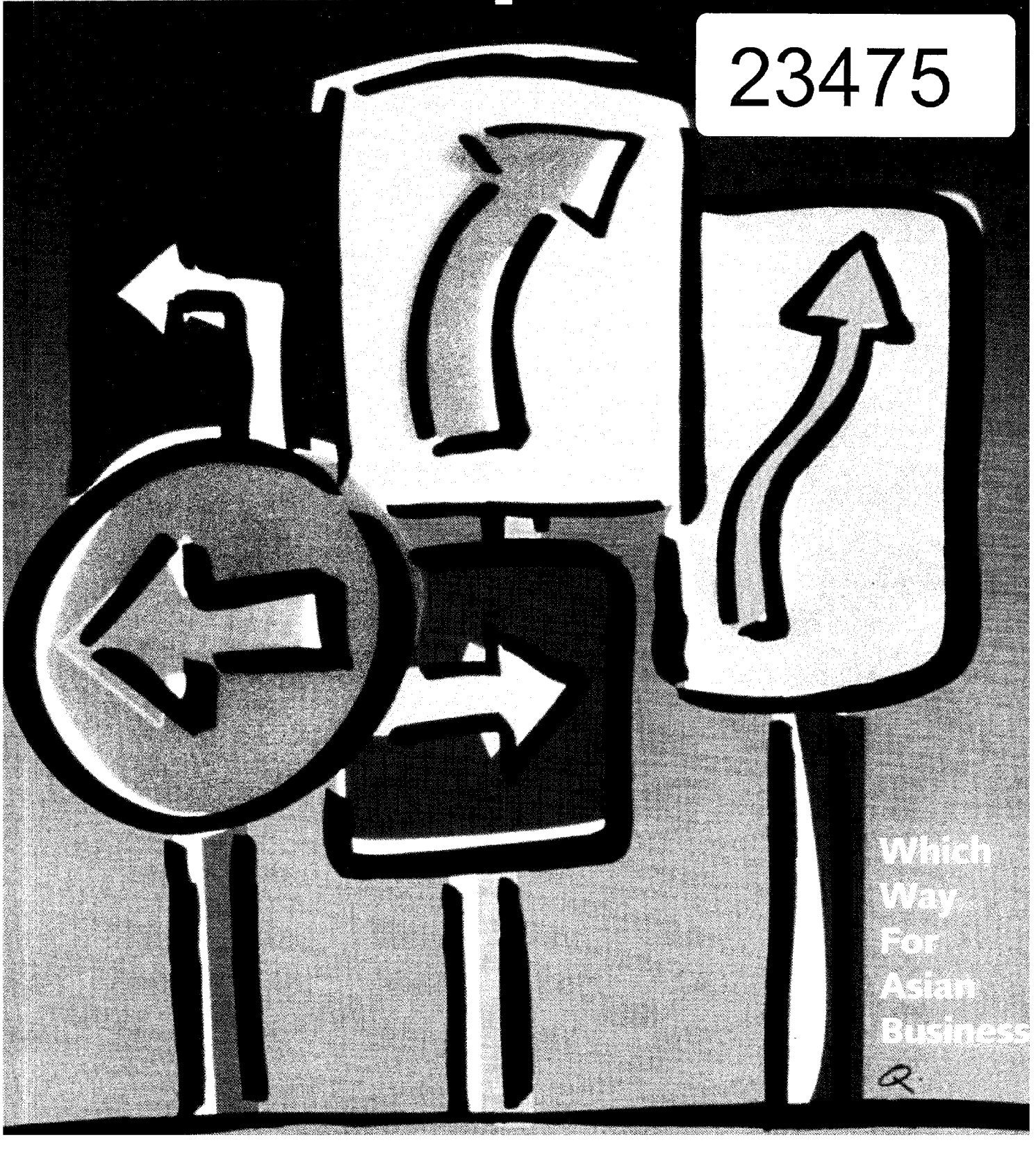
The IFC Review of Private Investment in Developing Countries

IFC impact

Winter 1999



Which Way For Asian Business

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IFC

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Winter 1999 | Vol. 3, No. 1

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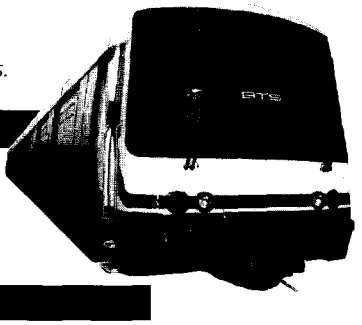

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Mailbag

To the Editor

Essential Reading?

I have just read the excellent summer issue of *Impact*, which focused on the role of large multinational firms in developing countries. I found the case study by Debora Spar ("Whale in a Swimming Pool") of Costa Rica's efforts to attract Intel Corporation to its shores particularly illustrative of numerous basic lessons that nations all too often ignore in their investment promotion efforts.

As someone who has been involved in many economic development activities on behalf of both developed and developing countries, I found the case study essential reading because it highlights the factors that multinationals, in fact companies of all sizes, seek with respect to international investment decisions. Too often, investment promotion efforts are believed to end with the simple identification of a prospect and the dissemination of basic information.

Those who have had more success recognize the importance not only of providing detailed information but also of trying to understand the nature of the prospect's business and the issues and concerns of the potential investor so that these issues can be effectively addressed and resolved. Companies expect, not unreasonably, that economic development officials will come armed with a basic understanding of the business and its needs as well as comprehensive information and creative solutions to whatever obstacles may arise.

Costa Rica's successful effort in attracting Intel also highlights the importance of a long-term commitment to prospective investors and an ongoing process of communication. The competitive nature of attracting international foreign investment requires this type of commitment, which is particularly underlined in the Costa Rican example by the government's willingness to devote the time of its most senior officials to the effort. After all of the commercial issues are addressed, investment decisions still rely on nothing more and nothing less than good personal relationships. While each country's circumstances are undoubtedly different, the lessons of the Costa Rican effort need to be implemented by any country hoping to achieve similar investment successes.

Paul J. Fekete
Senior Vice President
Samuels International Associates
Washington, DC

Progress in Ukraine

Thanks for presenting the very interesting Ukraine privatization discussion by Alyona Voloshina in your summer issue. I know Ukraine reasonably well, and I share the optimism expressed in the discussion. I can fully understand the pride and enthusiasm. I have visited many countries in Central and Eastern Europe and the former Soviet Union, observed many privatization efforts, and read many accounts of privatization progress. But I have seen few programs that can report the progress noted in Ukraine.

My continuing optimism regarding future progress stems from my recent visits to business schools throughout Ukraine. In early 1997 a colleague and I visited approximately 30 business and management training programs throughout Ukraine — traveling from Kiev to Lviv in the west, to Kharkiv in the east, to Odessa in the south — and to many colleges and universities between these cities. Without exception, the faculty members and academic administrators we met understood the importance of management training to the future of Ukraine and had exhibited the necessary initiative to create credible academic programs to prepare future business managers. It is not surprising that most of the emerging business schools, both public and private, had encountered many obstacles similar to those encountered, and overcome, by champions of privatization in Ukraine. It was especially gratifying to note that the academics creating the new management training programs had completed most of the pioneering intellectual work without any external assistance.

During Ukraine's privatization process, and (presumably) the post-privatization phase, continued support of management training programs is critical. Clearly, it will be very helpful to have a large number of trained managers to ensure that privatized firms become, and remain, profitable. Much work remains to be done to improve management training in Ukraine — and to make programs available to students and managers across Ukraine. It is my understanding that a recently announced US Agency for International Development program will assist in the development of management training programs in Ukraine — and thus provide the inventory of managers, at all levels, necessary to ensure continued business success. That is good news for Ukraine's businesses and for Ukraine.

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Under Reconstruc
An Asian Journal

Rob Wright, *IFC Corporate Relations Unit*

A great new financial challenge faces the world: **corporate restructuring** *in Asia.*

During the boom years, when it seemed private capital would keep pouring into Asia forever, local companies fueled their expansions by loading up with debt. It was often denominated in hard currency, unhedged and short-term in nature, and seemingly could always be rolled over in an environment of stable exchange rates. It all felt so good.

But then came disaster: the July 1997 devaluation of the Thai baht that spread exchange rate volatility like a contagious disease, eventually hitting even mighty Korea. Servicing all that dollar debt suddenly became a near impossibility for companies across the region, even the very best. Unemployment soared, banks became insolvent, and new sources of credit vanished. In a word, crisis.

Now that initial stabilization measures have been taken, the emphasis is on finding ways to bring Asia's troubled banks and companies back to life. Vast numbers of "workouts" must be concluded, involving debt-for-equity swaps, asset sales, injections of new equity from abroad, and management improvements.

Yet 18 months after the crisis began, there are still only a handful of completed transactions. Why?

Entrepreneurs in crisis countries have little experience with distress...key banks lack capital and fear collapse if they declare the extent of their losses...sellers and buyers can't agree on asset prices...lack of secure domestic property rights and well-defined bankruptcy procedures make it hard to settle creditors' claims, especially when dispersed among many parties. Still, lack of action is unacceptable. The longer the situation drags on, the harder it will be to resolve.

IFC has worked hard to find initial solutions in the past year and has even more work ahead. In Tokyo on November 16, US President Bill Clinton and Japanese Prime Minister Keizo Obuchi announced that IFC would join a major effort to "mobilize new private sector capital to help Asian companies rebuild their balance sheets and move forward quickly with restructuring so they can make new investments and grow again." The expected result: a privately managed, large-scale investment fund to offer new capital infusions for viable restructuring companies in countries such as Korea, Thailand, the Philippines, and Indonesia, with IFC's support playing an important role in enticing investors back to the region.

It's still early to generalize on success strategies, since conditions vary so much from country to country. But in the meantime, here's a glimpse at what's been happening on the front lines in three key battlegrounds: Korea, where the biggest action is; Thailand, where things are starting to happen; and Indonesia, a far more difficult situation...

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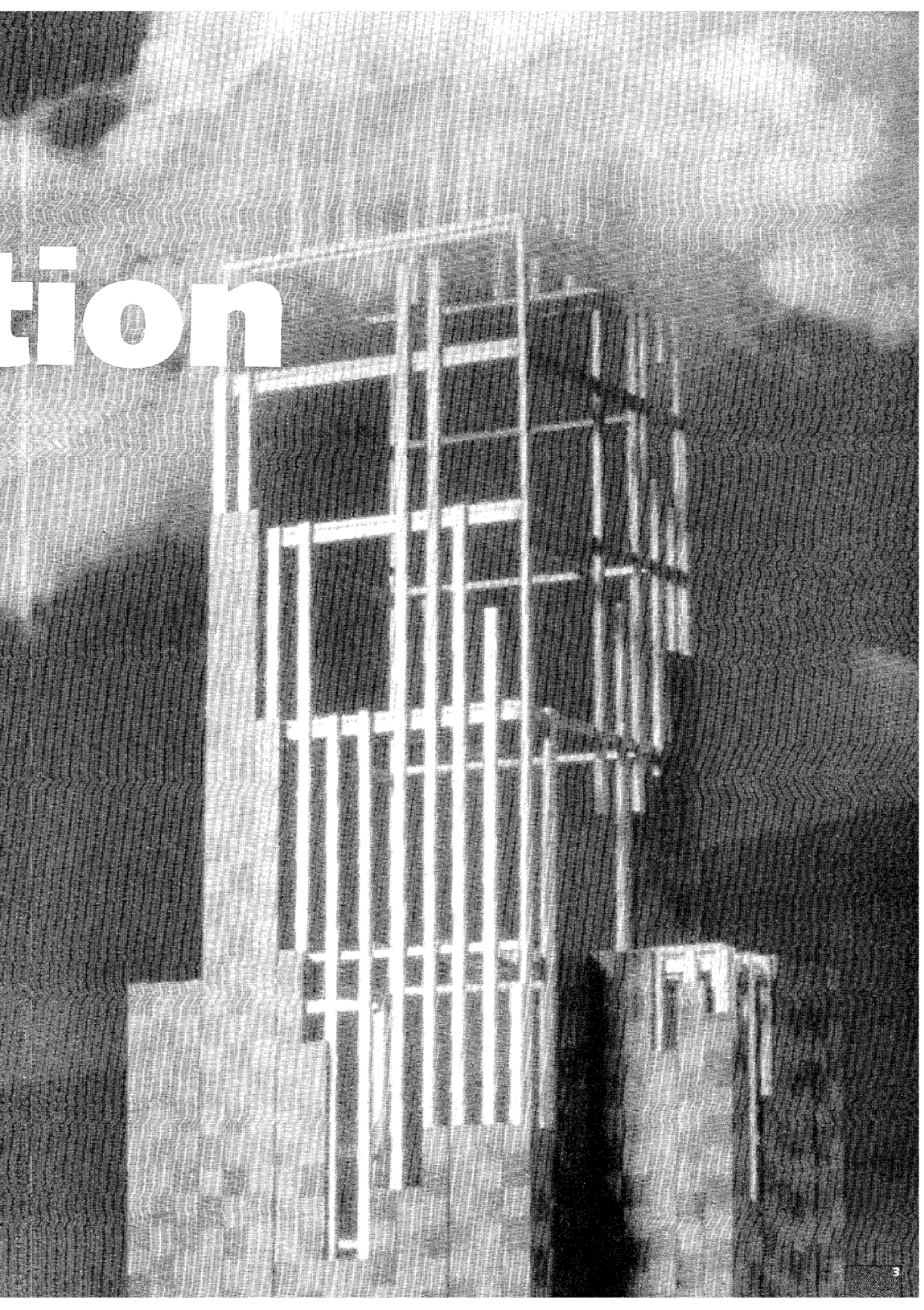


Korea

The Comeback Begins

Seoul

"The problem is not the conflict," the speaker says, "but whether the society concerned has the ability to absorb the conflict."

The speaker is Young-Soo Ahn. He is vice minister of labor in Korea, where consensus, not conflict, has long been king. He is addressing the investors attending the country's first "Summit on Private Equity Investment." One thing, at least, is clear to all present: Korea has taken its worst economic downturn in 45 years as a cue to enact monumental change, opening up its long-closed industries to foreign capital as never before. With domestic sources of capital all but dried up, local businesses from the biggest *chaebols* (industrial groups) on down have adopted a common survival strategy, putting unprecedented numbers of assets up for sale and seeking new joint venture partners from abroad. The vice minister understands that his listeners want to know how much control they will have over their work force. So he touts recent legislative moves easing the way for layoffs, in a culture with a militant trade union tradition and a belief in lifetime employment policies. As proof, he cites the summer's peaceful resolution of strikes at the country's largest automaker, Hyundai Motor Co., whose union accepted mass layoffs for the first time in history. With first-half car sales drastically down, Hyundai let roughly 10,000 workers go, in the process contributing to the year's tripling of unemployment. Times are undeniably tough. But "in the race to attract foreign private equity capital, Korea leads over all other Asian nations," reports Hong Kong's Asia-Pacific Private Equity Bulletin.

Local business leaders say the current openings mark the biggest transformation in Korea since the Yi Dynasty fell in 1910, beginning 35 years of Japanese rule. Despite many sore memories of that era, the country has industrialized since the 1960s on a largely Japanese model, embracing heavy state direction of the private economy and a highly protected local market while recording 30 ·

Thailand

Three Baht a Share

Bangkok

"Made in Thailand," say the brown paper cartons the workers at Semiconductor Ventures International (SVI) load and ship for export to Europe. Although the past 18 months have seen the worst economic downturn in Thailand's modern history, including a doubling of unemployment, these workers' jobs are safe. The thriving small business they work for has not only maintained operations at a consistent level throughout these hard times but recently received a major capital infusion from US high-tech investors as prestigious as any in the field.

That capital, however, could be raised only after SVI's existing management had successfully restructured a debt burden of $24 million in local currency equivalent — debt that would otherwise have killed the company.

SVI works in one of emerging Asia's foundation industries, outsourced electronics assembly. Its clients are European original-equipment manufacturers: Germans who make smart card readers, Danes who fabricate pay phone control boards, and others. Committed to adding value, SVI offers them several design options, then assembles the final choice of customized circuitry at costs far lower than if they did it themselves. ISO 9002 quality-assurance certification and technical relationships with Imperial College (London) and Mahanakorn University (Bangkok) boost the foreigners' considerable confidence in this Asian "total solution provider" that has been in business since 1985.

Today's undeniably positive atmosphere at the company is hard to believe since only two years ago it was on the brink of collapse, plundered by unscrupulous owners motivated solely by greed.

The problems began in early 1995, SVI Managing Director Peter Roskam recalls, when a manipulative Indian financier named Rakesh Saxena arranged for the now-defunct Bangkok Bank of

Indonesia

Many Rivers to Cross

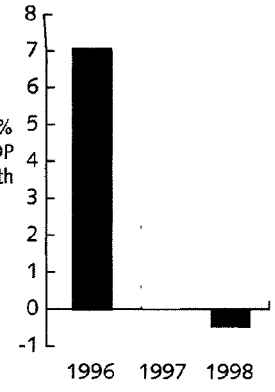
Jakarta

The luncheon takes place in an Indonesian sports arena. It's part of the same cavernous convention center where a minor White House sex scandal figure named Kathleen Willey once made an undeserved appearance as an "observer" with the US delegation to an international biodiversity conference. But this time the endangered species are neither fish nor fowl. They are the private companies of the world's fourth most populous country, companies whose inability to pay the roughly $80 billion they owe foreign banks has prompted record unemployment and is the largest component of a national debt/GDP ratio larger than Mexico had when it sparked the last great debt crisis in 1982. Nearly 80% of them are now basically broke. It is not an amusing situation. Nevertheless, the gallows humor begins.

Looking up into a vast array of empty seats, one foreign diner has a suggestion: "Tonight let's just sell tickets, fill up the stands, then let 'em run in from opposite sides and fight it out — Debtors vs. Creditors, just like the gladiators in ancient Rome." Remembering that 8,000 angry student protesters had been camped out in front of the parliament only a few days before, his lunch partner then recommends the postfight entertainment: a special screening of *The Year of Living Dangerously*.

Less than six months earlier, riots claimed more than 500 lives in this city, hastening the end of President Suharto's notoriously corrupt 32-year rule. More than 1,200 business people, including most of Indonesia's troubled companies and the bankers who gave them the nonperforming loans, have now gathered under World Bank auspices to seek a solution. The after-lunch speakers make it clear that this is no time for jest. A World Bank lawyer sets the mood by recalling his grim conversation with a local real estate tycoon a few months before.

Korea

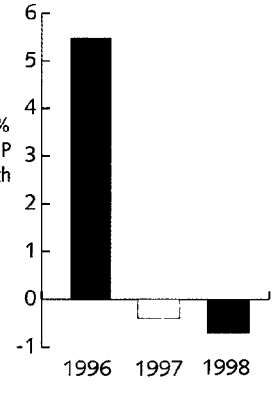


consecutive years of booming 8.2% annual growth. But ever since the crash of December 1997, when only a $57 billion IMF-led package could rescue the country from potential bankruptcy, the "Japan, Inc." approach that long seemed so successful has been questioned as never before.

"It was a big mistake," says Chong S. Lee, executive vice president and head of corporate restructuring at one of the largest chaebols, LG Group. "We should have modeled ourselves more on Western business, or at least a balance between East and West. Look at Japan today — Japan, Inc. is in trouble, and so is Korea, Inc."

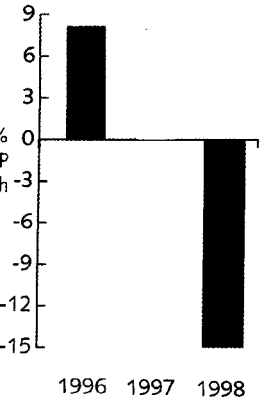
Last October his highly leveraged company

Thailand



Commerce (BBC) to lend $60 million to foreign investors seeking to buy the company. Leading the consortium: Saudi billionaire Adnan Khashoggi, the shadowy arms merchant whose complex dealings and CIA ties lay at the heart of the 1980s Iran-Contra scandal in Washington. Subject of a 1987 biography titled *The Richest Man in the World*, Khashoggi has led a legendary lifestyle centered on the 86-meter yacht named for his daughter, the *Nubila*, which he eventually sold to Donald Trump after it had appeared in the James Bond film *Never Say Never Again*. One look at this apparent new boss was enough for Roskam, a frugal Dutchman in his sixties who has devoted a decade of his life to SVI. "Our first meeting was at the Ritz in Paris," he quipped ruefully. "He

Indonesia



"As he began talking to me, he started to cry," the official says. "He said, 'What I've learned in the last 40 years is how to be rich, and now I no longer know how to be poor. I've always borrowed whenever and wherever the rates were best and directed the funds to whichever of my various companies seemed to need it at the time, and now I don't even know how to account for it all — but there's a lot of it. The very same sense that made me a wealthy man in the first place has now completely eluded me.' And as I talked to him, the image that came to me was that of a rabbit sitting in the middle of the highway with its ears up and its eyes bright, just waiting to be run over."

Corporate Restructuring 101

When business people hear a company is undergoing a **restructuring**, they know right away it is in grim financial shape. It has either defaulted on some of its outstanding debt or is about to, and needs major changes to survive.

More often than not, there have been warning signs that the firm's owners ignored for too long: high indebtedness, declining sales, debt arrears, or a worsening local economic context. Rather than take all the painful steps necessary, at this point they often merely seek **debt rescheduling**. Their lenders (usually banks, but sometimes also bondholders) then usually form a **creditors committee** and consider various unpleasant options in hope of recovering some or all of the money they lent. The more the debt and the more the creditors, the more complicated the process is, since conflicting and competing motivations often get in the way.

Reschedulings, though, are not the same as restructurings, the full-scale revamps that save troubled companies. The latter usually result from the pressure of one or more lenders acting under a fair **burden-sharing** principle. In Asia there are several unresolved negotiations currently underway where more than $1 billion of corporate debt is at stake.

The easiest option for creditors often is to **extend maturities**, giving the company more time to pay. But at the same time — or instead, if that's not enough — creditors can try a **debt-equity swap**, converting their unpaid debt into shares. This move usually brings them no immediate cash gain but offers hope of selling the new shares at a profit later if the company recovers, as frequently occurred in Latin America in the early 1990s. The least-favored alternative is to take a **"haircut,"** writing off some interest or even principal forever so the company can at least make some reduced payments. Lenders don't like that, though. It requires **provisioning**, or using some of their equity to cover expected loan losses. It's bad for their profitability, and if too much of it occurs without new equity being raised, the banks themselves can go bankrupt.

If after considering all these steps the parties cannot reach a deal, the company can choose, or be forced by its creditors, to go into **bankruptcy**. But it can occur only if there's a local tradition of that complex legal process that puts matters in the hands of an independent overseer and often leads to a worse outcome for both sides than one they could have negotiated themselves. Bankruptcy is just now being introduced in parts of developing Asia. But it's important. The lack of its threat has enabled some near-broke companies to stay in business while blithely ignoring their creditors' demands for restructuring talks.

The first step to a successful deal is reaching a viable **standstill agreement**. Here the lenders, despite their different repayment schedules, agree among themselves to temporarily stop trying to collect on unpaid loans. The company also vows not to do anything major affecting its financial health, such as **asset sales** to raise cash. After that, the goal is to move on to a **workout**, overhauling the firm's operations, management, and sales in order to get on with things. If done well, near-dead companies can then sometimes pay off their debts and come back to life, especially if they raise **new equity** from an outside investor attracted by the chance for a good **turnaround** opportunity cheap. The cost of raising new equity, though, is often **dilution** of the existing owners' stake and ouster of the old boss. Credit Lyonnais Securities Asia estimates that Asian companies will need **$200 billion** of new equity to recover. And since so little is available locally at this point, most of it must come from foreign investors.

— Rob Wright

KOREA

The Company: Shinmoorim Paper
The Industry: Paper
The Deal: Restructured with a $48 million IFC-led investment package providing new equity and replacing costly short-term local currency debt; allows competitive mid-size company to maintain operations and continue expansion started before economic crisis

sold 23.5% of its Personal Communications Services (PCS) business to British Telecom for $400 million. Such a move would never have happened a year ago but is now an "absolute survival issue," Lee says, since "in today's environment, there's no way you can compete globally with just your own resources, and our first priority is looking for reliable partners to enhance our general competitive strengths."

He articulates the new watchwords in Korea's business world: competitiveness, focus, shareholder value, and corporate governance. Many firms realize, he says, that their confusing cross-guaranteed loans and less than transparent financial statements contributed heavily to the collapse and must be phased out to attract world-class investors. "Building transparency is the most important thing that can be done in our economic reform," adds Byung-Woong Lee, a counterpart at the powerful Federation of Korean Industry.

After not being needed in Korea for a decade, IFC has thought long and hard in the past year about how it can best support the country's recovery. The emphasis has been on choosing model transactions whose effects can ripple far beyond the mere money invested. So far three transactions stand out: one of the first recapitalizations of a viable local bank, support for an investment fund targeting restructurings, and direct investment in a midsize corporate turnaround.

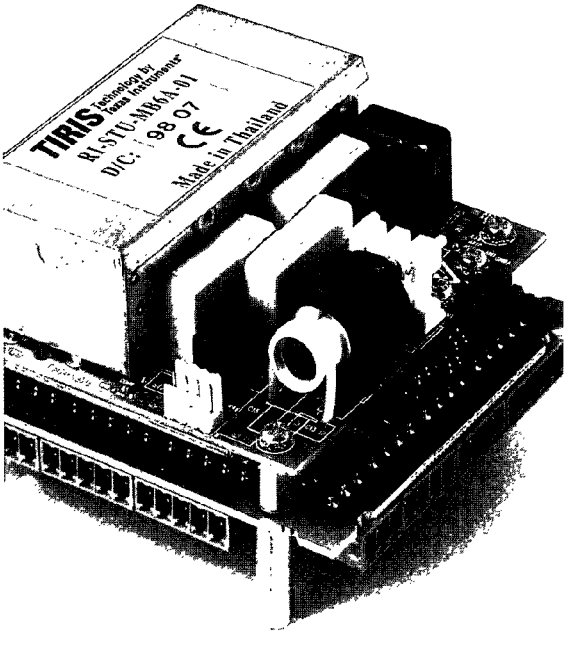
Last June IFC took a $22.8 million equity stake in Hana Bank, a midsize local financial institution that Warburg Dillon Read analyst Yong-Chul Yoon calls the "best-run bank in Korea." It was first set up under

THAILAND

The Company: Semiconductor Ventures International
The Industry: Electronics
The Deal: Comprehensive workout based on extension of maturities and potential for debt-equity swaps; prestigious new investors attracted by low purchase price, strong management, and potential for capital gain

offered me a cognac that was five years older than I was. I don't know what it cost — probably at least my entire salary."

Enforceability of the assets Khashoggi put up as security for the BBC loan did not deter Saxena, who had climbed high in the Bangkok financial world since his arrival in 1985 as a Cambridge-educated unknown. After marrying the daughter of a local logging baron and becoming a financial columnist for the *Bangkok Post*, he built on his fast-talking ways and undeniable mastery of the markets to begin advising BBC on a rash of high-risk corporate takeovers. They made him a wealthy man, so much so that he reportedly once bought his own corporate jet outright with cash. "He played it like a piano," Roskam said.



In High Demand: *SVI's Thai-made semiconductors.*

The Company: BBL Dharmala Finance
The Industry: Financial Services
The Deal: Standstill agreement with creditors reached with IFC help Nov. 6, 1998, believed to be first of its kind in Indonesia

Roadkill seems an apt comparison, for in one horrific nine-month period, rupiah-dollar exchange rates plunged from 2,400:1 to 16,000:1. Although they have since improved, the descent dealt a near-fatal blow to the local legions who had borrowed heavily in dollars from euphoric foreign lenders. By official estimates Indonesia's corporate debt stock is $67 billion, although press reports have put the number at $130 billion. But whatever the case, it has brought on one of the century's most frightening economic crises.

After 30 virtually uninterrupted years of rapid growth, the economy is in the midst of a 15% contraction, seeing the local stock market drop by 85%, along with skyrocketing inflation, joblessness, and capital outflows. Sovereign debt rated investment grade in October 1997 now carries a scary CCC+ from Standard & Poor's. "No country in recent history, let alone one the size of Indonesia, has ever suffered such a dramatic reversal of fortune," a World Bank report says. It warns that a country that had cut poverty from 50% to 10% of the population since 1970 may now see it double again in a few short years.

Making matters worse is the fact that, in Indonesia as opposed to Korea and Thailand, virtually no corporate restructurings occurred in the first year of the crisis. With no history of bankruptcy law, creditors had no leverage over debtors, who were free to sit on mountains of unpaid debt so long as they could keep enough cash flowing to stay in business at some level. Reports of fraud were widespread. There was also no

In Good Shape: *Shinmoorim Paper Company's restructuring points the way for others in Korea.*

a different name in 1971 with 40% foreign owners, including IFC, Bankers Trust, and Goldman Sachs, and has operated ever since as a small island of international standards in a financial sector that tried, and failed, to ignore them. In mid-1997, when virtually no one saw the coming crisis, Hana declined to join its peers in lending to number-three automaker Kia Motors – later the country's most celebrated bankruptcy with the local currency equivalent of $9.3 billion in unpaid debts. In a country where nonperforming loans are at least 15%

Saxena saw to it that Khashoggi's group got the loan from his friends at the bank, who showed no more concern for credit analysis than many others of their peers at the time in Thailand's freewheeling financial system. Fun while it lasted perhaps, but the day of reckoning finally came in 1996, upon Roskam's discovery that Khashoggi's group had never actually made a promised $10 million equity investment used to secure loans for new equipment purchases.

At the time, SVI was carrying a heavy short-term baht debt burden at 18% interest. Like so many others in Southeast Asia, it assumed this debt could be rolled over almost indefinitely. Not so, though, when the Thai authorities closed down BBC and Saxena fled the country the next day. He was blamed for provoking approximately $3 billion in cumulative BBC losses by arranging fraudulent loans to SVI and 21 other local companies in which he reportedly had hidden interests. It was the biggest financial scandal in Thai history, and Saxena was soon being compared to Nick Leeson, the rogue trader in Singapore whose $1.3 billion in hidden trading losses the year before had brought down Britain's oldest merchant bank, Barings.

With the phantom investors now gone for good and the loans in default, the Stock Exchange of Thailand suspended trading of shares in SVI, a company now with huge debts, no equity, and no owners — yet with strong operating fundamentals and holdover management. It could survive only by finding new investors, and they would have to be technology specialists with a strong appetite for risk. So in November 1996 Roskam turned to H&Q Asia Pacific (H&QAP). An IFC client in other Asian countries, it is the $700 million autonomous regional venture capital arm of San Francisco investment bank Hambrecht & Quist, renowned for its role in arranging financing for the global knowledge economy's nerve center, Silicon Valley.

H&QAP had the right profile. It had been in Bangkok since 1990, liked turnarounds at the right price, and had money to invest from a

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regulatory basis for debt-equity swaps — one of the keys to the end of the 1980s Latin American debt crisis. In any case, these were often seen locally as a ruthless attempt by foreigners to seize control of long-established companies at fire-sale prices. As the squabbling dragged on, any hope of renewing the private capital flows on which the economy had so long depended grew more and more remote. It was a lose-lose situation, resulting in unemployment that fueled the rise in social tensions.

Realizing that there was no time to waste, IFC worked at a feverish pace with its Indonesian clients throughout 1998 to produce an initial corporate restructuring that could serve as a model for others to follow. A vital breakthrough finally occurred on November 6 when, after eight months of IFC-led negotiations, a midsize nonbank financial institution, BBL Dharmala Finance (BDF), reached a landmark "standstill agreement" that will allow it to stay in business and honor its debts.

Agreements of this kind are considered fundamental to the corporate restructuring process in developed countries, enabling a troubled debtor company to pledge not to sell assets or take other major actions affecting its finances in return for its creditors' vow not to force it into bankruptcy or liquidation. Without such a pact, there can be little hope of orderly recovery acceptable to everyone involved; with one, companies that once appeared almost dead can sometimes be successfully revived.

BDF is a publicly traded company whose primary business is leasing heavy equipment to small and medium enterprises. It was formed in 1982 as a joint venture between Thailand's largest bank, Bangkok Bank, and the financial services arm of a vast Indonesian conglomerate, Dharmala Group. Its most recent annual report showed a leasing portfolio worth Rp 404.6 billion (approximately $170 million at the time), with branches in 11 major Indonesian cities and steady profitability between 1993 and 1996. But the unforeseeable economic

of the average bank's portfolio, Hana's are less than 4%. Its return on its roughly $1 billion equity is likewise a healthy 7.4%.

"Our bank is a little bit different," says Hana Bank CEO Byung Chul Yoon. "Our lending was always based on credit quality and cash flow when everyone else made their decisions based on collateral. Our corporate governance system was also always completely different, with independent directors who are solely accountable to shareholders. The reason we're sound today is that we've stuck with our principles, which originally came from IFC."

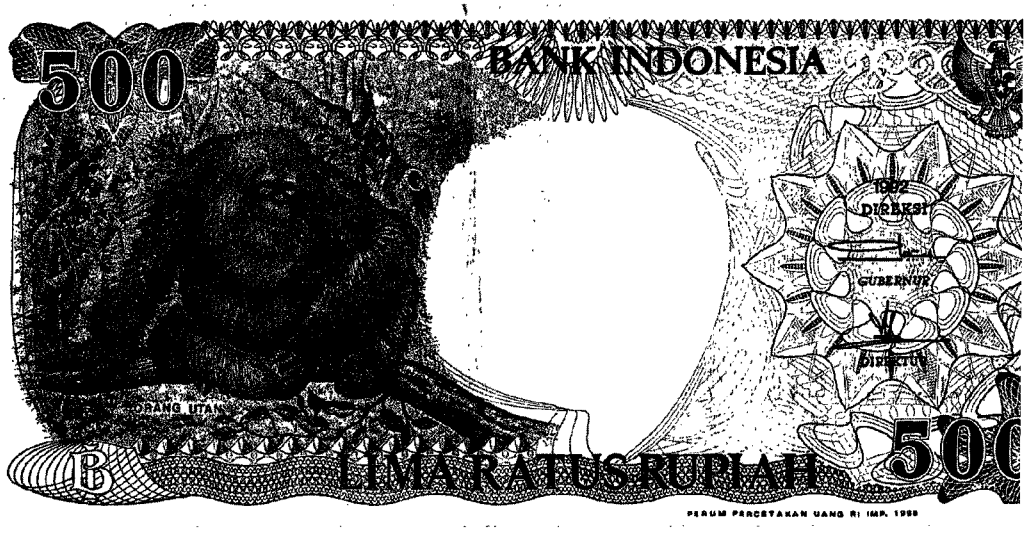
The new IFC investment in Hana has so far had its desired effect: rebuilding confidence in Korea and its financial institutions. Only a month after approval of the investment, the government chose Hana as the merger partner for an insolvent provincial institution, Chungchong Bank, one of the five banks it had to close as part of the IMF package. The authorities first transferred Chungchong's bad loans into the new governmental bailout agency Korean Asset Management Co. and gave Hana an equity infusion so the good loans it assumed would not dilute its equity. In addition to setting an early precedent in the country's financial sector restructuring, the transaction enabled Hana to enter a potentially lucrative new retail market. It carried no cash cost, merely the assumption of Chungchong's liabilities.

On September 7 Hana then acted on its own to buy another troubled local institution, Boram Bank, thus becoming Korea's seventh-largest bank. It has since passed the all-important market test:

well-performing $278 million regional venture fund backed by US bluechips like New York Life, Metropolitan Life, Eli Lilly, and others. But it didn't like sleeping in unmade beds. Before it would consider a buyout, the firm demanded that SVI completely resolve its crippling debt overhang. And there was leverage to do so, since the lack of true bankruptcy laws in Thailand meant creditors could not force action on the company. Once the July 1997 baht devaluation sent shockwaves through the system, the local banks saw they could only hope to recover anything if H&QAP came in and kept SVI from closing shop. By the end of that year they agreed to forgive all interest, stretched maturities of the principal out to eight years, and took an option to connect some of the debt to up to 10% equity in SVI down the road. "It was the name of Hambrecht & Quist that allowed me to get the restructuring deal done with my creditors," Roskam said.

Attracted by the success of the workout and SVI's willingness to write off all preacquisition losses, the reputable new investors then acquired 95% of the firm for only $1.2 million, in April 1998. They paid the company's temporary trustees at the Thai central bank but 3 baht (less than 10 US cents) a share, while making a simultaneous commitment to invest another $6 million along the way to rebuild the company.

When last heard from, Saxena was in Canada fighting extradition, and Khashoggi was said to be involved in a great game of oil and



collapse put it under extreme duress, even though it had been well managed and had maintained conservative debt-equity ratios of roughly 3:1. The exchange rate spike and worsening client repayment record quickly threatened its ability to service its $140 million of dollar-denominated debts, including $50 million owed to IFC and its participant commercial banks, $40 million to Dutch development finance company FMO, $20 million to the London-based Commonwealth Development Corp., and others. But having worked closely with BDF since 1993, IFC took the lead in coordinating the combined creditors once the crisis began on options for restructuring the company's debt and eventually developed a strategy for survival that enabled it to stay current on interest payments to all creditors.

Although BDF's standstill is only the first step in an ongoing corporate restructuring process expected to continue for several more months, both the firm and its combined lenders now believe the prospects of the company are good. Although the deal would be considered routine in the US or Europe, it is believed to be the first of its kind in Indonesia, which had no true bankruptcy laws until last August and little tradition of either protecting shareholder rights or enforcing creditors' security arrangements. And while relatively small, the agreement makes an important contribution by being first to the table. The country's largest companies have yet to do anything of the kind.

becoming the first Korean bank since the crisis to get commercial funds by securing a $50 million three-year loan from an international syndicate led by Standard Chartered. This money will in turn complement an upcoming $100 million seven-year loan that IFC is assembling, with the overall package doing its part to ease the country's credit crunch and restart private sector growth.

But working through local banks is only one way to help Korea's corporate restructuring process. Knowing that companies abound that must rebalance their books by raising new international capital, IFC last year contacted Hambrecht & Quist Asia Pacific about the possibility of starting a new venture capital fund targeting small and mid-size Korean companies. H&QAP was an ideal partner, with a track record of 13 funds in the East Asia-Pacific region and a successful history of working with IFC in the Philippines. While the deals will clearly be difficult to structure, the new opportunities for previously unthinkable controlling positions astound fund manager Ta-Lin Hsu. He recently tapped other resources to buy one of the top retail brokerages, Ssangyong Securities. Once worth $1.2 billion, his fund bought it for only $120 million. "I've never seen anything like this in 30 years," exults the usually low-key Hsu.

The big turnaround deals are important. But so are the small ones, which are less likely to draw the attention of major foreign investors. For that reason IFC has put together a $48 million package for Korea's largest manufacturer of the coated paper used in catalogues and magazines, Shinmoorim Paper. As a precondition, the family-

(continued on page 29)

politics in the volatile Caspian Sea region. SVI has nothing to show for its involvement with Saxena and Khashoggi and has spent the past three years rebuilding the good name they tarnished. But with the debt burden resolved, it has recovered from their misdeeds and is back in good health today, showing monthly profits again for the first time in three years and reporting annual revenues of $17 million. For unlike the previous owners, H&QAP brings not only capital but also extensive industrial expertise and strategic guidance as a way to increase the value of its investment targets. It is currently recruiting new marketing personnel to help the company diversify into the US market, a move it projects will soon enable SVI's sales to jump to $100 million and make it an attractive property for sale in a few years.

Such explosive growth is always possible in the technology sector, H&QAP Chairman Ta-Lin Hsu has learned after 13 years of investing and a previous career at IBM. In 1997 his same fund also bought out Hewlett-Packard's 50% interest in a money-losing company that manufactures computer disk drive components in China and then made a few changes and watched its revenues climb from $25 million to $175 million within two years.

"There's no reason SVI can't do the same," Hsu said. "No reason at all. Once they get into the market, there's as much work waiting for them in the US as they want to take on." ■

Going Ape:
Corporate restructuring in Indonesia? It's a jungle out there.

In October, for example, Indonesia's biggest automaker PT Astra International told its creditors with full transparency that it had declared a unilateral 90-day debt service moratorium, immediately ceasing payments on $1.4 billion in outstanding interest. A month before, in the absence of a standstill agreement, it had moved on its own to sell its "noncore" microchip assembly plant near Singapore to the US investment fund Newbridge Asia for $90 million. It was the first major asset sale in Indonesia since the crisis and a sign to Astra's new president, Rini Soewandi, that under the right conditions "foreign investors want to come to Indonesia." But it still raised only a tiny portion of the money needed to pay off the parent company's enormous debts. And country specialists see few bluechips like Astra that have the wherewithal to make such transactions happen, leaving a clear role for IFC to play as a neutral party able to help the many smaller companies that do not.

Astra had been one of few local big companies to stay current on its debt until this fall despite the death of demand for its cars. Many others had enraged creditors by taking advantage of the lack of tradition of bankruptcy laws to simply stop payment and go incommunicado. For this reason, IFC felt compelled to present one of the first test cases to the new bankruptcy courts that were created in August as part of Indonesia's comprehensive IMF agreement. The new system aims to hold recalcitrant debtors accountable, calling for tight 30-day deadlines for court rulings, and introduces 45 new internationally trained judges as well as independent receivers for liquidation. But it will be only as good as its track record in a country with no tradition of an independent judiciary. Regrettably, the initial results leave investors disappointed.

After exhausting all attempts to reach an agreement with another Dharmala Group unit, integrated poultry producer PT Dharmala Agrifood, IFC and its colenders ING Bank and Bank Niaga took the company to the new court over more than $35 million in unpaid loans. But in December the court denied the bankruptcy ruling that IFC and the other petitioners had sought, leaving no verdict on whether the system can work as planned under such difficult conditions.

"There's an old saying, 'Capitalism without bankruptcy is like Christianity without the devil — it just doesn't work,'" says Tim Ferdinand, an astute watcher of the corporate restructuring process at Credit Lyonnais Securities Asia in Hong Kong. "I don't know who said it, probably some economist, but it's true. Without a threat to make you behave, you won't behave. If your creditors won't force

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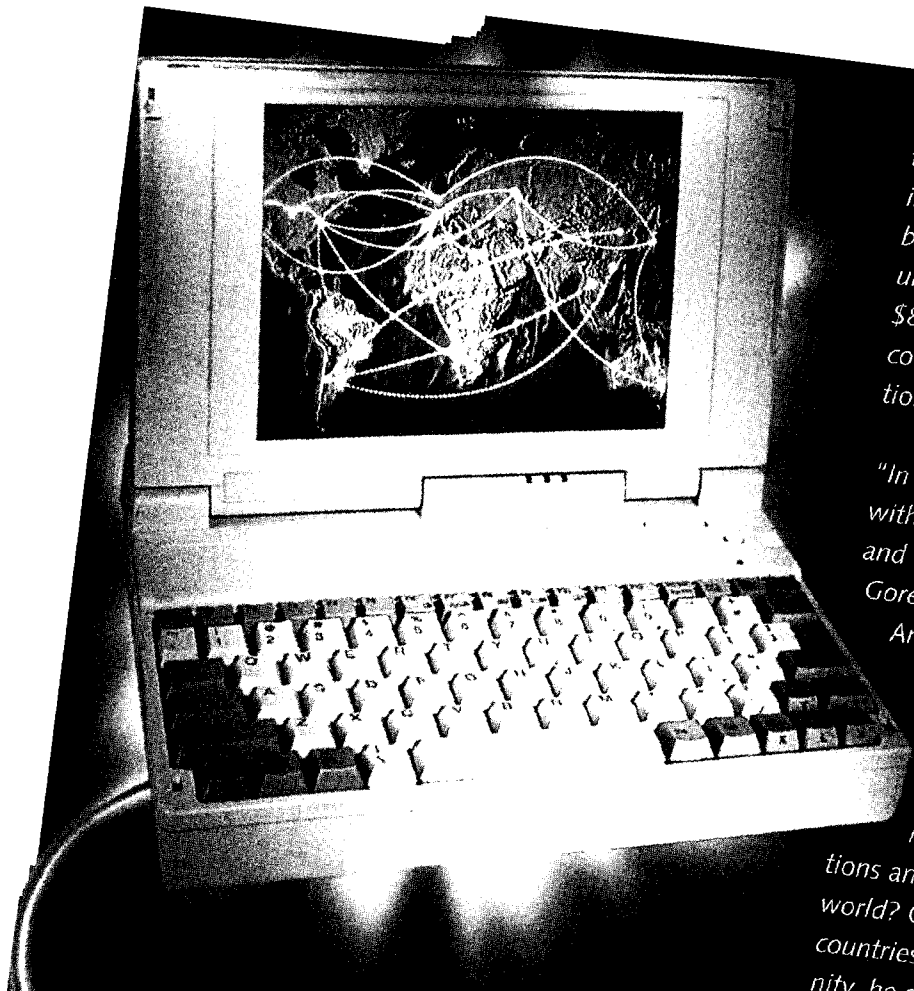


The Net E on the Natio

Charles J. Doyle, Glover T. Ferguson, and Hugh F. Morris,
Andersen Consulting

"A quantum shift in commerce and the human condi-
tion." That's what US Vice President Al Gore calls the
coming of Internet-based business. 1998 was the year
this electronic commerce, (eCommerce) took off, link-
ing products and markets with a 24-hour ease never
before imagined. The industry estimates that the vol-
ume of global transactions on the Web climbed from
$8 billion to $80 billion in the past year, and by 2003
could reach $3.4 trillion, changing traditional distribu-
tion channels forever.

"In this emerging digital marketplace, nearly anyone
with a good idea and a little software can set up shop
and become the corner store for the entire planet,"
Gore told a White House eCommerce forum this fall.
Anyone, he said, like the Peruvian village that quin-
tupled its income by partnering on-line with an
exporter who shipped its vegetables for sale in
New York.

Mere hype, given the high costs of Net connec-
tions and Web page start-ups in the developing
world? Gore doesn't think so. If enough
countries capitalize on this opportu-
nity, he said, "by the year
2010 we can triple the
number of people who
can support their families."

Can we? Will we? The
challenge is formidable...

The Electronic Economy Will Force Change within Nation States.

The modern nation state remains the most prevalent unit of governance in the developed and the developing world. The concept has, in the last 50 years, been extended rather than retracted. There are now more than 200 hugely different nation states, with different legal and regulatory systems, existing in the world. In this context, we define a nation state as a coherent territory circumscribed by defined borders over which the single national government has legitimate jurisdiction. During its 200-year history, the nation state has endured many changes. However, the advent of the electronic economy is confronting the nation state, with intimations of a future in which its relevance to its citizens and enterprises will be challenged.

The apparatus of economic regulation and taxation through which nation states operate was developed to support and facilitate an industrial economy. That economy produces tangible goods and location-bound services that are sold and distributed within and between fixed borders. In that familiar world of national and international trade, nation states have a variety of tools at their disposal to achieve their economic ends: They can levy tariffs on imports, raise taxes, protect consumers' rights, punish economic criminals, set commercial standards, and provide guarantees of monetary payment. Until recently, these tools were supported by governments' majority control over communications networks and information dissemination.

Because of the emergence of global communications networks, the nation state is gradually losing monopoly control of information and financial flows. Private individuals and enterprises and groups now have the ability to source, package, and transmit information in compressed time and space. Through "digitization," currency, services, and even some goods can be conveyed immediately, transacted invisibly across the globe. Interactive networks are creating a new, network-linked world without borders, in which many commercial transactions are beyond the reach of national jurisdictions, laws, and taxation systems. As a result, many of the economic instruments and processes of the nation state need to be reexamined in the light of these new challenges.

Is the nation state powerless before this new global economic system? As electronic commerce grows, there is some risk that those nation states that have not fully embraced the changes could become marginal to the creation of economic value and irrelevant to their citizens and enterprises. Is the nation state threatened by the electronic economy? Could the changes erode the individual's sense of national belonging, undermine tax bases, bypass national laws and undermine the rights of citizens?

What Is eCommerce?

eEnterprises conduct **eCommerce** in the **eEconomy**. New forms of capital — primarily the information and knowledge created through the flow of value through the global electronic network — are driving fundamental economic transformation.

An eEnterprise is an enterprise prepared to conduct commerce in this new economy. This means it has created and embraced a business strategy informed by changing economics, new opportunities, and new threats. It has laid down the necessary technology infrastructure to support new business processes. It has used information technology to hone internal processes such as human resources, work flow management, and training.

Thus prepared, the enterprise is able to conduct eCommerce: "the commercial exchange of value (money, goods, services, or information) between an enterprise and an external entity (an upstream supplier, a partner, or a down-stream customer) over a universal, ubiquitous electronic medium."

To conduct eCommerce, enterprises must achieve a new level of openness, connectivity, and integration. Few executives set out to buy eCommerce. Instead, most are seeking the kind of new results, strategies, business processes, and organizations that eCommerce capabilities enable. Likewise, no business will realize these goals by simply acquiring new technology capability.

Creating value through eCommerce also entails:

- Opening the enterprise to encompass partners, suppliers, and customers.
- Connecting the new, expanded enterprise through a universal electronic medium.
- Aligning and integrating technology, strategic intent, processes, and human performance.

In other words, most commerce will soon be eCommerce. At current projections, the electronic economy will overtake the industrial economy by the year 2003. Several factors are responsible for this phenomenon; each factor reinforces the above three:

- The technology infrastructure is in place and expanding. Consumers are increasingly open to conducting business electronically.
- The regulatory environment has become cooperative and encouraging.
- The business value is compelling.
- eCommerce is a pervasive, global force.
- Electronic commerce transcends geographic boundaries, cultural biases, and political differences.
- eCommerce is an inevitable, irresistible force.

— *Andersen Consulting*

Scenarios

In answer to these questions, there is a "dark side" scenario, which foresees an unregulated, electronic economy promoting a wild and lawless frontier where electronic crime is rife, government regulation of markets is inconsequential, intellectual property rights are disregarded, and consumers are left without effective protection. In this scenario, the nation state is dead.

But there is also a "bright side" scenario, which foresees vast opportunities for wealth and job creation, individual learning, and international cooperation. Legislators and regulators who seek the benefits of this optimistic scenario need to develop appropriate policies and invest resources in their implementation. In this scenario, the nation state adds value.

Despite the undoubted challenges that the nation state will face in navigating toward the future, we would argue that it has a central role to play in the technological revolution that is transforming the world economy. Indeed, many nation states have formulated strategies and concrete policies to embrace and to exploit the potential of the electronic economy. They (often in concert with other nation states or multiple groupings) have assumed that the advent of the electronic economy is inevitable, and are starting to develop the means, tools, and frameworks to exploit it for the benefit of their citizens.

Nation states have a responsibility for assuring a balance of peace, prosperity, and liberty for their citizens. If they are to continue to meet these time-honored obligations in the next century, they cannot afford to be bystanders at the birth of the electronic economy. They need to find ways, as many are, to exert some degree of productive influence that underwrites and supports the electronic economy. Failure to do so will impair economic growth and, in the historic sense, their "national interests." For example, if their consumers and enterprises are unable to trust interactive commercial networks, which will continue to offer them a bewildering array of complex choices, they will be loath to use them, and their full potential will remain unfulfilled.

No nation state has either the means or the jurisdictional rights to regulate fully the complex global nexus of commercial transactions. Each nation has different laws governing taxation, electronic commerce, privacy, consumer and individual citizen protection, crime, and intellectual property. Each has numerous regulatory and enforcement authorities. Each has different cultural perspectives and interests. If each nation state attempted to impose its own unilateral frameworks, the result would either be electronic balkanization or, more likely, a migration of business toward those nations with the weakest regulatory regimes. Flight of digital enterprises and services from one nation to another can be immediate and undetectable.

As interactive networks have a global presence, they require a global, rather than a national, response. Workable regulatory systems can only be imposed through a multilateral framework of appropriate laws and enforcement structures. These laws should have provisions for international dispute resolution as well as regulatory enforcement. We believe that this would provide a balanced regime

within which electronic trade, commerce, education, and creative communities could flourish without harming the consumer of digital services.

Historical precedent, however, does not inspire great optimism. Nation states have enjoyed only limited success at creating global treaties and frameworks that are universally applied in practice. Moreover, multinational treaties and accords are notoriously slow to negotiate and complete. Given the pace of current technological change, it is possible that such a regulatory framework would forever limp behind economic reality.

Approaches

The least workable approach would be to impose unreformed national laws and regulatory protection in defense of national economic interests. Inevitably, this would provoke constant litigation between nation states, the cost of which would be a heavy burden on enterprises and consumers.

The most practical approach, perhaps, would be for nation states to adapt national legal and regulatory regimes on an ad hoc basis to meet the new challenges as they arise, constantly negotiating with other nation states through the multiple international bodies and frameworks that already have an interest in these matters. This would be a practical approach and would encourage cooperation among nation states. Rather than creating a whole new generation of laws, it would also facilitate the sharing and adoption of best practices.

However, this approach, while superficially attractive, does not create arbitration and dispute resolution mechanisms with global legitimacy, nor does it provide a framework for dealing with law enforcement across multiple jurisdictions. The fundamental problem of legal incompatibility between nations could remain, and transnational cooperation easily could be undermined by nations choosing to opt out.

While a few nation states have started to address these large choices in terms of legality, regulation, autonomy, and authority, very real problems are now proliferating. They reach deep into every aspect of economic life, and their resolution must become a priority for all nation states if the full benefits of the electronic economy are to be realized.

Tariffs and taxes are an area of disjunction and complexity. In cyberspace there are no customs posts or tax-collecting services. On the surface, it would seem reasonable for nation states to attempt to regulate and tax trade flows over interactive networks in an effort to stanch the loss of receipts from digitized goods and services.

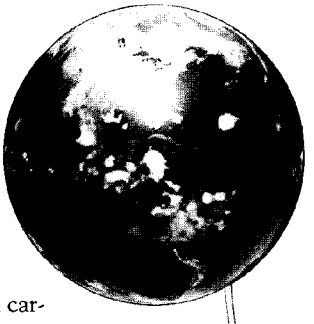
However, the problems of tax and tariff collection in cyberspace are legion and growing, given the difficulty of identifying the exact geographic location at which value has been added or a transaction conducted. To appreciate the scale of the problem, one only has to consider the case of a commercial Web site whose owner is registered in one country, whose server is physically located in a second country, and whose customer transactions are conducted in a third. Current commercial laws are useless in the face of such a multidimensional scenario.

Completely New

While nation states have had to contend with offshore-registered corporations with myriad national representatives for decades, never before have they had to address companies being able to separate and "digitize" the various components of a product or means of payment, or try to trace a product's transmission down multiple digital lines and its reassembly in a single location (as they will be able to do when selling, for instance, digitized music or artistic works).

In creating an international framework to address the issue of taxes and tariffs on eCommerce, national governments should adopt a positive position that focuses on the commercial benefits that accrue from mass use of interactive networks, rather than showing undue concern for potential losses within the traditional economic model.

Some advocates of laissez faire would go further, urging nation states to declare by treaty that the Internet is a completely tariff-free environment for the buying and selling of all goods and services that can be delivered digitally. This, however, fails to meet the criterion of fairness. Citizens may well ask why those who trade digitally operate tax-free, while those who trade physically bear the nation state's fiscal burden.



Whether nation states choose intervention or laissez faire, the inescapable reality is that workable tax systems appropriate to electronic trade can only be imposed through a negotiated, multilateral framework of laws and regulation.

The lack of such a multilateral framework carries significant risks for individual security and intellectual property. These dangers could undermine one of the nation state's most fundamental guarantees: the protection of its citizens and their property.

Ten Ways Nation States Can Participate in the Electronic Economy

1. Educate government officials, top civil servants, and voters on the nature of the electronic economy.
2. Cooperate internationally to regulate consumer protection and develop a priority list of network crimes and agreed punishments.
3. Invest or encourage investment in the physical infrastructure of the electronic economy, such as interactive networks and terminal access equipment.
4. Equip citizens with the means to log on to the global network of wealth, information, and power, recognizing that there will be a direct relationship between network access and the wealth of nations.
5. Replace the measures and statistics of the industrial economy with the measures and statistics of the electronic economy. Official statistics, which form the basis of trade negotiations, are derived from an outdated data collection model.
6. Provide individual consumer and citizen access to information networks as a right rather than a privilege.
7. Appoint a chief public information officer empowered to act as a champion of public information used to support consumers' and citizens' rights.
8. Use electronic tools to support government processes such as social pro-vision, education services, and public procurement.
9. Develop inward investment programs to attract and develop knowledge industries based on electronic networks. Make location-bound resources (connectivity, network infrastructure, taxation regime, price of bandwidth, education and information services, etc.) attractive to these enterprises.
10. Intervene directly to guarantee and regulate the digital exchange of money.

— *Charles J. Doyle, Glover T. Ferguson, and Hugh F. Morris, Andersen Consulting*

Currently, there is no internationally agreed framework for the detection and prosecution of crime facilitated by computers and interactive networks. Nor are there any mechanisms for the creation of internationally agreed standards and guarantees about the security of financial payment systems operating over digital networks. In the absence of such standards and guarantees backed by national governments, the growth of digital networks is likely to be inhibited by consumer anxiety. The absence of any effective internationally agreed protection of intellectual property rights, trademarks, and consumer rights represents a further barrier to development.

Nation states can indeed prosper in the interactive age, as we have already seen, if they have the foresight and courage to change. We should remember that it was the nation state that brought the enabling networks of the electronic economy (global telecommunications networks and the Internet) into being. Just as many businesses have had to transform their operations in order to survive and prosper in global markets, so also must nation states undergo a process of reinvention.

In a global, increasingly electronic, economy, the stakes are high. Groups of nation states that successfully evolve international laws and regulations appropriate to the electronic economy will realize large economic returns and other benefits for their citizens. Those nation states that opt for more short-term or shortsighted approaches will be treated like an outage in the Internet: Economic activity will find an alternative route around them, or worse, relegate them perpetually to the margins. The starting point for nation states must be education. Within every government, there are those with the vision to see that the future world will be interconnected, digital, and borderless. Work can start with them on evolving and aligning the nation states' processes and instruments with the new economic reality, while developing that which is enduring and valuable from the nation state's historic legacy.

Above all else, the challenges of eCommerce will require nation states to cooperate more closely and more creatively than ever before. In pursuit of gains in which all could share, the loss of economic autonomy is inevitable. The risk is increasing marginalization; the reward is contributing in an integral way in the electronic economy. ■

Andersen Consulting is a global management and technology consulting organization with $6.6 billion in annual revenues whose mission is to help its clients change to be more successful. With more than 59,000 people in 46 countries, it helps clients from a wide range of industries to link their people, processes, and technologies to their strategies.

Charles J. Doyle directs AC's Global Image Development team from London. Glover T. Ferguson, who works out of Chicago, is codirector of its Worldwide eCommerce Program, while Hugh F. Morris, based in London, is responsible for global capability in the company's Business Process Management group. This article represents the views of the individual authors. It is reprinted with permission from Outlook, *Andersen Consulting's "magazine on changing to be more successful."*

The New EVP: Peter Woicke

Peter L. Woicke officially took the reins as IFC's new executive vice president January 1, though he was here familiarizing himself with the surroundings for most of December. He succeeds Jannik Lindbaek, who has stepped down after five years and returned to his native Norway.

Woicke, a 55-year old German national, has worked for 29 years with J.P. Morgan. For the past three years, he has been chairman of J.P. Morgan Securities Asia based in Singapore, while also serving as a member of the global investment banking firm's management group. Under his leadership, Morgan's revenues for Asia and the Pacific more than doubled. Prior to that he comanaged the global markets operation of Morgan, following a two-year assignment to reorganize information technology support for the company. Other management roles that he held during his period at New York headquarters between 1987 and 1995 included managing the brokerage and custody departments and heading the company's activities in Latin America. Additional foreign assignments with Morgan have posted him to Beirut and London.

The new EVP said he welcomes the move to working for a development institution. "I've had tremendous fun working for J.P. Morgan, having had opportunities to work in different regions and in different jobs," he said this fall. "But in the end, the aim of every position I have had was to improve the lot of shareholders. That's OK, but there is a time in your life when the objective or mission of an organization like IFC — to reduce poverty and improve the living conditions in the developing world — are more appealing than the shareholders' lot."

Yet with his background in emerging markets, Woicke is well aware of the pressures he will face in apportioning IFC's limited resources. As lenders pull out of risky Asian markets, even companies in countries once considered to have "graduated" from IFC's programs are again seeking help from IFC and other multilateral institutions. That demand poses risks, Woicke told the newspaper *Emerging Markets*: "We will have to be careful in the face of massive demand that we do not ignore the frontier countries."

In both the *Emerging Markets* interview and another with the *Wall Street Journal*, Woicke said he would like to see IFC leverage its staff expertise, prestige, and reputation — as well as its financial resources and relationship with the World Bank — to expand its activities in the developing world. "If I look at what is happening in the world market, there is going to

be huge demand for IFC resources," Woicke told the *Journal*. "Commercial and investment banks are trying to reduce their exposure in emerging markets. There is tremendous pent-up loan demand in these countries and the demand for multilateral institutions is going to be big."

In announcing Woicke's appointment, World Bank President James Wolfensohn expressed confidence in the new EVP's ability to handle the demands of the job, saying: "Peter is the right kind of leader to guide IFC through these challenging times."

Welcome, Peter, we look forward to working with you! ■

— *Linda McCormick*

Latin America and the Caribbean

Storm of the Century

IFC money will soon be at work helping businesses in Nicaragua and Honduras recover from the devastating blow of Hurricane Mitch.

In mid-October, working with the region's largest private lender, BAC International Bank, IFC agreed to provide US$30 million in long-term financing for small and medium enterprises in Central America. The two countries most affected by the hemisphere's deadliest storm in 200 years, Honduras and Nicaragua, had already been designated to split the first $10 million in loans before sustained 180 mph winds and 75 inches of rain pounded them at the end of the month, causing widespread destruction and at least 11,000 deaths. The damages in Honduras alone are estimated to have amounted to $4 billion, or roughly the size of the country's gross domestic product, setting development efforts back by as much as 50 years.

"Although this certainly could not have been anticipated, IFC was in the right place at the right time. Because of Mitch, the need for investment in Nicaragua and Honduras is going to be enormous," said Mario Alonso, who recently stepped down as an IFC investment officer to return to his home country of Nicaragua and work in the private sector.

In a region where years of economic stagnation and civil war had already made it difficult for owners of small and medium businesses to access private capital, IFC's program aims at providing new money for expansion, modernization, and financial restructuring. Its funds will be channeled through BAC, which has a strong presence in each of the target countries.

BAC will direct IFC's money to borrowers through its regional subsidiary banks. The first $10 million will go to businesses in Nicaragua and Honduras, with the other $20 million to be invested in El Salvador, Costa Rica, Guatemala, and Panama. IFC will closely monitor the investments and provide environmental expertise.

Central and Southern Europe

Hot Dog!

Raif Dzafic's $1.7 million meat-processing plant a few miles outside of Sarajevo was destroyed during the 1992–95 war in Bosnia-Herzegovina. The loss was a terrible blow to Dzafic, an entrepreneur who had successfully built his company from a chain of butcher shops and retail food stores since 1980. But he did not give up.

Even while the war was still raging in 1993, Dzafic began to rebuild his company, Akova Impex, by importing fresh and frozen beef, poultry, and other food products from outside the region. He was eventually able to take over and partially refurbish a huge but empty government-owned warehouse, turning a portion of it into a cold storage facility for ripening fruits and vegetables.

Now, with the help of IFC, Dzafic's company has substantially refurbished another section of the warehouse to accommodate a new meat processing facility. A $2.2 million IFC loan has provided approximately half the money needed for the new plant, with the remainder to come from private investments and a US Agency for International Development commercial loan facility channeled through local banks.

The new plant will start commercial operations in March 1999 with an annual production capacity of 2,500 tons of processed meat. It will employ about 70 workers, who will produce chops, salami, hamburger, and hot dogs. The company is expected to regain its position soon as the second-largest meat-processing plant in Bosnia-Herzegovina.

The project also breaks ground in another way — it is the first joint venture between private investors and a state-owned company (Sipad-Komerc, owner of the warehouse site) to receive a long-term loan from an international institution.

The project is expected to help in the rebuilding of the country by making the food supply more stable, easing the need to use hard currency reserves for expensive imported items, and adding desirable skilled jobs into an economy racked by approximately 33% unemployment.

Meaty Solution: *Akoua Impex's Raif Dzafic (right), IFC VP and General Counsel Carol Lee (center), and others met in Bosnia-Herzegovina.*

Sub-Saharan Africa

A New Partner

IFC has found a new way to stretch its small business development efforts in sub-Saharan Africa a little further: teaming up with PROPARCO, the private sector lending arm of Agence Française de Développement (AFD), the French development agency.

Under the $20 million agreement, PROPARCO will become the agent for IFC in some 20 sub-Saharan countries where IFC has a limited presence. PROPARCO will identify projects, conduct appraisals, and close and supervise the IFC investments. It will also match each IFC investment with money of its own under terms similar to IFC's.

The French organization has a staff of 40 and relies heavily for its operations on AFD's 30 field offices in Africa. In 1997, it approved 64 new investments with a value of $230 million. IFC hopes the coordinated effort will help to reach the kinds of small and medium enterprises that play vital roles in social and economic development in the region. An initial agribusiness investment in Burkina Faso has already been approved, helping launch a factory to peel organically grown sesame grain for the export market. This first IFC-PROPARCO joint investment will amount to about US$1 million equivalent.

"PROPARCO is a very good fit for IFC because it has a dense network in parts of Africa where IFC's presence is small, and has a proven track record," said IFC's Antoine Courcelle-Labrousse. "It provides a very economical way for IFC to expand its efforts in Africa. On the other hand, we assist PROPARCO in assessing the environmental and social impact of the projects. This partnership has created a real synergy."

Although the initial agreement between the two institutions is for only three years, Courcelle-Labrousse hopes the partnership will be continued and perhaps even expanded, as it provides such a good way for IFC to invest in sub-Saharan Africa without incurring substantial administrative costs. The agreement to coordinate efforts with PROPARCO was signed during the World Bank-IMF Annual Meetings, in the presence of World Bank President James D. Wolfensohn and Dominique Strauss-Kahn, the French minister of finance.

— Reporting by Linda McCormick

Bangkok's Mass Transit Solution: Take the SkyTrain

Rob Wright, *IFC Corporate Relations Unit*

Bangkok

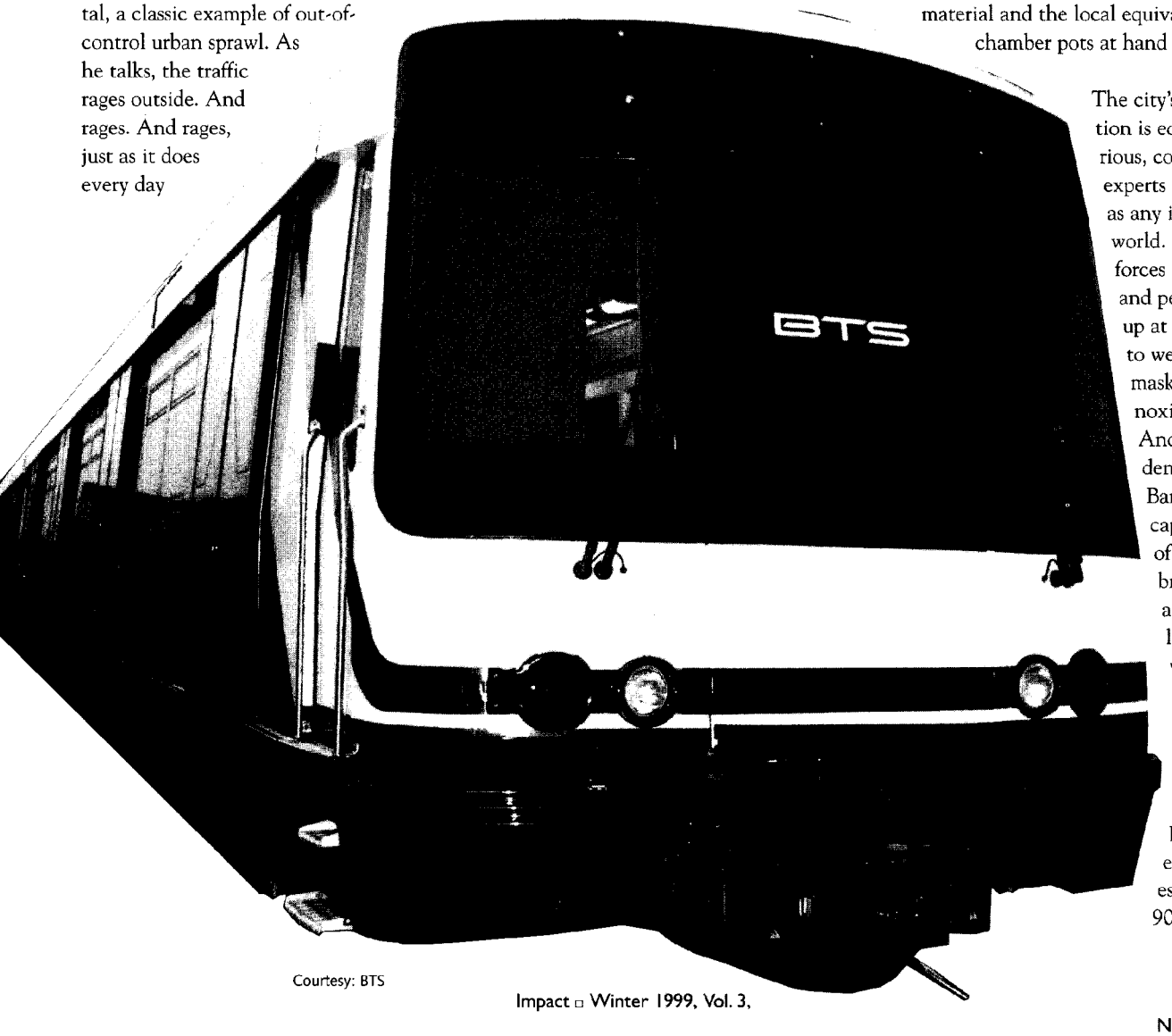
"The first thing to emphasize about this project is that it is private," the chairman says, "*totally* private."

The chairman is Kasame Chatikavanij, former chief of Thailand's national power utility EGAT and now head of the first new mass transit system to be built in recent memory in the country's capital, a classic example of out-of-control urban sprawl. As he talks, the traffic rages outside. And rages. And rages, just as it does every day — for Bangkok has few transportation options to offer its 10 million residents beyond its local streets.

Some expressways run in from the outskirts, of course. But within the central business district it's a competition for limited space among cars, buses, taxis, and the traditional motorized rickshaws called tuk-tuks. OK for a secondary city perhaps, but not for a high-energy metropolis whose skyline now is essentially only a slightly smaller, more stretched-out version of New York's.

Bangkok has long been infamous for these traffic woes. Routine trips often deteriorate into bumper-to-bumper agony, and the business climate inevitably suffers for the constant waste of its most precious resource, time. Residents tell of occasionally being stuck in their cars for three nightmarish hours, keeping food, reading material and the local equivalent of chamber pots at hand just in case.

The city's air pollution is equally notorious, considered by experts to be as bad as any in the world. It often forces traffic cops and people lined up at bus stations to wear surgical masks to avoid noxious fumes. And while residents of Bangladesh's capital city of Dhaka breathe in a lot more lead, anyone with lungs can sense the awful truth of Bangkok's problem. By the government's estimate 900,000



Courtesy: BTS

people, or almost 10% of the city's population, seek medical treatment each year with air pollution–related respiratory illnesses.

"The police, street vendors, and little children who play by the street every day are exposed to such a high level of pollution that there is a very high probability of their getting chronic emphysema and other acute respiratory disorders, maybe even lung cancer," says one specialist. "They will definitely all die sooner than they would normally. What they are doing is basically sucking on an exhaust pipe day in and day out, but just at lower levels."

For too many years the government did nothing about the problem, even though traffic volumes grew by 35% a year and average road speeds dropped to less than 10 km per hour — just above the pace of a brisk walk and about a third less than the norm in the world's other cities. But in 1992 the authorities finally decided to turn to the private sector, offering potential operators 30-year concessions so long as they brought their own financing to the table. In return, the operators would be entitled to all fare and advertising revenues.

It is on that basis that the winning bidder, a Thai-led consortium called Bangkok Mass Transit System Corp. (BTS), has forged ahead to build the $1.2 billion, 23.5 km elevated rail system that is expected to open in December 1999. $100 million of IFC support has played an important role in the project's financing.

Willpower

Getting this far has been quite a journey in itself.

"For 10 years before we got involved, the government looked at building its own elevated train, but in the end they had no money," Chatikavanij recalled. "They were trying to do a much larger project, where the land acquisition costs would have been huge. But they had no real willpower to do it. Eventually, though, a new prime minister came in and washed his hands of the whole thing and put it out to tender, using concession rights to existing roads to which the Bangkok Metropolitan Administration already had complete control."

"Even so," he added, "the government was always full of skepticism, bringing in experts who said it could never be done. That made our starting point very difficult. Without IFC we would never have gotten this far. Talking to the government here is not easy, but IFC, as a part of the World Bank Group, has the ability to liase with the government due to established areas of cooperation. I think we definitely made the right decision to bring in IFC as both a shareholder and a lender. It also is very helpful in our negotiations with the bankers and the lawyers, and let's face it, we're kind of green at this sort of thing."

The Crisis

Who wouldn't be? BTS is in all likelihood the largest urban mass transit system ever built on a fully private basis anywhere in the world. Were that not a big enough challenge, the project has also had to survive the local currency's steep July 1997 devaluation, first of many dominoes to fall in the Asian financial crisis.

With a flair for understatement, Chatikavanij well recalls the day the baht dollar exchange rate that had long been 25:1 fell to 50:1. "That scared us," he says. "For a while we thought we might really have problems."

He credits the unique financial package IFC helped structure in 1996 with allowing the project to survive. The baht collapse will only have a "serious, but not critical" effect on the project, he says, stressing that it will not delay completion and in the end probably reduce his consortium's eventual return on investment only slightly.

Rolling Stock: *Pedestrians will not be disrupted by the quiet Bangkok Transit System trains running overhead.*

Straightway: *IFC support helps work on railbeds of the Bangkok Transit System (left) to proceed despite the Asian financial crisis.*

There were several financial keys that have enabled the project to survive the severe economic downturn. One was the gutsy move by the BTS consortium to pay for the start of construction out of its pocket in February 1995, 18 months before loan agreements were signed with the banks. Another was the high reliance on baht debt from Thai banks for a project generating revenues exclusively in local currency. As it stands, baht financing accounts for 59% of the total, meaning BTS is far less vulnerable to devaluation risk than it would be had it opted to fund itself more heavily with the dollars that once flowed so freely throughout Southeast Asia. And even though baht interest rates were higher than dollar rates, the fact that the revenue was in baht and could be adjusted in line with local inflation and interest rates provided a natural hedge. BTS is also not yet required to make any repayments, enjoying a grace period that does not expire until 2002.

"There are four key reasons why this major project has stayed on schedule despite the problems in the Thai economy," says IFC Telecommunications, Transportation, and Utilities Department director Declan Duff. "First, all three lead agents did a tremendous job in understanding and mitigating the project's risks. But also the financial plan provided for most of the equity to come up front, while the cost-overrun and ramp-up risks were well provided for, which gave lenders confidence to continue disbursing. Also, some of the risks were shouldered by the contractors, and when the crisis started, IFC and the other lead agents worked proactively with the sponsor to put together a new financing package to mitigate the risks posed by the financial- and liquidity-related problems of some of the members of the Thai syndicate. That helped insulate the project from serious turmoil."

High Profile

Few developing countries have private sectors strong enough to build a project of this size primarily with their own sponsors and banks. But the formula is a winning one in Thailand, where BTS has about as high a profile as it could have. BTS is led by Tanayong, a major local developer with real estate and hotel projects across the country. And the November 3 test drive of the system's first Siemens-built, Porsche-designed train was covered by 300 local journalists, including live broadcasts on national television and front-page treatment the next day in Bangkok's major newspapers. The country's much-revered royal family is expected at the system's formal opening, just as it was at groundbreaking in 1994.

Elevate!

Name of Project: Bangkok Mass Transit System Public Company, Ltd. (BTS)
Concept: Private, for-profit 23.5-km elevated rail line in downtown Bangkok
Total Cost: $1.2 billion
Concession Period: 30 years
Debt-Equity Ratio: 61/39
Lead Shareholders: Tanayong (Thailand, 65.1%); Italian-Thai Development (Thailand, 8.8%); Land and Houses (Thailand, 3%); IFC (2%)
Lead Lenders: IFC; KfW (Germany); Siam Commercial Bank (Thailand)
Lenders' Independent Analysis: Ridership forecasts to confirm revenue projections done by Asia's largest independent traffic consulting firm, MVA (Hong Kong); technical and environmental studies and monitoring of sponsors' construction progress reports done by Electrowatt (Switzerland)
Total Financing Currency Mix: 59% in Thai baht, 41% in US dollars
Source of Revenue: Projected flat fare of 30 baht (approximately 80 US cents); sale of advertising space
Construction Contractors: Siemens (electrical and mechanical works); Italian-Thai Development (civil works)
Development Impact: First mass transit system to be operated in a city often considered to have world's worst traffic congestion; will carry more than 650,000 passengers per day
Planned Opening: December 1999
Financial Advisers: IFC, Salomon Brothers, Siam Commercial Bank

The sleek and quiet "SkyTrain" system is similar to the highly efficient ones in Hong Kong and Singapore that also use state-of-the-art Siemens trains. Each air-conditioned, 22x3-meter car can carry about 350 passengers, most of whom will stand. The design also allows for Tokyo-style "crush loading" at rush hour of eight passengers per square meter. Not completely pleasant perhaps, but well worth it nevertheless. It will take only 30 minutes to cover a route that currently takes about 90 minutes by car or bus — on a good day.

BTS's "Green Line" is only the first leg of a 200-km system the government hopes to build with a combination of public and private money over the coming decades, and the Tanayong-led group already has an extension in mind. Meanwhile, the government is using Japanese aid money to begin work on an underground system, a far costlier construction proposition that all sides agree could never be viable on a for-profit basis — and whose completion schedule continues to be a question mark.

What Next?

The big question, though, is what will ultimately happen to the city's mega-mass transit project. Hong Kong–based Hopewell Holdings, a key pioneer of Asia's privately financed infrastructure, has ambitious plans for a $4 billion, 60-km Bangkok Elevated Road and Train System (BERTS). They envision a triple-decker combination: a toll road built above tracks for both new light rail and existing State Railway of Thailand trains, running in turn above existing streets with new shopping plazas whose revenues would flow to the concessionaire. Hopewell won the concession in November 1990 and had hoped to open key portions of it by the time of the Asian Games in Bangkok in December 1998.

He Likes It: *BTS Chairman Kasame Chatikavanij (center) test-rides the system's first train.*

But after much squabbling with the government, it saw its concession agreement canceled and was expelled from the project earlier this year, after spending what it estimates as $724 million of its own equity funds on initial development.

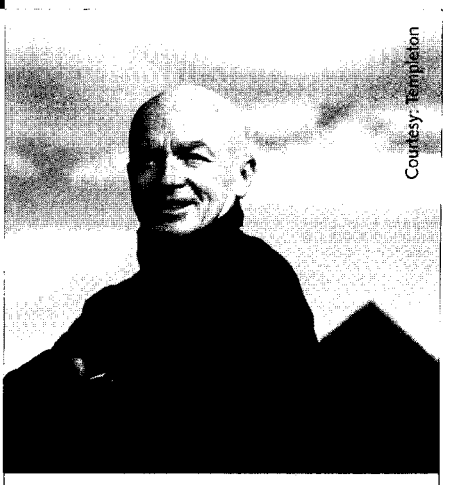
BERTS's unfinished pylons dot the city today. Counterparts at BTS, though, hope BERTS can still somehow eventually be finished, since as a commuter line carrying suburbanites in and out of the city it would complement their own intracity distributor line. The two systems would share a transfer station, and the combination would make a far more powerful dent in the city's traffic congestion than just BTS alone — by all accounts only an important first step in tackling a huge problem.

"I think eventually BERTS will be built," says BTS Senior Vice President Surapong Laoha-Unya. "The government is trying to find other investors and work out a compromise, but a solution has to be found because the impact on Bangkok's traffic would just be so great. In a city of this size, you need to have a mass transit system. There is no way to solve our problem without diverting road users to other means of transport, because there is also no way to build new expressways inside the city — the land acquisition costs would just be too high and the impact of relocating people just too difficult."

When the Green Line officially opens, it will provide a new model of privately financed urban mass transit for all to see.

"The lesson to be drawn from BTS," says IFC's Duff, "is the importance of old-fashioned rigorous analysis, consistent supervision, and of course the ability to carry forward ever-divergent views of different lenders, equity holders, and regulators to achieve the common goal. The SkyTrain project is almost 80% complete now and stands as an excellent symbol of cooperation between all the numerous stakeholders." ■

Ever the Optimist


Courtesy: Templeton

On the record

Name: J. Mark Mobius
Title: Managing Director, Templeton Asset Management Ltd., Singapore
Age: 62
County: USA
Assets under Management: Approximately $13 billion invested in developing-country stock markets worldwide
Investment Funds Overseen: Templeton Emerging Market Fund, Templeton China World Fund, Templeton Developing Markets Trust, Templeton Dragon Fund, Templeton Emerging Markets Appreciation Fund, Templeton Russia Fund, Templeton Vietnam and Southeast Asia Fund
Background: Ph.D. in economics and political science from Massachusetts Institute of Technology (1964); has spent more than 30 years living in Asia and working in emerging markets, with extensive experience in economic research and analysis; ran his own consulting company in Hong Kong for 10 years, then was a research scientist for Monsanto Overseas Enterprises Co. and a director at international securities firm Vickers da Costa, also in Hong Kong; joined Templeton in 1987 with responsibility for all its emerging markets investments (which then totaled $87 million) and started the Templeton Emerging Market Fund, the world's first fund dedicated to investments in multiple emerging markets to be listed on a stock exchange
Investment Philosophy: "Buy when others are despondently selling and sell when others are greedily buying"
Lately Bullish On: Thailand (invested approximately $300 million there in 1998)
Number of Days Spent Traveling in Developing Countries Each Year: 200
Top Five Holdings: Telefonos de Mexico; Cemex (Mexico); HSBC Holdings (UK); Eletrobras (Brazil); Telebras (Brazil); Electricidad de Caracas (Venezuela)
IFC Ties: Member, IFC Emerging Market Data Base Advisory Panel

By his own admission his investment funds have recently declined in value by $2 billion, for now at least. But you'd never know it by talking to J. Mark Mobius, the widely hailed grand guru of emerging market investing. He looks to developing-country stock markets' future, not their past.

Having lived in the Far East since the early 1960s, long before anyone talked of a Pacific Century or Asian Miracle, Mobius is known for his shrewd long-term perspective on opportunities in developing countries. It is one that led him to list a multi–developing-country investment fund on the New York Stock Exchange amid the cold war and the Latin American debt crisis in 1986, when few could foresee that within five years every major global financial institution in the world would have an emerging market department. It is also one that has kept most of his Templeton clients with him despite the many ups and downs along the way, allowing the portfolio he and his staff of 30 manage to grow by more than a factor of 100 over 12 years. And the press never loses interest: in October New York–based Money *magazine put him on its list of "the world's most powerful financial players," writing that "despite the carnage, Mobius, whose look and manner are somewhat reminiscent of a mysterious James Bond character, remains as bullish as ever about emerging markets' long-term potential."*

Mobius has long been a valued partner of IFC, serving as an adviser to the Corporation's indexes of emerging stock markets — indexes he says are one of the tools he uses in making his own investment decisions. When he visited IFC headquarters this fall he was as good-humored and relaxed as ever, despite the uncertainty in the market and his largest fund's 23.8% drop in value over the past five years. He repeated his loud calls for improving capital market infrastructure so both foreign investors and host countries can maximize the contribution of portfolio capital flows. And he offered some predictably unpredictable analysis on countries such as China and Japan. He showed no sign of worry. After all, he said, it's a "new era," one marked by the need to "embrace volatility."

IFC: How do the current Asian and Russian financial crises compare with others you've seen before?

Mobius: This is actually the third crisis we've been through. In 1987, we had the big crash in New York that affected the six markets we were in then: Hong Kong, Philippines, Thailand, Malaysia, Singapore, and Mexico. In that one we lost 30% of the fund in a very short time.

Then in the 1994 Mexican crisis we lost 30% of our fund again. It seems that 30% is always the number that we are losing on these downturns, but of course anyone who had bought at that time would be in pretty good shape today. And that's the problem we are facing: the confidence factor. You have to buy when things are cheap. But it's a very difficult thing to do. You have to live through these crises.

IFC: But what about now?

Mobius: We are in a new crisis, which is bigger than the Mexican crisis and is covering more countries. Templeton is now in 40 countries around the world, and they all seem to be affected with the exception of a few like Portugal and Greece. Plus, we have the real threat that countries like Malaysia will say, "Hey, we are not going to play this game anymore. We have decided to close down the playing field — and we've got our own game: we're going to grab your assets and not let you out." This is a real threat to the future of emerging markets.

IFC: Why?

Mobius: Because, if people begin to question the idea of capitalism and doubt the validity of open capital markets, then we're really in trouble. We are in a different era, and we are hoping and praying that this kind of thinking does not spread. At this critical juncture, all of us must get together and find solutions to these problems.

IFC: How do you suggest we find a long-term solution?

Mobius: The bottom line: a lot of people talk about the shortages of money, the lack of liquidity, and the problems of getting finance. But there is no shortage of money globally! We are at this time sitting on $1 billion of cash looking for places to invest. There is no shortage. That is not the question.

IFC: What is?

Mobius: The question is the global infrastructure for capital markets: is there a liquid market available for us mutual fund investors? We have to price our securities on a daily basis and meet the demands of our own securities commission, which says that unless the stocks we own can be sold within a five-day period, then we have illiquid securities, and once we get to 15% illiquid, we are in trouble — we are breaking the law. The question of liquidity is extremely important. That's the reason I was happy to learn that the World Bank and IFC are looking more and more at institution building in the capital markets in these countries. It's critical.

IFC: What would you tell countries their priorities should be in this regard?

Mobius: You must have a central depository, a central clearing system, and a computerized stock exchange, which allows for transparency and a level playing field. The good news is that as a result of this crisis these questions are finally being addressed.

IFC: But what about the argument that says emerging market investors such as you and others are partly at fault for pouring in too much money too fast?

Mobius: No one is really to blame, because things got ahead of all of us. But, sure, we had too much money, and the markets were not ready in many cases. Now we are catching up. And we will catch up, there's no question about it. We've been through this before. The leads, the lags — it's all part of the market.

We've got to remember that we knew that this was possible. And we know that it is possible in the future. Volatility is with us. We must learn to embrace it.

IFC: Why?

Mobius: Because that is the value of the market. The market sends messages to all of us. When we get emotionally involved, eventually it hits us over the head and says, "You made an error. You did not use reason. You used emotion." And then we learn.

IFC: But still the crisis goes on...

Mobius: A lot of people keep talking about a crisis. But in my view this crisis is over, because crisis comes only when everything is uncertain. We now know that companies are bankrupt. Whenever uncertainty ends, then the crisis is over and new money begins to come in.

IFC: What does that mean for you?

Mobius: If you don't know anything else, you know that you've got to be in the game. You've got to be invested, and it's those long-term investors who stay in the market, who continue to invest, and who, by the way, are optimistic and not pessimistic, who will win in the

end. And that's basically our stance. We are aggressively investing in these emerging markets, and we are very happy to know that IFC is there alongside us. I think that IFC's influence in advising as a disinterested third party — a referee if you will, advising governments on how they can best use this finance that is coming at them at great speed — is making a tremendous contribution.

IFC: Let's move to a different topic. Looking back, what would you say has been your biggest mistake?

Mobius: I think the biggest oversight was the people, in that at the beginning we looked only at balance sheets and profit-and-loss statements. Sure, we knew there were differences in the way accounting was done in Brazil compared with Hong Kong, and we took all that into account. But we didn't pay enough attention to the people behind the companies — the control, the management. As we go forward, we will look more closely at who's running the company, what their background is, how many jail sentences have they had, things like that. That, we are finding, is as serious a determinant as the historical performance of a company. The human factor is probably the one we overlooked more than any other.

IFC: What does it take in general to be good at finding opportunities in equity markets?

Mobius: That's a good question. I think one requirement is a very eclectic mind. You have to be open-minded, interested in many different things, and constantly learning new things. And then, finally, you have to be able to make some judgments about what's good and what's bad. You don't necessarily need a Ph.D. in accounting or need to have some special knowledge. But you do need an inquiring mind and a willingness to learn and listen, because most of what we do is go from one company to another, listening, observing, and keeping records. If at the end of the day, you're able to do that diligently, and work 30 hours a day, you'll be a good analyst.

IFC: How do you see China fitting into the wave of currency devaluations ravaging Asia?

Mobius: My views on China? In reality we think that the Chinese have already devalued. They've given tax breaks to exporters, and in effect, that's a kind of devaluation. We don't think they will go further than that, particularly now that the Hong Kong situation seems to be stabilized, but the bad news is that they have pulled back on reform. The state-owned enterprises still need a tremendous cleaning up, and we don't see that happening. That is why their domestic B-share market is so sick, because the companies, one after the other, are just poorly managed, poorly run. It's a real problem, especially if you consider some of the estimates that the state-owned enterprises represent 80% of the bank loans and 20% of the economy. And by extension, the banking system is in trouble because these state-owned enterprises are not being reformed.

IFC: What should they do about it?

Mobius: The answer, of course, is a very rapid, dramatic liberalization of the economy so that the private sector can pick up and the small and medium enterprises can employ people as they're being let go from the state-owned enterprises. Unfortunately, the Chinese are not taking that path because they're afraid of unemployment and the political fallout.

So we are cautious about China. We think the growth will continue because of the government expenditure, but down the road we will have to face these problems. On balance, though, when we go into China, we go into Hong Kong, because there we are dealing with a known entity, with efficient management and with good disclosure and transparency that we don't get in the rest of China, unfortunately.

IFC: How about Japan in comparison?

Mobius: The situation in Japan is known — that's the difference. The unknown has been reduced in Japan as well as in some of the other countries. There's good news in the new bank bailout program. Remember, a few months ago everybody was concerned that the banks were not going to accept reform because they didn't want disclosure of this terrible loan book they had. But in the end the banks did bite the bullet, and all is now being revealed. That's a giant step forward.

IFC: Why?

Mobius: If you recognize the problem and it's known, then you can deal with it. And that's what's finally happening in Japan. I don't think people realize the degree to which Japan has gone through reform — the pain that they've experienced, the reform in the Ministry of Finance, for example. A lot of people don't remember that Yamaichi, one of the largest brokerage companies in the world, not only went bust but was *allowed* to go bust. This is earth-shaking change for Japan with its background and culture. I think Japan is on the mend, on the brink of a dramatic change. I'm much more optimistic about Japan than about China.

IFC: How about the broader issue of corporate transparency and compliance with securities regulation? Do you see any real progress being made in the developing world?

Mobius: The answer is yes. Not as fast as we'd like, but we're seeing a lot more change in attitude. In Korea, for example, we recently met with one of the professors at Korea University, a champion of minority shareholder rights. This is something we would never expect: someone who's fighting the *chaebols*, who's taking them to court, and who's got a group of young, intelligent accountants and lawyers doing this with him for the good of the country. This is the kind of thing beginning to happen in these countries, and that's a great step forward.

In contrast, though, we at Templeton are also embroiled in a number of lawsuits in places

like Hungary and Brazil, trying to defend our shareholder rights. And, I must say, we have failed miserably because of the complexities of taking people to court in various parts of the world. In Brazil, for example, the Brazilian judge said, "Yes, it's a violation of the law, but the jobs of the people in this company are more important. Therefore we will not obey the law." He didn't really say it like that, of course, but that is the essence of what he said.

IFC: That must be discouraging.

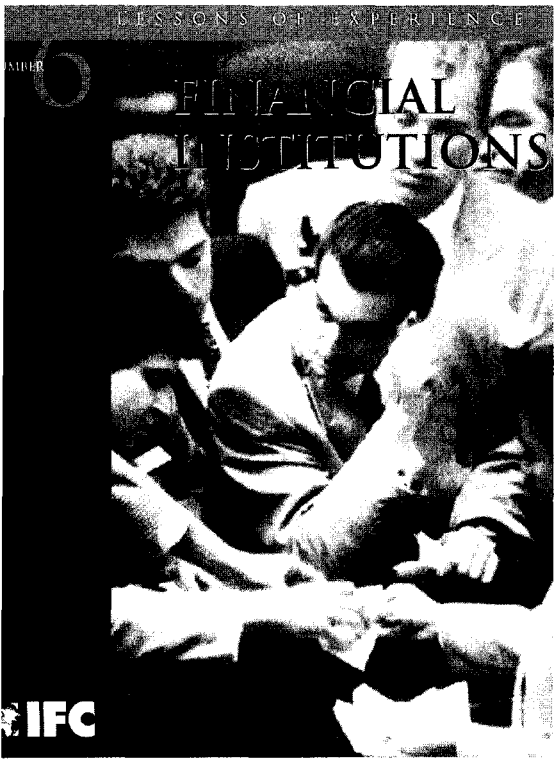
Mobius: We are hoping that more and more people will join us in taking action, because until that happens, you don't get any results. You've got to at least try. Gradually, more countries in the developing world are coming to agree that shareholders have to be protected. In Russia, for example, Mr. Vasiliev, the head of the securities commission, has done a wonderful job. The problem is that he doesn't have the power, but at least he's moving in the right direction. He needs support.

IFC: So where does it leave us in the end?

Mobius: The one thing that is very clear after all these years of investing in developing-country markets is that there's no shortage of money, and, more important, there's no shortage of local money.

Many of these countries are not poor. But their money is not in their country. It's in Switzerland, London, New York, and everywhere else. The reason it's in these other places is that it doesn't feel safe in its own country, for good reason. Russia is a clear example. Half the Russians have been keeping their money under the mattress. I asked an analyst in Moscow where he kept his money. He hesitated for a while and then he said, "Under my mattress!" And this is a security analyst with our company! That tells you something about the confidence that Russians have in their own government. But if all this money can be tempted out and feel safe at home, then countries like Russia would have plenty of money to grow the country. ■

Just Out!



Lessons of Experience 6: Financial Institutions

There is one key lesson that IFC has learned after investing $5.3 billion in more than 700 financial sector projects in 90 countries over the past 21 years: capital is made at home.

While foreign capital clearly plays a vital role in development, the latest volume in IFC's Lessons of Experience series argues that countries grow primarily by productively investing their own domestic savings. That can happen over the long term only if they have well-regulated private banks, securities markets, insurance companies, pension funds, and other financial institutions. A basic principle applies to both developing and developed countries: countries with the most dynamic financial sectors do the best economically, and those without them suffer the painful consequences.

This new report written by IFC's Teresa Barger sums up IFC's financial sector knowledge. It stresses that Asia's economic miracle never extended to finance. It shows that longstanding problems in Asia's financial sectors have now become evident: directed credit and administered interest rates; lack of international standards; reluctance to allow sufficient foreign competition; poor and nontransparent banking supervision; inadequate local debt markets; and an overall scarcity of equity. However, it shows that nations such as Chile, Hungary, and Poland have overcome these problems and worked to bring their domestic financial sectors more in line with international standards, leaving them in a much healthier economic condition today.

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Building Business: The Mekong Model

Frederik Balfour

Entrepreneurial: *Businessman Phan Khac Hoa (below left) and workers at his Hanoi garment factory stitch away, despite the tough local business climate.*

Hanoi

Phan Khac Hoa has all the makings of a successful businessman. New orders from overseas customers are pouring into the Hanoi garment company his family owns, its workers seem genuinely happy, and he pays his bills on time. And even with annual revenues that are only in the $360,000 range, Vinh Phat is one of Vietnam's largest and most successful fully private, locally owned manufacturing companies. But there's a catch — although a model entrepreneur, Hoa also holds down a job at a state-owned company and wouldn't dream of quitting.

Sound paradoxical? Welcome to Vietnam, one of the world's five remaining Communist nations. Capitalism is still a dirty word in some quarters, and entrepreneurs hedge their risks in the private sector by keeping their state jobs. When asked why, Hoa concedes he makes less working for the government than do most of his own factory's employees. But he can't afford to lose the contacts, especially given his uncertainty about the future political attitude in his country toward pioneering start-up companies such as his.

But even with his sterling connections, local lenders still won't give Hoa the loans he needs. Credit at Vietnam's dominant state-owned banks is driven by patronage and politics, local private banks have no dollars, and foreign banks won't touch a small businessman with a limited track record and few mortgageable assets.

Enter the Mekong Project Development Facility (MPDF), a $25 million multidonor initiative IFC has managed since early 1997. It vets and grooms small private businesses like Vinh Phat so that bankers — and IFC itself — will be willing to lend them money.

Since it began working in Vietnam in 1993, IFC has invested more than $235.6

million in 21 projects ranging from a glass factory backed by Philippine beer maker San Miguel to a luxury Hanoi hotel with Groupe Accor of France. But all these deals involved joint ventures between foreign investors and state-owned enterprises (SOEs). They were unable to reach down into the ranks of a domestic private sector overwhelmingly consisting of small and unsophisticated players.

Given IFC's exacting standards and the lack of formal business training among Vietnam's fledgling entrepreneurs, the Corporation's difficulty in finding suitable projects isn't particularly surprising. But Hanoi's policies also had something to do with it: foreign capital should go to state companies first; the private sector could wait. Indeed, Vietnam's playing field remains strongly tilted in favor of the state sector today, highlighting the need for the MPDF to help private businesses address that imbalance.

Uphill Battle

The local legal and regulatory environment at virtually all levels discourages development of the formal private sector, while SOEs enjoy preferential access to land, credit, and export and import quotas. Unlike the private sector, they can readily borrow without collateral from a financial sector dominated by state-owned banks and still enjoy implicit subsidies of various forms. These conditions are to ensure state domination of the economy — a pillar of the Communist Party's development strategy. SOEs' and government administration's share of gross domestic product is 42%, having grown steadily through the increase of foreign joint ventures with government-owned firms. Such is the paradox of modern Vietnam: a Communist state with a majority private economy, albeit one in which the large-scale, legally incorporated private sector represents only about 2% of GDP. Almost all its private sector activity, in other words, is in the form of either microenterprises or small farms.

Hoa's firm, Vinh Phat, became the first Vietnamese private company to get IFC backing when its $300,000 eight-year

And in Vientiane...

Vietnam's chief obstacle is the ideological bias against the private sector. In the Lao PDR the problem is mainly one of size — the mountainous landlocked country has just 4.6 million people. While the Lao PDR remains Vietnam's ideological ally, it doesn't share Hanoi's allergy to the private sector, mainly because it has so few state-owned enterprises to protect. Of the 640 SOEs in 1989, only 91 remained by 1995, and 59 of these are targeted for privatization, leaving only 32 "strategic" enterprises.

Rich in natural resources, the Lao PDR relies on mineral and timber exports and is dominated by the military, which controls valuable concessions. Still, it has yet to throw off its image of a sleepy backwater on the Mekong and is not known for its entrepreneurial acumen. Its nonconvertible currency, the kip, has depreciated by more than 50% in the past 18 months, and official sources of finances have dried up, making raising finance locally virtually impossible.

Nevertheless, thanks to MPDF's efforts two promising export-oriented projects have recently come to fruition. One is a $2.9 million laminated-wood–processing project involving Swedish retailing giant IKEA and Burapha Group, a local joint venture between Lao and Swedish private investors. IKEA is providing $550,000 in loans, while Swedish IFC counterpart Swedfund is lending a further $300,000 and IFC itself has approved an eight-year loan of $800,000.

Sumphorn Manodham, the Lao partner in Burapha, thinks the timing of the deal could not have been better. His company controls 1,200 hectares of eucalyptus forest and was looking for a foreign buyer, while IKEA was looking to source raw materials in Lao but was unsure of a local partner's ability to deliver. MPDF played a key role in packaging the deal and getting IKEA and Swedfund on board. "We do not think we could have arranged the financing without MPDF, and the proof is that after the MPDF study, the same financiers that were reluctant are now providing funds," said Sumphorn.

Package Deal: *In addition to bustling Vietnam (left) MPDF works in the slower-moving Lao PDR (below), where it is helping this private eucalyptus plantation produce wood for sale to IKEA.*

loan got the green light from Vietnam's state bank in October 1998. Without MPDF's help, the deal would never have been approved. Without IFC, foreign bankers would never have gone near it. "IFC gave us the comfort we needed to go in there. Its involvement made the difference between being in or out," said Ross Officer, group representative in Hanoi for Hongkong Bank, which has extended Vinh Phat a $60,000 working-capital facility. It was the first time this regional financial power had lent to a private company in the north of Vietnam.

Upon visiting Vinh Phat, MPDF found what senior investment officer Anil Sinha called "pretty darn basic" accounting practices of little use to potential lenders outside the country. A team worked with Hoa to establish rudimentary financial controlling and hammer out a marketing plan that would help Vinh Phat deal directly with overseas customers and cut out costly Korean middlemen. The result: a feasibility study that cost Hoa $7,000 and established enough order to the business to attract loans from IFC and Hongkong Bank that will allow a major expansion of his business.

After a year and a half of operations, the MPDF team says it is still on the steep part of the learning curve and that its search for winners is tough. "The tall poppy is the first to be mowed down," says a local proverb, and Vietnam has a "tall poppy syndrome" that discourages successful local private business men and women from drawing too much attention for fear they will be harassed by government officials seeking bribes. Corporate role models are few and far between. "This is a very difficult place to do business," says IFC East Asia–Pacific director Javed Hamid.

Tough All Over

He's not alone in that assessment. Witness the decision by many investors in Templeton's $93 million Vietnam Opportunities Fund to take a cash refund in early 1998 after emerging markets maven Mark Mobius admitted he couldn't find enough decent investments. Other foreign fund managers in the country are sitting on piles of cash after exhaustive searches for attractive deals in the country.

One reason is the glacial pace at which Vietnam's self-styled "equitization" program of privatization has moved since its launch in 1992. At the end of 1997, only 17 small and medium state-owned companies had actually sold shares, with the largest, most powerful assets remaining firmly under government control. Although up to 50 state companies will likely soon have been sold, combined offerings still amount to less than $25 million. What's more, the state has usually retained at least 30% of equity and a high degree of management control in equitized firms. But to help spur faster action, IFC is soon to begin a $1 million technical assistance project financed by the IFC/Australia Trust Fund to work with local authorities on a wide-ranging equitization program in Haiphong over the next 18 months. At least 50 SOEs are targeted for equitization, at least 10 of which will be disposed of through the auction method that has proved so effective in promoting fast, fair, and transparent privatization of small-scale assets in Central and Eastern Europe. The enterprises targeted in Haiphong range from hotels, restaurants, and bus companies to firms from the food-processing and chemical industries.

Once the belle of the ball for the region's emerging market investors, Vietnam has failed to meet their and many others' expectations. While these expectations may have been exaggerated in the first place, the stampede of hopeful suitors into the country in the early 1990s has clearly given way to a growing exodus of disgruntled foreign investors. Annual levels of foreign direct investment have plummeted from $8.5 billion in 1996 to about $2 billion today, and the government has had to change its policy to allow 100% foreign ownership of local companies to keep what foreign investors remain in the country from pulling out. The swanky business-class hotels of Hanoi and Ho Chi Minh City have become ghost towns.

Ask why and you will elicit a litany of responses: fallout from the Asian crisis, a domestic market with far less buying power than people thought, a Byzantine and opaque legal sys-

MPDF
Mekong Project Development Facility

Created: 1997
Objective: To promote establishment and expansion of privately owned small and medium enterprises in Vietnam, Cambodia, and the Lao PDR
Budget: $25 million for initial five years, pledged by the governments of Australia, Finland, Japan, Norway, Sweden, Switzerland, and the United Kingdom plus the European Union and IFC
How It Works: 1) *Project Development Component* provides financial analysis and feasibility studies on a cost-recovery basis to local entrepreneurs whose projects cost between $250,000 and $10 million, then helps match them with sources of financing, who typically see its involvement as an important sign of quality assurance;
2) *Business Support Services Component* helps develop the overall environment for SME growth through training, research, consulting, and other services
Record to Date: With total billings of $40,000, has raised $9 million in financing for 11 private business projects, resulting in more than 1200 jobs; also has completed seven business support projects with local partners
Headquarters: Hanoi, offices in Ho Chi Minh and Vientiane (Phnom Penh planned for 1999)
Managed by: IFC

Cambodia: *MPDF-supported training class for microfinanciers.*

tem, say some. Red tape bound in red tape, corruption, and forced joint ventures with state-owned enterprises that soon unravel, say others. Many domestic banks are also technically insolvent by international accounting standards, and lending is often based on who you know and what collateral you have. Risk management and cash-flow analysis are almost nonexistent. What's more, there is a widespread distrust of the banks, with most of Vietnam's 76 million people preferring to keep their savings tucked away at home. There is an estimated $3 billion held outside the banking system — a small fortune in a country with 1998 GDP of about $26 billion.

Vietnam's pervading culture of secrecy makes matters worse. Most companies don't use receipts, their accounts could fit on the back of a very small envelope, and bookkeeping is designed mainly to fool the taxman.

The Reason Why

It was for this very reason that industrialized-country governments pooled their resources to create MPDF and put it under IFC's management in the first place. Knowing that Vietnam is one of Asia's poorest countries, and that much depended on creation of a stronger local business environment, they gave the entity a mandate that went beyond merely working with local entrepreneurs to build bankable projects. Teaching Vietnamese businessmen modern business skills is just as much a part of MPDF's objectives. One example is a pilot program of fee-based management training courses that has received an enthusiastic response. Four 36-hour modules in marketing, human resources, accounting and finance, and operations were developed by local schools with input from business professors in the United States, Australia, the Philippines, and Venezuela. The courses quickly sold out, with business owners paying $110 apiece to attend. These modules have become the foundation of a small and medium enterprise training program that the country's three top business schools will be launching on a regular basis in early 1999. Plans are also afoot to develop a distance-learning program to take advantage of the explosion in computer growth in Vietnamese cities.

Since access to credit is one of the main constraints inhibiting the growth of private enterprise, MPDF has also enabled more than 450 credit officers at state-owned Incombank and public/private Maritime Bank to take an MPDF credit analysis course developed by Australia's Swinburne University. As a result, these credit officers can apply sound project analysis instead of a merely accepting collateral when considering loans, a foundation of modern banking anywhere. As a next step, MPDF will also soon begin training the banks' credit committees.

An even more difficult environment may lie next door. When MPDF was first established, Cambodia looked promising. By mid-1997, it was working with five companies with good prospects in the pipeline. But the controversial political tactics of Cambodian leader Hun Sen in July of that year changed everything, and business confidence still hasn't recovered. Cambodia's admission to the

Association of Southeast Asian Nations was delayed, and the local riel currency went into a tailspin. The country, with one of the highest infection rates for AIDS in the world, is racked with poverty— four out of ten people live below the poverty line, and inflation is growing.

But there are some encouraging signs. Cambodia's first self-managed pluralistic elections were held in July of 1998, and the leaders of the three main parties agreed to a coalition deal in early November. Perhaps investors will start to trickle back into Cambodia as a result of the settlement.

In the meantime, MPDF is helping by providing technical assistance to the country's leading microcredit institution, ACLEDA, which is in the process of converting into a full commercial bank. It is an institution that already reaches many thousands of rural poor women with loans that average $85 in size, and in the next year it is expected to break even and start to turn a profit. MPDF is helping it make this transformation by financing technical assistance to bring the accounting system and organizational structures up to banking standards. MPDF will then prepare a project document and take it to IFC, with hope that IFC might be among the new for-profit microcredit bank's first shareholders. A small victory perhaps, but one through which MPDF can help Cambodia, like its larger neighbor Vietnam, take important steps forward. ■

— *Reporting by Frederik Balfour in Hanoi*

Korea

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owned company eliminated all its major cross-guarantees and consolidated its affiliate companies. It also committed to disclose financial statements in accordance with International Accounting Standards and agreed to add outside directors to its board.

The IFC package helps reduce total debt and refinances costlier short-term loans from Korean banks. It also allows the well-managed company to complete a $230 million expansion it had started before the crisis but would otherwise have had to put in mothballs. That would have been a shame, as Shinmoorim had repositioned itself after the drop in domestic demand and is now earning most of its $150 million in annual revenues from foreign sales. IFC has also signaled its commitment by investing $32 million in equity and quasi-equity that would have been even harder to find locally and attracting a like amount from a fund involving one of the largest US investors in Asia, insurance company American International Group.

"Shinmoorim is a classic example of an otherwise good company that had very high leveraging that became unsustainable because of the increase in interest rates and the devaluation of the won during the crisis, which unfortunately are trends that have become all too common in Korea," says IFC's East Asia-Pacific director, Javed Hamid. "By supporting them now, we can help them take advantage of their established strengths, grow their way back into strong financial health, and set an important precedent for the recovery process in Korea and the rest of Asia." ■

Indonesia

(continued from page 9)

you to play by the rules of capitalism, you won't, and this is precisely what has happened. Or put it another way: it's like a football match without referees. If they're not there, you'll just pick up the ball, throw it in the net, and win. This is the way Asian companies have been allowed to operate until now, but it simply can't go on."

The clock is ticking in a country of 200 million that desperately needs its private sector to clean up its debt problems and get back into the business of creating jobs. The World Bank's country director for Indonesia, Dennis de Tray, puts it to them this way: "If you choose to wait, you wait for collapse: banking collapse, corporate collapse, economic collapse. Restructuring will be very painful, but waiting will be far worse." ■

Learning from the Asian Crisis

Though it is still early days, lessons are emerging from East Asia, about both the prevention of crisis and the response to it.

Preventing crisis requires:

- ☐ *Reducing the incentives for excessive borrowing.* Thailand, Korea, and Indonesia created policy-induced incentives to borrow through implicit and explicit guarantees, exchange rate policies, and lax rules governing public disclosure and reporting. Removing these incentives would mitigate inflow-fueled credit booms.
- ☐ *Improving governance in the financial and corporate sectors.* Countries with weak capacity to intermediate credit, especially from abroad, and with weak systems of corporate governance experienced the most severe problems. Reducing the government-directed credits, increasing capital adequacy ratios, and strengthening regulation of financial intermediation as well as improving bankruptcy laws, accounting and auditing, and disclosure requirements can play important roles in ensuring that capital will be well invested.
- ☐ *Enhancing prudential regulation, especially for short-term capital flows.* In crisis, the distinction between private and public debt easily blurs. Private external bank debt tends to become socialized to prevent collapse of the banking system, and thus constitutes huge and implicit contingent liabilities. To prevent an excessive build-up of short-term liabilities, governments should monitor short-term debt and establish tight prudential regulations limiting exposure of financial institutions. Similarly, better disclosure of information would reduce one source of speculation affecting investors' outlook.

Even the best of policies cannot guarantee that financial crises will not occur. Many well-regulated and supervised developed countries have had crises in the last decade. However, good regulation can reduce the probability of crises and minimize their costs.

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Too Many No-Shows: *Instead of empty chairs, Indonesia needs companies and their creditors to sit down and work out deals.*

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