THAILAND

KEY POINTS

- Relationships between many Thai corporates and their banks are strained due to high non performing loans, and banks' need to retain capital adequacy and meet new regulatory requirements; hence new lending is limited.

- The Thai corporate sector is emerging from the crisis dominated somewhat less by family ownership and featuring more government and foreign ownership.

- After 1997, authorities made significant progress in strengthening the formal business environment, requiring listed firms to establish audit committees, tightening listed firms' disclosure and accountancy standards and issuing best practice guidelines on protecting outside investors, audit committee operation, directors' performance and shareholder meeting proceedings.

- In 2000, the Government initiated Committee on Good Corporate Governance Practices recommended non-mandatory guidelines on good corporate governance which the Stock Exchange of Thailand released and endorsed.

- After the crisis, Thailand increased competition in some goods and services markets, reducing trade barriers on imports and relaxing some foreign investment restrictions, somewhat improving the competitive environment.

- However, since 2000 this process has slowed and even partially reversed. To strengthen corporate governance, Thailand needs to take its foreign direct investment reforms forward and make clear its intention to expand further recent corporate governance initiatives.

The 1997 financial crisis originated in Thailand, profoundly affecting South East Asia's and particularly Thailand's corporate environment. First, a high proportion of Thai corporates and financial institutions became insolvent, requiring restructuring and in some cases foreign entry; this undermined some old relationships and exposed more local firms to market forces (East Asia Analytical Unit, 2000). Second, regulators started reviewing and upgrading corporate and prudential regulation supporting transactions between unrelated parties; if this process is continued, eventually it should increase minority shareholder and creditor protection and management accountability. Finally, the crisis markedly raised awareness about corporate governance shortcomings, spawning new non-government organisations promoting corporate governance reform. However, the Government has yet to announce its strategy for policies promoting and extending recent corporate governance initiatives. Despite this, the Thai economy's opening to global trade and investment probably is irreversible; eventually this should enforce stronger corporate governance.

CORPORATE SECTOR

Thailand's corporate sector is typical of many South East Asian economies, with mainly large and diverse family owned conglomerates, mostly financed by banks that often have close relationships with borrowing firms. The crisis exposed minority shareholders and bank depositors to significant losses; the Government was forced to guarantee bank deposits, at a major cost to taxpayers (East Asia Analytical Unit, 2000). Listed companies' performance deteriorated sharply in the lead up to the crisis, with corporate sector returns on equity declining to a low 5 per cent in 1996, compared with an average of 9 per cent in the late 1980s; few have returned to profitability (Asian Development Bank, 2001).

Family Owners Dominate

Rules based models of corporate governance are very difficult to impose when founding families or individuals majority own most listed companies. Large corporates' family owners control 52 per cent of Thailand's share market capitalisation, with the largest ten families alone controlling half of all corporate assets (Figure 2.6) (Claessens et al., 1999).[1] Thai corporates use pyramid and cross holdings to secure control less than other South East Asian corporates. Instead, many business groups originate from informal alliances among families, with one family often assuming control (Suehiro, 1993). Also some holding companies are unlisted whilst subsidiary or associated entities in the group may be listed. In most cases, family members manage these firms, appointing relatives and friends to boards, ensuring they vote along family lines (Claessens et al., 1999).

[1] The 100 or so powerful Thai corporate families which essentially control corporate Thailand include the Sophonpanich family (Bangkok Bank), the Lam Sam family (Thai Farmers Bank), the Techapaiboon family (previous owners of Nakornthon Bank) the Chearavnont family (Chareon Phokaphand conglomerate) and the Chirativat family (The Central department store and a hotel chain).

Large Diverse Conglomerates

In the search for prestige, growth and profit, family owned conglomerates operate in many sectors, including property, finance, agribusiness and manufacturing, but transparency often is low (Naughton, 2001). Holding companies house the bulk of a typical group's companies, including both listed and non-listed ventures. This mix of ownership makes outside investors vulnerable to losses related to undisclosed related party transactions and poor transparency (Naughton, 2001).

These diverse business groups often centre on banks. For example, Thailand's largest bank, Bangkok Bank, belongs to a group active in property, infrastructure and rice trading. This bank holds 10 per cent of shares in 30 non-financial companies in sectors including textiles, food trading and chemicals (Backman, 1999). Prior to the crisis, enforcement of connected lending prohibitions was weak, so such related banks often provided finance for conglomerate investments; group ties and close informal relations with borrowers reduced commitment to proper credit assessment processes.[2] Firms within the same group also financially assist each other, providing a buffer for struggling firms and insulating poor managers from market discipline.

Debt Financing Dominates

Debt, mostly via bank loans, provides around two thirds of Thai corporate financing needs, with equity providing the remainder (Nikomborirak et al., 1999). With many business groups owning their own banks and finance companies, finance was readily available before the crisis, causing debt-to-equity ratios to soar (Figure 2.7) (Alba et al., 1998).[3] Debt financing also allowed family controlled companies to expand without issuing equity to new owners, thereby retaining control and preserving relationships between companies within the conglomerate. Hence, few significant outside shareholders discipline large Thai corporates.

Direct Financing Weak

With firms avoiding equity issues and, prior to the crisis, banks offering cheap finance, direct finance markets were small. Family controlled firms often list only to gain tax concessions, with listed companies offering as little as 7 per cent of their total capitalisation to the public. Furthermore, domestic institutional investors hold only 10 per cent of market capitalisation, shielding managers from active investors (Naughton, 2001). Only the stocks of 50 out of 420 listed firms, mainly big banks and a few large corporates, trade actively, reducing liquidity and making portfolio investment risky.

The demand side of the market also is weak; only 1 per cent of Thai household savings are invested in stocks and formal pension schemes cover under 15 per cent of Thai employees (Naughton, 2001). Hence, institutional investors play a small role. In many sectors, foreign ownership is restricted to 49 per cent of domestic firms, also reducing demand for Thai shares.

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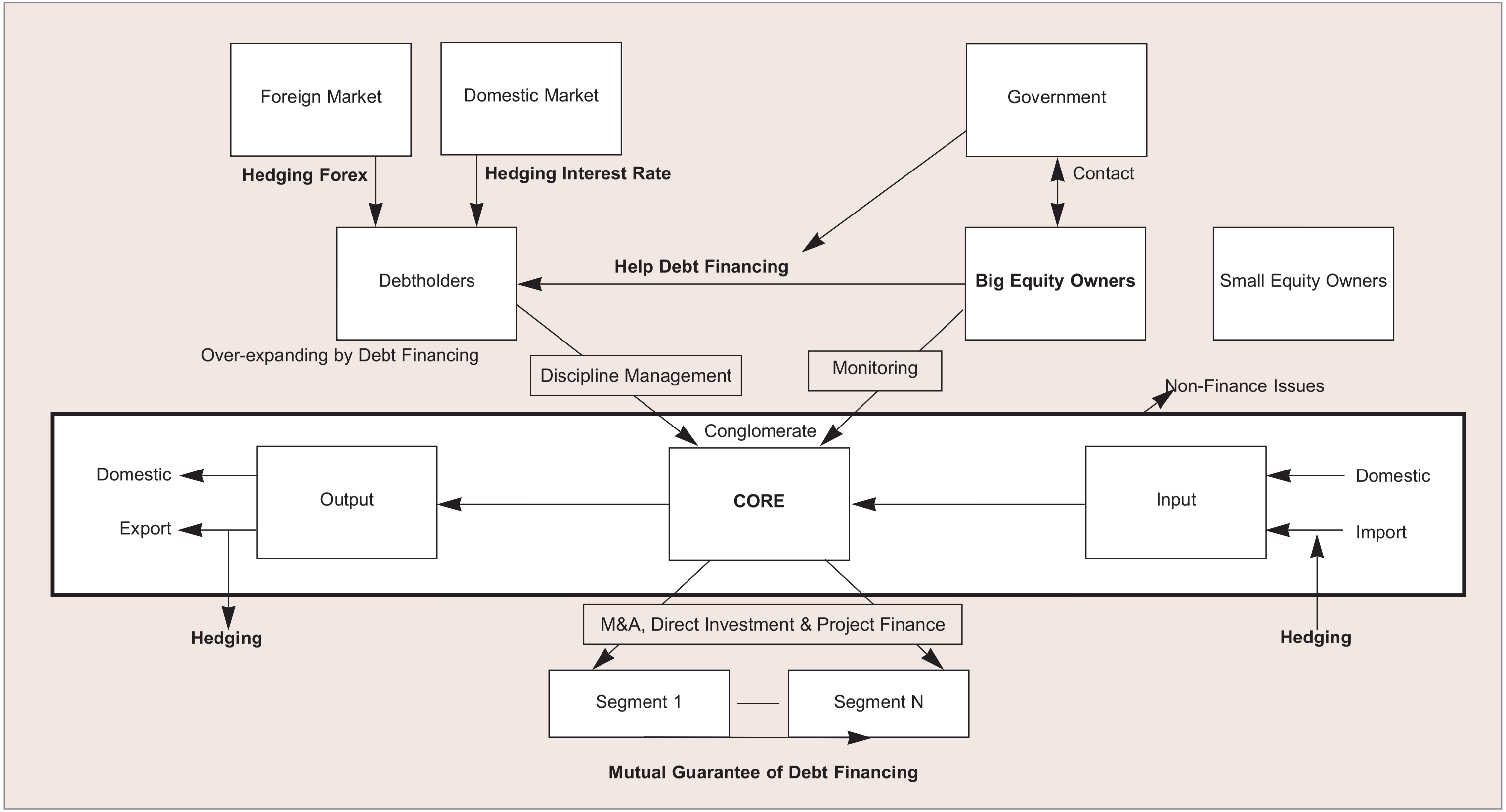
2 Non-bank financial institutions also feature prominently in these diverse business groups, as bank holdings of non-financial firm equity are unlimited. About half of listed Thai companies have a non-bank financial institution amongst their top five shareholders (Asian Development Bank, 2001). This equity is rarely traded, so group cross-shareholdings weaken corporate discipline.

3 Statistical analysis confirms the link between family ownership and high debt-to-equity ratios (Asian Development Bank, 2001).

Figure 12.1

Minority Shareholders out of the Loop

Organisational Chart of a Typical Thai Conglomerate



Source: Institutional Analysis, 2001.

Since the financial crisis, Thai stock market performance has been the region's poorest. Market capitalisation fell from US$100 billion in 1996 to US$37 billion in 2001, and closely held shares keep market liquidity low (Naughton, 2001). In 2001, monthly market turnover averaged about 7.5 per cent of market capitalisation (CEIC, 2002). This has limited any expansion of direct financing, and the discipline it can bring to corporate governance, to a few large 'blue chip' firms.

Competition Patchy

Barriers to foreign entry reduce competition in agribusiness, manufacturing and many service sectors, especially real estate and financial and business services. Individual private ownership of companies is extremely high in the property and finance industries, sectors the crisis affected most (Nikomborirak, 2001). Close relationships between large business groups can reduce competition in those markets and excessive expansion by incumbent firms deters new entrants (World Trade Organization, 2000).

Benefiting from preferential treatment and restrictions on entry into certain sectors, state enterprises contributed around 20 per cent of GDP in 2000 (Naughton, 2001). Many large state enterprises operate as monopolies; for example, three state owned trading enterprises, the Public Warehouse Organisation, the Liquor Distillery Organisation and the Thailand Tobacco monopoly, have strong market positions. Due to state directed lending and weak risk management strategies, since the crisis, state owned banks have suffered much higher non performing loan ratios than private banks. In 2000, when overall non performing loans averaged about 40 per cent of total loans, state banks' non performing loans averaged about 60 per cent and the largest state bank, Krung Thai, still had non performing loans of over 63 per cent in early 2001. Since 2001, the Thai Asset Management Company has purchased many non performing loans, including a large share of state banks' loans (East Asia Analytical Unit, 2000; CEIC, 2002).

MARKET PRESSURES BREAKING DOWN RELATIONSHIPS

Despite the Thai corporate sector's serious structural problems, market forces unleashed by the crisis and recent corporate restructuring are undermining some old relationships. If supported by enforced commercial regulations and laws, such forces could eventually provide sufficient discipline to generate a culture of shareholder value and facilitate the growth of a more rules based business environment.

FINANCE MARKETS

While still heavily family owned, since the crisis, the Thai corporate sector has experienced more government and foreign ownership. The Government now owns a large minority of the banking industry. Recent bank sales to foreigners and planned public placements should reduce families' former dominance and allow more transactions between hitherto unrelated parties, increasing opportunities for new business entrants. However, earlier Alien Business Act reforms appear under review, possibly hindering foreign investor and professional service suppliers contributing to improved corporate governance standards.

Finance Sector Restructuring

The 1997 financial crisis forced the Government to take over seven of the major 15 banks, notionally putting most of the banking system in government hands and undermining ties with some former corporate customers (Table 12.1). Subsequently, the Government sold three of these banks to foreigners, two others merged into Krung Thai Bank and two more are preparing for public offers (East Asia Analytical Unit, 2000). Sales of the two nationalised banks, Nakornthon and UOB Radanasin banks, to foreign banks, Standard Chartered Bank and Singapore's United Development Bank, and the partial sale of two private banks, Bank of Asia and Thai Danu Bank, also to foreign banks, is boosting competition in the sector.

Table 12.1

Bank Ownership Changing

Ownership of Major Banks Pre and Post Crisis

	Share of bank sector deposits (per cent)	Ownership before crisis	Ownership after crisis
Bangkok Bank	21.5	Majority family	Family 10-15 per cent/ FDI 49 per cent
Thai Farmers Bank	12.5	Majority family	Family 7-8 per cent/ FDI 49 per cent
Siam Commercial Bank	12.3	Controlled by Crown Property Company	Government owned under Tier 1
Bank of Ayudhaya	8.5	Majority family	Family 35-40 per cent
Siam City Bank	5.3	Over 20 per cent family owned	Government owned under Tier 1
Bangkok Metropolitan Bank	4.1	Majority family owned and related business	Government owned under Tier 1

Source: Khan, 1999.

Opportunity to Reduce Family Ownership

While many family owned corporates are hanging on to non-core assets despite high leveraging and low cash flows, more enlightened entrepreneurs are restoring their companies through restructuring. If the global downturn makes asset sales more widespread, they will reduce corporate ownership concentration and increase competition in key sectors. This trend is already evident; in 1999 foreign banks were among the top five shareholders in banking, finance, securities, energy, telecommunications and electronic sectors (Nikomborirak et al., 1999).

LEADING TYCOON TAKES PROACTIVE APPROACH

In some cases, family heads have voluntarily restructured their business groups, listed their companies and sought external managers and directors to attract new finance. For example, before the crisis, Dhanin Chearavanont's corporate empire, Charoen Pokphand, typified many Thai family owned businesses, operating in many sectors including food, telecommunications, insurance, retailing, pharmaceuticals and petrochemicals. It was financed by a mix of bank borrowing and equity, but favoured borrowing. Following the crisis, the group shed non-core businesses, including supermarkets, a brewery and a motor cycle manufacturer, and turned down offers to expand into airports, motorways and power plants. The group also became more transparent, by placing the entire conglomerate in a public holding company. Dhanin recognised the business had to deleverage to remain viable, had outgrown his family, and needed new equity owners and capital to thrive.

Source: *Economist*, 6 June 2001.

In mid 2001, the Government established the Thai Asset Management Corporation to buy a proportion of banks' non performing loans.[4] Already, the Government controls a large portfolio of corporate assets through debts owed to state owned and nationalised banks; Thai Asset Management Company purchases will expand this portfolio. The sale of these assets would open significantly the Thai corporate sector to new entrants and boost the equity market's size and liquidity.

However, except in the case of severely insolvent companies, the Thai Asset Management Company generally will seek debt and corporate restructuring, rather than precipitate bankruptcy cases (Tumnong, 2001). Many private bank asset management companies also are holding on to assets, generally opting for superficial debt rescheduling rather than more thorough government restructuring, raising concerns about powerful corporates' influence on asset disposal outcomes. Many analysts believe strong commitment is needed to avoid lenient debt restructuring, allowing insolvent original owners to retain control of their assets. Instead, the market needs viable enterprises and contestable markets (Markels et al., 2001).

4 Non performing loans fell from over 30 per cent to 12 per cent in the 12 months to September 2001 (CEIC, 2001), due mainly to banks transferring non performing loans to their asset management companies. Most of these loans have not been restructured thoroughly and few assets realised, nor are they realisable, so some of this steep fall is cosmetic rather than actual.

CORPORATE RESTRUCTURING AT THE CROSSROADS

Despite several families making early progress in rationalising their business groups, indecisive outcomes in key bankruptcy cases encouraged others to retain non-core business, maintaining highly leveraged balance sheets. For example, in 1998, Thailand's largest industrial conglomerate, Siam Cement, which produces cement, chemicals and electronics, committed to shedding several non-core businesses to reduce its debts from US$5.4 billion. Through 1999, the business sold nearly half the promised assets. Banks previously supplying lending were less willing or able to lend, so the company also raised finance by issuing equity.

However, with more court decisions running against creditors after 1999, Siam Cement did not sell any more assets in 2000. Businesses scheduled for sale returned to the company's fold and, by mid 2000, the group's debt-to-equity ratio was once more increasing. Over the first half of 2000, security analysts sold down the company's equity by 20 per cent, anxious about high leveraging and opacity in the firms' accounts; this made it difficult to decipher which group businesses owed debts.

Source: *Far Eastern Economic Review*, 12 June 2000.

Direct Finance Markets Developing

Since the crisis, with banks unable to lend or preferring to hold government bonds, several blue chip Thai corporates have turned to the equity and bond markets (Kawai et al., 1999). Most banks are unlikely to resume past lending levels rapidly, so as the economy recovers, corporates will have a strong incentive to seek direct finance. Outstanding bonds in the corporate bond market almost trebled between 1998 and 2000, exceeding Baht 500 billion (US$11.4) in 2000. Foreign private banks hold about half this corporate debt (Naughton, 2001, CEIC, 2002).[5] Several big companies, including Siam Cement and many banks, successfully issued bonds after the crisis (Sucharitakul, 2001).

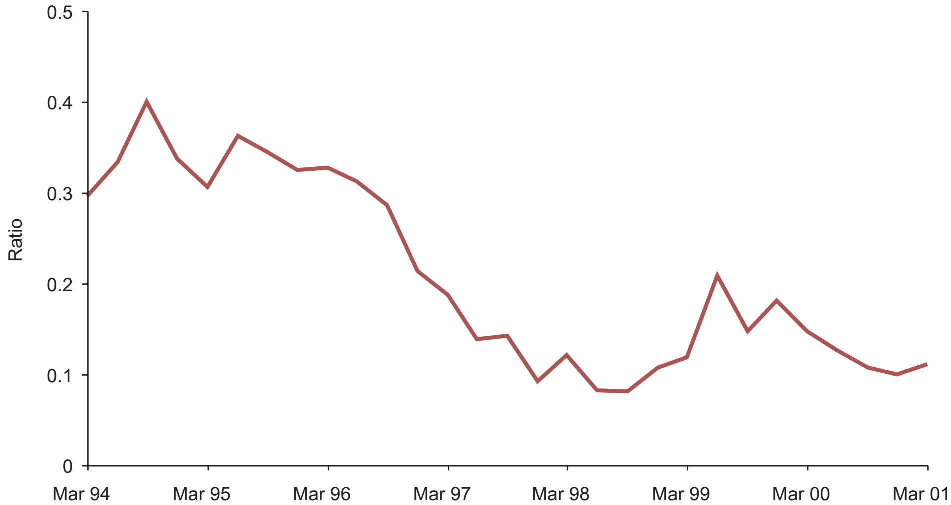
By contrast, despite a modest rally and several large banks successfully issuing non-voting shares in 1998-99, the share market remained relatively flat after prices collapsed in 1996-97 (Figure 12.2). No new listings occurred in 1999, two in 2000 and three in the six months to June 2001. However, some firms placed equity privately with strategic partners; for example, Society Generale injected capital into Bangkok Bank. Such activity fuelled a boom in new equity raisings in 1998 and 1999, but this was not maintained in 2000 and 2001 (Figure 12.3). In late 2001, strong demand for initial public offerings of INET, Thailand's largest internet provider, and Thai Petroleum, both as part of the privatisation program, boosted the share market.

5 Government bond issues helped establish a yield curve for pricing corporate bonds, and secondary market liquidity, although small, is increasing steadily (Sucharitakul, 2001).

Figure 12.2

Share Market Flat

Stock Market Capitalisation to GDP, 1994-2001

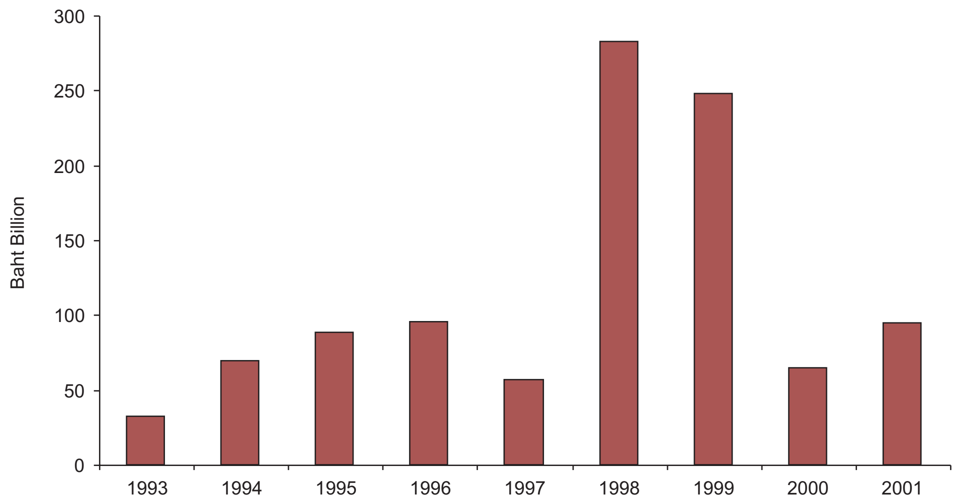


Source: CEIC, 2002

Figure 12.3

Strategic Placements Succeed till 2000

New Capital Raised through Equity Issues by Listed Companies, 1993-2001



Source: CEIC, 2002

As the economy recovers, corporate bond and share market growth could encourage better corporate governance, as companies with sound standards can access cheaper capital, and bond and share issuers must meet listing rules and have ratings. The Thai Ratings and Information Services, the first and, until recently, only Thai credit rating service, incorporates some corporate governance indicators in their rating process and publishes corporate governance guidelines.[6] The service now has 45 clients, mainly large companies; 90 per cent of these are issuing debentures (Todhanakasen, 2001).

Institutional Investors

Institutional investors are important because they allocate funds to firms on commercial grounds, bypassing the traditional firm-bank funding relationship. Thailand has few large institutional investors to develop markets for direct finance and represent minority investors; PTT is an example. A formal pension fund covers only 15 per cent of Thais and only 1.5 per cent of companies operate provident funds providing employee pension benefits (Werner, 2001). However, the largest institutional investor, the Government's Thai Pension Fund, already leads in encouraging better corporate governance. With Baht 140 billion in assets, it plans to invest in blue chip listed companies which meet the Stock Exchange of Thailand's corporate governance guidelines (Charuvastr, 2001). The fund also rates companies (Benjapolchai, 2001).

While the number of fund managers, provident funds, and private and public service pension schemes is growing, obstacles hamper these funds from investing more in the local share market. First, state pension funds presently can invest a limit of 25 per cent of their funds in shares. Second, government guarantees on bank deposits deter broader savings and community interest in shares. Third, foreign institutional investors face a 50 per cent limit on foreign equity holdings in many sectors.[7]

PRODUCT MARKET COMPETITION

After the crisis, Thailand increased competition in some goods and services markets, reducing trade barriers on many imports and relaxing some foreign investment restrictions. However, in 2000, this process slowed; Thai trade restrictions remain some of the highest in the region. Hence, more reforms would ensure Thai corporate managers face competitive discipline when investing and producing, especially through privatising state enterprises, dismantling public and government supported private monopolies, easing visa restrictions on foreign professionals and reducing barriers to trade and foreign investment, including in services. This is particularly the case given the added impact from the global economic downturn in 2001/02.

[6] Fitch-IBA set up a new ratings company in May 2001 (Benjapolchai, 2001).

[7] The Government is launching a foreign share market board to attract foreigners into stocks that reach the 50 per cent foreign ownership limit, but shares will not have voting rights (*Financial Times*, www.globalarchive.ft.com, 16 May 2001).

Privatisation and Deregulation

Since the crisis, successive administrations have committed to privatising most of the remaining 50 state enterprises (East Asia Analytical Unit, 2000). Widespread privatisation in competitive market environments would boost product and service market contestability, raising incentives for protecting investors (Naughton, 2001). While public sector managers and unions slowed privatisation in 1999 and 2000, the newly elected administration announced in 2001 it would prioritise privatisation, commencing in late 2001 partial sales of Thai Petroleum, PTT and INET (*Dow Jones International News*, 10 July 2001).

State enterprises generally exhibit poor corporate governance standards and political factors can influence their operation. The Government previously attempted to improve their corporate governance by introducing audit committees and considered requiring half the boards' members be non-political (Todhanakasen et al., 2001). However, government controlled and supported monopolies still remain in some sectors, reducing competition, and corporatisation and privatisation has faced considerable resistance.

Trade Reforms

Since the mid 1970s, Thailand progressively opened its markets to international trade, but in the late 1990s, reforms slowed. While the simple average tariff rate fell from 44 per cent in 1991 to 17 per cent in 1999, compared to many other emerging East Asian economies, Thailand's tariffs remain relatively high for East Asia. In 1999, Thailand and China had the region's highest simple average tariff rates, double Malaysia's rate, 60 to 70 per cent higher than Philippine and Indonesian rates, and over triple Australia's average rate of 5 per cent (East Asia Analytical Unit, 2000).[8] Moreover, strong support for import substitution amongst senior ministerial and bureaucratic quarters is re-emerging.

While at this stage the Government does not have a specific timetable for lowering tariffs over the short to medium term, trade liberalisation achieved to date has produced a steady climb in import penetration (Figure 12.4). Notably, imports jumped suddenly as a share of GDP from 0.46 in 1999 to 0.58 in 2000. While this to some extent reflects the increasing openness of the Thai economy, and should impose more competitive discipline on firms, the boom in export processing zones producing autos in part explains this jump.

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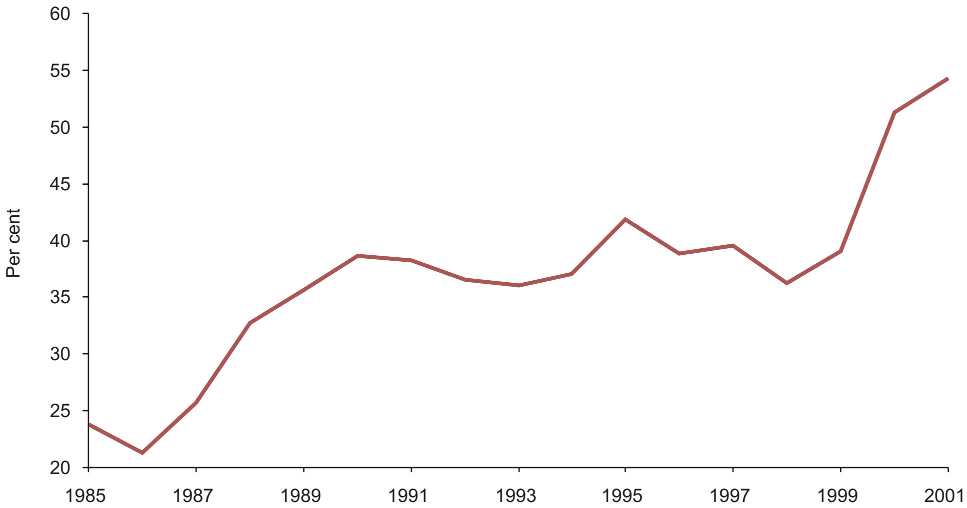
8 However, because of the large share of duty free imports, Thailand's effective tariff rate, measured as the ratio of customs revenue to merchandise imports, was only 3.8 per cent in 1999 (CEIC, 2001; World Trade Organization, 1999). This low rate reflects Thailand's complex system of duty exemptions.

Figure 12.4

Imports Imply Competition

Imports as a Share of GDP, 1985-2000



Source: CEIC, 2001.

Foreign Direct Investment

Foreign direct investment, FDI, has risen strongly since the crisis as the Government relaxed sectoral and ownership limit controls. In the financial sector, new FDI is increasing risk and prudential management standards, with four of the 13 banks and 27 of the pre-crisis 53 securities companies now wholly or partially foreign owned (McMillan et al., 2001; East Asia Analytical Unit, 2000). The 1999 Alien Business Law review reduced sectors restricting FDI from 63 to 43.[9] Key reforms include allowing 100 per cent foreign ownership of large retail chains with foreign equity over Baht 100 million, banks, finance companies, security houses and manufacturing enterprises outside Bangkok.

Nevertheless, in many activities, FDI remains restricted, reducing its potential to boost competition and corporate governance standards.[10] Foreign investment is banned in the media, farming, livestock raising, forestry, fishing and real estate sectors. Cabinet must approve foreign participation in water and air transport, natural resource exploitation, sugar, salt farming and mining, and locals must control a minimum of 40 per cent of any venture in these sectors. Foreigners also must obtain Ministry of Commerce approval before entering many professions, including accounting and law. Recent decisions not to extend visas for professionals may indicate a more restrictive trend.

9 An alien company now is defined as any legal entity in which foreigners hold 50 per cent or more of the share value.

10 In banking, foreigners may hold up to 100 per cent of shares in commercial banks for up to ten years before divesting 51 per cent of the stock. For foreign banks, the number of foreign bank branches, use of automatic teller machines and the number of personnel each branch may hire remain restricted.

FOREIGN RETAIL GIANTS BOOST COMPETITION

The entry of foreign hypermarket operators is increasing retail sector competition. Britain's Tesco, France's Carrefour and Dutch Siam Makro are recent entrants, opening several new stores and pumping millions of dollars into the sector. Many of these foreign retailers favour joint ventures. Casino, a French discounter, has employed a Thai chairman and invested Baht 4 billion opening several new Big C stores selling products that are 95 per cent locally made.

Local operators, feeling the threat from foreign competition, have improved their services to Thai consumers. For example, the Mall, a wholly owned Thai retailer, is stepping up its battle against foreign entrants by targeting low income earners. Its strategies include competitive prices and service. Its sales increased 15 per cent in the March quarter 2001 and similar growth was forecast for the second quarter.

Source: *Far Eastern Economic Review*, 5 June 2001, p. 34.

New Anti-trust Regulations

The Government also reviewed competition policy in 1999, introducing the Business Competition Act; this aims to prevent abuses of market power and ensure new firms can enter most sectors. This law focuses on large firms, prohibiting them from limiting supply and setting unfair prices and outlawing collusion. The Committee on Business Competition must approve all mergers; though this law does not apply to state enterprises. Finally, authorities are dismantling some regulations differentiating firms with foreign participation from local firms.

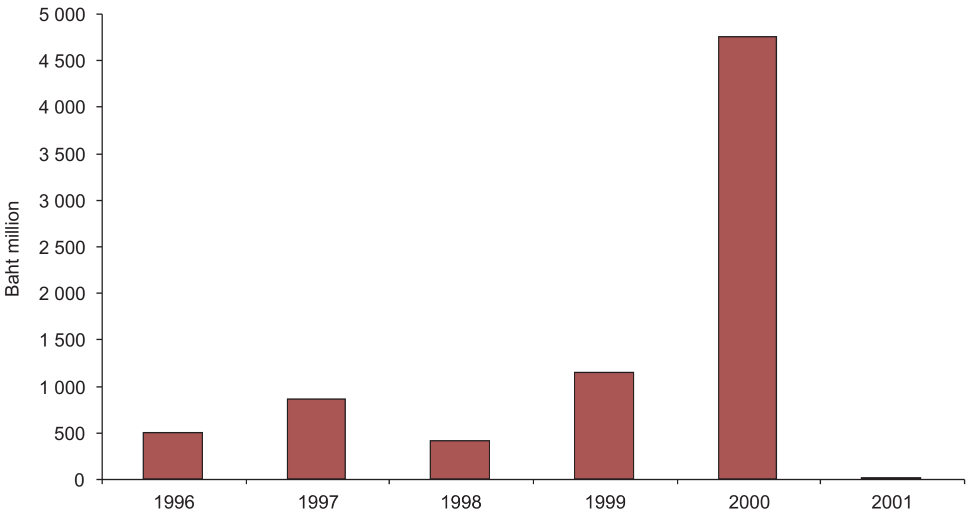
Exit of Inefficient Firms

High levels of indebtedness and collapsed demand led to the number of insolvent firms and non performing loans skyrocketing immediately after the crisis. New bankruptcy laws passed in 1999 provided a better framework for adjudicating whether a firm should be wound up, and a new commercial court was supposed to expedite hearings. This finally produced a jump in the rate of firm exits in 2000, although lenient debt restructuring deals and debtor oriented decisions on some key cases including the benchmark Thai Petrochemical Industry Case, ensure many marginal firms survive. In 2001, bankruptcies slowed to a trickle (Figure 12.5).

Figure 12.5

Bankruptcies Slow to a Trickle

Capital of Bankrupt Firms, 1996-2001



Source: CEIC, 2002.

NEW RULES FOR DOING BUSINESS

Despite considerable post crisis government efforts to build new institutions, tighten regulations and raise consciousness to establish a more rules based system of doing business, Thailand is still working towards this ideal.[11] Since 1997, authorities have issued best practice guidelines on protecting outside investors, including audit committee operation, directors' performance and shareholder meeting proceedings and tightened listed firms' disclosure and accountancy standards. Importantly, the Stock Exchange of Thailand established the Committee on Good Corporate Governance Practices which, in 2000, released non-mandatory guidelines on good corporate governance.

TRANSPARENCY

Before the crisis, outside investors in listed Thai companies had little access to accurate information on majority shareholder activities affecting the firm's value. Company directors generally were, and in many cases still are, friends and relatives of company majority shareholders; traditionally, business was based on connections and relationships, so most firm owners and directors came from 300 to 400 elite Thai families. Preference for relationship based business was due to the relatively

[11] Richard Moore, Gloria Warbanoff, Michelle Narracott and Anna Guthleben, from PricewaterhouseCoopers and PricewaterhouseCoopers Legal, contributed to this section.

weak legal and court system, and cultural and historical reasons. Connected deals were a normal part of business life and conflict of interest was a little known concept (Charuvastr, 2001; Chittmittrapap, 2001). However, new government and non-government efforts seek to upgrade transparency for outside investors and depositors.

Financial Reporting

The 1992 Securities and Exchange Act requires companies to submit periodic and non-periodic reports following the Stock Exchange of Thailand's Disclosure Manual standards. Firms must disclose and distribute information correctly and quickly to all investors. Listed companies must disclose all relevant information that may affect shareholder rights and investments. Listed company directors must constantly report their holdings and purchases or sales of company securities. Since 1999, directors also must disclose any non-compliance with the Directors' Code on Corporate Governance in their companies' annual reports. The Stock Exchange of Thailand and Securities and Exchange Commission are enforcing disclosure requirements more strictly, demanding related party transactions, such as real estate sales and mergers and acquisitions, are disclosed fully (McMillan, 2001).

Accounting Standards

Thai accounting standard upgrades commenced in 1997.[12] Now, 95 per cent of auditing standards and 90 per cent of accounting standards comply with International Standards.[13] The Stock Exchange of Thailand and Securities and Exchange Commission enforce standards. The May 2000 Accountancy Law makes company management, not the auditor or accountant, responsible for legal behaviour (Nimsomboon, 2001). Consequently, accounting standards have improved (McMillan, 2001).

However, many companies still run multiple sets of books, depending on the audience and poor accounting and auditing continue to undermine the quality of financial reports. A survey of listed companies' compliance showed only 25 out of 46 respondents adhered to International Accounting Standards, although a further 19 observed some of these standards (Asian Development Bank, 2001). In traditional Thai corporates, junior staff, including accountants and auditors, often will not challenge their superiors, even when irregularities occur.

A proposed Accounting Profession Act should introduce self regulation for the profession, which would accredit accountants. At present, the Institute of Certified Accountants and Auditors of Thailand can issue professional standards but cannot legally enforce them. The Ministry of Commerce dispenses licences to accountants who have a university degree in accountancy, 2 000 hours of practice, and pass five tests (Nimsomboon, 2001).

[12] National accounting standards are derived from standards the Institute of Chartered Accountants and Auditors issue and the Securities and Exchange Commission's ministerial regulations.

[13] Two of the most important ways Thai accounting standards differ from International Accounting Standards are in accounting for employee benefits and revalued assets.

Auditing

Since July 1999, listed companies have had to establish an audit committee to review company financial reports to ensure they are accurate and provide shareholders sufficient information; they also examine internal financial controls and supervise internal audits. Boards of directors appoint audit committees, which must include at least three independent directors.[14]

By 2001, 88 per cent of Thailand's 380 listed companies had established audit committees; most of the rest were in rehabilitation (Benjapolchai, 2001). While most companies have complied, as audit committees are a new concept, many committees are not yet clear about their role and some still have difficulty asking hard questions of managers (Moore, 2001). Audit committee members are legally liable for their actions, but since none have yet been prosecuted, legal action may not appear a credible threat.

Internal and external auditor standards still are relatively weak; improvement is not as great as for accountants. However, local companies increasingly use the big five international accounting companies as auditors. The Securities and Exchange Commission also lists approved auditors, pressuring locals to maintain standards; verified complaints about auditors result in those auditors being struck off. Hence, auditors' reputations are becoming more important (McMillan, 2001).

MINORITY SHAREHOLDERS RIGHTS

Thai minority shareholders traditionally are rather passive and their interests often are not a priority for majority shareholders, who mostly are family owners. Majority shareholders can issue warrants to themselves, rather than pay dividends to all shareholders, and many listed companies borrow money and on-lend to unlisted subsidiaries. A Thai company, Alphatex, did this in a Baht 5 billion transaction, which is under investigation (Haines, 2001). However, the Securities and Exchange Commission is seeking to strengthen minority shareholders' rights (Sucharitakul, 2001).

Listing Rules

Since the crisis, the Government has tightened listing rules, requiring listed companies to establish audit committees and appoint outside directors to at least one quarter of board positions (or two directors, whichever is greater). However, as initial public offers have dried up since the crisis, the Government passed a new law in mid 2000 weakening listing rules, allowing more companies to list. Now, companies need to have had profits for one year, not three (Charuvastr, 2001); listed companies attract a lower 25 per cent tax rate, not the normal 30 per cent. Despite these relaxed rules, only three companies made new initial public offers in the 12 months to June 2001. The Government also opened a second bourse for small and medium sized enterprises, with an even lower tax rate, but no companies have listed on this yet (Benjapolchai, 2001).

[14] The Stock Exchange of Thailand's Best Practice Guidelines for Audit Committees requires members to meet four times a year, inform board directors of all decisions and report on company activities and any other relevant information. Clear rules also govern the relationship between audit committee members and management and members' interests in affiliated companies.

The Securities and Exchange Commission and Stock Exchange of Thailand are being strengthened, providing more effective monitoring and enforcement of listing standards and other regulations. The increasing amount and frequency of fines reflects this (McMillan, 2001).

Representation

In 1999, to improve representation of shareholders' rights, the Stock Exchange of Thailand issued a Code of Practice for listed companies organising and operating shareholders' meetings. The Code states that listed companies should provide all relevant information at shareholders' meetings and encourage shareholders to comment or object. However, the code is voluntary, minimising its effect to date in protecting minority shareholders.

A new company law was intended to increase minority shareholders' rights, including lowering the proportion of shareholders who could precipitate a general meeting. The previous government delayed these amendments and the new government has not yet indicated whether it will back them. Although proxy voting is allowed, absent shareholders often are not sufficiently informed of a meeting's agenda (Asian Development Bank, 2001).[15] Shareholders may call an emergency meeting and must approve major transactions, although the quorum is set at a high 20 per cent of shareholders. However, minority shareholder approval is not needed to approve connected transactions and issue warrants to majority shareholders; dominant shareholders can use this provision to reduce minority shareholders' wealth. On average, only 8 per cent of shareholders attend meetings (Asian Development Bank, 2001).

THAI INSTITUTE OF DIRECTORS PROMOTES BEST PRACTICE

Established in 1999 through Corporate Governance Committee reforms, the Thai Institute of Directors helps implement the Stock Exchange of Thailand's 60 do's and don'ts for listed company directors. The Institute of Directors seeks to upgrade corporate governance standards by providing training and seminars for company directors. Its curriculum is based on an Australian Institute of Company Directors training package; so far, 200 directors from listed and major unlisted companies have studied fiduciary duties and good corporate governance. The institute can train 250 directors per year, but more funding could double or triple this. Its targets are the 3 800 listed company directors, of which it hopes to train 1 300 or so.

The institute's course focuses on director's responsibilities and issues raised in financial accounts. Most directors trained to date are from blue chip companies, but some unlisted family companies also have trained directors. Company annual reports show which directors have graduated from the course.

The Thai Institute of Directors also has graduated 36 top CEOs and Board Chairmen from its Chairman's class. This one-day course covers conflict of interest, responsibilities of directors, managers and shareholders, disclosure, fiduciary duties and directors' legal responsibilities.

The Institute also has engaged McKinsey to benchmark firms' corporate governance standards.

Source: Charuvastr, 2001.

15 An Asian Development Bank survey in 2001 showed 44 out of 46 firms offered proxy voting (Asian Development Bank, 2001).

The Securities and Exchange Commission sends staff to attend shareholders' meetings to help secure fair conduct and shareholders' rights; with the Stock Exchange of Thailand, it also may establish a shareholders' watchdog group (Sucharitakul, 2001).

Board Structure and Duties

After a 1997 Stock Exchange of Thailand survey indicated most directors knew little about good corporate governance, in 1998, the exchange issued company directors with a company director's manual. This outlined relevant laws, regulations, fiduciary duties and best practice approaches to corporate governance (Benjapolchai, 2001).

Subsequent changes to listing rules required outside directors to comprise one quarter of the total board. Of 382 listed companies in 2000, about 60 per cent of boards had two or fewer independent directors, 38 per cent had three to four and 2 per cent had five or more (Charuvastr, 2001). With an average board size of 12 directors, compliance is still reasonably low (Asian Development Bank, 2001). A person can hold unlimited board positions, except in the financial services sector, but can be managing director of only one company.[16]

Cumulative voting for directors is permitted, and a proposed amendment to the Public Company Act may make it compulsory. Shareholders may dismiss directors through a simple majority vote, although highly concentrated ownership allows dominant family shareholders to carry the vote (Nikomborirak et al., 1999).

Legal sanctions apply to a director's failure to perform some but not all fiduciary duties. For example, directors can engage in business activities that may affect the company, with board approval; this could leave minority shareholders vulnerable. Previously, few legal provisions controlled disclosure of related party transactions, although now these are monitored more closely. Still, a majority vote at an annual general meeting can pardon directors for violating fiduciary duties (Asian Development Bank, 2001). Authorities currently are drafting new regulations to address these inadequacies. Under the Best Practice Code, directors must disclose the degree of compliance with the code in company annual reports, but compliance with the code is not compulsory. Shareholders can sue directors for misconduct leading to loss, although fiduciary duty is defined vaguely (Nikomborirak et al., 1999).[17]

CREDITORS' RIGHTS

Despite new laws, and positive early court decisions, in 2001, the courts failed to resolve quickly the steep rise in corporate insolvencies the crisis caused, suggesting inadequacies in creditor rights protection. Consequently, very few foreign banks currently are prepared to lend to Thai corporates, and local bank lending also is declining (CEIC, 2001). Failure to protect creditors' rights, enforce reasonable and fair restructuring or secure collateral from severely insolvent companies may create a serious moral hazard and weak credit culture. Analysts believe many non performing loans are strategic (Haines, 2001).

[16] This is slightly higher for companies in the financial services sector.

[17] However, as in most economies, court rulings better clarify this issue.

Bankruptcy

The financial crisis forced the Government to establish new bankruptcy laws strengthening creditor rights, but their implementation strongly emphasises financially rehabilitating insolvent companies. Insolvent firms have an automatic stay, protecting them from foreclosure for five years while they restructure. In 1999, creditors gained the right to claim repayment for new loans to a debtor business, enabling restructuring firms to gain finance.

Shortcomings of the new legislation include adopting a balance sheet rather than a cash-flow test of insolvency, increasing the burden of proving insolvency and debtors' leverage. Directors who fail to act when they become aware of insolvency face no personal liability and creditors cannot force a company into bankruptcy or restructuring until it declares itself insolvent (PricewaterhouseCoopers, 2001).

The new Bankruptcy Court initially won creditors' confidence with landmark rulings against the largest and most notorious Thai corporate debtor, Thai Petrochemical Industry. However, in 2001, the court allowed an appeal against a previous ruling in this case, precipitating a flood of similar appeals, further slowing restructuring (Chittmittrapap, 2001).[18] Most cases can take up to 10 years, so creditors receive little net value from collateral, even if eventually it is realised.

The Corporate Debt Restructuring Advisory Committee facilitates formal out-of-court debt workouts to complement court activity.[19] This program has restructured about 81 per cent of signatory cases (Tumnong, 2001). The recently established Thai Asset Management Company is designed to take more non performing loans off banks' books and dispose of collateral backing these loans. However, analysts are as yet unclear whether this will expedite or slow the restructuring process.

To date restructuring has often entailed only debt rescheduling with long grace periods and lower interest rates; thorough corporate restructuring, imposing write-offs on banks and forcing companies to shed non-core assets is more rare. Hence a significant proportion, up to 20 per cent, of restructured non performing loans already are non performing again. Many banks resist more restructuring, as this avoids admitting greater losses and forcing recapitalisation (Chittmittrapap, 2001; Markels et al., 2001).

In the long term, the bankruptcy system's weakness could well undermine Thai credit culture and reduce effective sanctions on corporate managers. This could undermine Thai corporates adopting good risk management and corporate governance standards.

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18 The court appointed administrator, Australian company Ferrier Hodgson, was also remanded in custody in 2001, raising concerns about legal and police bias.

19 Chaired by the Governor of the Bank of Thailand, the Corporate Debt Restructuring Advisory Committee issued guidelines on restructuring debt and valuing collateral. Its methods follow the London Approach featuring inapplicability of legal court procedures, automatic stays, the appointment of a bank or committee to steer the process and discussion, and new loan extension.

Bank Supervision

After the crisis, the Bank of Thailand, the Securities and Exchange Commission and the Stock Exchange of Thailand worked to strengthen financial institution prudential control. The Financial Institutions Law modernised prudential supervision of deposit-taking institutions and the Deposit Insurance Law superseded the blanket guarantee of the financial system. The new Central Bank Law enhanced the Bank of Thailand's authority and independence, and the Bank of Thailand has increased disclosure and transparency pressure on financial institution CEOs and board members. However, in 2001, the replacement of the Bank of Thailand's Governor raised market questions about its independence.

COMPLIANCE

Enforcing a more rules based system of corporate governance will take time. Compliance with many standards, including audit committees and directors' duties, requires more technical skill than many corporates presently have. Many directors continue to adopt a 'tick the box' approach to compliance (Moore, 2001). Many directors and audit committee members are unaware of their legal obligations (Charuvastr, 2001). However, training by the Institute of Directors should slowly build directors' capacity and awareness of their fiduciary duties, so long as the Government maintains its commitment to stronger corporate governance.

Enforcement

Authorities increasingly enforce new tighter accounting, disclosure and corporate governance requirements, like audit committees, although as yet most companies see this as a burden rather than essential for their businesses (Nikomborirak et al., 1999; Sucharitakul, 2001). Both listed and non-listed companies must conform with Thai Accounting Standards, including for consolidated reporting. If auditors issue a verdict of non-compliance, the Securities and Exchange Commission can reject the company's annual report, fine the company or delist it.[20]

The May 2000 Accountancy Act provides criminal and civil penalties for directors and managers of companies if they provide false information to auditors and accountants (Nimsomboon, 2001).[21] However, very few company or bank directors or executives have been prosecuted, despite the many corporate scandals before and since the crisis. Analysts consider a high profile prosecution is needed to make directors take their responsibilities seriously.[22]

20 In the 12 months to June 2001, the Securities and Exchange Commission sent about ten companies' accounts back to them for clarification. If accounts are not corrected satisfactorily in one month, the Stock Exchange of Thailand publicises the case; this happens from 'time to time' (Benjapolchai, 2001).

21 Smaller registered partnerships are exempted from certified public accountant audits, although tax auditors can inspect them, as the Taxation Office believes compliance at this level is a problem.

22 In October 2001, a former CEO of one of the defunct financial institutions was convicted.

Press

In 2000 and 2001, investigative journalism uncovered several large corporate frauds. For example, Thai journalists uncovered dubious lending by the Bangkok Bank of Commerce, which fell as a result of their investigations (*Far Eastern Economic Review*, 1 March, 2001). Also, the television show *Transparency 360 Degrees* provides an excellent forum for raising issues relating to corporate governance. However, large corporates own most of the Thai press, so the press is relatively passive in scrutinising corporate behaviour. As generally, the financial press does not act as a whistleblower on corporate wrong doers, the onus falls on regulators to enforce standards (Sucharitakul, 2001).

IMPLICATIONS

Only since the crisis have most Thai authorities and corporates focused on the need for stronger corporate governance standards. The Securities and Exchange Commission, Stock Exchange of Thailand, Bank of Thailand and Institute of Directors include skilled personnel committed to helping corporates strengthen their compliance. They have made substantial progress in strengthening corporate governance standards, including upgrading financial reporting standards, tightening listing rules and promoting adherence to judiciary duties among company directors. However, the dominance of family owned companies, a shortage of major institutional investors, weaker bankruptcy and corporate restructuring outcomes and delays in proposed new legislation seem set to slow improvements in corporate governance standards. Nevertheless, most market analysts recognise significant progress in these all areas is crucial to the corporate sector restoring business confidence and Thailand resuming strong and sustainable economic growth.

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