almost fourfold in 1998. As revealed in Table 10, the manufacturing sector was the main sector affected by the crisis, retrenching 45,021 of the total of 83,441 people retrenched.[41]

The above are signs of concern for the government since businesses that go under will contribute to the growing number of non-performing loans (NPLs). This will definitely generate concern among banking and financial institutions. As such, government intervention at this juncture is somewhat unavoidable—as these are tell tale signs of deeper weaknesses.

The above scenarios place a lot of pressure on the government to come up with policies and measures to ease the current economic situation. More urgent, however, is the need to formulate immediate expansionary policies and measures to stop the economy from sinking further into "recession", given such unfavourable and unanticipated circumstances. ,See Table 7 for selected economic indicators, especially in 1998.

However, falling government revenues have put greater constraints on policy initiatives. The Malaysian government, it seems, has experienced shocks to their foreign reserves – limiting monetary policy maneuverability, and government revenue in 1998 (see Table 11) – minimizing capacity for government-led bailouts and/or restructuring programs, and expansionary/stimulus fiscal policies.

4. Establishing Concepts and Defining Parameters

At this juncture, I will define different terms employed here. Corporate governance (which depends on the key distinction between principals and agents) is defined as "the legal and institutional arrangements governing the behaviour of an economic entity, by which owners, creditors, markets and the government compel or induce agents to behave

according to the interests of the principals, or those of the broader society" (Lanyi and Lee, 1999: 19).[42]

According to Lanyi and Lee (1999), there are two key elements of governance. First, the structure of incentives and rules confronting agents with respect to issues such as granting and terminating lending, bankruptcy, the rights of directors, compensation structure, and termination of employment. Second, the structure of information flows from agents to principals, i.e. the rules and incentives affecting accountability, transparency and disclosure of information.

According to Lanyi and Lee (1999), there are five sources or channels through which corporate and financial governance operate: governance by creditors, governance by owners, government regulation, market competition and internal organization. [See Lanyi and Lee (1999: 20-23) for details.]

The government plays an important role in setting the rules by which private actors operate (i.e. affecting actions as they react to (dis)incentives). "Good" governance is generally characterized by effectiveness, transparency[43], accountability, predictability, integrity, equity and participation. Improvements to corporate governance, i.e. modifying the current broad regulatory framework, involve medium and/or long-term commitments. (The role of the government will be discussed in more detail in Section 6.)

According to OECD Online, "insolvency" is defined as "[T]he fact of being unable to pay one's debts or discharge one's liabilities". However, as suggested by Armour (2001), it is essential to distinguish between (i) "balance sheet insolvency"; (ii) cash-flow insolvency (or "financial distress"); (iii) economic failure (or "economic distress"); (iv) liquidation; (v) reorganization; and (vi) insolvency proceedings or

"bankruptcy" (e.g. Wruck, 1990: 421-422; Belcher, 1997: 39-55) in order to assess the right measures to undertake.

Balance sheet insolvency is an accounting concept (Belcher, 1997: 46-48). It indicates that the book value of a firm's assets is less than that of its liabilities. This differs from "cash flow" insolvency,[44] in which case a firm is unable to pay its *debt when it falls due*. Referring to English law, such inability may be inferred from the fact that a company has failed to pay, on demand, a debt which is due.[45] "Financial distress", on the other hand, refers to the condition experienced by a firm having difficulty paying its creditors. Although there are some terminological differences among authors,[46] the phrase is often used to refer to the condition of a firm in substantial default on its debt obligations (e.g. Gilson *et al*, 1990: 325; Wruck, 1990: 422). Following this definition, the expression is similar to 'cash flow' insolvency.

Since Armour (2001) does an excellent job in defining the terms above in a simple and understandable manner, most of his definitions will be employed here. Armour (2001) highlights the fact that financial distress, to a far greater extent than the balance sheet test of insolvency, is dependent on the structure of repayments of outstanding debt obligations, and the nature of the assets available to satisfy them. Illiquid assets and large repayments may mean that a firm which is solvent in a balance-sheet sense cannot pay its debts as they fall due. Conversely, a firm which has significant growth opportunities and debt repayments spread over a number of years may be insolvent in a balance sheet sense, but may nonetheless be able to pay its debts as they fall due.

Solvency should be distinguished from economic viability (White, 1989). Insolvency is concerned with the relationship between a firm's assets or cash flows, and

the amount of debt in its financial structure. Viability is a function of the net present value of its business as a going concern. A corporation is economically viable if and only if the business has a going concern value which is greater than the value of its assets sold on a break-up basis, and also greater than zero.[47] To put it differently, its assets are being put to their highest-valued use.[48] "Economic distress" refers to a lack of economic viability. Financial distress and economic viability are related in the following respect: all firms which are economically distressed *will* also become financially distressed.[49] The opposite, however, does not hold. A firm with an economically viable business *may* become financially distressed simply because it has taken on more debt than it can service.

The term "liquidation" and "reorganization" are used to refer to the *outcomes* of financial distress. According to Bebchuk (1998), when a corporation becomes insolvent and bankruptcy proceedings are commenced, the corporation will be either liquidated or reorganized. Liquidation, in this context, simply implies the conversion of a firm's assets by means of sale into cash. Care has to be taken to distinguish this concept from its usual usage as a synonym for winding-up proceedings. Although liquidation is a necessary component of winding-up proceedings, it can also occur with other procedures, for example, with administrative receivership.[50] The sale of assets can take two forms: either on a "going concern" basis, which involves sale of the entire business, including goodwill and other intangibles, or on a "break-up" basis, where assets are sold piecemeal.

Reorganization refers to the financial restructuring of a financially distressed firm. Claimants exchange their old claims against the firm for new ones, which – because the firm has been unable to pay its debt – will necessarily be less than the face value of their old claims. A reorganization is functionally equivalent to a going-concern liquidation in

which existing claimants are the purchasers (Baird, 1986). It should be highlighted that there are differences between these and various types of legal (corporate) insolvency procedures (known as "bankruptcy" in the US) related to them.[51]

According to Claessens (1998), restructuring refers to several, related processes, recognizing financial losses, and restructuring claims and the operational restructuring of corporations and banks. In cases of systemic restructuring, in tandem with these restructuring processes, the institutional framework for the financial and corporate sector undergoes major changes. Recognition involves allocation of existing losses. Losses can be allocated to shareholders – by dilution[52], to depositors and external creditors[53], by reduction of (the present value of) their claims – and the government, that is, the public at large, through increased taxes and expenditure cuts. Restructuring of financial claims can take many forms: reschedulings (extensions of maturities), lower interest rates, debt-for-equity swaps, debt forgiveness, indexing interest payments to earnings, and so on. Operational restructuring, an ongoing process, includes improvements in efficiency and management, reductions in staff and wages, asset sales, enhancing marketing efforts, and so on, with the expectation of increased profitability and cash flow.

Restructuring will have to be assessed on a case-by-case basis. Claessens (1998) provides the following conceptually useful classification of corporations: those that are profitable in the medium-term, those that cannot cover their financial costs [financially, but not economically distressed], and those that cannot cover their financial, labor and material costs [economically and financially distressed]. The first probably do not require any financial assistance, the second have potential for financial relief, while the third are candidates for liquidation.[54] Obviously, projected medium-term profitability will be

contingent on the intensity of operational restructuring and on overall economic conditions.

It should now be easier to understand the definition of a bailout and the subsequent difficulties that follow. Bailouts are assistance to corporations which, if evaluated by market principles, would have exited from the marketplace if not for such financial assistance (Financial Supervisory Commission, South Korea, 1999). Alternatively, for ease of analysis, I will define bailouts as government-assisted finance to *apparently* non-viable corporations.[55]

A workout, unlike a bailout, as defined by the FSC, is a process involving creditor financial institutions working closely with and providing support to the *economically viable* corporation. Workouts, in this case, are a result of object assessment of viability, based on transparent and fair procedures. This is synonymous with the government "bailing in corporations", not bailing them out by providing temporary financing where needed (which only acts as a catalyst or complement to private funds), *conditional* on corporate reforms.

Bailouts are often associated with cronyism since it is the common perception that the government (including officials) will try to aid corporations that have economic, political and/or personal importance. Bailouts can take numerous forms. According to Bansfield (1995), clear-cut forms of bailouts include the government giving the failed entity cash or cheap loans, or allowing it to write off its creditors without liability, so that it can resume business despite past poor performance.

According to Adam and Cavendish (1994: 15), "cronyism is the distribution of rentier opportunities to companies controlled by politicians, retired bureaucrats, parties in

the ruling coalition and politically well-connected businessmen, which in turn 'raised concerns about the transparency of government policymaking and implementation'." Yoshihara, on the other hand, views crony capitalist as "rent-seeking 'private-sector businessmen who benefit enormously from close relations' with government leaders by obtaining 'not only protection from foreign competition, but also concessions, licences, monopoly rights, and government subsidies (usually in the form of soft loans)', resulting in 'all sort of irregularities' in the economy" (Yoshihara, 1988: 3-4, 71).

It should be highlighted that a "rent", like a bailout, is in itself neither good nor evil since rent(s) *may* be efficient or inefficient depending on how they are obtained, and deployed and for what purpose – affecting the outcome. As such, financial assistance given to firms, that would otherwise have been liquidated, given market forces, constitutes a rent. Put differently, bailouts can be seen as rents that accrue to those parties that receive financial assistance or "protection" against market discipline. This rent *could* be socially undesirable since it may signal allocative inefficiency, by allocating too many resources to aiding firms that are not economically viable when other more deserving corporations are crowded out because of such choices.

In the following section, I will look at the debate between those favouring government intervention and the "no bailout" advocates.

5. Arguments For and Against Corporate Bailouts

The interconnectedness and interwoven relationship of banks and corporations have created a symbiosis that can be extreme in its effects – exceptional and impressive growth if the environment proves favorable, or severe contraction of output and growth when the reverse happens; there is a positive synergy in the former case and negative synergy in the