6.0 LESSONS LEARNT

It has been more than five (5) years since the Asian financial crisis. Recovery in the region has been remarkably rapid and strong. This can be seen in the economic indicators of the countries in the region, including Malaysia and South Korea.

It was a difficult time for the region to endure. Malaysia and South Korea should take heed from the crisis and prevent the same scenario from repeating. There were many causes to the contagion crisis and they should be identified and cured, using the right channels and methods. The lessons learnt should not be forgotten, as a huge price had been paid.

6.1 The Importance of Corporate Governance

The financial crisis brought attention to the long neglected issue of corporate governance. Transparency was one of the most important issues raised by many parties. In Korea, the *chaebols* accounted for over 50% of bank loans; this implied that they were indebted to the taxpayers or shareholders (Aiyer, 1999).

Korea has been weak in shareholders' rights, which was a reflection of the dominance of large inside owner or managers in the corporate structures. According to Aiyer (1999), the founders or owners of the top 30 *chaebols* were estimated at end of 1996 to hold an average of 10.3% of shares in their companies, but exercised near complete control of decisions.

Although creditors rights were stronger, since the corporate governance of the creditor institutions were weak, that did not amount to an effective channel of exercising corporate governance. The accounting standards existed were very poor, which raised many questions on the quality of the financial reporting system. Another shortcoming in the Korean financial system was the close connections between non-bank financial institutions controlled by *chaebols*, and their other affiliates.

For the case of Malaysia, awareness on corporate governance has not been at a satisfactory level. Minority shareholders did not realize their rights and were often manipulated by the major shareholders or the management, whom most of them were merely representing the major shareholders. The crisis brought attention to the importance of corporate governance and transparency among public listed companies, particularly for those known to be politically well connected.

Therefore, corporate governance remained a much-debated issue. Stone (2002) argued that corporate governance must be brought up to international standards to provide incentives for viable firms to restructure their balance sheets and maximize their value. Improved governance is needed not only to push managers to restructure the existing debt stock, but also to operate profitably and improve future profit flows. Among the measures that could be undertaken, include liberalization of foreign investment, which could promote good governance through the importing of international best practices.

Visco (1999), the Chief Economist of OECD, suggested that further increasing transparency was essential. Investigations in South Korea appeared to show that in the process of reform and recovery, some *chaebols* continue to subsidize weak affiliates, a practice that appeared to be inefficient. Increased transparency could spotlight inefficient practices so that those injured could take the necessary actions.

In Malaysia, corporate governance has been given attention and enacted by the government for companies to follow. A high level Finance Committee on corporate governance was formed and was an outcome; the Malaysian Code of Corporate Governance (MCCG) was produced in March 1999. MCCG focuses on building structure and rules to govern the Board of Directors, creating independent audit committee, ensuring disclosure of all relevant and material information to shareholders and credits, and control management. The code has two main parts, where part one set out broad principles of good governance in Malaysia and part two sets out best management practices for public listed companies to follow.

6.2 Structural Weaknesses in the Financial System

There was no doubt that Asian countries had recorded remarkable growth. The four "tigers" in the region include China, Taiwan, Korea and Singapore.

However, the crisis had only revealed that the Asian "miracle" was not reflective of the reality. Korean *chaebols* might have developed to be strong and huge conglomerates; Malaysian companies could be expanding, however, they did not expand with strong and solid background or base. The expansion in size was not accompanied with strength.

Prior to the crisis, the financial system appeared to be fragile due to structural weaknesses. In Korea, its financial system was characterized by pervasive government intervention and discretionary enforcement of prudential rules. In addition, the government played a significant role in resource allocation and was responsible for the soundness of individual financial institutions. The crisis left the financial institutions under capitalized and burdened with high levels of non-performing assets.

Financial institutions in Malaysia, too, had to adopt "flexible" lending policies, especially in approving loans to politically well-connected companies, so that major projects desired by the government could be carried out. Besides, close associates of influential politicians were granted licenses to operate financial institutions, thus approving loans that were way beyond the repayment ability of the companies.

Many of the investors had lost their confidence in the financial sector. This had a huge implication especially during vulnerable times. Therefore, restoring confidence in the financial system was vital. Various efforts had been carried out by both Malaysian and Korean governments to eliminate the weaknesses in the financial system. Mergers and acquisitions were implemented in Malaysia. It was the government's aim to retain only major banks in the financial system when all merger efforts ended. South Korean government, too, had more than 100 financial institutions closed or suspended, and launched a major programme to rehabilitate the viable ones. The Bank of Korea was given greater autonomous, while the government was to refrain from intervening in bank management and individual lending decisions (Saito, 1998).

It is hoped that the weaknesses in the financial system could be reduced, thus strengthening the system to be more resilient against future crises.

6.3 The Nature of Business-Government Relations

As discussed earlier, business-government relations existed in most Asian countries, including Malaysia and South Korea. However, evidence suggested that the nature of business-government relations in these countries brought more frauds than benefits. On one hand, the role of government in developing and bringing growth to the countries should be acknowledged and appreciated. On the other hand, coupled with the rapid development were cases of corruption, cronyism, unequal distribution of resources, rent-seeking etc.

According to Drysdale (2000), three weaknesses arising from the system of business-government relationships in many East Asian countries have been particularly important. First, the existing structures have not provided effective discipline for firms and banks. In order for market mechanisms to provide efficient outcomes, discipline is needed to prevent firms from abusing market power, to stop managers from exploiting privileged information and to ensure that resources are allocated to the most efficient firms and projects. Inadequate regulation and close links between government agencies and the corporate sector have made regulatory forbearance common.

Second, institutional arrangements have encouraged inefficient management and allocation of risk. Exposure to risk is an important discipline in ensuring that firms face the consequences of their own actions. However, by subsidizing or suppressing the risks, government involvement in business can cause excessive risk-taking and over-investment. The consequences could be hazardous.

Third, the relationship between government and business sometimes increased opportunities for rent seeking. Where government is closely involved in business activities, there is a risk that rent-seeking or outright corruption becomes entrenched. This might increase the fragility of the political system and inhibit the smooth transfer of political power in crises. Besides, increased rent seeking or corruption not only resulted in inefficiency of resource allocation, but also undermined government legitimacy and weakened the prospects for transparent and predictable policymaking.

The instances discussed in the earlier chapters revealed the negative aspects and outcome of close business-government relations. There were weaknesses in many areas, such as the financial system, political system and economy system of both countries. The financial crisis should have given a clear indication to Malaysian and Korean governments that the nature of business-government relations adopted has not been healthy. The politics and close business-government relations had weakened the regulatory capacity of government and its ability to respond to the crisis once it struck (Haggard, 2000). This lesson was learnt the hard way. The nature of the relationship should be revised and forged from a different perspective to ensure that history would not repeat itself again.

6.4 The Importance of Competition

In both Malaysia and South Korea, free market competition has not been practiced entirely. Therefore, companies nurtured in both countries lacked the competitiveness in not only the local environment but also the international market. The problem was more acute in Malaysia than in South Korea after the crisis.

In South Korea, the Kim Dae Jung administration realized the importance to encourage competition. It was also part of the IMF package that South Korea practice further trade liberalization and a firm exit policy. Firms that could not compete were allowed to fail. It was a world of "survival of the fittest". Although many firms failed, which included one of the largest *chaebols* in Korea, Daewoo, there were also many that could withstand the turbulence.

Malaysia, which refused to adopt IMF policies, continued to bail out ailing companies through mergers and acquisitions by government-owned companies or selected businesspersons. Cross shareholding became one of the measures to prevent these highly indebted companies from collapsing. In general, the companies still operate in a safe environment, protected from uncertainties in the international market.

From the perspective of business-government relations, the relationship formed had produced structurally weak companies in both countries, particularly in Malaysia. If trade liberalization were to be implemented, many of the companies would have to struggle to survive the competition brought in by foreign companies. Therefore, Malaysia should revise the form of business-government nexus to increase local companies' competitiveness in the international arena, especially when the AFTA 2005 timeline is approaching. Malaysian companies could not be protected from the reality forever, with globalization being the upcoming trend worldwide.

The lessons learnt from the financial crisis should always be remembered. With the currently ongoing reform and restructuring in both countries, it is believed the same mistakes would not be repeated in time to come. Various aspects of the system, such as corporate governance, financial system, nature of business-government relations, and companies' competitiveness, should be revised.

The core of the revision, however, lies in the business-government relations itself. Although dynamic in nature, the relationship should be formed on a healthy basis and encourage more growth and benefits to the country and public at large than promoting frauds such as corruption and cronyism. It is important for the business-government relations to be beneficial to the businesses in strengthening their abilities than creating companies that are incompetent in the international market.

7.0 CONCLUSION

7.1 Concluding Thoughts

The 1997 Asian financial crisis had close connections with the nature of business-government relations in the region. It is believed that the nature of the relationship has had a huge bearing on the impact of the crisis and recovery process. As illustrated in the examples of Malaysia and South Korea, where both countries practiced close business-government relations, the relationship demonstrated more negative impacts than positive ones.

In general, there are strengths as well as weaknesses to a system of close networks between business and government. At early stages of growth, where there is great potential for productivity gains, investment returns are high and market failures may be substantial, forging close relationships between companies, banks and governments may serve as an assurance mechanism. The relationship may encourage investment by promoting long-term relationships and lowering the cost of credit.

However, as development progresses, the risks appear to rise. As marginal returns fall and the scope for easy productivity gains is exhausted, the costs of maintaining institutions and relationships developed earlier have risen. As a result, the weaknesses of the political and economical structure are visible as they reflect the relationship between the government and business sectors.

In South Korea, companies have grown to be huge in size, only to be financed using the wrong channel. Most of them were financed with short-term debts, especially from foreign banks and company-controlled financial institutions. Indirectly, the government that approved and granted most of the projects to these companies had placed them in a difficult position. In order to maintain good relationship with the government, many of the firms could not reject the offer, as that would probably jeopardize the network formed.

As a result, they became highly leveraged firms and vulnerable to any uncertainties. Therefore, when foreign banks refused to roll over their loans, many of them were highly indebted. The dreams of these "too big to fail" companies were also shattered.

In Malaysia, the situation is more complex as the government has long maintained ethnic preferences (Haggard, 1999). Companies mushroomed under the implementation of the New Economic Policy (NEP). Under such protected environment, companies that mostly belong to the new rich Bumiputeras have been nurtured with the mindset of "subsidization". They were not exposed to the risk and uncertainties of business, thus making them lacked the competitiveness especially in the international market.

When the crisis struck, it was revealed that many of them were trapped with the problem of excessive risk taking and over-investment. Because of their incompetence, Malaysia could not implement tight monetary and fiscal policy, as what Korea has done. The close relationship between government and business did not bring up these companies to be tough but pushed them into a comfortable zone that resulted in incompatibility and incompetence.

The commitment and willingness to accept changes demonstrated by the South Korean firms proved that they were tougher compared to Malaysian firms. There has been no doubt that both countries were recovering after the crisis, as discussed earlier. However, the ability of South Korea to repay all debts to the IMF on August 23, 2001, which was three (3) years ahead of schedule, proved that they operate much better than Malaysian companies do. The latter, still operating under a much-protected environment, have not been demonstrating such remarkable results since the implementation of capital control measures after the crisis.

Therefore, actions should be taken to revise and reform the nature of business-government relations in Malaysia and South Korea, for this instance, to ensure a "healthier" relationship and increase the effectiveness and efficiency of both sectors.

7.2 Implications of the Study

This study was set out to examine the past and existing business-government relations in Malaysia and South Korea, on how the relationship affect the pace of reform and recovery of the countries, and the extent to which the relationship is beneficial to the countries.

At the beginning of the development stages of both the countries, the network was vital to ensure rapid growth. However, the relationship was then manipulated by certain individuals for personal interests. This resulted in various cases of frauds and damaged the political and economy structure as a whole.

Of both the countries, South Korea, which practices authoritarian political system and made government assistance conditional on good export performance, particularly in the Park Chung Hee era, has created many world-class manufacturers that are competitive and more resilient to crises. However, the financial crisis hit Korea hard. By accepting the economy package of the IMF after the crisis, trade liberalization is implemented in the country, and as an outcome, some firms were allowed to fail instead of being bailed out by the government. Despite this, many survived and are doing well in the international market, such as Kia.

Malaysia, which practices democracy system but takes a different approach in terms of business-government relations, has companies nurtured by the government but lacked the competitiveness in the international market. In battling the financial crisis, the country has resorted to its own capital control measures. Fiscal and monetary policies had to be loosened but politically well-connected companies were still protected by the government, far from reaching the level of world-class companies. However, this is not a long-term measure, as these companies would soon be played out once they venture into the international market.

To a very large extent, the pace of recovery after the crisis in both the mentioned countries has close connection with the circumstances in the countries resulting from the nature of business-government relations thus far. Looking from the perspective of business-government relations, the findings of this study suggest that the relationship need to be revised to ensure long-term profitability to the financial system, corporate sector and the political structure. A healthy and beneficial relationship should be forged and maintained to create a win-win situation where both parties will benefit from the network.

7.3 Limitations of the Study

The study was only examining two countries in the Asian region where the Asian "miracle" to have occurred. There were other countries where the practice of close business-government relations has long been existed as well as affected by the Asian financial crisis. More examples could have been used to compare and contrast with Malaysia to examine the nature of the relationship in these countries.

Furthermore, not many write-ups were found on Malaysia due to the nature of the issue, which was supposed to be sensitive in the context of the country. Sources of information were limited in examining the nature of the business-government relations in Malaysia.

7.4 Suggestions for Further Research

For further research purposes, studies could be done on other countries in the East and Southeast Asian region, where a close business-government relation has been practiced.

From the social aspect, study could also be concentrated on the area of industrial relations in countries affected by the crisis. With the restructuring effort going on, workers are very much affected and it is important to maintain a positive relationship with them because labour is the pillar of the economy engine. Business activities depend on the utilization of labour to be successful.

Another area that could be studied is the extent to which the recovery process is completed. It is difficult to determine when the process is considered complete. It would be interesting to examine the future possible policies that are going to be implemented to prevent the country from plunging into another financial crisis in time to come.