

## GOVERNMENT ANNOUNCES FIRST LIST OF NON-VIABLE FIRMS

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### Current Situation

In an abrupt turnabout from its previous position of entrusting the disposition of ailing firms to the corporate sector, the government has recently stepped forward to take the lead in deciding the fate of ailing firms. This move appears to reflect the government's judgment that voluntary corporate restructuring is not moving along at an adequate pace. Although the main creditor banks are acting as the instruments through which the decisions are enforced, in reality it is the Financial Supervisory Commission (FSC) which is setting the tone and pace of corporate restructuring.

The FSC's first notable move was its recent announcement of the first list of nonviable firms that would be terminated. The list included 20 affiliates of the 5 largest conglomerates, 32 from the 6th to 64th-ranked conglomerates, and 3 independent companies. Altogether these 55 firms comprise 17.6% of the 313 ailing firms listed previously as candidates for forced exit. The total debt of these 55 firms, 10 of which are listed on the Korea Stock Exchange,

amount to 8,500 trillion won as of December, 1997. Their annual sales add up to 7,700 trillion won, with 19,000 total employees.

In making its final decision, the FSC considered financial factors such as each firm's ability to repay or service its debt, as well as its prospects for generating future profits.

The FSC also called a meeting of bank directors in charge of lending, where it asked them to agree to a "Financial Institution Pact on the Establishment and Operation of the Committee on Corporate Restructuring" (Corporate Restructuring Pact), which is scheduled to remain in effect until the end of 1999. This pact is an agreement among financial institutions that they will withhold from demanding the repayment of loans from an ailing firm during deliberation of the firm's termination or while plans for its restitution are being drawn up.

The scope of this pact will cover firms that belong to the 64 largest conglomerates and that have more than 250 billion won in bank loans. The members of the pact will include banks as

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<Table 1> Summary Statistics for the 55 Terminated Firms

	Capital	Debt	Annual Sales	Net Profit	Employees
All 55 firms	1,139 tril. won	8,526 tril. won	7,731 tril. won	-733bil. won	19,800
Average	21 bil. won	155 bil. won	141 bil. won	-13 bil. won	360

a matter of course, and the secondary financial sector such as merchant banks is also expected to join the pact. The participation of the tertiary financial sector such as mutual trust funds remains questionable, however, since there is no way to enforce their compliance.

### *Problems and Prospects*

The announcement of the first list of firms to be terminated is not expected to have much real impact on the course of corporate restructuring. Rather, considering the relatively small size of the firms on the list and the limited effect that their termination is expected to have on the market, it is questionable whether the desired dual effects of raising the international credibility of Korean firms and attracting inward investment will actually take place.


Measures that anticipate some foreseeable side effects also need to be considered, especially as the second and third group of nonviable firms are determined and announced in the future. Foremost of such undesirable effects is the credit crunch that can result by banks' refusing to extend new credit or renew existing loans, a situation that will be all the more likely since the financial sector has yet to complete its own restructuring and much uncertainty exists about the viability of firms.

Second, there is the problem of unemployment. Although some unemployment will be unavoidable during restructuring, forcing the termination of nonviable firms without measures to deal with the resulting unemployment can result in considerable social and economic

anxiety.

Third, it will be important to have supportive measures in place to help sound firms and ailing firms that are deemed recoverable. In order to do so, the restructuring of the financial sector should be completed quickly, after which financial institutions can serve as the focal instruments of policy support. Experience shows that mere governmental suggestions or persuasions are likely to be ineffective in bringing about this outcome; the situation calls for some innovative initiatives on the part of the government.

Besides the main purpose of weeding out unproductive firms, the decision to force the exit of nonviable firms may also be a means to push along the "Big Deal" business swap arrangements among the 5 big conglomerates. The decision to include information about illegal transactions inside a conglomerate in future deliberations on nonviable firms clearly takes aim at the 5 big conglomerates. It is expected that investigations into their funding arrangements will be used to bring considerable pressure on the 5 conglomerates to come up with a "Big Deal" agreement.

The success of the Corporate Restructuring Pact will depend on the continued compliance of the pact members. Last year's Bankruptcy Prevention Accord failed in the end because members of the second and tertiary financial sectors went to extreme ends to retrieve their loans. It is also doubtful whether the month that is allowed in the Corporate Restructuring Pact is a long enough period of time for an ailing firm and its creditor banks to come up with a realistic plan for recovery. 

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