the company. However, trading had resumed beginning 19 June 2000 about 18 months, after the suspension began.

extended for another three months up to and including 2 August 1999, and extended again for another four months up to and including 30 November 1999.

2a.1.3 Restructuring Solutions

As noted earlier, YCS' CR is fairly comprehensive. YCS shareholder circular shows 7 different components of the CR (see Appendix 6). To facilitate a focused discussion, the 7 **specific components** of YCS' CR (items I-VII in the table below) has been rearranged under **5 broader classifications** (items FR1-FR3 and BR1-BR2) in the table below. For completeness, the cost-cutting measure undertaken by YCS early during the crisis is also included in this table (namely item BR3), despite it not being included in the CR proposal:

Table 2: YCS' CR

WHAT Type of CR	**WHY** Need for CR	**HOW** CR is Done	
		Broad Methods	Specific Elements
FR	Facilitate CR	**FR1. Setting up equity accounts**	I. Reduce Accumulated Losses Account by reducing Share Capital & Share Premium Accounts (Capital Reduction) VII. Increase Authorized Paid-up Share Capital
	↑ inflow	**FR2. Equity issuance**	II. Issue rights
	↓ outflow	**FR3. Debt rescheduling, Debt to equity conversion & Debt waiver**	III. Scheme of Arrangement & Compromise Repayment ("Compromise Scheme")
BR: Portfolio Restructuring	↑ inflow (& ↓ outflow, & ↑competitiveness)	**BR1. Asset disposal (& cost cutting)**	V. Dispose Subang Twin Business Centre ("*STBC*") VI. Issue shares to compensate *STBC* unit purchasers
	↑ inflow (&↑competitivnes)	**BR2. Merger and acquisition**	IV. Non-cash purchase of Energy Park Sdn Bhd
BR: Process Restructuring	↓ outflow	**BR3. Cost-cutting / down-sizing**	Halting *STBC* construction

2a.1.3.1 ***Financial Restructuring***

We first discuss the FR of YCS before discussing its BR. Note that reference to the CR processes is made in present term since, **despite having been approved by shareholders, creditors and the authorities, YCS' CR has barely begun**, given that the last approval from a relevant authority was only obtained on 23 March 2000. There are 3 broad steps taken to restructure YCS financially, namely setting up the equity accounts, rights issue and the "Scheme of Arrangement" (i.e. FR1-FR3 in the above Table 2).

- **FR1 Setting up equity accounts**

Table 2 on YCS' CR describes the reason for the setting up the equity accounts as being to "Facilitate CR". Specifically, the equity accounts of YCS has to be set up as a prerequisite for YCS' CR since (1) the shareholder's funds show a negative balance, and (2) the authorized paid-up capital is too small to accommodate the CR. The setting up of the equity accounts of YCS therefore comprise the two components below:

- Reducing Accumulated Losses Account via Capital Reduction
- Increasing Authorized Paid-up Share Capital

The first component, the reduction of the Accumulated Losses Account, is required so as to make the paid-up share capital of YCS more representative. Appendix 7 (Setting Up Equity Accounts & Restructuring YCS' Balance Sheet, Panel A) shows YCS' overall negative equity position prior to the FR, with the "negative equity" item on the debit side of the balance sheet more than offsetting the "equity" item on the credit side of the balance sheet. This had come about from the large losses accumulated by YCS, which had grown to exceed the size of the share capital and share premium accounts combined. By accounting identity, the negative equity position of YCS also means that the company has negative net tangible assets (NTA), given that YCS' liabilities exceed its assets. YCS is therefore not only illiquid, but also technically insolvent. Given the subordinate position of equity to liabilities in terms of claims on the assets of YCS, the existing share capital balance is

really overstating the claims of shareholders on the company. This is especially so considering that shareholders will get absolutely nothing if YCS winds up, since even creditors would not get all their claims settled in the event of a liquidation. The reduction of the Accumulated Losses Account would effectively cancel paid-up capital which was unrepresented by assets, thereby making YCS' paid-up share capital more representative.

As shown in Appendix 7, the reduction of the Accumulated Losses Account would be effected through a reduction in the Share Premium Account as well as through a reduction of the Share Capital Account. The entire Share Premium as at 31 August 1998 of RM52,321,327 would be reduced in order to reduce part of YCS' accumulated losses of RM176,806,334. Meanwhile, the reduction of the Accumulated Losses Account through a reduction in the Share Capital Account takes place in two stages. First, the issued and paid-up capital of YCS would be reduced 50 sen for every RM1.00 par value, which effectively halves the total value of the Share Capital. Next, the issued and paid-up capital of YCS would be consolidated on the basis of every two ordinary shares of 50 sen each into one consolidated share of RM1.00 each, thereby consolidating the 54,742,050 ordinary shares of 50 sen each into 27,371,025 ordinary shares of RM1.00 each.

While the first part of setting up the equity accounts involves ***reducing*** the **actual** Paid-up Share Capital of YCS, the second part involves ***increasing*** the **Authorized** Paid-up Share Capital of YCS, namely by a magnitude of ten, from RM100 million to RM1 billion. The latter was necessary **to accommodate the capital expansion of YCS** in conjunction with the CR. YCS' CR would involve substantial issuance of equity by way of:

- **rights issue** (see section on FR2, next)
- **conversion to equity** of existing debt/obligation (as a means of restructuring YCS'debt; see sections on FR3 and BR1)
- **conversion to equity** of future convertible loans stocks – namely the redeemable convertible secured loans stocks (RCSLS) and irredeemable convertible unsecured