Beyond the Asian Turmoil: Capital Account Crisis and Family-Based Corporate Governance

Executive Summary of Proceedings

MACROVIEW

[¶] References are to paragraphs

Key Issues: What went right with the pre-crisis economic systems in Southeast Asia, which had enjoyed miraculous growth over the preceding few decades? When the unpredicted Asian crisis suddenly broke out, analytical attention shifted overwhelmingly to consider what went wrong with those same economic systems. This overall problem was taken up at two levels in the main presentations at this seminar: that of capital account crises, and that of corporate governance among the predominantly family-controlled business groups typical of the crisis-affected economies in East Asia. [¶2, 3]

Characterization of Crisis: The Asian turmoil can best be characterized as a capital account crisis, which should be differentiated very clearly from a traditional current account crisis. The latter is often caused by poor macroeconomic performances as evidenced by high inflation, large budget deficits, and low domestic saving rates. In the case of the Asian economies, however, their macroeconomic performances had been excellent prior to the crisis and yet they were not spared. Different prescriptions are recommended for managing a capital account crisis as opposed to a current account crisis. [¶4]

Policy Package: In the case of the capital account crisis problem, different kinds of policies would have to be introduced at the right time and in the right sequence, otherwise the crisis would get worse before it gets better. The priority should be to stop both external and internal panic. To stop panic on the external front, policies are needed to stop foreign currency and international equity crisis. On the domestic front, policies have to be implemented to address the banking crisis and the credit crunch. Once the panic is curbed, the collapse in output would have been arrested, and recovery would resume. [¶12]

Beyond the turmoil, policies on bold structural adjustments could then be recommended, including bank closures, bank mergers and so forth, and other structural adjustment measures as well. It would not be appropriate to carry out bank rescue and bank restructuring at the same time; bank rescue should be undertaken ahead of bank restructuring, or else the crisis would worsen. [¶13]

Nine New Policies: were recommended for handling the capital account crisis and the resulting credit crunch. [¶14]

On international plane

1 Credible emergency financing from official sources, with less strings, to prevent liquidity from turning into insolvency problem. [¶15]

2 Foreign private creditors should be induced to maintain exposure ("bail-in"), to stop unnecessary runs. [¶16]

3 Collective measures to restore systemic currency stability, including joint interventions in foreign exchange markets. [¶17]

4 Coordination of macroeconomic demand expansion by crisis-hit neighbors, rather than competitive devaluation. [¶18]

At country level

5 Domestically, avoid tighter money or fiscal consolidation during panic. [¶19]

6 Offer generous domestic liquidity via "lender of last resort" role of the central bank. [¶20]

7 Quick and compulsory bank recapitalization so that systemic insolvency can be prevented and normal lending can resume. [¶21]

8 Consider temporary easing or even suspension of capital adequacy standards of banks until they can be reestablished without exacerbating credit contraction. [¶22]

9 Provide credit through non-market channels, such as development and long-term credit banks, to speed up recovery when market is paralyzed. [¶23]

These above measures must be taken first to restore confidence, following which the crisis-hit economies can then proceed to carry out bank restructuring and implement other structural reforms. Since there are two targets, there should be two policy instruments, one for handling the international liquidity crisis through some standby arrangement, and another policy instrument to handle the domestic banking crisis by maintaining the status quo while new instruments are designed to handle the crisis. [¶24, 34]

Case Specifics: One vexing problem in the **Thai case** in particular was that as the crisis originated from the private sector it was very difficult for the general public to understand why public money was needed to resolve a problem created by the private sector. Unless this can be explained satisfactorily to the public, so as to clarify the appropriate linkages, it may be difficult to adopt the right measures the next time a similar crisis erupts. [¶30]

The key to help the **export sector** is to resolve the export financing problem which has caused some delays in the process of quick economic recovery. [¶32]

There is also a need for greater **competition and efficiency among banks**, whether it comes from foreign participation or domestic participation through privatization. The key is that there is a need to improve corporate governance by taking government intervention out of the banking sector. [¶33]

Family-based Governance System (FBS): The key difference between FBS as a governance system, and either a bank-led (BLS) or equity-market-based (EMS) systems lie in that neither the banks nor the equity markets ultimately control the family business groups. That control resides with the family in the final analysis. This may not be without economic rationale (especially in the early stages), but ultimately FBS can run into trouble as well. [¶37]

What went right during this period at the firm level is the economically efficient use of the flexibility of family-based management. Part of what went wrong - at the micro level - certainly came with the expansion of the family enterprises beyond the point where they could be financed primarily from the internal resources of the family groups. This resulted in highly leveraged debt-financing. At the same time the control of the firm was not shared with outside shareholders. As a result, neither BLS nor EMS type of governance could be exercised efficiently. [¶38, 39]

Failures in Monitoring: It seems that monitoring problems by creditors and equity-holders may have also become increasingly more severe, leading to a failure of FBS. In sum, legal frameworks defining property rights in particular are important as much of the strengths and weaknesses of the family-based corporate governance system may come from not having well-defined property rights structure and weak enforcement of property rights when they exist in the Asian continent. [¶40, 42]

In general, at a low level of development when institutional foundations are weak and underdeveloped, FBS, characterized by a high degree of family-group control, economizes on transactions costs; but further growth leads to problems unless relevant laws are well-defined and enforced and markets are competitive.

Future Research Directions: To mitigate a capital-account crisis, a new international financial architecture should be designed, including in particular, appropriate capital control on massive short-term capital inflows, proper sequencing between domestic financial liberalization and capital account convertibility, and an appropriate way of promptly providing international liquidity. For the domestic front, a key issue is how to strengthen the banking industry and nurture sound securities markets.

Summary of Proceedings

1. The ADB Institute seminar on Capital Account Crisis and Family-Based Corporate Governance was conducted in the Bank's Headquarters on 29 April 1999 as part of the Bank's 32nd Annual Meeting Seminar Series. It was attended by about 100 participants, comprising officers from commercial banks, the Bank, academic and multilateral institutions, and government agencies, who were invitees to the Bank's Annual Meeting.

2. In the session on Capital Account Crisis, **Dr. Masaru Yoshitomi**, Dean of ADB Institute, spoke on the nature of the capital account crisis and **Prof. Kenichi Ohno**, Visiting Scholar, ADB Institute, on the appropriate policy prescriptions for the capital account crisis. The panelist was **Dr. Teerana Bhongmakapat**, Professor, Faculty of Economics, Chulalongkorn University. The following issues were addressed during the session. What went right with the pre-crisis economic systems in Southeast Asia which enjoyed miraculous growth over the preceding few decades? Then suddenly the never-predicted Asian crisis broke out. What went wrong with the same economic systems? The Asian turmoil was characterized as a capital account crisis, in sharp contrast to traditional current account crisis caused by poor macroeconomic fundamentals. Different prescriptions were recommended for managing a capital account crisis as opposed to a current account crisis.

3. In the session on Family-Based Corporate Governance, the speaker was **Dr. Haider Khan**, Visiting Scholar, ADB Institute, and the panelist **Dr. Joseph P. H. Fan**, Associate Professor at the Department of Finance, Hong Kong University of Science and Technology. Corporate governance problems were discussed at the micro level in two contrasted ways. One related to the bank-led system or the equity-market based system, compared with, on the other hand, the family-based corporate governance system.

A. Session on Capital Account Crisis

Dr. Yoshitomi's Presentation

4. Dr. Yoshitomi emphasized that a capital account crisis should be differentiated very clearly from the conventional current account crisis, which is often caused by poor macroeconomic performances as evidenced by high inflation, large budget deficits, and low domestic saving rates. In the case of the Asian economies, their macroeconomic performances had been excellent prior to the crisis but yet they were not spared from the crisis. For this reason, he would prefer to call it a capital account crisis as distinct from a current account crisis.

5. He explained that the capital account crisis has two features, one, the international currency crisis and the second, a domestic banking crisis. The linkage of a capital account crisis and the associated credit contraction could be explained by taking note of two factors, one is the massive capital inflows, and the other the composition of capital inflows which was dominated by short-term loans. The capital inflow was massive in the respect that the net capital account surplus substantially surpassed the current account deficit. For example, in the case of Thailand, from 1992 to 1994, the current account deficit was about 5 to 5.5 percent of GDP, but in the same period, the net capital account surplus amounted to 8 percent of GDP, indicating that the balance of payment as a whole had increased by 3 per of GDP in the form of external reserves accumulation. Under the fixed exchange regime as was effectively practiced by Thailand at the time, accumulation of reserves meant that Thailand had to expand its domestic money supply and therefore its domestic bank credit. Such expansion of monetary aggregates resulted in the expansion of the absorption capacity in the economy, and in the case of Thailand, the absorption capacity once expanded resulted in lower net exports. Imports then increased to fuel the strong domestic consumption, and second, because of the strong domestic demand as compared with the domestic

capacity to produce, exports began to decline. So the current account deficit widened in the case of Thailand up to 8 percent of GDP. The balance of payments which was in equilibrium earlier, deteriorated rapidly by 1995 and 1996, as by then the current account deficit widened to as much as 8 percent of GDP. This was a situation very similar to that which prevailed before the Mexican crisis when that country suffered a current account deficit of around 8 percent of its GDP. But the mechanisms of the two crises appeared to be different; in the Asian crisis, it is the capital account crisis which caused the widening of the deficit on the current account unlike the Mexican crisis which was clearly caused by poor macroeconomic fundamentals.

6. The other factor that needs to be considered is the composition of the capital inflows. They were predominantly in the form of short-term loans, resulting in a double mismatch: a maturity as well as a currency mismatch. Both domestic financial and non-financial institutions were borrowing short and lending long, a practice common in the commercial banking business. However, the degree of mismatch in maturity was much larger among the crisis-hit economies compared with other advanced economies. The serious maturity mismatch together with the currency mismatch - with both financial and non-financial institutions borrowing in foreign currencies and lending in local currencies - led to rapid deterioration of their balance sheets once the local currency started to depreciate.

7. When the adverse effects of the two features of the capital account crisis were taken together, they led to the collapse of the domestic economy or the bursting of the bubble in the case of Thailand and to the emerging of excess manufacturing capacity in the case of Korea.

8. When international investors saw the rapid deterioration of the balance sheets of domestic institutions, they began first to reduce their capital inflows. This happened in the first half of 1997 as is evident from that period's balance of payment statistics, where capital account surplus began to shrink, resulting in the balance of payment as a whole registering a deficit rather than a surplus. External reserves started to decline because they were used to defend the exchange rate by buying up the local currencies and by selling external reserves, mostly in US dollars. Once the crisis started, the reversal of capital flows was very sudden and massive; in just one year, from 1997 to 1998, in the case of Thailand, the reversal of capital flows accounted for 19 percent of GDP; for the remaining crisis-hit economies, nearly 10 percent of GDP. The massive and sudden reversal of capital flow together with the double maturity and currency mismatches led to the domestic banking crisis. Once the international investors began to withdraw their funds, the balance of payments started to deteriorate, and with dwindling reserves, the governments could no longer defend their currencies; so many economies, as in the case of Thailand, had to allow their currencies to float. But once the local currencies were allowed to float, they suffered free-falls because of the massive and sudden reversal of capital flows.

9. The banking crisis and the currency crisis aggravated each other. With the banking crisis, the banks were squeezed and not willing to lend and credit contraction then followed. Dr. Yoshitomi called this "a double financial crisis", a financial crisis leading to credit contraction.

10. And under such drastic credit contraction, production began to collapse, resulting in the collapse of imports. The collapse of production was evident until very recently. This is the mechanism of the capital account crisis and credit contraction. For this new crisis, we need new policy prescriptions, without which the economies would simply get worse and worse. Prof. Ohno spoke next on those new policy prescriptions.

Prof. Ohno's Presentation

11. Prof. Ohno pointed out that a different set of policies would be required to deal with the capital account crisis as compared with the traditional current account crisis and that timing and sequencing of the new policy prescriptions were crucial. In the case of traditional current account crisis, what was normally done on the demand side was to tighten control of budget expenditures and on the supply side to liberalize, to deregulate and to privatize as part of a structural adjustment program. Such prescriptions did not need to change with time. The only important consideration was that the sooner they were implemented, the better it would be for the economy in question.

12. In the case of the capital account crisis problem, in Prof. Ohno's view, different kinds of policies would have to be introduced at the right time and in the right sequence; otherwise the crisis would get worse before it gets better. In his view, the priority should be to stop both external and internal panic. To stop panic on the external

front, policies are needed to ameliorate foreign currency and international equity crises. On the domestic front, policies have to be implemented to address the banking crisis and the credit crunch. Once the panic is curbed, the collapse in output would have been arrested, and recovery would resume.

13. Once panic has been eradicated, policies on bold structural adjustments could then be recommended, including bank closures, bank mergers and so forth, and other structural adjustment measures as well. The point he wanted to make was that it would not be appropriate to carry out bank rescue and bank restructuring at the same time. Bank rescue should be done ahead of bank restructuring. If bank restructuring was done ahead of a bank rescue in the case of a capital account crisis situation, in his view, the crisis would worsen.

14. Continuing, Prof. Ohno listed nine policies, which he recommended for handling the capital account crisis and the resulting credit crunch.

15. **Emergency Financing**. The speed and size of the financial package, in Prof. Ohno's view, are very important. He recommended large sums of money be committed up-front with very few strings attached from international lending agencies as this will impress the financial market and change drastically the market psychology. After the crisis ends, reforms could then be introduced, but during the critical months no difficult conditionalities should be attached to the emergency financing required to eradicate market panic. He cited the example of the 1994 Mexican Crisis where there was a big rescue package of $50 billion which was put together within one month of the crisis with no strings attached. The Mexican Government undertook reforms three months later after the panic ended. In the case of the Asian financial crisis, such sequential action was not taken.

16. **Private-Debt Rollover (Bail-in) by Foreign Creditors.** There should be stand-by arrangements, or a moratorium, to stop foreign private creditors from causing a run on a particular country. The possibility of this being accepted has been discussed by IMF, the G-7 countries and elsewhere before.

17. **Correction of Excessive Under-Valuation of Domestic Currencies.** Under a capital account crisis, there is a need to avoid raising interest rates too high to stop the rapid depreciation of domestic currencies, as this will worsen the domestic side of the crisis. International efforts would be needed to arrest the decline. An announcement by G-7 countries that the currencies were too low, together with mentioning of exchange rate targets, might help. Exchange rate stabilization funds and credit line arrangements among central banks, and particularly coordinated international interventions in the foreign markets of these multiple currencies will help without the need to raise interest rates.

18. **Coordinated Aggregate Demand Expansion At the Regional Level.** Current account crises inherently involve the immediate collapse of domestic demand. In a regional currency crisis, it would be preferable that each country expand domestic demand with positive spillover effects on its neighbors, and that international agencies help provide the coordination of necessary fiscal and monetary policies.

19. **No Fiscal and Monetary Tightening.** Under the capital-account crisis, no fiscal and monetary tightening is necessary at the beginning.

20. **Unlimited and Unconditional Provision of Liquidity.** The central bank must act as a lender of last resort, providing unlimited and unconditional liquidity until panic subsides. If this is not done, bankruptcy would continue and become worse as institutions which are otherwise sound will deteriorate rapidly because of lack of liquidity.

21. **Compulsory Bank Recapitalization by the Government.** During a capital account crisis, banks’ lending is constrained not by the usual reserve ratio, but by lack of capital, so there is a need to ease this constraint through injection of capital in banks. But this must be made compulsory, otherwise bank managers will hesitate and may not take timely action. Any delay will be critical as it would worsen the situation.

22. **Temporary Suspension of Capital Adequacy Standard.** In order to let the banks function again, in Prof. Ohno's view, there will be a need to suspend or at least ease the BIS capital adequacy standard during the initial stages. This view was also supported by **Joseph Stiglitz,** Chief Economist at the World Bank. Achieving BIS standards is an acceptable practice during normal times, but insistence on banks' compliance during the crisis period will result in worsening of the situation.

23. **Provision of Credit through Non-market Sources.** When private financial market and the country's banking system are paralyzed, financing from non-market sources such as development and long-term credit banks for small and medium enterprises is important.

24. All or some of the above measures should be implemented, depending on the situation. The key message that Prof. Ohno wanted to convey was that the above measures must be taken first to restore confidence, following which the crisis-hit economies can then proceed to carry out bank restructuring and implement other structural reforms.

Dr. Teerana's Discussion

25. Dr. Teerana pointed out that he shared most of the views expressed by Dr. Yoshitomi and Prof. Ohno. It was indeed a crisis of confidence. To him, it was a crisis of this decade and not the next one. It was essentially not a real sector crisis. It was certainly a banking crisis with the sudden stop of capital flows, and perhaps could be called a capital market crisis. A crisis of this type requires prompt outside help.

26. He indicated that he would like to touch on the post-crisis phase where financial liberalization would have to be considered. There will be continuing debate on this, as there are pros and cons. For a country to embark on financial liberalization, it has to be at a certain stage of development and its agencies must have the capacity to undertake the reforms without suffering the consequences of another financial crisis. It takes time for developing countries to be sufficiently well prepared for rapid financial liberalization and there is not much they can do to prevent possible financial panic alone.

27. He shared Dr. Yoshitomi and Prof. Ohno's views that raising interest rates during the initial phase of the crisis is not the way to stop capital outflows, due to weak links between high interest rates and currency appreciation. In the case of Thailand, this did not work; instead, raising interest rates has imposed a serious burden on the banking system, which faces a liquidity crunch and the need to quickly upgrade its standard. Rising interest rates were interpreted by the market that firms would not be able to service their debt and the Thai economy had inevitably collapsed. Tight monetary policy could be harmful and should be neutralized.

28. On the fiscal side, in 1997, Thailand also raised taxes in an attempt to balance the budget in the presence of tight monetary conditions. This may be a result of weighting currency stability over output concerns, leading to the default of many businesses and eventually, the government has to reduce the value-added tax rate down to its previous level. Easing tough conditions on budget deficits may be important to cope with the cyclical output decline. However, it is very crucial to ensure that the authorities involved are disciplined and have adequately channeled the funds in the budget for productive activities and policy reform facilitation. Therefore, fiscal expansion is not sufficient and can impose longer-term problems without tough conditionality on its uses.

29. He remembered that at the time of the crisis, Thailand needed a substantial sum of money to combat the liquidity crisis, but it obtained only $17 billion, which was hardly adequate to restore investors' confidence. He predicted that external borrowing would not be needed after the panic eased.

30. One aspect of the crisis which Dr. Teerana wanted to make clear was that the crisis originated from the private sector and it became very difficult for the general public to understand why public money was needed to resolve a problem created by the private sector. A lot of education and information sharing is necessary to explain this response to the public and make them understand the appropriate linkages. Until they understand, it may be difficult to adopt the right measures the next time a similar crisis erupts.

Question and Answer Session

? *A question was raised on how Prof. Ohno would handle the inflationary impact of massive devaluation and liquidity injections into the banking system.*

31. Prof. Ohno replied that he did look at the movement of WPI and CPI after the shock. He did not think that there was a vicious circle of inflation and depreciation. In fact, currencies were not falling because of purchasing power parity, but due more to financial and psychological effects. From the purchasing power parity point of view, the currency was undervalued. He believed that one must make sure that the policy prescription will not ignite a vicious circle of inflation and depreciation. He agreed that one needs to be concerned about inflationary impact and the social consequences of inflation.

? *Questions were raised on whether banks in Thailand were efficient and whether Thailand was facing problems with export financing.*

32. Dr. Teerana replied that the banking system in Thailand has improved significantly and most of the inefficient institutions have now been closed. The ones that survived should be in much better shape compared to before the crisis. On the question of non-performing loans (NPLs), the issue has been addressed and the number of NPLs has started to peak in certain banks. Solving Thailand's banking system has been slowed but is progressing at a steady pace. The key to help the export sector is to resolve the export financing problem, which has caused some delays in the process of quick economic recovery. Exporters continue to face problems with export financing but the government will be providing assistance, so Thailand's export sector should perform better in the second half of 1999.

33. **?** To a question on the banking industry in the region being dominated by government-owned banks and no concerted effort exerted by governments to open the banking industry to private banks, Dr. Yoshitomi responded that there is a need for competition among banks, whether it comes from foreign participation or domestic participation through privatization. The key is that there is a need to improve corporate governance by taking government intervention out of the banking sector.

? *A question was raised on how macroeconomic stabilization could be addressed without raising interest rates.*

34. Prof. Ohno replied that the question of whether high interest rates and macroeconomic tightening is the only way out in time of crisis has neither been proven or disproven. And so it could not be assumed that it was the only way out. Dr. Yoshitomi added that he would like to go further than Prof. Ohno on this point. He believed that in handling a double financial crisis, there is a need to mitigate both the currency crisis and the domestic banking crisis. But there is only one instrument used - high interest rates - to cope with the currency crisis, without paying attention to its implications for domestic production and credit contraction. In his view, since there are two targets, there should be two policy instruments: one for handling the international liquidity crisis through some standby arrangement, and another policy instrument to handle the domestic banking crisis by maintaining the status quo while new instruments are designed to handle the crisis. This approach was proposed in the paper authored by Prof. Ohno and Dr. Yoshitomi. (see Capital-Account Crisis and Credit Contraction: The New Nature of Crisis Requires New Policy Responses, ADB Institute Working Paper, May 1999)

35. **?** A question was raised as to whether the international lending agencies would be prepared to come up with the funds, when external financing is needed more or less unconditionally. Money has always been lent with conditionalities attached, and thus money without policy conditions may be difficult to come by.

B. Session on Family-Based Corporate Governance in East Asia

36. Dr. Haider Khan presented a paper-in-progress entitled "The Problem of Transition from Family-Based Corporate Governance in East Asia", the contents of which are summarized below.

37. The Asian financial crisis, which can be characterized as a capital account crisis with the twin features of a financial crisis, i.e. currency crisis (international) and banking crisis (domestic), has highlighted the weaknesses of the domestic banking system and hence underlying corporate governance. Dr. Khan identified the nature of corporate governance problems at the micro level in two related ways. First of all, in addition to the bank-led system (BLS) and equity market-based system (EMS), he develops the idea of a family-based corporate governance system (FBS). BLS and EMS represent the dominant mode of corporate finance by banks and equity markets, respectively. In the case of FBS in East Asia, the financing can come from three different sources. First,

FBS, especially in the initial stages of development of family businesses, could be financed internally in large part. Second, as the enterprise grows over time, the role of banks and outside equity becomes more prominent. However, the key difference between FBS as a governance system, and BLS and EMS, lies in that neither the banks nor the equity markets ultimately control the family business groups. That control resides with the family (or families) in the final analysis. This may not be without economic rationale (especially in the early stages), but ultimately FBS can run into trouble as well. Secondly, Dr. Khan, in his paper, tries to analyze the problems of FBS type of governance by considering five sets of stylized facts and characteristics with regard to FBS. These are: (i) extent of family controlled corporations in East Asia; (ii) dominant modes of financing; (iii) key information asymmetries and agency conflicts; (iv) problems of monitoring family businesses; and (v) investment and capital accumulation.

38. It is clear that family-based corporations have played a major role during the boom period of the "East Asian Miracle". What went right during this period at the firm level is the economically efficient use of flexible family-based management. The owner - managers, together with the professional managers they hired (e.g. the CP Group in Thailand, the Ayala Group in the Philippines, or the Samsung and Lucky-Goldstar conglomerates in Korea, among others) met the challenges of late industrialization in many sectors by exploiting profit opportunities as they arose. These ventures were certainly helped by government policies, including policies to build infrastructure, and their family and kinship networks, especially among the Southeast Asian overseas Chinese, which made "internal" (in the broad sense of the word) financing a source of expansion for a reasonable length of time initially. During this period, self-monitoring may also have been effective to a large extent. In addition, the family members in leading positions probably monitored the hired management closely as well.

39. Part of what went wrong – at the micro level – certainly came with the expansion of the family enterprises beyond the point where they could be financed primarily from the internal resources of the family groups. This resulted in highly leveraged debt-financing. At the same time the control of the firm was not shared with outside shareholders and their mounting debt not adequately monitored by independent bankers. As a result, neither BLS nor EMS type of governance could be exercised efficiently.

40. An important area of on-going and future research will be to examine the broad hypotheses advanced in the previous paragraphs in the context of late industrialization at the level of family-based corporate systems. It is possible, in principle, through further empirical work to ascertain whether FBS should be completely replaced with BLS or EMS (or some combination of both – a hybrid form of governance perhaps), or whether FBS can still be a viable form for some East Asian economies, particularly those at a lower stage of development (perhaps with GDP/capita of US$3,000 or below). Even if this hypothesis can be demonstrated to be true for the low or middle income economies in the aggregate, there is still the question of whether diversification has reached beyond the economies of scope allowed by the level of development of the economy. If this is true, then diversification is now a drag on scarce managerial and financial resources of the corporation. In addition, the monitoring problems may also have become increasingly more severe, leading to a failure of FBS. These significant issues require further empirical research using and building upon the conceptual framework presented in this paper.

41. Discussion of the paper was focussed on several conceptual, empirical and policy issues.

Dr. Fan's Discussion

42. On the conceptual side, the main discussant, Dr. Joseph Fan of Hong Kong University of Science and Technology, agreed that the concept of FBS was useful for analyzing corporate behavior in East Asia. The major governance problems such as self-monitoring can be presented clearly in this framework. Major performance indicators, such as investment and capital accumulation, can also be examined in this context. However, he pointed out that legal frameworks defining property rights in particular are important, as much of the strengths and weaknesses of the family-based corporate governance system may come from not having well-defined property rights structures and weak enforcement of property rights when they exist in the Asian continent.

43. Empirically, questions were raised regarding the relevance of the arms-length model of corporate governance to Asia. Institutions may be country- and culture-specific, one member of the audience pointed out. Another participant raised a question regarding the relationship between ownership concentration and profitability. Whether there is an inverted U-shaped relation between the two is an empirical issue that is not settled yet in the

Asian context.

44. Finally, on the policy side, it was emphasized that policies for both improving the self-monitoring of the family-based corporation and monitoring of these corporations by banks or equity markets needed to be considered. It was pointed out that the paper listed a number of specific policy questions of this type. At the present, however, it is far from clear where family-based governance is still applicable. At the same time problems of banking system restructuring and capital market deepening need to be addressed simultaneously to make other types of corporate governance viable options for East Asian corporations.

FURTHER REFERENCES

Capital-Account Crisis and Credit Contraction: The New Nature of Crisis Requires New Policy Responses *by Masaru Yoshitomi & Kenichi Ohno, ADB Institute Working Paper (May 1999)*

Corporate Governance of Family Businesses in Asia: What's Right and What's Wrong?
by Haider A. Khan, , ADB Institute Working Paper (August 1999)