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Governance of firms during reorganization following The Bankruptcy Act of Thailand : An agency consistent model

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บทคัดย่อ

บทความนี้ได้ทบทวนวรรณกรรมเพื่อพัฒนาข้อเสนอสำคัญสามประการ ที่จะช่วยปรับปรุงบรรษัทภิบาลของบริษัทที่อยู่ระหว่างการฟื้นฟูกิจการตามกระบวนการทางศาลให้มีประสิทธิภาพมากขึ้น ข้อเสนอที่สำคัญนี้อยู่บนพื้นฐานของรูปแบบต่าง ๆ ในทฤษฎีตัวแทน ซึ่งเป็นรูปแบบที่แนะแนวทางการปรับปรุงการดำเนินงานของบริษัทด้วยการผสมผสานวิธีที่มีประสิทธิภาพในการควบคุมและจูงใจผู้บริหารบริษัทที่กำลังฟื้นฟูกิจการ ซึ่งก็คือ ผู้ทำแผนฟื้นฟูกิจการ และผู้บริหารแผน ทั้งนี้ตามพระราชบัญญัติล้มละลายของประเทศไทยระบุว่า บุคคลทั้งสองประเภทนี้ มีบทบาทสำคัญอย่างมากต่อกระบวนการฟื้นฟูกิจการ พวกเขาอาจเป็นบุคคลคนเดียว เป็นบริษัทหรืออาจเป็นคณะกรรมการก็ได้ ไม่มีข้อกำหนดใด ๆ ในกฎหมายที่กล่าวถึงองค์ประกอบที่สำคัญของพวกเขา ดังนั้นข้อเสนอของบทความนี้จึงได้นำเสนอแนวทางไปสู่องค์ประกอบที่สำคัญของผู้บริหารสองประเภทนี้ ที่จะช่วยส่งเสริมให้การฟื้นฟูกิจการสามารถประสบความสำเร็จได้ อย่างที่สำคัญข้อเสนอที่พบแนะนำว่า น่าจะเป็นประโยชน์ต่อการฟื้นฟูกิจการ หากศาลอนุมัติผู้ทำแผนและผู้บริหารแผนที่มาจากการรวมตัวของผู้อำนวยการอิสระเป็นส่วนใหญ่ และพิจารณาเงื่อนไขของผลตอบแทนที่จูงใจผู้ทำแผนและผู้บริหารแผนให้หลากหลายรูปแบบ โดยควรมีผลตอบแทนในรูปของหุ้นทุนอย่างมีนัยสำคัญด้วย ยิ่งไปกว่านั้น แม้ว่าจะไม่มีสัญญาณใด ๆ จากตลาดระหว่างการฟื้นฟูกิจการ แม้ว่าระหว่างการฟื้นฟูกิจการบริษัทเหล่านี้จะได้รับการคุ้มครองว่าจะไม่ถูกครอบงำกิจการจากผู้ใด หรือถูกบังคับด้วยระเบียบเกี่ยวกับราคาตลาดของหุ้นทุน ศาลก็ควรแน่ใจว่าจะมีตัวแทนของผู้ถือหุ้นอย่างเพียงพอในคณะของผู้ที่จะมาเป็นผู้ทำแผนและผู้บริหารแผน

Abstract

This paper reviews previous research to develop 3 key propositions which will improve the governance of companies during bankruptcy reorganization. The model is based in Agency Theory and suggests avenues for improving the performance of restructured companies by effective monitoring and incentive alignment of the managers of the restructuring process. The Thai Bankruptcy Act specifies two critical positions to be involved in the reorganization process, the Planner and Plan Administrator. These may be individual, Companies or committees, but the Act is silent on their composition. The propositions provide guidance to the ideal composition of these positions to enhance the chances of successful reorganization. Specifically, they suggest that the court approved Planner and Plan Administrator would benefit by the inclusion of a majority of independent directors and the provision of incentive based remuneration packages to managers including a significant equity component. Further, given the absence of market signals during the restructure process, where the firm is effectively protected from takeover and market price discipline, the court should ensure the adequate representation of equity holders on the overseeing Planner and Plan Administrator committees.

คำสำคัญ : การฟื้นฟูกิจการตามกฎหมายล้มละลาย พระราชบัญญัติล้มละลายของประเทศไทย ทฤษฎีตัวแทน บรรษัทภิบาล ประเทศไทย

Keywords : Bankruptcy Reorganization, The Thai Bankruptcy Act, Agency Theory, Corporate Governance, Thailand

1.0 Introduction

This paper reviews previous research to develop propositions which impact on the critical governance factors impacting on post-bankruptcy reorganization performance in Thailand. Reorganization is an extensive alteration of a financially distressed firm regarding capital, organizational and management structure following a plan worked out during the reorganization proceedings under the bankruptcy law. The objectives of reorganization are to eliminate the cause of the failure, settle with creditors and allow the firm to remain in business (Ross, Westerfield & Jordan, 2000). Legally, there are two alternatives for firms which have filed for bankruptcy; liquidating and reorganizing. Liquidation is the process of winding up the operation of firms that are not viable whereas bankruptcy reorganization provides for rehabilitating the debtor. The reorganization process involves the debtor, who is known as the debtor-in-possession (DIP) or incumbent manager, remaining in possession of his or her property and developing a plan to generate funds, while the business's debts are restructured in order to allow the debtor to continue business operations. It enables valuable firms to improve and continue their operations by providing several mechanisms for ensuring that these firms can emerge from bankruptcy adequately (Brigham & Houston, 2001; White, 1989).

In Thailand, only three research studies on a formal legal reorganization procedure have been conducted. The first, by Vongvipanond, Jumpa and Wichitaksorn (2002) investigated economic and legal perspectives of court - supervised corporate restructuring including the implementation of the reorganization plan and a firm's post-bankruptcy performance. The second study by Pipatsitee, Kuldilouk and Ekukara (2003), investigated the effectiveness of the Thai bankruptcy court in terms of managing and controlling debt restructuring proceedings by comparing it with the Corporate Restructuring Group, Bank of Thailand and the Thai Asset Management Corporation. The third paper was also by Pipatsitee, Kuldilouk, Ekukara and Kuntong (2004) who utilized their 2003 research results to recommend methods for the development of law enforcement to improve debt restructuring efficiency.

The Thai research to date has thus concentrated on legal aspects of the reorganization procedure rather than investigating the governance settings

which will lead to improved outcomes for restructuring firms. This study will consider these variables based on the theoretical framework of agency theory and propose an optimal model for governance settings of companies undergoing reorganization.

The remainder of the paper is divided into 4 sections. Section 2 describes the literature specific to the Thai bankruptcy reorganization process and its key governance mechanisms. Section 3 develops an agency theory consistent model which outlines the governance settings which will theoretically contribute to reorganization success. Section 4 presents the conclusion and policy implications arising from the model.

2.0 The Thai bankruptcy reorganization process

A brief review of the Thai bankruptcy reorganization process follows to outline the administration process and key governance mechanisms included.

The Bankruptcy Court in Thailand opened on June 18, 1999 after the National Assembly passed an amended 1940 Bankruptcy Act and approved the establishment of special bankruptcy courts in March 1998 (Debt Restructuring Regimes in Thailand, n.d.; Urapeepatanapong, Sethsathira & Okanurak, 1998). The primary purpose of the establishment of new reorganization provisions was to deal with the economic fallout from the Asian economic crisis in 1997. The new Bankruptcy Act included elements of the US bankruptcy code's Chapter 11, British insolvency law and the Singapore Companies Act concerning Judicial Management (Pornavalai, 1998; Urapeepatanapong et al., 1998). Being similar to Chapter 11, the aim of amending the 1940 Bankruptcy Act was to give an opportunity to economically distressed companies to restructure their assets, operations, liabilities, and other obligations. The amendment was designed to encourage creditors and debtor companies to cooperate in maintaining future viability of debtor companies.

The process commences with the filing of a petition for reorganization to the court. The petition will be accepted if the person who petitions for reorganization is: 1) a creditor(s) to whom the debtor owes at least 10 million Baht, 2) an insolvent debtor owing creditor(s) at least 10 million Baht, 3) the Bank of Thailand, Securities and Exchange Commission, the Insurance Department and certain other government agencies being responsible

for overseeing the operations of the debtor. After examining the facts, the court will then decide whether to order business reorganization and appoint a plan preparer or dismiss the petition.

Once the court orders reorganization, proceedings commence and an automatic stay comes into effect. The debtor may no longer manage the business but the firm can continue business operations under the governance mechanisms of the reorganization process. Shareholders will retain only the right to dividend payments. The court will appoint an interim manager to act under the official receiver's supervision until the planner is appointed. When a planner is appointed, powers to manage the business and shareholder rights will be vested in the planner. The planner may be any person, company or committee nominated by the petitioner (the debtor or the creditor) and approved by the court.

Once appointed, the planner has three to five months to prepare a reorganization plan for approval by the creditors' and confirmation by the Bankruptcy Court. In the reorganization plan, the Bankruptcy Act only specifies broad requirements of the plan (section 90/42). They comprise reasons for the reorganization, details of the debtor's assets, guidelines and methods for reorganization, and releases of the security of secured creditors. Moreover, the reorganization plan must involve guidelines for the transfer of rights of claim, a period for the implementation not exceeding five years, and the name and qualifications of the plan administrator including creditors' approval of the plan. The plan must be able to show to the court that reorganization value exceeds liquidation value.

When the court issues an order accepting the reorganization plan, it will appoint a plan administrator who has rights and duties pursuant to section 90/59 of the Bankruptcy Act. The plan administrator may be any person, company, or committee nominated by the planner, accepted by the creditor voting and approved by the court. Once the court appoints the administrator, the duties of the planner immediately pass to the plan administrator who must manage the debtor's business in accordance with the plan until reorganization of the debtor's business operations is achieved.

During the implementation of the approved plan, the creditors may pass a resolution at a meeting to appoint a committee of creditors to monitor and give guidance to the plan administrator.

The plan administrator must manage the debtor firm following the plan, continuously report the progress of its implementation to a creditor committee and then submit it to the official receiver. The planner or the plan administrator acts as a board of directors to implement the reorganization plan, while the existing management team of an insolvent firm still manages the day to day business by cooperating with the planner and the plan administrator.

If the plan administrator or the official receiver believes that reorganization has been achieved, they may request the court to order the cancellation of the business reorganization. It should be noted that the success of the process is directly related to the reorganization plan and its implementation. Two positions are critical to this success: firstly the Planner as the person/committee who proposes the plan and secondly the Plan Administrator who implements it.

2.1 The key control mechanisms in the process

There are several control mechanisms set up by Chapter 3/1 of the Thai Bankruptcy Act to govern firms during the reorganization process. The key mechanisms are:

The planner: The planner has the duty to prepare a firm's formal reorganization plan in three to five months and manage the debtor firm during the time the plan is being proposed. The planner may be any person, company or committee nominated by the petitioner (the debtor or the creditor) and approved by the court. Their duties commence upon the court's order for business reorganization and finish when the court approves the plan.

The reorganization plan: The plan which is prepared by the planner must be accepted by three-fourths of the creditors voting at a creditors' meeting. It must contain all the information required in Section 90/42 such as reasons for the reorganization, details of the debtor's assets, guidelines and methods for reorganization namely restructuring methods, and name and qualifications of the plan administrator including creditor's approval of the plan. When the court issues an order accepting the reorganization plan, it will be used as guidelines for the plan administrator for managing the reorganized firm.

The plan administrator: The plan administrator may be any person, company, or committee nominated by the planner, accepted by the creditor

voting and approved by the court. The appointment, tenure, qualifications and compensation of the plan administrator are specifically contained in the plan. Once the court approves the plan and appoints the plan administrator, their duties commence and the duties of the planner immediately pass to them. They must manage the debtor's business in accordance with the plan until reorganization of the debtor's business operations is achieved. In addition, a remuneration package such as cash compensation and equity shareholding for the plan administrators is specified in the plan.

The creditors and a creditor committee: In the reorganization process, the creditors participate in all activities beginning with filing a petition and nominating or approving the planner. Further, they approve the reorganization plan and monitor the plan administrator via a creditor committee. The law specifies that the committee must be composed of at least three, but not more than seven members, from among the creditors or people assigned by the creditors to act on their behalf.

The next section presents a model of agency theory and the governance settings recommended to control agency problems and enhance post-bankruptcy performance.

3.0 An agency theory based governance model

Agency theory has been studied since the early 1970s and deals with the relationship of two parties, principals and agents (Fama & Jensen, 1983). In a business setting, the principals are represented by owners, shareholders or other stakeholders, such as potential investors and creditors, and the agents are professional managers (Hatch, 1997). Jensen and Meckling (1976) define the agency relationship as a theory of the firm based upon conflicts of interest between principals (owners) and agents (managers). Managers are hired to act as agents for owners, to make decisions to pursue organizational objectives and create corporate value so that stakeholders can receive high returns. However, agents are expected to have their own interests and may pursue strategies and goals to serve these interests rather than those of the owners and other stakeholders, leading to agency costs (Eisenhardt, 1989).

Jensen and Meckling (1976) define agency costs as the sum of monitoring cost, bonding cost and residual loss. Monitoring costs are expenditures paid by the principal/shareholders to directly monitor the

behavior of managers and may include internal and external audit costs. Bonding costs are incentives such as pay and equity holdings given to agent/managers to align their interests with those of the owners. Monitoring and bonding costs are never fully effective due to difficulties in measuring outputs and information asymmetry (i.e. managers' access to detailed information which is unavailable to the owners) giving rise to a residual loss (Godfrey & Hill, 1995).

The main objective of agency theory is to identify effective mechanisms to encourage managers to serve the firm owners' interests (Keasey, Thompson and Wright, 1997). Numerous prior studies attempted to understand agency problems and seek a number of effective mechanisms to reduce these costs (for example, Agrawal & Knoeber, 1996; Keasey et al., 1997; Fosberg & Rosenberg, 2003 and Core, Guay & Verrecchia, 2003).

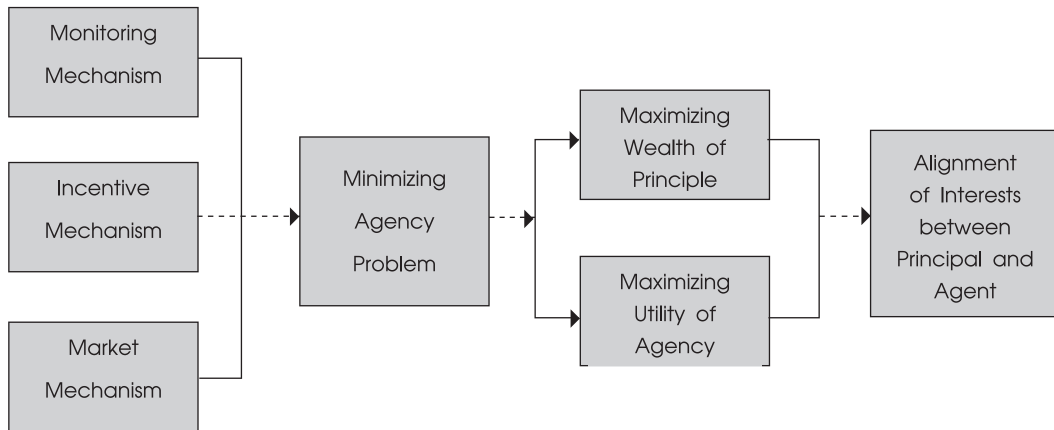
Figure 1 presents a model of agency theory which is developed from theory and prior research in the field. The mechanisms are divided into three categories: monitoring, incentive, and market mechanisms.

Monitoring mechanisms control managers' behavior through direct monitoring on managers actions. Methods include the use of a board of directors to provide guidelines or to directly supervise managers including evaluating their performance (Hatch, 1997) and the use of information systems such as a cost accounting system, budget system and other formal reporting to the owners or board of directors (Baiman, 1990).

Incentive mechanisms motivate managers to act towards maximizing organizational profit. These include the use of incentive based pay, which directly links the rewards paid to managers with those of the shareholders (examples include the use of options and share rewards).

Finally, market mechanisms act to control managers from outside the organization (for example through the threat of takeover and loss of employment). All three mechanisms contribute to minimizing agency costs and lead to a convergence of the interests of shareholders and managers.

Figure 1: An Agency based model to minimize agency cost through the use of Monitoring, Incentive and Market mechanisms



3.1 Applying the agency based model to the Thai bankruptcy reorganization process

Under the Thai Bankruptcy Act, the planner and plan administrator are the key governance mechanisms of the reorganization process (refer section 2.0). The planner has the duty to prepare a firm's formal reorganization plan in three to five months and manage a debtor firm during the preparation time. Once the court approves the plan and appoints the plan administrator, the duties of the planner immediately pass to him/her. The plan administrator must manage the debtor's business in accordance with the plan until the reorganization of the debtor's business operations is achieved. The planner and plan administrator may be a person, company or group of persons and also may be insiders (company executives) or outsiders (shareholders only). There are no regulations limiting the number of planners and plan administrators, their composition and their remuneration. The application of the principles of Agency Theory to the composition of the Planner and Plan Administrator leads to the following propositions.

Proposition 1.0: Outside (independent) directors should form a majority representation in the Planner and Plan Administrator

Fama (1980) and Fama & Jensen (1983) suggest a board with a high proportion of outside directors is more likely to perform its duties in monitoring business management effectively. There

are a number of empirical studies that have supported this conclusion. Baysinger and Butler (1985) explored the relationships between board composition, changes in compositions, corporate financial performance and changes in performance for a 266-firm sample between 1970 and 1980. The measure of financial performance selected was calculated by dividing the firm's return on equity by the average return on equity for all the firms in its primary industry, including those not in the sample. A key finding was that the ratio of independent to inside directors (i.e. company executives) was higher in firms which had a performance above average than firms with a performance below average.

Westphal (1999) studied board effectiveness and firm performance and found significant results in the survey data from 243 CEOs and 564 outside directors in April 1995. Westphal used multiple regression analysis and two measures of firm performance: return on equity - ROE (an accounting-based measure) and the market-to-book value of equity - MTB (a market-based measure) to investigate board involvement. The findings of this study suggested that board effectiveness may increase by encouraging collaboration between top managers and outside directors in strategic decision making. Judge and Zeithaml (1992) also found that a high proportion of inside directors on boards was associated with lower board involvement in strategic decision and a negative impact on firm performance.

Coles and Hesterly (2000) confirmed that there was a critical monitoring role for outside directors. They examined the independence of the chairman and board composition and shareholder value in the context of poison pill adoptions by using 247 sample firms reported in the financial press (i.e. the Wall Street Journal, the New York Times) during the period 1984-1986. They found that when leadership structure is not independent, the monitoring and control functions of outside directors are most important and most beneficial for shareholders. Brickley, Coles and Terry (1994) also indicated that outsiders represent shareholder interests better than inside directors. Gales and Kesner (1994), Daily and Dalton (1994a, 1994b) and Daily (1995) also confirmed that outside directors in the board of bankrupt firms are more likely to be highly involved in improving post-bankruptcy performance.

A more recent study by Peng (2004) was consistent with the study of Coles & Hesterly (2000) and Brickley et

al. (1994). Peng's study was based on an archival database covering 405 publicly listed Chinese firms and found that outside directors do make a difference in firm performance as measured by sales growth, although less when measured by return on equity (ROE).

The above studies support the effectiveness of an independent board, as represented by majority outside director membership, in guiding company management towards maximum profitability. The application of this principle to firms undergoing reorganization should improve their probability of success.

Proposition 2.0: Owners with significant equity ownership should be represented in the Planner and Plan Administrator

The notion that shareholders with a significant investment in the company will have strong incentives to monitor managerial activities has been widely supported in the empirical literature.

Cubbin and Leech (1983) studied the effect of shareholding dispersion on the degree of control in British companies and found a positive relationship between ownership concentration and profitability. Shleifer and Vishny (1986) studied large shareholders and corporate control and their findings from a sample of the Fortune 500 firms confirmed that the greater the percentage of ownership, the more expected profits.

Wruck (1989) studied equity ownership concentration and firm value from private equity financings and concluded that increased concentrated ownership from private equity sales have a positive effect on a stock price. Similarly, Oswald and Jahera (1991) explored the influence of ownership on performance by using a large sample size and also by controlling firm size differences. Their findings show a significant effect of ownership on financial performance as measured by excess stock returns even after controlling for size.

Bethel, Liebeskind and Opler (1998) investigated the consequences of block share purchases between 1980 and 1989 using a sample of U.S. firms and found that return on assets (ROA) as a proxy for a firm's operating performance improves in years two and three after the acquisition of large share blocks by activist shareholders. In the same year, Cho (1998) examined the relationship among ownership structure, investment and corporate value using ordinary least square regression with the control variables; firm size, financial

leverage, and industry effect. Cho's findings suggested that ownership structure affects investment and corporate value as measured by Tobin's Q.

In Thailand, Wiwattanakantang (1999) also studied the effect of ownership structure and corporate governance on performance. She used a sample of Thai firms and found that firms' major shareholders enhance profitability (ROA and Tobin's Q) as compared to firms with no major shareholders. The study of Suehiro (2001) on ownership patterns and corporate performance in Thailand also found statistically significant relationships.

The above literature indicates that the effect of equity ownership by the Board of Directors on performance is positive and significant. This should similarly hold when this is applied to the composition of the Planner and Plan Administrator.

Proposition 3.0: Members of the Planner and Plan Administrator should receive remuneration packages which include results based incentive payments

Managerial remuneration such as salary, profit-based bonus, and stock options are an efficient incentive mechanism to improve the goal alignment of shareholders and managers (Grant, 1998; Kaplan & Atkinson, 1998). Jensen and Murphy (1990) suggested that stock options, equity ownership, performance-related-pay and performance-related dismissals should be included as part of remuneration packages in order to provide financial incentives for management to make value-maximizing decisions, and increase company value. Numerous studies support the use of incentive mechanisms as an appropriate way to help shareholders encourage managers to pursue company goals (Baiman & Demski, 1980; Kim, 1995; Harrison, 2003).

Dyl (1988) examined listed firms in the Fortune 500 companies during 1982, and found that the levels of management compensation reduce the residual loss portion of agency costs. Jensen and Murphy (1990) investigated the pay-performance relationship for chief executive officers (CEO) by using the data of the Forbes surveys from 1974 to 1986. In their analysis, they measured a regression of change in CEO salary and bonus on changes in net accounting income and found a statistically significant and positive relationship. Albeit, this empirical relation is small for an occupation in which incentive pay is expected to play an important role.

Goldberg and Idson (1995) also

tested the performance effects of executive remuneration, using data from the listed firms of Fortune 500 companies during the period 1980-1981. Their results which are consistent with Jensen and Murphy's (1990) study and indicate that there was a significant agency effect on executive pay, though the total magnitude of the effect appears to be small, relative to company assets.

Similarly, Mehran (1995) examined the executive compensation structure of randomly-selected small and large manufacturing firms 1979-1980 and found empirical evidence on the relationship between the form of compensation and firm value. The findings showed that the form, rather than the level, in particular equity-based compensation can motivate managers to increase firm value as measured by Tobin's Q and by return on assets (ROA). Fosberg and Rosenberg (2003) also investigated agency cost control mechanisms. Their results suggested that share ownership by the firm's CEO is one of the effective mechanisms in controlling a firm's agency costs.

In the Thai reorganization process, cash and equity compensation for the plan administrator may be specified in the reorganization plan. Evidence from empirical studies in the literature generally confirms a positive link between executive remuneration and performance of the firms. Thus, it is possible to hypothesize that managerial remuneration (particularly that portion directly linked to performance) for the plan administrators is likely to be related to the financial performance improvement of insolvent firms.

4.0 Conclusion

The reorganization process involves the debtor, or incumbent manager, remaining in possession of their property and developing a plan to generate funds, while the business's debts are restructured in order to allow the debtor to continue business operations. It enables distressed firms the opportunity to improve and continue their operations with the objective of successfully emerging from bankruptcy. Two key players are involved in this process: first, the Planner as the body who proposes the plan for reorganization and second the Plan Administrator, who implements it. These positions may be held by any person, company or committee approved by the Court. There are currently no regulations guiding the composition or remuneration of those serving on the Planner and Plan Administrator committees.

This paper reviewed previous

research to develop propositions (Table 1) which outline the critical governance factors impacting on post-bankruptcy reorganization performance in Thailand. The model is based in Agency Theory and suggests avenues for improving the performance of restructured companies by effective monitoring and incentive alignment of the managers of the restructuring process.

These 3 propositions provide guidance to the ideal composition of the Planner and Plan administrator to enhance the chances of successful reorganization. They propose that the court approved Planner and Plan Administrator would benefit by the inclusion of a majority of independent directors and the provision of incentive based remuneration packages to those serving on these boards, including a significant equity linked component. In addition they require there to be an adequate representation of equity holders on these overseeing committees. This ensures proper monitoring of the reorganizing companies management by an independent board who will be motivated to maximize the returns to stakeholders.

It is argued that the facilitation of the above by either the enshrining in the Thai Bankruptcy Act, or less prescriptively through recommend codes of best practice, would ensure the best possible outcome for all companies entering the reorganization process.

Table 1: Propositions identified in the study

	Proposition
Proposition 1	Outside (independent) directors should form a majority representation in the Planner and Plan Administrator
Proposition 2	Owners with significant equity ownership should be represented in the Planner and Plan Administrator
Proposition 3	Members of the Planner and Plan Administrator should receive remuneration packages which include results based incentive payments

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