



MERGERS & ACQUISITIONS

Lessons from the Asian Financial Crisis

by Firend Al Rasheed, PhD

The current global financial crisis is forcing various global economic sectors to reshape their business operations. This is evident from a large number of recent incidents ranging from acquisitions in the US banking industry to mergers in the UAE construction sector. As the impact of the current financial crisis is being felt around the globe, the resurface of mergers and acquisitions (M&A) appears to be a mere necessity for many, and the Asian financial crisis of 1997 provides numerous lessons to be learned from.

Mergers and acquisitions are viewed traditionally as an effective corporate financial strategy. It is clearly distinguished from Foreign Direct Investment (FDI), which accounts for transfer of funds that takes place across borders and all additional insertions of capital equity. M&A, on the other hand, is only one component in the total FDI inflow or outflow. For developing economies, as investment activities improve, M&A activities become a direct reflection of the current business conditions and macroeconomic outlook.

As companies cut losses by unifying forces to salvage projects and business units that otherwise had to be liquidated, the price of local assets becomes more attractive. The value of local currency helps in the determination of the attractiveness of assets as well.

The current financial crisis, which is forcing such massive restructuring in the corporate

and financial sectors, is creating such a condition that redirects local and foreign equity to M&A. A decline in exchange rates, combined with low stock prices, in addition to government's efforts to attract foreign investments, can play a significant role in the economic recovery.

Asian financial crisis

The Asian financial crisis of 1996 and 1997 provided lessons that can serve best in the present global financial crisis. M&A reached its heights during the Asian financial crisis, driven primarily by augmented cross-border M&A. Between 2003 and 2005, M&A reached new heights as the leading form of FDI. M&A was especially attractive to the European and the US private equity firms and global investment funds.

M&A played a vital role in the Asian experience of post-1997. Today, Asian countries are preaching other nations

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from the painful lessons they learned during the past ten years. For the most part, Asian countries, namely Thailand, Malaysia, Indonesia, and Korea, managed to steer their economies to growth by floating their currencies against the US dollar with the exception of Malaysia, which chose to fix the value of the Ringet against the US dollar despite international pressure. However, the collective Asian experience in handling the crisis differs in methodology and results.

The Malaysian experience represented by the former Prime Minister Mahathir Mohammad consisted of two fundamentals. First, to keep fixed monetary policy regarding the value of the Ringet; the second was of macroeconomic nature. To the Malaysians, working their way out of the crisis by increasing their GDP was essential. To the Indonesians, bailout by International Monetary Fund (IMF) was a necessity to ease mounting social tension, while the Koreans favored more of a restructuring approach of their industries.



which was reflected in the value of their currencies prior to the recent crisis, each country experienced a re-shoveling in almost all industries. To the Koreans, M&A played a vital role in their economic recovery process. The reorganization of the Korean industries included mergers and acquisitions, selling-off bankrupt business units, and liquidating non-performing assets. FDI, in the form of M&A, was a necessity.



Traditionally, the Korean economy in the post 1950s was highly dependent on American direct investments and transfer of technology. This led to the centralization of the Korean economy into what is known as Chaebol.

The Korean Chaebol is often compared to the Japanese 'keiretsu' as a group

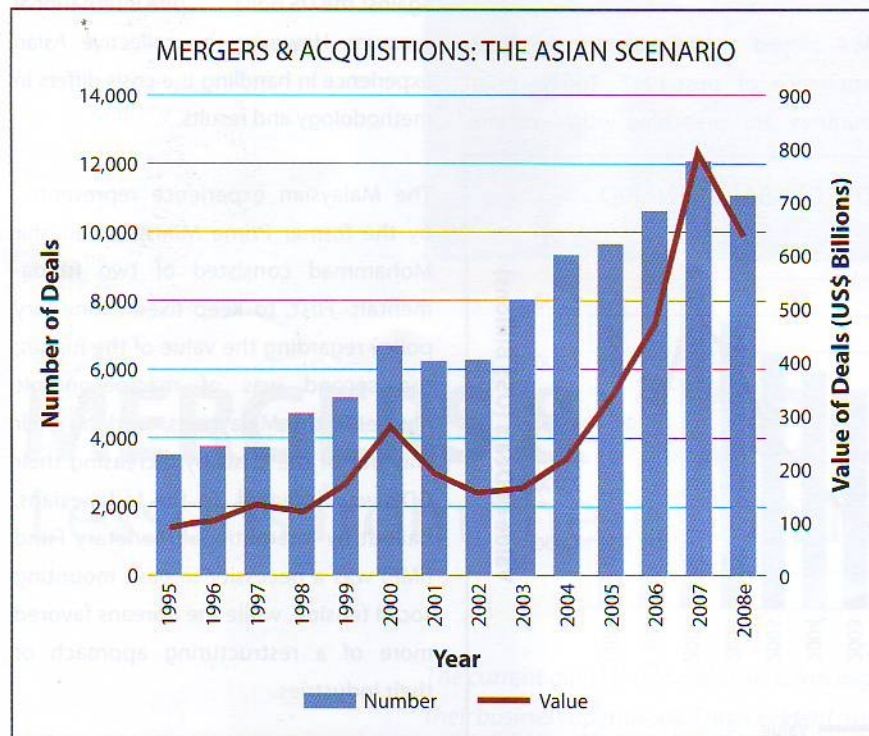
of industrial and economic power houses, which support one another. The centralization of the Korean economy facilitated improvements in industrial efficiency and capital structure. Yet, according to leading economists like Chansik Cho, the Chaebol left the Korean core economic jewels to vulnerability in

the face of global economic crisis. Such fears were accurate as most business units of the Korean Chaebol were a prime target for M&A during the post-1997 era.

By 1997, the Korean Chaebol's high debt-equity ratio exceeded 400%, and the average ratio for the largest Chaebol reached 518% (Bank of Korea report, 2008). The combination of insolvent corporations and problems in financial institutions caused the government to make a conscious policy shift targeting M&A and outward-looking growth strategy of export promotion. The fundamental nature of export promotion growth strategy in the post 1997 crisis was to promote exports of light manufactured goods such as semiconductors and electronics in which Korea possessed competitive advantage, given its cheap labor cost.

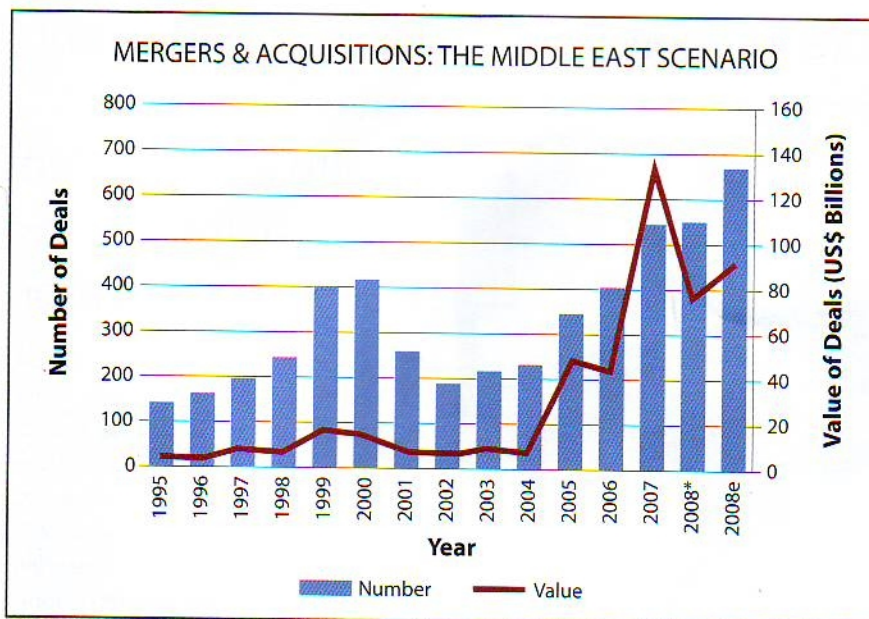
Macroeconomic policy

Among the macroeconomic mechanisms utilized was maintaining high interest rates to encourage domestic savings, and enforcing the Foreign Capital Promotion Act to increase the inflow of FDI. The Korean government also sought to devalue the Won to encourage exports and provided short-term export financing;



The total number of 2008 M&A deals with Asian participation will be about 11,000 transactions with a total value of US\$639 billions. In comparison to 2007, the number of deals is down by 9% and the value of deals is 24% less.

Source: Institute of Mergers, Acquisitions and Alliances



The total number of 2008 M&A deals with the Middle East participation will be about 671 transactions with a total value of US\$92 billions. This represents 1.7% share in number (1995: 0.5%) and 2.9% share in value of deals (1995: 0.6%) globally. In comparison to 2007, the number of deals is up by 23% and the value of deals is down by 32%.

Source: Institute of Mergers, Acquisitions and Alliances

allowed tariff rebates on materials imported for re-export use; and simplified customs procedures. However, the crisis in Asia required a larger institutional framework action.

Moreover, Asian nations impacted by the crisis had to arrive at some agreement with IMF despite its reluctance to interfere. The Asian economic reform programs largely focus on macroeconomic stability and overall reform of financial institutions. The aim of the macroeconomic policy was to attain stabilization by requiring acquisition of sufficient foreign reserves, reforming the corporate and the financial sectors, and laying a foundation for enhancing the long-term growth likelihood of the affected countries.

But, since central banks maintained a firm monetary policy position, the

market interest rates took multiple hikes since 1997, which at some points reached as high as 20%, as in the case of Korea, Indonesia and Thailand. The public sector experienced a makeover as well. While government budgets were significantly reduced, in the reform of the poorly performing Asian financial sectors, with the aim of improving confidence, governments sought that reforms of financial institutions should be open for M&A.

For instance, Korea First Bank and Seoul Bank, the decline capital adequacy ratios of which were the direct result of mismanagement, were recapitalized by the government. The shares owned by the government were sold later on to local and global investors. The Korean government also shut down fourteen merchant banking corporations and

revoked the licenses of non-performing security and trust companies.

A sound economic initiative

The evaluation and restructuring on the national economy, as in the case of Korea and other Asian nations or the global economy, for that matter, and restructuring of the public and private sectors with foreign acquisition and local mergers are not only a necessity, but also can prove to be a sound economic policy.

Recently, the markets worldwide are reporting increasing activities in M&A. This trend will continue to be a viable option as long as they can survive the current financial storm.



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