

# CHAPTER 1

## **1. INTRODUCTION**

The financial turmoil that erupted from Thailand since June 1997 and spread rapidly to Malaysia and its neighbouring countries was debatably due to many causes. From macroeconomic viewpoint, it's due to current account deficit (IFCI) and capital inflow surge. Lax of lending by banking system (Pilbeam 2001, pp. 119-122; Masuyama, Vandenbrink and Chia 1999, p.157; Jao 2000, pp. 13-24) and inadequate disclosure of corporate governance (IFCI) are the crux of the structural issues. Financial Markets issues i.e. contagion<sup>1</sup> effect, high indebtedness (Pilbeam 2001), and credit crunch<sup>2</sup> are among the causes that were brought up by analysts. Furthermore, Pilbeam 2001 argued that policy errors by effected national governments and the initial IMF response seem to be the reasons of further deterioration of the crisis in the short term.

Malaysia, however, did not suffered a serious impacts as its neighbours i.e. Thailand and Indonesia. Some argue that if Malaysian government let IMF to intervene in its financial rescue, it would has been the same case as South Korea, Thailand and Indonesia. Instead, Malaysia imposed capital control to prevent capital outflow, and established assets management companies and debt restructuring vehicles (i.e. Danaharta, Danamodal and Corporate Debt Restructuring Committee (CDRC)) to rescue its economy (Masuyama, Vandenbrink and Chia 1999, pp. 160-161; Bank Negara Malaysia (BNM) 1999 pp. 596-600). From the implementation and results of the capital control policy by Malaysia government, the policy was proven to be effective in crisis rescuing, at least in Malaysia.

---

<sup>1</sup> Goldstein (1998, pp. 17-22), Goldstein brought out two most possible causes of contagion; the "wake up call" hypothesis and the competitive dynamics of devaluation. Also, see Pilbeam (2001, p. 123), Jao (2000, pp. 5-10) and IFCI.

<sup>2</sup> "A credit crunch can be defined as a restriction of credit by financial intermediaries, to an amount that is less than the quantity that is desired by the borrowers, even if they are willing to pay for the cost of credit, and are able to satisfy the non-price terms of credit that are posted by the lenders." (Gang and Soon 2001).

Construction sector of Malaysia faced severe downturn after its half decade of rapid growth from 1990 to 1996, due to the crisis. Nevertheless, construction sector did not immediately effected by the impacts of the crisis. The impacts were realised in 1998. Properties are over supplied than the demand of the market during 1998. *"Construction sector, output growth had moderated from a peak of 17.5% in the first quarter of 1997 to 7.8% in the fourth quarter of 1997...."* (BNM 1999 p. 579)

Several major projects were deferred by government to reduce its current account deficit (BNM 1999 pp. 579-580; Hendon 2001). Some construction companies like Road Builder, Bina Puri, Gamuda and IJM have ventured into the foreign market such as India, Vietnam and China (The Edge June 28, 1999 and July 26, 1999) to sustain their growth. Financial institutions was experienced an increasing number of non-performing loans (NPLs) from construction companies. Even after the financial crisis, performance in construction sector is still sluggish and hardly shown any significant upward movement. What could have caused the construction sector in such a bad condition?

## **1.2 PURPOSE AND SIGNIFICANCE OF THE STUDY**

The purpose of this study is to examine the financial performance of the corporations in construction sector in Malaysia during the 1997 financial and economic crisis. This study used various financial ratios to evaluate the performance of construction sector. It's trying to find out the possible cause or causes that might contribute to the financial distress of the construction sector and to portray the financial health of the sector.

The objectives of this paper are

- O1 - To determine the financial ratios that effect the financial health of construction firms.

- O2 - To determine the construction firms' vulnerability by using the Altman's Z Score<sup>3</sup>, Tobin's Q and other key financial ratios as benchmark during the financial crisis.
- O3 - To generate an overview of the financial performance of construction sector during the financial crisis.

### **1.3 SCOPE OF STUDY**

The study of this paper was to narrow down the scope of financial analysis in a more corporate sense. The study focused on the corporations in the construction sector of Malaysian public listed company in Kuala Lumpur Stock Exchange (KLSE). Key financial ratios (i.e. leverage, cash flow to debts, current ratio, liquidity and tangible fixed assets growth) were used to examine the performance of the corporations. Detail examination of the accuracy and effectiveness of the financial ratios was not under the scope of this study. The selection of the ratios was based on the related literature reviews and empirical studies.

### **1.4 LIMITATIONS**

Companies listed in and after 1996 have not been selected for sample as their financial data before their listing is not accessible publicly in KLSE library, KLSE web site and Bloomberg web site library. These companies do not have their complete financial data of three financial periods (i.e. pre-crisis, crisis and post-crisis), available for assessment. Furthermore, it's very time-consuming to approach them individually for their financial data.

The accounting periods of corporations' annual report was not standardised. Inevitably, causes comparison error when two corporations with different accounting periods were being compared for their financial performance. Also, not all the historical annual reports were available in KLSE library; some of them were missing. This caused the data of some companies marked "data unavailable" in this report.

---

<sup>3</sup> Kaveri (1980 pp. 6-10), Altman's Z Score was developed to predict the corporate bankruptcy status. The issue of the accuracy of Altman's Z Score is out of the scope of this study. Also, see Yadav (1986 pp. 22-25).

A sample of pure construction firms for the study was not possible. This is because most of the construction firms listed in KLSE are diversified into others construction-related business such as trading of construction machinery, quarrying business and construction materials manufacturing. Some even diversified into unrelated field of the construction business such as plantation. All these might cause the evaluation of the financial performance of his paper not representative of the pure construction firms.

## **1.5 ORGANISATION OF THE STUDY**

This paper consists of five chapters. The present chapter has dealt with introduction and background study of 1997 financial crisis. This chapter explained the objectives, scope and limitations of this study. Chapter 2 reviews the financial ratios for predicting corporate financial performance. This chapter outlines and reviews the construction sector in Malaysia from pre-crisis, crisis, to post-crisis period. Leverage, competition, structure and funding of the sector. Issue of corporate governance is also discusses in the chapter. The research design, selection of research measures, sampling method and data collection procedure are discusses in Chapter 3. Chapter 4 forms the core of this research paper. Results and findings are detail in this chapter. Finally, Chapter 5 summarises and concludes the study of this research paper. Suggestions for additional research and pitfalls of present study are outline in this chapter.