"Bankruptcy prediction & restructuring efforts in Pakistan"

By
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MBA-2002

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MASTER'S THESIS WORK
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3. Name: ____________________
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Signature of Thesis Advisor Signature of Student

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Name of Student: ______________________________

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Institute: NUST Institute of Management Sciences

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_______ First preliminary examination
_______ Second preliminary examination following as unsuccessful first attempt.

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2. _______________________	_________________________________
3. _______________________	_________________________________
4. _______________________	_________________________________
_________________________	_________________________________
Advisor (committee chair)	Advisor (committee chair)

________________________________ __________________________
Signature of Advisor Date

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Final Oral Exam

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ABSTRACT

Complete 3/4 page abstract of thesis of individual.

Attached as per Anx A.

Open to Public

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MASTER'S THESIS WORK

WE HEREBY RECOMMEND THAT THE DISSERTATION PREPARED UNDER OUR SUPERVISION BY: ______________________________

ENTITLED: ______________________________

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BE ACCEPTED AS FULFILLING IN PART OF PHILOSOPHY.

Guidance & Examination Committee

Member 1. ______________ Signature: ______________

2. ______________ Signature: ______________

3. ______________ Signature: ______________

Advisor/Supervisor: ______________ Signature: ______________
Date : ______________

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Pakistan's financial sector developed along predictable lines, given direct state intervention in the allocation of financial resources on the one hand and chronic fiscal deficits financed by borrowing on the other. Banks are by far the biggest component of the financial sector. Of banking system assets, nationalized commercial banks (NCBs) and privatized banks account for over 60 percent. While NCBs have been a prime source of working capital loans, development finance institutions (DFIs) have been important in long-term credit. As a result of political interference and directed credits, non-performing loans (NPLs) have become a major problem. The equity market, small relative to GDP, became dormant in the 1990s after foreign investors pulled out because of risk, although it has shown signs of revival in the past few years with the KSE Index reaching its highest ever.

Loan recovery efforts were intensified in early 2001. Contingent liabilities (CLs) stemming from NPLs and the need to re-capitalize banks have become a serious fiscal problem. However, there is a plus side to CLs in the sense,

(a) That they have come to the fore partly as a result of stricter standards and better supervision; and
(b) They create a compulsion for drastic change.

As SBP's strategy document notes, "The old model of long-term project financing through public sector owned and managed DFIs or specialized banks has become redundant and outdated. Non-performing assets of DFIs and specialized banks account for 65 percent of their total advances thus affecting the overall quality of banking system assets".

To improve loan recovery and facilitate privatization, the government also established an asset management agency, the Corporate and Industrial Restructuring Corporation (CIRC), which assumed all private sector NPLs over Rs.10 million, starting with those that already have court orders for execution. With special legal powers, the CIRC is expected to be more successful in liquidating and disposing of assets than the banks.

1.1 Problem Identification

Considering the above-mentioned scenario being faced in Pakistan at present the purpose of my research is to identify some of the prominent defaulter companies, evaluate their bankruptcy/default status and determine the most appropriate procedure to either revive or liquidate them, what ever is necessary.

1.2 Objectives

The objective of the thesis will, therefore revolve around the three-stated criterion through the use of bankruptcy prediction models dominantly the Altman's Z-Score model. Through this as well as the steps taken by the companies themselves, an in-depth analysis of the status of defaulter companies and non-performing loans and what steps have been taken to rectify this situation.

1.3 Scope of the Study

The scope of the study will take in to consideration 5 to 6 defaulter companies from the various sick unit that have already been identified by the Corporate and Industrial Restructuring Company. Data collected through various secondary resources will help in determining through the Altman model whether the companies' dire position could have been predicted through the use of various financial indicators. The next phase of the study would include the companies identified in the first phase and what is being and has been done to revive these companies. The various restructuring program being carried out by the government institutions to lead these identified companies to a new dimension will be the basis of this research.

All in all, the research will be broken down into three main categories,

1.3.1. Diagnosing the cause of underperformance

For an organization to successfully restructure its business to improve performance, it must first understand the causes of the problem. This will be done through analyzing its financial indicators and annual reports.

1.3.2. Planning a restructure

The successful restructure of an under performing business requires careful upfront planning. Government initiative to develop a tailored restructuring plan that will ensure all initiatives are prioritized for maximum effect, that organizational change is well-managed and that any challenges are anticipated and overcome efficiently, will be considered in this category.

1.3.3. Implementing a restructure

The implementation of a restructuring plan to ensure its effective execution, on time, on budget and in accordance with each deliverable specificied in the plan will be assessed on the basis of those companies, which have already been restructured by the CIRC.

1.4. Research Methodology

The methodology of this Study, firstly involves collecting data regarding the historical evidence regarding the companies under consideration. The key emphasis of the Study as already mentioned will be on the Institutions involved. Regarding the time period involved, previous data as far back as 1990 will be taken in to account.

The research will be conducted through

1. Literature review from secondary data i.e. the libraries as well as the Internet.
2. One prominent source of secondary data will be articles from local newspapers.
3. Interview with concerned authorities the Stock Exchange as well as the Securities and Exchange Commission of Pakistan.

2.1.What is Bankruptcy?

2.1.1 Definition

Bankruptcy is a legal method of eliminating debt and providing a means for debt-oppressed people to obtain a "fresh start." In many cases, bankruptcy means the elimination of the debt that you owe to your creditors. Bankruptcy involves an exchange. The company hands over control of their property and finances to a Trustee (the person who takes control over their property) in exchange for protection from legal action by the company's creditors (the people/companies the money is owed to). The bankruting company does not have to have a minimum amount of debts or property to enter bankruptcy.

Some of the assets may be sold to pay the debts. If the company's annual income is over a certain amount the company must make payments to the Trustee, which goes towards paying your debts.

Bankruptcy usually lasts 3 years but can be shortened or extended. At the end of the bankruptcy the outstanding debts (with a few exceptions) will be cleared.

2.1.2. Forms of Bankruptcy

They are two primary forms of bankruptcy, Chapter 7 and Chapter 13.

- **Chapter 7 Bankruptcy**

This is commonly referred to as "straight bankruptcy" and it is the most commonly filed form. Only individuals (not businesses or partnerships) may obtain a discharge in a Chapter 7 proceeding. Large credit card debt and other unsecured bills coupled with few assets, typify the filer of this form of bankruptcy. In the vast majority of cases this type of bankruptcy is able to completely eliminate all of the filers debts.

- **Chapter 13 Bankruptcy**

Under a Chapter 13 bankruptcy, a debtor proposes a 3-5 year repayment plan to the creditors offering to pay off all or part of the debts from the debtors' future income. The amount to be repaid is determined by several factors including the debtors' disposable income. To file under this chapter you must have a "regular source of income" and have some disposable income. Like in a Chapter 7, corporations and partnerships may not file under this chapter.

There are several situations where a Chapter 13 is preferable to a Chapter 7. A Chapter 13 bankruptcy is normally for people who have too much income to file a Chapter 7 bankruptcy or have the kind of debt that is non- dischargeable in a Chapter 7 (e.g. certain taxes). Also, people file Chapter 13 because they are behind on their mortgage or business payments and are trying to avoid foreclosure. A chapter 13 bankruptcy allows them to make up their overdue payments over time and to reinstate the original agreement. Also, where a debtor has valuable non-exempt property and wants to keep it, a chapter 13 may be a better option.

However, for the vast majority of individuals who simply want to eliminate their heavy debt burden without paying any of it back, Chapter 7 provides the most attractive choice.

2.1.3. Advantages of bankruptcy

Most debts are cleared when the company is discharged from bankruptcy. Examples of debts not cleared by bankruptcy are:

1. Court fines
2. Child support payments
3. Debts incurred by fraud
4. Student Loans

Companies filing for bankruptcy will need to continue to make these payments while they are bankrupt. Once a company becomes bankrupt its creditors and debt collectors must cease collection of the debt(s) from it.

2.1.4. Disadvantages of bankruptcy

The assets that vest in the defaulter company’s Trustee might be taken and sold to pay the company’s debts. The following assets do not vest and so they cannot be taken:

a. A car up to the value of about $5650
b. Necessary household property and clothes
c. Tools of trade up to $2850
d. Money or property bought with compensation payments for personal injuries
e. Superannuation and life insurance may be protected. Check with your insurer.

Warning: Your home may be taken and sold by the Trustee even after you have been discharged from bankruptcy.

The bankrupt company cannot borrow more than $3901 without informing the lender that they are an undischarged bankrupt. The bankruptcy will be recorded on the defaulter's credit record for 7 years from the date that they become bankrupt. After the company has been discharged from the bankruptcy they can have this fact noted on their credit report. The listing may cause problems for the company if it needs to borrow money later on. The bankruptcy will be recorded permanently on the National Personal Insolvency Index which is a public record, and which further put the company in a tenous position.

Furthermore the defaulter may have to surrender his passport to his Trustee. Permission of the Trustee will be needed in case the concerned party has to travel overseas. Inaddition to this, the defaulter may not be able to continue working in some professions and cannot be a company director or manager while they are bankrupt.

2.2. Indicators of Financial Distress/Sickness

It is becoming increasingly important for Board Members to quickly understand the operations of their company and be active participants in its' future success. For the successful analysis of a company's financial standing, it is important to look at both the financial as well as the non-financial indicators.

Some of the non-financial indicators include employee turnover (a negative indicator for culture, as well as a measure of the company's ability to deliver goods and/or services), brand identity (what the brand "promises" a customer and whether it is delivered), and corporate strategy with a focus on three to five years out. Seeing the company in action is also obviously important. Perhaps the easiest way to see how a company is doing, however, is to look at its financial statements.

2.2.1. Cash Flow Statement

One of the most important documents is a cash flow statement with a breakdown of Income and Expenses incurred by the company.

The Income category includes within it income itemized by each of the major revenue outlets as well as the extraordinary income such as the sale of an asset shown separately. By having the breakout of income, it will become instantly apparent if the company is obtaining an un-proportionate percentage of its revenue outside its core business line, thereby masking serious issues. It is important to understand the difference between what is showing on the balance sheet as cash and how much cash is available to pay bills or re-invest. In retail business for instance, much of the cash is in the individual stores' cash drawers. This does not represent free-and-clear cash to pay bills

Included in the Expenses category are the normal, company operating expenses, cash expenditures outside normal operating expenses such as debt payments, capital expenditures for new plant and equipment, shown on the dates the cash flows out. Companies with sizable capital expenditures for plant and equipment should have a comprehensive schedule showing the contract signing date, when the liability occurs, and when the cash goes out to satisfy those liabilities, cash outflows resulting from write-offs, which no longer show on the profit and loss statement but which are still regular cash outlays e.g. closed stores, litigation liability, with a note as to when a settlement write-off may occur, along with the timing of any cash payments, and any other extraordinary cash items.

2.2.2. EBITDA

EBITDA is the standard measurement of earnings and stands for *Earnings Before Interest, Taxes, Depreciation, and Amortization*. A reconciliation of EBITDA to cash provides a good measure of how earnings relate to actual cash flow. A chart illustrating revenue, broken down by core businesses, over the past five years will provide the direction for sales. EBITDA, broken down by the same core businesses should be superimposed on the same chart. This will provide a clear illustration of what has happened to revenue and earnings for the last five years and the direction the company has been heading.

2.2.3. The Balance Sheet

Reviewing the balance sheet with the lead outside auditor and corporate council is next. Key points include:

1. Under funded pension liability
2. Off-balance-sheet liabilities
3. Control within the company
4. Potential impact/cost of litigation
5. Any concerns that auditor/general counsel have.

Other financial indicators that can be assessed through the help of a balance sheet include poor budget and planning processes, failure to meet forecasts, decrease in sales, decrease in profit margins, inability to pass on price increases, increase in overheads, inventory build up, receivables build up, creditors build up etc.

2.2.4. Bank Debt

Another indicator of potential bankrupt companies is the level of bank debt in its capital structure. Along with this there is frequent change in the bankers or creditors, loan repayment deferrals, change in security coverage, breach of bank covenants, loan defaults, constant overdraft excesses, failure to repay seasonal facilities and the level of un-drawn facilities is at its minimum.

In addition to this failure to meet forecasts is often observed in such companies. Delays in responding to bank requests, inadequate financial reporting, loss of confidence by bank, alteration in the timing of regular payments is often the norm.

2.2.5. Corporate Culture.

Excessive employee turnover is a clear symptom of distress. Review the employee turnover in comparison to industry average for the past 3 - 5 years. This provides the trends in the company with a direct comparison to the industry as a whole.

Excessive turnover also creates a situation where no one knows how to run the business. When everyone is new they create their own systems and procedures. As this continues, the result is every unit running as a separate entity with its own rules. No longer are there consistent corporate policies and procedures. Training becomes an extraordinary expense, as the company is churning employees. Predictably, because vacant positions are a concern, the training period is reduced and the training programs compromised. This adds to the inconsistencies already existing in the company.

Lastly, long-term employees who typically had pride in their positions and/or their division have usually resigned. Employee theft increases dramatically.

The most important information comes from seeing the company in action. Observing how sales occur, the creation of the product or service, and its delivery is invaluable. Nothing replaces seeing how the company sells its product or service, creates it, delivers it to the customer, and then verifies customer satisfaction.

Reviewing the above information and having it updated periodically allows board members to quickly become comfortable with their role on the board, be able to make a meaningful contribution, remain current, and avoid some of the pitfalls that lead companies to become insolvent.

2.3. How to Predict Bankruptcy?

What has been so unnerving about a number of the recent bankruptcies is the speed at which they unfolded. Many were current on their financial obligations right up until the time they filed. As those who have had the dubious pleasure of dealing with trustees demanding the return of preference claims are painfully aware, such unforeseen bankruptcies can cost a bundle. The financial and non-financial indicators mentioned previously all help in analyzing the financial strength of the company and where it will stand in the foreseeable future. However companies facing financial distress have often been seen to withhold financial information through *lack of financial reporting* as well as failure to hold *Annual General Meetings*. Due to this gaining enough data to analyze the company's standing through its various financial indicators may pose as a problem. It is therefore, imperative that some other method be adopted. While there is no crystal ball that will allow credit executives to predict every customer bankruptcy, over the years those faithfully calculating Dr. Altman's Z-score have had good success identifying potential bankruptcy candidates as much as a year in advance.

2.3.1. Altman's Bankruptcy Predictor (or Z-score) Model

There is a specific mathematical model called the Altman Bankruptcy Predictor that is widely used in the turnaround industry to assess and predict a company's short-term survival prospects. The model is named after the renowned Edward I. Altman, Max L. Heine Professor of Finance at New York University's Stern School of Business, who published the initial research back in 1968.

Altman's Bankruptcy Predictor (or Z-score) is calculated as follows:

Z = (1.2*X1)+(1.4*X2)+(3.3*X3)+(0.6*X4)+(1.0*X5)

Where,

X1 = Working Capital / Total Assets = WC/TA

X2 = Retained Earnings / Total Assets = RE/TA

X3 = EBIT / Total Assets = EBIT/TA

X4 = Market Value of Equity / Book Value of Liabilities = MVE/BVTL

X5 = Total Sales / Total Assets = TS/TA

The Altman Z-score is used to determine a company's short-term outlook or future viability, where,

- **>3.0 ... Strong**
- **1.8 - 3.0 ... In danger**
- **< 1.8 ... Near death**

According to one scholarly journal, Altman's Bankruptcy Predictor has proven consistently accurate over the period of time since its development. The original samples in Altman's research displayed accuracy of 95 percent based on data from approximately one year prior to failure. The accuracy dropped to 72 percent based on two-year data. Subsequent tests on firms that have gone bankrupt since 1968 have shown an accuracy level of 82 to 85 percent.

Credit professionals who analyze the financial statements of both potential customers and existing customers are advised to include a calculation of the Z-score in their analysis. The model can be used in two ways:

1. To identify potential bankrupt accounts; and
2. To identify trends toward or away from bankruptcy.

Those who rely on trend analysis will be able to observe if a company is beginning to veer toward bankruptcy by simply measuring the changes in the Z-scores of the target company over several years.

Although the model was initially developed for manufacturing firms, further advancements have developed scores for both manufacturing and non-manufacturing firms.

For Manufacturing Companies

Probability of	Public	Privately Held

Bankruptcy	Companies	Companies
Low	3.073 and above	2.90 and above
Gray Area	3.075-1.875	2.90-l.23
High *	1.875 and below	1.23 and below

*Insolvency within 12 months

For Non-manufacturing Companies

Probability of Bankruptcy	Score
Low	2.60 and above
Gray area-company requires careful monitoring *	0.10 to 2.60

*Insolvency likely within 12 months 1.10 and below

2.4. "Which way to go?" Restructuring Alternatives available to bankrupt companies

Weaknesses in financial and corporate sectors can ultimately lead to crisis situations in even the strongest of economies. Rapid financial liberalization with limited institutional capacities; vulnerabilities get accumulated and put at risk the solvency of large parts of the affected economies. Inadequate regulation, weak supervision of financial institutions, poor accounting standards and disclosure rules, outmoded laws; corporate recklessness and inferior governance all contribute in escalating the already weak situation. Together, these factors legitimize investor panic that culminates in the disorderly collapse of asset prices and exchange rates.

2.4.1. Definition

Most of us confuse restructuring with layoffs, reductions, asset sales, and even premature foreclosure, and moreover downsizing. However most if not all understand that restructuring must occur in order not to go bankrupt. But what they do not realize is that downsizing is not equal to restructuring, but it is just a single part of restructuring. Restructuring is not just changing the size of a company but rather as the word shows, the structure of it.

"Restructuring is a corporate value creation technique applied at the highest levels by the top management through more efficient and effective management activities, the sales and purchases business units and assets, and other various strategy methods".

Restructuring of such a corporate sector therefore encompasses many things. It may include closing insolvent institutions or merging them into viable entities, re-capitalizing viable but illiquid institutions, and developing a framework for the resolution of debts. When debt rests largely with the corporate sector, corporate financial and operational restructuring is likely to become an integral part of the overall debt resolution process. To varying degrees, recovery plans may be accompanied by policy and institutional reforms intended to promote the future efficiency of the financial system and make it less vulnerable. These plans may include measures to strengthen the regulation and supervision of the financial system as well as those to encourage capital market development.

2.4.2. Restructuring Strategy: Government or Private Sector Led?

The first step towards the restructuring of the corporate and financial sector is determining the scale and depth of financial distress. A recovery plan can than be drawn up and the restructuring process begun. Restructuring then begins with the implementation of the recovery plan. One simple way of characterizing restructuring approaches is in terms of the role played by government and markets. Government has played a prominent role in resolving some crises, not only setting the policies, but effectively leading and guiding the restructuring process through financial support, nationalization of troubled institutions, establishment of centralized agencies to manage NPLs and facilitate corporate debt workouts. In other cases, government has chosen to set policies and a general framework, but then let market forces lead the process. These different approaches can have very different implications for how fast the restructuring progresses, who bears the costs, and what kind of financial system eventually emerges.

An advantage that is claimed for a government-led approach is that it can deliver quick results in terms of reducing the non-performing assets of the system and re-capitalizing viable institutions. Government-led approaches have most to commend them when human and financial resources are to hand and institutional capacities are high. The greater the disarray in markets and the larger the scale of the problem, the more a government-led approach makes sense.

But government-led approaches entail risks. They create substantial fiscal obligations and impose a heavy burden on the taxpayer. They may effectively bail out negligent owners and managers, and invite a recurrence of reckless behavior. System efficiency may also be compromised if government ends up owning and controlling a large part of the banking and financial system. Of course, these are not inevitable consequences of a government-led approach. Careful attention to fiscal limits, equitable cost sharing arrangements, incentive structures and an exit strategy that maximizes the recovery value of assets increase the chances of a successful government-led approach.

A market-led approach to restructuring has, in principle, three main attractions. First, by drawing on private rather than public resources to facilitate restructuring it helps limit costs to the taxpayer. Equitable cost sharing arrangements under a market led approach should help mitigate problems of moral hazard and create incentives for more efficient monitoring. Second, a market- led approach generally works better in recovering the value of non-performing and bad loans than a bureaucratically administered system. Competition in the acquisition and disposal of assets should eventually make for more efficient debt workouts.

Finally, a market-led approach should enhance systemic efficiency and safety. These benefits follow if market players who are better capitalized and managed are able to increase their market share at the expense of those that are weak and a potential threat to system stability.

In practice, a mixed approach is often followed, even where a market-led strategy might otherwise be favored. In developing economies, especially, there are usually a number of constraints that limit options. For example, the highly qualified and skilled personnel needed to steer banks out of their difficulties are often in short supply. In these circumstances, punishing managers and owners for their earlier mistakes may deprive the process of needed expertise. Likewise, markets are unlikely to work well in the midst of a financial crisis. Disposing of NPLs at the fire-sale prices that extremely bearish markets would dictate may serve only to increase the costs of restructuring. Also, the private sector simply may not have the resources needed to re-capitalize illiquid banks or an appetite for risk on the required scale. In these circumstances, public capital and other incentives may be needed. For these, and other reasons, crisis-hit countries often choose to blend elements of market-based and government-led strategies.

2.4.3. Operational vs. Financial Restructuring

There are many different dimensions to corporate restructuring. Before moving on to the specific bankruptcy procedures available to firms, it is necessary that we first consider whether the company should go for operational restructuring or financial restructuring. There is a distinct difference between financial and operational restructuring. The former entails a financial workout, while the latter focuses on a viable business strategy to secure profits. Ideally, these aspects of restructuring should be dealt with in tandem, since the benefits of financial restructuring are unlikely to prove durable in the presence of operational weaknesses. Corporate difficulties may be resolved by the market or within special purpose frameworks intended to ease coordination problems. Market solutions entail mergers, acquisitions and bankruptcies within an established framework of company law. Special purpose frameworks may be either voluntary or compulsory. Voluntary frameworks are usually preferred since they provide an opportunity for the rehabilitation of asset values and a recovery of debt. The role of such agencies is crucial when there are many interlocking debtors and creditors. Negotiations among these parties are usually guided by a set of well-defined rules. These would normally assert creditors' rights, while providing some breathing space during which businesses enjoy a stay on their debt. The rules are likely to require that debtors submit plans for financial and operational restructuring to creditors for their approval. To help resolve coordination problems, majority voting on these and other matters is the norm. To the extent that voluntary arrangements work, both debtors and creditors should benefit. If they fail, or no agreement can be reached, resolution of debts would normally occur through bankruptcy proceedings. Therefore for voluntary arrangements to work, there should also be a credible threat of action under binding foreclosure and bankruptcy procedures.

If these do not exist, voluntary frameworks are unlikely to achieve much. Normally, some combination of market and special purpose frameworks for debt resolution will be applied. In cases where there are a few large creditors, who may wield considerable political and economic influence, voluntary procedures like these may not be so appealing. In these circumstances more direct involvement by government in the process of corporate restructuring may be called for.

The issue of what role banks should play in the resolution of corporate debt is not a straightforward one. While banks may have "insider" knowledge of their clients, they may have little expertise to offer on how their businesses can be operationally restructured. In attempting to resuscitate bad and non-performing loans, bank can make matters worse. For example, to avoid provisioning and a dilution of equity, some banks may be willing to lend into arrears, even where businesses are not viable. Ultimately, this only increases overall costs. But in other cases, illiquid banks may attempt to foreclose loans and seek earlier repayments from creditworthy borrowers, thus undermining their viability. Incentive incompatibilities often mean that there are risks in letting banks lead corporate debt restructuring.

Finally, there is the issue of timing. Corporate sector debt resolution and restructuring cannot really begin until a resolution strategy has been determined for the banking system. To some degree, banks may also need to replenish their capital before they can agree to debt stays or to reschedule non-performing debts owed to them.

2.4.4. Traditional Chapter 11 Bankruptcy, Prepackaged Bankruptcy & Out-of-Court Restructuring

Financially distressed firms have three options available to them to continue independent operations: traditional Chapter 11 bankruptcy, prepackaged bankruptcy, and out-of-court restructuring.

2.4.4.1. Prepackaged Bankruptcy

When a company prepares a reorganization plan that is negotiated and voted on by creditors and shareholders before the company actually files for bankruptcy, the process is called prepackaged bankruptcy. The idea behind a pre-packaged bankruptcy plan is to shorten and simplify the bankruptcy process in order to save the company money in legal fees, cause less disruption to the company's business, less damage to its goodwill and hopefully generate more for the creditors.

Many distressed companies attempt to restructure with an exchange offer and, if unable to garner sufficient approval from creditors (usually an exchange offer requires 90% acceptance), file a prepackaged bankruptcy. If the prepackaged plan involves an offer to sell a security, it may have to be registered with the SEC. Under the Bankruptcy Code, two-thirds of the stockholders who vote must accept the plan before it can be implemented, and dissenters have to go along with the majority.

Committees of creditors and stockholders typically negotiate a plan with the company to relieve the company from repaying part of its debt so that the company can try to get back on its feet. One committee that must be formed is called the "official committee of unsecured creditors." They represent all unsecured creditors, including bondholders. If the company has publicly held bonds, the "indenture trustee," often a bank hired by the company when it originally issued a bond, may sit on the committee. Additional official committees may sometimes be appointed to represent stockholders. The Trustee may appoint another committee to represent a distinct class of creditors, such as secured creditors, employees or subordinated bondholders.

After the committees work with the company to develop a plan, the court must find that it legally complies with the Bankruptcy Code before the plan can be implemented. This process is known as plan confirmation. Many restructurings are filed in a hybrid form containing both the terms of the exchange offer and the terms of the prepackaged bankruptcy.

2.4.4.2. Chapter 11 Bankruptcy

Court conciliation (sometimes called "arrangement") is a workout process that dates from 1934. It was adopted simultaneously with the bankruptcy law of that year, and was designed to provide an alternative to liquidation for ailing firms that were able to restructure their debts with their creditors and continue in business. Chapter 11 is classified as a court conciliation bankruptcy. A debtor company can apply for a court conciliation only if it ceased to pay debt service "due to reasons that are exceptional and independent of it ... and insolvency is due to circumstances over which [it] had and could have had no impact." Workouts under court conciliation exclude secured creditors and government creditors (such as tax and social security offices), and thus they cover only trade creditors and bank creditors (to the extent they are not covered by, or choose to forego, security interests). Because the procedure was designed to provide debt relief, the law envisioned only financial terms in the restructuring agreement; operational conditions -- such as changes in employment, investment, or management -- were not expected (although they presumably could be included if all parties agreed). Any agreement must be approved by a two-thirds majority (in terms of value of claims), or four-fifths for write-offs greater than 40 percent. Finally, only parties attending the proceedings are allowed to vote on the proposed agreement. It may be difficult for a debtor with many creditors to assemble the required majority in one place for the vote.

Once the debtor applies for court conciliation, the court must decide within two weeks whether to proceed. If it decides to open a case, the judge appoints a "judge commissioner" and a "reorganization trustee". Incumbent management stays in control of the firm, supervised by the trustee, but must obtain permission from the judge commissioner for all business activities outside the normal course. Secured creditors can be barred from foreclosing on assets if such foreclosure would hinder reorganization, and all creditors are barred from filing for bankruptcy or accepting debt repayments outside of a conciliation agreement.

Chapter 11 is, therefore a form of bankruptcy that involves a reorganization of a debtor's business affairs and assets. It is generally filed by corporations, which require time to restructure their debts. Chapter 11 gives the debtor a fresh start, subject to the debtor's fulfillment of its obligations under its plan of reorganization. Chapter 11 reorganization is the most complex of all bankruptcy cases and generally the most expensive. It should be considered only after careful analysis and exploration of all other alternatives.

After filing a bankruptcy petition under Chapter 11 of the U. S. Bankruptcy Code, the firm is protected by an automatic stay. Unless waived by the court, this automatic stay remains in effect until the firm emerges from bankruptcy. While protected from creditors, managers propose and seek acceptance of a reorganization plan. Acceptance of the plan occurs through a voting process requiring approval from a majority (two-thirds in value and one-half in number) of each impaired class of claimholders. In addition, the bankruptcy judge reserves the right to cram down a fair and reasonable plan on dissenting parties.

This form of bankruptcy restructuring is far better approach than liquidation as it yields higher returns. Furthermore as it is under Court supervision, transparency and fair treatment is ensured through prevention of preferential and fraudulent transfers. The business has the opportunity to continue its operations and thus become, in time, financially self-sufficient. The debtor is discharged of his debt and time-limit as well as specific obligations owed are clearly defined. Potential investors are also protected through restriction on additional capital injection.

The down side to this type of restructuring is that non-approval of creditor can result in court's cancellation of restructuring order. In addition management loses all control over the business operations. Overall viability of business is called into questioning including business relationship and transactions. The business suffers much negative publicity. Furthermore this process is quite expensive as well as time consuming.

2.4.4.3. Out-of-Court Restructuring

Under this category we have 2 main sub-classifications:

- **Informal Restructuring**

Informal restructuring is more on the debt restructuring type. It is usually done between the banks/financial institution and their borrowers having NPLs. These are usually based on bilateral contracts between the financial institution/creditors and the borrowers. There is no set guideline, other than the specific policies of the creditor, nor is there a third party intervention. Informal restructuring is based on mutual agreement, is less time consuming as no legal processes are involved. However for cases involving large number of creditors and type of loans, difficulties often arise while designing the plan. Delays in negotiations are often seen. One of the main disadvantages of this form of restructuring is that it requires 100% agreement on the part of all the parties, which contributes to the time consuming negotiations.

- **Asset Management Company**

A public asset management company takes over corporate loans of failed financial institutions and attempts to restructure them. The asset management company's role is to provide bank liquidity through purchases of NPLs at substantial discounts on face value. One of the biggest successful restructuring stories was the acquisition of Daewoo Motors by General Motors in September 2002 and it included debt rescheduling, debt-equity conversion, repayment measures and splitting of operations.

2.4.5. Other Alternatives for Defaulter Companies

- **Straight Bankruptcy**

Designed as a liquidation process for insolvent firms. A creditor, owner, or manager of a firm can petition the court for a declaration of bankruptcy. The judge is generally supposed to open the case if the petition is complete and if the company has sufficient assets to cover procedural costs.

The judge then appoints an official trustee, who takes over management of the firm's assets. All debts immediately fall due, and all creditors are asked to file their claims. The trustee can continue to keep the firm in operation during bankruptcy if needed to preserve the value of company assets. The trustee draws up a balance sheet of the company and publishes a detailed list of debts. Interest stops accruing, except on secured debts, once bankruptcy is declared. Most setoffs of claims are no longer allowed, and the trustee can prohibit any new foreclosures on collateral. The district court sets the level of remuneration of the trustee, based on a recommendation of the bankruptcy judge. The bankruptcy judge can appoint a creditors' council to help manage and dispose of assets, and must do so if 20 percent of creditors so request.

The law as now designed has several major deficiencies. First and perhaps foremost, the priority list discourages any active involvement by non-government creditors in the bankruptcy process, because it makes it virtually impossible for banks and other creditors to recover anything. Creditors often express the view that "the government always comes first. " In fact, if the government and procedural costs do not consume the entire estate, it is likely that employee' claims will. Second, even with little expectation of recovery, creditors are asked to pay between 5 and 13 percent of the value of their debt as advance payment of court fees. A third deficiency is that the law provides few means for a trustee or judge to void fraudulent transactions made by managers or owners, at the expense of creditors, prior to the bankruptcy filing.

Fraudulent transactions are indeed thought to be common, and the legal system must find a way to identify and punish them if the bankruptcy process (or indeed any debt collection process) is to be credible.

- **State Enterprise Liquidation**

Creditors may initiate the liquidation of a state-owned borrower by petitioning the governmental entity charged with exercising ownership control (the "founding body"), or the founding body may initiate the procedure (if they obtain the authorization of the Ministries of Privatization and Finance). The law specifies several criteria that justify (but do not require) a liquidation filing, including inability to pay the obligatory dividend to the state treasury and negative after-tax earnings. Only companies that are still solvent (that is, whose assets exceed their debts) are in theory eligible for this procedure.

However, many of the companies in liquidation prove to be insolvent, and many ultimately end up in the bankruptcy courts.

Liquidation is a process controlled by owners and managers. The founding body appoints a trustee charged with drawing up a balance sheet and list of liabilities and selling off the assets in whole or part. There are no restrictions on who may serve as liquidator, and appointment of the incumbent manager as the liquidator has reportedly been quite common. Creditors have means to influence the process. Nevertheless, they may prefer Article 19 liquidation to bankruptcy because the costs of realizing collateral are lower and because liquidation affords an opportunity to neutralize the super-priority of state claims.

- **Sale of Debt**

In theory sale of debt is an interesting and innovative alternative to traditional debt collection routes. It allows banks to rid themselves of problem debt without resorting to costly negotiations or judicial procedures, and to put it in the hands of firms or individuals better able to deal with it. There are several hypothetical reasons why such parties might want to purchase bad debt from banks. First, they may be more willing or able than banks to collect the debt. Second, they may be customers of the debtor firm who can use such debt to pay for goods and services. Third, they may wish to swap the debt for equity and take control of the debtor firm. Under any of these scenarios sale of debt can increase financial discipline and improve corporate governance in debtor firms.

2.5. Determinants of Restructuring Decision

One hypothesis is that the restructuring decision is based on firm performance and liquidity. To the extent that firms with greater performance and firms from industries with greater performance are more likely to generate future cash flows to service debt and are less likely to become distressed in the future, these firms are more likely to successfully complete an out-of-court restructuring. Firms that are more liquid and less financially distressed are also more likely to successfully restructure out-of-court. On the other hand, sudden liquidity constraints or severe financial distress might increase the likelihood that firms choose traditional Chapter 11 because of Chapter 11's automatic stay feature, prohibiting creditors and others from collecting claims against the firm.

Another hypothesis is that a firm's capital structure determines the restructuring method chosen. For example, firms with a large number of creditors face a creditor coordination problem. If traditional Chapter 11 mitigates creditor coordination problems by forming creditor classes, which allows for negotiations with groups of creditors holding claims of similar seniority and risk, then firms likely to be constrained by the creditor coordination problem are more likely to choose traditional Chapter 11 to resolve their distress. Similarly, firms likely to suffer from creditor holdout problems, in which a minority of claimholders refuse to accept a restructuring plan, are better off restructuring under the less stringent voting requirements of traditional Chapter 11 or prepackaged bankruptcy than an out-of-court workout.

A third view is that self-serving managers choose the method of restructuring that best serves their needs, without regard for value maximization. In other words, agency conflicts between managers and other claimholders exist, permitting managers to choose a restructuring alternative other than the optimal, least-cost method for the firm.

Traditional Chapter 11 allows managers to remain in control of their firm while providing them the exclusive right, at least temporarily, to propose a reorganization plan. If managers are concerned about their own employment, and to the extent that traditional Chapter 11 insulates managers from being terminated, self-serving managers will choose traditional Chapter 11 over alternative, and perhaps less costly, restructuring methods. Because of the control granted to incumbent managers by the Bankruptcy Code and it's automatic stay provision, self-serving managers might choose traditional Chapter 11 over alternative methods of restructuring in order to continue unprofitable operating strategies or pet projects. The three determinants are further described as follows.

2.5.1. Liquidity and Firm Performance

The restructuring decision may depend on liquidity and firm performance. Firms suffering from a lack of liquidity are most in need of an automatic stay from creditors, a benefit not provided (or utilized) by prepackaged bankruptcy or out-of-court restructuring. Thus, to the extent that firms choose the least-cost restructuring alternative, firms choosing traditional Chapter 11 have more severe liquidity problems than firms choosing alternative methods of restructuring.

Similarly, firms in more severe financial distress are likely to require a more complex reorganization. As often seen, traditional Chapter 11 reduces transaction costs, this cost saving is greater for firms requiring more extensive restructuring. In addition, firms in Chapter 11 can receive debtor-in-possession financing with superpriority status. For these reasons, traditional Chapter 11 is more likely the least-cost alternative for firms in more severe financial distress. Firms in less severe financial distress are more likely to restructure out-of court, with prepackaged bankruptcy serving those firms in the middle. In the same way, firms with greater performance and firms from stronger industries are more likely to successfully restructure out-of-court. Stronger firm and industry performance in the period prior to restructuring increases the expected ability of the firm to generate future cash flows to service debt and decreases the probability of future financial distress.

2.5.2. Capital Structure

Another determinant of restructuring may be capital structure. Firms prone to creditor coordination or creditor holdout problems are more likely to benefit from the Bankruptcy Code's less stringent voting requirements. Therefore, either traditional Chapter 11 or prepackaged bankruptcy is more likely to be the least-cost alternative for these firms, as opposed to out-of court restructuring. The creditor coordination problem occurs when large numbers of creditors holding heterogeneous claims make it difficult for the firm to negotiate with all individual claimholders. This problem is mitigated by the Bankruptcy Code in two ways. First, the Bankruptcy Code groups claimholders into classes based on the similarity of claims, allowing the firm to negotiate with a fewer number of creditor classes than individual claimholders.

Second, and perhaps more important, the Bankruptcy Code only requires approval from a majority (two thirds in value and one-half in number) of the creditors in each impaired class. Thus, coordination is further simplified by only needing a majority of support from each class.

However, prepackaged bankruptcy requires creditors to voluntarily accept being placed into creditor classes in out-of-court, pre-filing negotiations. Therefore, it is expected that traditional Chapter 11 is more likely the least-cost alternative for firms negotiating with a larger number of creditors, while out-of-court restructuring is more likely the least-cost alternative for firms negotiating with relatively fewer creditors. Prepackaged bankruptcy likely serves those firms in the middle.

Similar to problems arising from creditor coordination, creditor holdout occurs when an individual creditor refuses to accept a plan of reorganization that reduces his claim, even though it is beneficial to the firm as a whole. These conflicts are more likely in firms with a larger number of creditors and a more complex capital structure (i.e., more heterogeneous claims). The creditor holdout problem is mitigated by the less stringent voting requirements of traditional Chapter 11 and prepackaged bankruptcy. Therefore, these restructuring alternatives are more likely than out-of-court restructuring to be the least-cost method for firms with larger numbers of creditors and more complex capital structures.

2.5.3. The Role of Managerial Discretion

Agency theory predicts that managers might not always act in the best interest of shareholders [Jensen and Meckling (1976)]. If agency conflicts exist in financially distressed firms, then the possibility exists for managers to make restructuring decisions out of self-interest rather than concern for value maximization. Corporate governance and monitoring mechanisms exist to mitigate these agency conflicts. These mechanisms include independent outside directors (directors with no other business or family ties to the firm) and unaffiliated equity block-holders (equity-holders owning at least 5% of the firm and having no business or family ties to the firm). In addition, equity holdings by managers and directors are used to align their interests with those of shareholders, although evidence suggests that excessive managerial holdings lead to managerial entrenchment, potentially exacerbating agency problems.

In addition to the automatic stay from creditors granted by the Bankruptcy Code upon filing a formal petition, managers of the firm are guaranteed 120 days to propose a plan of reorganization and an additional 60 days to have the plan approved by each impaired creditor class. However, this period is generally extended, and often, it is continuously extended until a reorganization plan is accepted. Thus, the incumbent management remains in control of the firm's operations and influences the reorganization process. Although the court can replace incumbent management with a trustee, the Bankruptcy Code reserves this for situations of "fraud, dishonesty, incompetence, or gross mismanagement." Because traditional Chapter 11 offers managers the exclusive right to propose an initial plan of reorganization and the ability to continue managing the firm's operations, managers are granted excessive power over the firm's reorganization and that traditional Chapter 11 provides a safe haven for managers, protecting them from disciplinary forces. For example, managers of financially distressed firms concerned about their own employment might file for traditional Chapter 11 in order to remain employed and in control of the firm, rather than attempt a less costly restructuring alternative unprotected from disciplinary forces. In doing so, the majority of the risk is borne by creditors, while shareholders potentially benefit.

In summary, traditional Chapter 11 is hypothesized to more likely be the least-cost alternative for firms with less liquidity, firms in greater financial distress, firms with poorer performance, firms from industries with poorer performance, firms with greater expected creditor coordination problems, and firms with a greater possibility of creditor holdout. Out-of court restructuring is more likely the least-cost alternative for firms with greater liquidity, firms in less financial distress, firms with stronger performance, firms from stronger industries, firms with fewer expected creditor coordination problems, and firms with a smaller possibility of creditor holdout. Prepackaged bankruptcy is hypothesized to serve those firms in the middle.

Ideally, value-maximizing firms should choose the restructuring alternative that results in the least costly resolution of financial distress. Prior evidence, discussed later on, suggests that traditional Chapter 11 bankruptcy results in higher direct costs (e.g., legal and administrative fees) and potentially higher indirect costs (e.g., the value of lost sales and managers' time) than prepackaged bankruptcy and out-of-court restructuring, with prepackaged bankruptcy falling between the other two. Given that traditional Chapter 11 is still a frequently used method of resolving financial distress, and assuming that not all of these firms are choosing inefficiently, it must either be the case that traditional Chapter 11 is less costly for some firms than restructuring out of- court or that Chapter 11 provides unique benefits to filing firms, of which firms restructuring out-of-court cannot take advantage. These benefits include an automatic stay from creditors and a less restrictive approval process for the plan or reorganization. In contrast, firms in an out-of-court restructuring must seek approval from all participating claimholders.

Firms that choose prepackaged bankruptcy inherently waive the benefits of the automatic stay provision by negotiating and seeking approval of a reorganization plan prior to filing. In addition, because firms using prepackaged bankruptcy are under court protection for significantly less time than traditional Chapter 11 firms, and thus protected from creditors for significantly less time, the accrued benefits of an automatic stay are likely to be significantly less. However, because the voting requirements under the Bankruptcy Code are the same for both prepackaged bankruptcy and traditional Chapter 11, firms choosing either of these two restructuring alternatives benefit from not having to seek unanimous consent. Therefore, traditional Chapter 11 is more likely the least-cost restructuring alternative for those firms seeking the benefit of an automatic stay. Either prepackaged bankruptcy or traditional Chapter 11 is more likely the least-cost alternative for those firms benefiting from the less restrictive voting requirements that the Bankruptcy Code provides.

Finally, the Bankruptcy Code provides three benefits, in addition to an automatic stay and less restrictive voting, which possibly make traditional Chapter 11 and prepackaged bankruptcy less costly than out-of-court restructuring. These include the tax liability on cancellation of indebtedness income, the use of net operating loss carry forwards, and the valuation of post restructuring claims. If a firm restructures out-of-court and exchanges debt with a higher face value for debt with a lower face value, the difference between the face values is considered taxable income. Similarly, if a firm restructures out-of-court and offers equity to debt holders, and if ownership by existing shareholders becomes less than 50% of their original ownership, the firm forfeits it's accumulated net operating loss carry forwards. Both the tax liability on cancellation of indebtedness income and the forfeiture of net operating loss carry forwards only apply to out-of-court restructuring. Therefore, firms seeking these benefits are more likely to restructure through traditional Chapter 11 or prepackaged bankruptcy. Related to the creditor holdout problem, some firms may seek Bankruptcy Code protection in order to preserve the value of restructured claims [McConnell and Servaes (1991). Firms can secure all of these benefits using prepackaged bankruptcy or traditional Chapter 11. To the extent that traditional Chapter 11 involves higher direct and indirect costs than prepackaged bankruptcy, prepackaged bankruptcy is more likely to be the least-cost alternative for firms seeking these benefits, but otherwise capable of restructuring out-of-court.

3.1. Present Scenario

Around the world, equity markets are grappling with tough times, except in Pakistan. *(Pakistani American Business Executives Association.)* Pakistan's tiny stock market is scoring record gains. Indeed, Bloomberg ranks the KSE-100, the benchmark Pakistani index, as the world's top-performing stock market. Despite a correction early this year, the index is up 51.4% for the 12-month period that ended on March 31. Thanks to a series of government reforms, Pakistan's economy is doing amazingly well. Gross domestic product is projected to grow at a solid 4.5% this year. The previously corrupt, inefficient tax-collecting authority, Central Board of Revenue, is being restructured, and for the first time in years, tax-collection revenues match up with target numbers. Privatization has also begun in earnest and United Bank, the country's third-largest bank, was sold in October for $200 million. In addition, a resumption of post-September 11 aid inflows from the U.S. has strengthened Pakistan's balance of payments and helped boost foreign-exchange reserves to a record $10.3 billion.

Another big plus for the Karachi market is record low interest rates. As the State Bank of Pakistan, the central bank, has driven interest rates down over the last two years, the yield on six-month government treasury bills has declined from 12.5% in July 2001, to 2% today. By contrast, companies in the KSE pay an average dividend yield of 10%. As investors seek higher returns, major new liquidity has found its way into the equity market. "Whether its wealthy individuals or big institutions, money is coming in, and there are no other avenues for it to go," says Moin M. Fudda, Managing Director, Karachi Stock Exchange. "That new liquidity is clearly the fundamental reason for the [stock market] rally."

The global crackdown on the hawala system of informal money transfers has also bolstered stocks. Remittances sent by expatriate Pakistanis through banks are expected to hit $4 billion in the fiscal year that ends on June 30, 2003, up from $2.4 billion in the previous fiscal year. And a significant chunk of that is making its way into equity investments.

Improvements in corporate governance have helped, too. In the last two years, a host of measures enforced by the Securities & Exchange Commission of Pakistan, including requiring listed companies to circulate quarterly reports and penalizing them if shareholder meetings aren't held on time, have enticed more individuals to get involved in the share market. The KSE also has beefed up its regulatory oversight of brokers. "Ensuring that brokers don't overstretch themselves has given investors comfort and given the market stability," says the KSE's Fudda. Brokers'. Capital adequacy, which until recently was monitored only on a weekly basis, is now tracked daily, and exposure to trading risks is now calculated hourly rather than daily.

For all the good news, many foreign fund managers are far from impressed. Indeed, they've been markedly absent during the market's historic rally. From July, 2002, to February, 2003, the net inflow of foreign portfolio investment amounted to just $9.4 million. Still, that's quite an improvement from the net outflow of $7.7 million from July, 2001 to February, 2002.

The KSE estimates that for all of 2003, net foreign investment could approach $50 million -- the bulk of the money from expatriate Pakistanis. The U.S. and European fund managers who could give the market added credibility outside Pakistan aren't expected to join in, however. Skeptics fear the market is still open to manipulation by a handful of big speculators. Although the Karachi Stock Exchange has 717 listed companies, only about 30 are easily traded, and the 10 most heavily traded stocks account for 80% of the market's total trading volume. Plus, poor investor awareness and a lack of marketing on the part of brokers means the country has only a tiny base of individual investors. Indeed, Mohammed Sohail, head of research at Invest Capital & Securities, a Karachi-based brokerage firm, estimates the number at no more than 100,000.

The government is working to improve liquidity. Under a new privatization strategy, it's selling off its shares of state-controlled companies while listing them on the bourse as well. In last four months, about $70 million worth of stock in three state-owned companies has been sold, and Abdul Hafeez Shaikh, Federal Privatization & Investment Minister, says more will follow. For instance, two state-owned energy companies, Pakistan Petroleum Limited, whose shares have already been sold to the public and small time investors, while the other namely, Pakistan Oil & Gas Development Corporation is expected to be listed this year.

For the foreseeable future, the KSE will continue to be overshadowed by neighboring India's $100 billion stock market, a natural choice for investors poking around in South Asia. Pakistan's market capitalization has more than doubled over the past year but is still just $10 billion. Muddassar Malik, director at Karachi-based brokerage firm BMA Capital Management, says to really get noticed the KSE's market cap must expand to the point where it accounts for at least 50% of GDP, up from 11.7% now.

3.2. Performance of Capital Market - the progressive 1990s

Considering the performance of the stock market, it certainly seems that investor confidence in the corporate sector has peaked. However, a few years back the scenario was quite the opposite. Market capitalization was quite low, investors who had money, and wanted the highest returns, considered the stock market as the least yielding and riskiest of all investments. This can be seen from the following evidential data that shows how the market has improved over the years, where it is and through what it has come.

Capital markets can play a crucial role in mobilizing domestic and foreign resources, and channeling them to the most productive medium and long-term uses. Since these funds are not intermediated, resource allocation should be more efficient.

Capital markets in Pakistan have two main components namely;

(i) An equity market represented by the stock exchanges and

(ii) An intermediated financial system dominated by an increasing number of non-bank financial institutions (NBFIs).

The capital market in Pakistan has been witnessing steady progress and structural developments in both its institutional set-up and operational matters since the early 1990s. Credible maturity has been achieved in the working of the capital market despite some adverse domestic and international shocks in the last few years. The present Government not only continued the market oriented development strategy of the 1990s but also added some new impetus to improve the working and depth of capital market in Pakistan. Along with domestic investors, foreigners and overseas Pakistanis are now also offered every possible incentive and opportunity to undertake investment in projects of their choice.

3.2.1. Equity Market

There has been phenomenal increase in the turnover of shares on the stock market from 1.0 billion in 1991-92 to 67.6 billion in 1999-2000. Aggregate market capitalization has increased from Rs.218.4 billion in 1991-92 to Rs.392 billion in 1999-2000 a rise of 79.5 percent. Number of listed companies on KSE has increased from 628 in 1991-92 to 762 in 1999-2000 (Table 1). Amongst global emerging markets, Pakistani stock market has been on top with the highest percentage gain achieved during the year 2000, in automated and electronic trading and settlement system. The Securities and Exchange Commission of Pakistan (SECP) has accelerated its drive to enhance the efficiency of the stock exchanges and ensure protection of the interest of investors. Disclosure requirements are being made more stringent.

With the recovery of Pakistani stock market, it is the opportune time for foreign funds to make their entry into Pakistani stock markets. The long-term outlook is promising and the markets are giving enough movement to pick up blue chips at attractive prices with good chances of reaping sizable capital gains on medium to long-term basis. There is ample scope for income funds to be launched. In short, Pakistani stock markets are on the road to better performance and efficiency. Although their volatility - an essential part of all emerging markets, creates higher risks they also magnify the potential for higher returns for any investor who has the patience and sophistication to participate in the growth of this emerging market.

Table 1				
Year	**KSE Share Index**	**Market Capitalization (Rs billion)**	**Listed Companies on KSE**	**Turnover of Share (No in billion)**
1991-92	1512.6	218.4	628	1
1992-93	1211.1	214.4	653	1
1993-94	2330.9	404.6	724	2.2
1994-95	1611.7	293.3	764	3.3
1995-96	1703.3	356.2	782	7.9
1996-97	1565.7	469.2	781	11
1997-98	879.6	259.3	773	21.1
1998-99	1054.7	289.2	765	38.7
1999-2000	1520.7	391.9	762	67.6
July-March 2000-01	1324.4	328.2	760	31.4
Source: SBP, SECP.				

- **Developments during July/Mar, 2000-01**

After showing bearish performance in 1997-98 and 1998-99, the stock market reasonably picked up some of its bullish fervors of mid 1990s in 1999-2000. Out of 12 major trading groups on the KSE (cotton and other textiles, pharmaceuticals & chemicals, engineering, auto & allied, cables and electric goods, sugar and allied, paper and board, cement, fuel and energy, transport and communication, banks and other financial institutions and miscellaneous) the share index of 9 groups showed declines including: cotton & other textiles, pharmaceuticals & chemicals, engineering, auto & allied, paper & board, cement, fuel & energy, transport & communications and banks & other financial institutions. The declines ranged from – 1.5 percent (engineering) to –27.9 percent (cement). While three groups showed some improvement over there level in June 2000, including: cable & electric goods, sugar & allied and miscellaneous. Five trading groups including engineering, cable & electric goods, sugar & allied, cement, paper & board and miscellaneous showed growth in their aggregate market capitalization ranging from 1.6 percent (miscellaneous) to 15.0 percent (paper & board). A total of 351 companies declared dividends on the KSE during July-March 2000-01 as against 330 companies in the comparable period of last year. Total market capitalization of five leading groups namely; cotton & other textile, fuel & energy, transport & communication, financial institutions and chemical & pharmaceuticals was Rs.267.7 billion on March 30, 2001 or 81.6 percent of the aggregate market capitalization of Rs.328.2 billion. Market capitalization of transport and communication which was the most rapidly growing sector since 1996-97, had incurred a decline of Rs.58.8 billion in one year from Rs.129.6 billion in March, 2000 to Rs.70.8 billion in March 2001. Fuel and energy, the second most rapidly growing sector also incurred a loss of Rs.47.9 billion in its market capitalization in one year, declining from Rs.125.9 billion in March 2000 to Rs.78 billion in March 2001. The rapid increase of share prices of these two trading groups in 1999-2000 was reportedly triggered by speculative news about the privatization of some leading public sector organizations including PTCL and WAPDA. However, as the privatization process lingered on, investors' euphoria started dying down and shares prices started declining since March 2000. The combined market capitalization of fuel & energy, and transport & communications was however, still the highest representing 45 percent of aggregate market capitalization in March.2001.

Table 2

Profile of Karachi Stock Exchange				
	1997-98	1998-99	1999-2000	2000-01 (July-March)
a) New Companies Listed	2	Nil	1	2

b) Fund Mobilized (Rs billion)	2.2	1.6	8.9	4.5
c) Listed Capital (Rs billion)	212.2	215	223.5	235.9
d) Turnover of Share (Rs billion)	15	25.5	48.1	24.1
e) KSE Share Index	880	1055	1521	1324
f) Aggregate Market Capitalization (Bn.)	259.3	289.2	391.9	328.2
Source: Karachi Stock Exchange.				

In 2000-01, 761 companies were listed on Karachi Stock Exchange, including 143 companies in textile spinning and 56 companies in textile composite sector. Sector-wise number of companies and their market capitalization are given in Table 3.

Table 3

Sectoral Companies listed on Stock Exchange		
Sector	**Listed Companies**	**Market Capitalization (Billion)**
Textile Spinning	143	11.6
Textile Composite	56	10.1
Modaraba Companies	46	3.4
Investment Companies	40	20.8
Mutual Funds	39	3
Insurance Companies	39	9.5
Sugar & Allied	38	4.2
Chemicals & Pharmaceuticals	38	49.9
Leasing Companies	32	3.2
Miscellaneous	29	43.5
Fuel & Energy	27	81.7
Textile Weaving	25	1.6
Auto & Allied Engineering	25	7.7
Synthetic & Rayon	25	14.7
Food & Allied	22	22.3

Cement	21	10.1
Vanaspati & Allied	19	0.3
Engineering	16	2.2
Cables & Electrical	18	1.6
Paper & Board	15	4.5
Glass & Ceramics	10	0.8
Transport & Communications	8	73
Woolen & Textile	7	0.3
Jute	7	0.3
Leather & Tanneries	6	1
Tobacco	6	5
Constructions	4	0.1
Total:	**761**	**390**

3.2.2. Intermediated Financial System

The Intermediated Financial System represents NBFIs, which could be segregated into DFIs, 14 investment banks, 33 leasing companies, 41 modaraba companies, 4 asset management companies, 2 finance companies, 2 discount houses and 2 ventures capital companies.

The sector is characterized by the following a shallow and narrow sector structure; heavy government involvement; inefficient banking system; and mixed performance of equity markets.

- **Shallow and Narrow Sector Structure:** Pakistan's financial sector is not very large and diversified. Deposits amount to only about 56 percent of GDP. The money to GDP ratio - which is an indicator for financial sector deepening - at only about 44 percent, suggests that a major portion of the economy is still not monetized.
- **Heavy Government Involvement:** Despite the number of reforms initiated by the Government in the past, which have sought to reduce its operational involvement in the financial sector, the Government still plays a predominant

role, and much financial intermediation is driven by its financing needs. Examples include the, National Saving Schemes (NSS), the State Life Insurance Corporation (SLIC) and the Employees Old-Age Benefits Institution (EOBI); remain Government controlled. This raises governance concerns, as most of the funds they are entrusted with belong to private individuals.

- **Inefficient Banking System:** Financial intermediation is dominated by the banking system, which accounts for 60% of deposits. About 34% of deposits are with the NSS, and only 5% are mobilized through NBFIs. Non-performing loans (NPLs) average around 24% for all banks, and more than 50% for specialized financial institutions, including development finance institutions. Performance of the banking sector is discussed more extensively, later on.
- **Mixed Performance of Equity Markets.** Pakistan's equity market, which is dominated by the Karachi Stock Exchange (KSE) but also include exchanges in Lahore and Islamabad, has seen some impressive growth over the past decade. But the economic impact of the equity market, despite the development, has been negligible. Market capitalization is still only around 11% of GDP. Many companies sought listing primarily for tax without subsequent trading taking place and little interest in investor relations or dividend payouts. Both the issuer and investor base is very narrow. Factoring in the devaluation of the Pakistan rupee and economic uncertainties, as well as the high guaranteed returns offered by the NSS, investing in the stock markets has not been a very attractive proposition.

All this has deterred long-term and foreign investors, and valuations of some economically sound companies are often very low. This environment is not very attractive for companies with serious economic ambitions to raise capital from the equity markets, and there have been only 13 new listings on all three exchanges over the past 5 years.

To counter the trend, the Securities and Exchange Commission of Pakistan (SECP) has, since its inception in 1999, and within the framework of the Government's first ADB financed Capital Market Development Program (CMDP) taken credible steps to restore investor confidence. In particular, SECP has been improving risk management and is vigorously enforcing compliance with rules and regulations, including delisting of defaulting companies. These measures will need to be enhanced further but constitute an important basis for more sustainable market development.

In order to address the above problems, Pakistan has since the mid-1990 embarked on comprehensive financial sector reforms. Key reforms include:

(i) Liberalization of the foreign exchange market and interest rates;

(ii) Increased autonomy of the central bank and its focus on monetary policy and banking supervision;

(iii) Establishment of an independent regulator for capital markets and NBFIs;

(iv) Upgrading of legal and regulatory frameworks;

(v) Reduction of NPLs in the banking sector, and

(vi) Restructuring of government-owned financial institutions including privatization, merger, closure, and enhanced management autonomy.

Yet, the reform agenda is far from complete, and reforms are ongoing at various levels to further reduce the Government's involvement in financial sector operations and enhance private sector participation on market-based principles.

3.2.3. The Banking Sector

The financial structure in Pakistan can broadly be categorized into Scheduled Banks and NBFIs. At present, there are 14 private commercial banks, 2 privatized commercial banks, 4 nationalized commercial banks, and 19 foreign banks (State Bank of Pakistan Annual Report 2000-2001). The banking sector has endured many ups and downs. In late 1996, the banking system was on the verge of a crisis. Non-performing loans had reached alarming proportions. Liquidity problems surfaced as dis-intermediation spread and banking losses accumulated. Majority of loan defaults remained caught in an ineffective court system. These were caused by deep-rooted problems, embedded in failure of governance and lack of financial discipline. The NBFIs and DFIs experienced continuous political interference, resulting in bad loans, which accounted for 90 percent of the non-performing loans in the entire system. Such a situation was not sustainable.

In the face of a difficult external situation, and recognizing the institutional and governance problems being faced, the authorities, in particular, the State Bank of Pakistan and the Ministry of Finance in early 1997 embarked on a "home-grown" banking reform program. In the same year, the World Bank financed a loan of $250 million (co-financed with another $250 million by Japan) under the Banking Sector Adjustment Loan, which supported the initial stages of Pakistan's national banking reform program. By 1999, the reform program had advanced significantly. Around one third of the value of defaulted loans had been recovered. Nationalized commercial banks, which still account for the majority of loans in the country, had stemmed operating losses. A new banking court system had processed nearly half of pending loan default cases at an unprecedented rate. Higher quality new loans combined with improved loan recovery and resolution of problem loans had helped the banking system achieve improvements in capital adequacy, asset quality, efficiency and profitability. Disclosure standards, fundamental to the reform program, had become much more stringent.

Subsequently, the crisis eased and financial institutions began to heal, the reform process substantially slowed down and in several respects, stalled. In mid - 1999, interference in the banking system through new centrally mandated credit programs increased. Loan recovery slowed down, except for the dramatic gains as a result of the accountability campaign that was started in October 1999 by the military government. Loan collateral foreclosure and bankruptcy procedures were not further strengthened as planned. Market reforms to reduce segmentation were not pursued completely. Most importantly, bank privatization did not materialize as planned, due on the one hand, to weak market conditions, the country's deteriorating foreign investment climate and lack of sustained efforts, and on the other, the distressed conditions of the banks with high cost structures and depleted balance sheets.

To assist and ensure the sustainability of the banking sector reform process, the World Bank approved the Banking Sector Restructuring and Privatization Project Loan for $300 million in 2001. The Project's objective was to assist Pakistan in the implementation of its banking reform program started in 1997. The Project focused on further restructuring of the NBFIs to improve their prospects for sale to qualified strategic investors, and completing the privatization of the partially privatized banks. The Project also included liberalizing bank branching and at the same time reducing the loss making institutions by amalgamating the largest DFI with one of the NBFIs.

Some of the major reforms achieved in the Banking Sector to-date include:

- Nationalized commercial banks are being privatized to reduce their dominance of the banking sector, which was almost 100 percent in 1991. Muslim Commercial Bank and Allied Bank have been privatized. The Government completed the privatization process of United Bank in 2002 and privatization is ongoing with Habib Bank. In addition, 10 percent of National Bank shares have been floated through the stock market and another 10 percent will be offered in the near future for small retail investors.
- Strong corporate governance by SBP's enforcement of Banking license regulations, transparent financial transactions, independent appointment to Board positions and Chief Executive positions, arms length transactions for Board family member representations, insider trading, regulations of external auditors' profession, and prudential guidelines for Board of Directors.
- Strict monitoring and reduction of non-performing loans by active involvement of the Corporate Industrial Restructuring Corporation (CIRC) and Committee of Revival of Sick Units (CRSU).
- SBP's removal of restrictions imposed on nationalized NCBs for commercial financing and incentive schemes for encouragement of mortgage financing by the banks.
- Implementation of the Financial Institutions (Recovery of Finances) Ordinance, 2001, and relaxation of licensing and regulatory environment for Micro-Credit

and Rural finance institutions, encouraging their establishment at district, provincial and national levels with varying capital requirements;

- Mandatory requirement for all banks to get themselves evaluated by credit rating agencies in order to facilitate depositors to make informed judgments about placing their savings with the banks.

While a good foundation has been established through the efforts of the various regulatory authorities as well as financial institutions, functioning of financial markets cannot be mandated by the Government or any other party. Their efficiency and effectiveness depends on building credibility with private sector investors and issuers, which needs to be sustained over time in a dynamic environment. Within this context, strengthening investor confidence through policy consistency, a strong and credible regulator, and effective dialogue among various stakeholders is of paramount importance. The development and sustainability of financial markets will depend highly on the framework of corporate governance adopted and the degree of adherence to the framework in practice. Poor governance, wide information asymmetry, and lack of confidence in the integrity of transactions and internal control mechanisms are the biggest investor concerns in Pakistan. Thus, governance frameworks need to be improved and vigorously adhered to at various levels. Key ingredients are adequate information disclosure and the right of key stakeholders to influence behavior or change management according to a set of rules.

The increasing sophistication of financial markets carries high inherent risks that must be adequately addressed. There is an increasing awareness internationally that concept of self-regulation need to be complemented through strong regulatory regimes and credible enforcement as well as adequate risk management systems and tools. This must also include mechanisms of investor compensation and market stabilization during times of stress on markets. The fear that companies would fail to yield adequate returns to the investors due to corruption and unethical management practices is still a prominent factor in the low contribution of equity markets in the overall GDP of the country. It is therefore essential that related authorities and financial institutions devise a criterion that can help predict the financial situation and position of any company beforehand and take effective and appropriate measures to restructure such organizations.

The Altman Bankruptcy Predictor that is widely used in the turnaround industry to assess and predict a company's short-term survival prospects, is calculated as follows:

Z = (1.2*Z1)+(1.4*Z2)+(3.3*Z3)+(0.6*Z4)+(1.0*Z5)

Where,
Z1 = Working Capital / Total Assets = WC/TA
Z2 = Retained Earnings / Total Assets = RE/TA
Z3 = EBIT / Total Assets = EBIT/TA
Z4 = Market Value of Equity / Book Value of Liabilities = MVE/BVTL
Z5 = Total Sales / Total Assets = TS/TA

The Altman Z-score is used to determine a company's short-term outlook or future viability, where,

- **>3.0 ... Strong**
- **1.8 - 3.0 ... In danger**
- **< 1.8 ... Near death**

Based on the above-mentioned model, analysis of several companies in Pakistan was carried out. The companies selected were listed on the stock exchange of Pakistan but had also been identified as defaulter companies either by the stock exchange authorities or the State Bank of Pakistan itself. Through the help of the annual reports of the companies, Z-Scores were calculated for five specific companies selected from different sectors of the industry. A summary of their default status is given below.

Defaulter Company	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	KSE Status	Default Rate

Bela Engineers Ltd.	0.61	-0.66	-1.62	-4.60	-5.76	-32.65	-38.05	-45.73	-53.99	-45.82	Up for liquidation	100.00%
Saritow Spinning Mills	0.96	2.03	0.70	0.68	1.13	1.78	2.97	3.14	2.04	0.86	Listed	67.61%
Service Fabrics Ltd.	0.57	1.64	1.12	1.44	0.75	0.99	0.29	0.15	-0.04	-0.94	Listed	57.60%
Shafiq Textile Mills	1.98	1.98	2.29	1.76	2.65	9.88	13.09	8.74	4.37	-2.10	Listed	100.00%
Suhail Jute Mills Ltd.	1.50	2.11	1.65	1.30	0.00	1.13	1.05	1.09	1.81	1.63	Listed	89.75%

4.1. Z-Score Calculations

Z-Score calculations for the selected companies are shown below along with a graphical representation. To explain the working of the Altman Model, calculation of the Z-Score for one company is shown as follows.

Calculations for Bela Engineers for the year 1995,

Z1 = Working Capital / Total Assets

= -172.5/14.87

= **-11.6**

Z2 = Retained Earnings / Total Assets

= -194.51/14.87

= -13.08

Z3 = EBIT / Total Assets

= -4.1/14.87

= -0.28

Z4 = Market Value of Equity / Book Value of Liabilities

= 34*3.25/10*224.65

= 0.049

Z5 = Total Sales / Total Assets

= 7.09/14.87

= **0.48**

Putting the values of Z1 to Z5 in the Altman equation,

Z = (1.2*Z1)+(1.4*Z2)+(3.3*Z3)+(0.6*Z4)+(1.0*Z5)

Z = {1.2*(11.6)} + {1.4*(13.08)} + {3.3*(0.28)} + {0.6*0.049} + {1.0*0.48}

= (13.92)+(18.3)+(0.92)+0.03+0.48

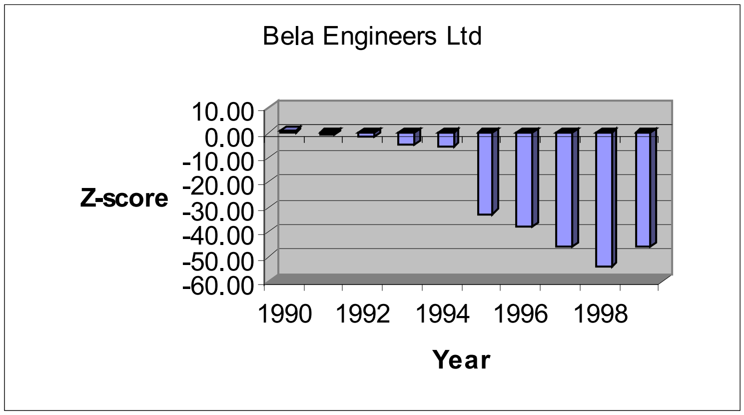
= (32.63)

As companies having Z-scores less than 1.8 are categorized as near death, considering the Z-score of Bela Engineers for the year 1995, it is clearly obvious that the company is beyond survival or revival and whatever strategy of restructuring that is to be carried out should be done in the near future.

4.2. Analysis of Bankruptcy Status of Selected Companies based on Altman Model

- **Bela Engineers Ltd.**

Bela Engineers Ltd.	Z_1	Z_2	Z_3	Z_4	Z_5	Z
1990	-0.03	-0.14	0.08	0.15	0.49	**0.61**
1991	-0.21	-0.33	-0.1	0.36	0.17	**-0.66**
1992	-0.45	-0.65	-0.14	0.15	0.2	**-1.62**
1993	-1.6	-1.86	-0.13	0.17	0.25	**-4.60**
1994	-2.04	-2.4	-0.06	0.12	0.18	**-5.76**
1995	-11.60	-13.08	-0.28	0.05	0.48	**-32.65**
1996	-13.99	-15.79	0.09	0.03	0.53	**-38.05**
1997	-16.69	-18.84	0.07	0.01	0.44	**-45.73**
1998	-19.73	-22.31	0.13	0.01	0.49	**-53.99**
1999	-16.55	-19.48	0.21	0.02	0.61	**-45.82**



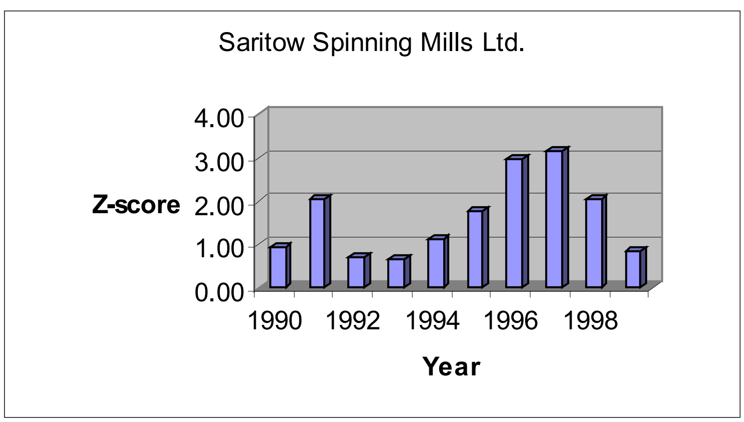
The calculations carried out through the Altman model indicate a drastically deteriorating position of Bela Engineers in the time span under consideration. The company's financial position as seen by its net working capital, retained earnings; its level of debt, decreasing level of assets and earnings before interest and taxes along with other such financial indicators proves that the company was headed towards disaster and investors, existing as well as potential should look elsewhere. The company's Z-Score value which was already quite low in 1994, reached its lowest ever in 1998. The major reason for this decline can be attributed to both Z_1 and Z_2. Both of these scores have remained negative through out the period and are responsible for the further decline, as most of the other scores have more or less remained the same.

The problems faced by the company can be mainly attributed to its short-term debt paying ability as well as a decline in sales. Its current liabilities were increasing over the years while on the other hand its short-term assets were consistently decreasing. Due to this the company was unable to meet its current liabilities, which pushed the company further towards its bankruptcy. The fact that its earnings before interest and taxes improved somewhat even though its sales was decreasing could indicate towards the fact that the management of the company was trying to push the company back towards profitability through decreased expenses, however due to its extremely weak position, was unable to do so.

It is therefore quite obvious that if the company was analyzed through the Altman model in the early 90s or even before that, bankruptcy could have been prevented or else at the least, liquidate it before further losses incurred.

4.2.1. Saritow Spinning Mills Ltd

Saritow Spinning Mills Ltd	Z_1	Z_2	Z_3	Z_4	Z_5	Z
1990	-0.12	0.01	0.11	0.44	0.47	**0.96**
1991	-0.15	0.03	0.16	1.03	1.01	**2.03**
1992	-0.15	-0.07	0.05	0.37	0.57	**0.70**
1993	-0.26	-0.21	0.07	0.23	0.92	**0.68**
1994	-0.13	-0.18	0.14	0.09	1.01	**1.13**
1995	-0.06	-0.51	0.03	0.20	2.35	**1.78**
1996	-0.18	-0.62	0.35	0.07	2.86	**2.97**
1997	-0.41	-0.76	0.44	0.09	3.19	**3.14**
1998	-0.75	-0.89	0.28	0.09	3.21	**2.04**
1999	-0.05	-0.46	0.08	0.04	1.28	**0.86**



Saritow Spinning Mills is a public limited company, incorporated in 1987. The company is engaged in the manufacturing and sale of yarn. Unlike Bela Engineers whose only option was to liquidate due to its dire financial position and Z-Scores that were negative through out the 10-year period, Saritow Spinning Mills is a little better off. Even though it's Z-Score was quite low in the early 90s, it showed signs of improvement and increased steadily to a 3.14 by 1997. This shows that the company was not in such a dire state that restructuring could not be done and in fact became quite strong financially by the year 1997 as shown by a Z-Score above 3. However, by 1999, that is, within 2 years the company's Z-Score had fallen to 0.86, which placed the company in an extremely dangerous and financially unstable position.

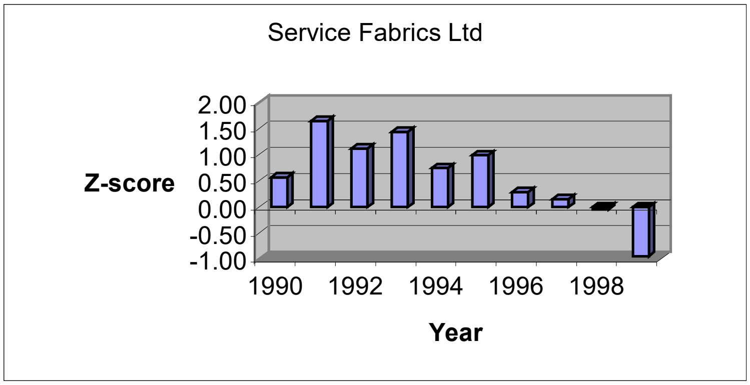
The reason behind the company's fluctuating performance is mainly due to the increase in sales, resulting in increased earnings for the company. However, all other indicators show that the company might not be in such a strong financial position. Its short-term debt paying ability is not very strong. Other than this, its retained earnings are not only decreasing but are registering significant losses. Another reason behind the decrease in the Z-Scores in the last years is the fact that while the company's sales were increasing, large investments were being made in the company assets as well. Further more, in 1999, the assets increased by 148% while the sales decreased by 0.61%. Due to this Z_5 declined causing the Z-score to decrease for the year.

The company could have prevented its present state if proper measures had been taken when the Z-Score started declining in 1998. The company through better utilization of resources and assets would have been able to manage its liability requirements as they incurred and in turn deflected the crisis that it faced by the end of 1999.

4.2.2. Service Fabrics Ltd

Service Fabrics Ltd	**Z_1**	**Z_2**	**Z_3**	**Z_4**	**Z_5**	**Z**
1990	-0.01	-0.03	0.03	0.39	0.28	**0.57**
1991	0.11	0.13	0.12	0.63	0.56	**1.64**
1992	-0.02	0.02	0.10	0.44	0.52	**1.12**
1993	0.00	0.02	0.14	0.34	0.76	**1.44**
1994	-0.12	-0.12	0.04	0.14	0.86	**0.75**
1995	-0.15	-0.46	0.07	0.07	1.54	**0.99**

1996	-0.18	-0.43	0.04	0.03	0.96	**0.29**
1997	-0.34	-0.64	0.06	0.01	1.25	**0.15**
1998	-0.29	-0.85	0.06	0.01	1.29	**-0.04**
1999	-0.29	-1.26	0.06	0.01	0.98	**-0.94**



Another of the companies, which was considered while carrying out this research, was Service Fabrics Ltd. The company incorporated in 1987 basically deals in manufacturing and sale of fabrics. Viewing the company form the Altman Model, we can see that through out the years, the Z-Score has remained below the '3' mark. Since the early 90s, the Z-score has been fluctuating between 0.5 and 2. The point to be noted over here is that the company was at no time during these years in a strong position what so ever. The highest it reached was 1.64, which still indicates that the company is going towards bankruptcy in the near future if not at present. However in the late 90s a declining trend is observed in terms of the performance of the company. If the management of the company had appropriately considered the company through the model, it would have been able to see the declining performance of the company, judge the potential of the company towards failure and would have been able to take appropriate measures. However due to lack of steps in the right direction, at the right time, the company was faced with further financial distress in the later years.

A large portion of the fault can be laid at the hands of the declining sales figure. The operations of the company were therefore failing causing lower profits and in turn decreased retained earnings. The company was also facing problems in its working capital requirements i.e. its current liabilities were exceeding its current asset base. The losses being registered by the company caused further financial problems for it.

4.2.3. Shafiq Textile Mills Ltd.

Shafiq Textile Mills Ltd.	Z_1	Z_2	Z_3	Z_4	Z_5	Z
1990	0.00	0.02	0.21	0.20	1.12	**1.98**
1991	-0.04	0.03	0.18	0.25	1.24	**1.98**
1992	-0.06	0.04	0.22	0.74	1.13	**2.29**
1993	-0.02	0.03	0.12	0.47	1.08	**1.76**
1994	-0.02	0.02	0.08	1.37	1.56	**2.65**
1995	-0.06	0.04	0.21	0.20	9.09	**9.88**
1996	0.05	0.05	0.51	0.27	11.13	**13.09**
1997	0.02	0.05	0.30	0.63	7.30	**8.74**
1998	-0.47	-0.54	-0.32	0.73	6.31	**4.37**
1999	-0.91	-1.00	-0.07	0.85	0.11	**-2.10**

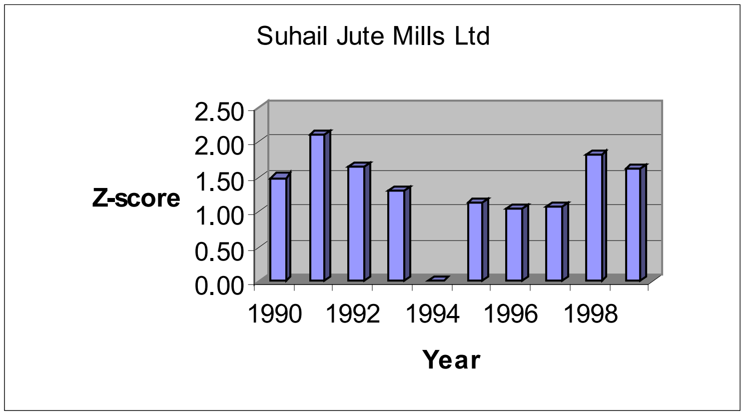
Shafiq Textile mills is another excellent example which proves the effectiveness of applying the Altman Model beforehand to avoid facing financial distress or in drastic cases business bankruptcy. If we take a look at the first few years we can see that where as the company was not in any dire situation, room for improvement was still there as the

Z-Score remained below 3. The company could have taken this as a warning signal and tried to analyze the source of its weakening position. Even though the Z-Score improved in the later years, up till 1996, where it started declining again. Analyzing it through the Altman Model could have given the management an insight in to the real problem rather than just pruning the surfaces.

A careful look at the financial statements of the company show that the changing Z values are greatly affected by changes in sales for the company. The sales affected the EBIT as well as the Retained earning causing the Z value to decline in the later years. The positive working capital, that is when the assets covered the liabilities was only in the two years where the z value was quite strong, indicating that Working Capital has a significant affect on changes in Z value along with sales. Therefore, if the company had studied its performance based on these assumptions, it is quite likely that it would have been able to successfully pinpoint the areas of weaknesses and would have been able to take appropriate and corrective measures.

4.2.4. Suhail Jute Mills Ltd.

Suhail Jute Mills Ltd.	Z_1	Z_2	Z_3	Z_4	Z_5	Z
1990	0.07	0.03	0.17	0.20	0.70	**1.50**
1991	0.15	0.07	0.23	0.32	0.89	**2.11**
1992	0.19	0.12	0.16	0.18	0.61	**1.65**
1993	0.16	0.07	0.13	0.09	0.54	**1.30**
1994						**0.00**
1995	0.15	0.09	0.07	0.04	0.58	**1.13**
1996	0.17	-0.02	0.10	0.02	0.54	**1.05**
1997	0.08	-0.03	0.13	0.03	0.59	**1.09**
1998	0.24	-0.01	0.24	0.03	0.73	**1.81**
1999	0.34		0.19	0.03	0.58	**1.63**



Considering Suhail Jute Mills from the Z-Score perspective, it is quite visible that the company is not performing that well. Its Z-Score, if not fallen below 1, has not gone above 2 either. Even though the fluctuations between the scores is not that high or extreme, still the company needs to look more closely in to its operations to make itself more profitable so as to steer clear from financial failure.

The company was in fact at that time faced with quite a dilemma. Its sales were increasing however if we look at its current asset portion of the balance sheet we can see that there was a significant decline in the accounts receivables. On the other hand cash had greatly increased. This may indicate that the company was forcing its customers to pay either direct cash or the credit deadline was significantly reduced. This might have an adverse affect on the business, which might not be visible immediately but in the later years caused sales to decline as seen in the year 1999. Further supporting this argument is the inventory lying around at year-end. This figure instead of declining has increased which shows that the company was unable to sell the products that it made.

The company was also faced with high expenses as compared to its profits. Around 80%of its revenues were contributed to covering the Cost of Goods Sold only, while 10% was going in financial charges. This left a very small amount for profit as taxes had yet to be deducted. Due to this the profitability of the company was suffering quite badly. It was therefore necessary for the company to manage its assets more efficiently and adopt a less stringent accounts receivable strategy. If not, the company is definitely headed towards disaster as indicated by the Altman Model.

4.3. Conclusion to the Altman Model Approach

The success of the Altman model can be judged from the fact that the companies studied under this model did indeed end up in financial ruin by the end of the decade. Their names were listed in the defaulter list of both the State Bank as well as the stock exchanges in which they were listed. Some of them were also de-listed from the stock exchange as in the case of Bela Engineers and were up for liquidation within the next year or so. Companies, which were in a less dire state, were forced to restructure themselves or else end up like their counterpart, Bela Engineers. However, which form of restructuring is appropriate for which type of company is another factor, which must be considered before any further steps are taken. The Next part of my research deals with this issue.

The first part of the research dealt with predicting the bankruptcy or default status of the companies before hand through the use of the Altman Z-Score Model. The effectiveness of the model has already been dealt with in the previous section. The next step is to see what appropriate measures need to be taken in accordance with the bankruptcy status of the company. What strategy for restructuring will be suited for which company? For this purpose three companies were selected, the default status of whom were quite different. Each of the companies are analyzed on the basis of their financial ratios, what was their financial position and how, if they were able to bring themselves towards the road of recovery.

5.1. Bolan Casting Ltd – A Corporate Restructuring Example!

5.1.1. Company Profile-Present Scenario

Being a modern and well-equipped foundry and holding a major market share of the tractor and automotive castings, BCL can rightly claim to be the No. 1 foundry of its kind in Pakistan.

The company was incorporated on 15th June 1982, as a public limited company by Pakistan Automobile Corporation Ltd. (PACO) under the administrative control of Ministry of Production, Government of Pakistan. The plant was commissioned in June 1986 with the assistance of Foundry Management & Design Company (FMD), U.K and the commercial production was started in July 1986. The company was privatized and handed over to the new group of management under a joint collaboration of Millat Tractors Ltd. and the Employees of Bolan Castings Ltd. on 13th June 1993.

Bolan Castings, through constant research and immaculate quality control, has set new standards for the manufacture of gray and ductile iron castings. BCL has so far developed over 180 different types of Castings, ranging from 2 kg to 150 kg by weight and from the simplest to the most intricate in shape. Whatever the size or shape, BCL Castings are the best and meet the highest international standards.

The company however was not always in such a strong position. In fact the company appeared on the default list of the Karachi stock exchange in the year 1998. How it came to where it is now is explained through the help of the following ratios.

5.1.2. Financial Analysis

- **Liquidity Ratio**

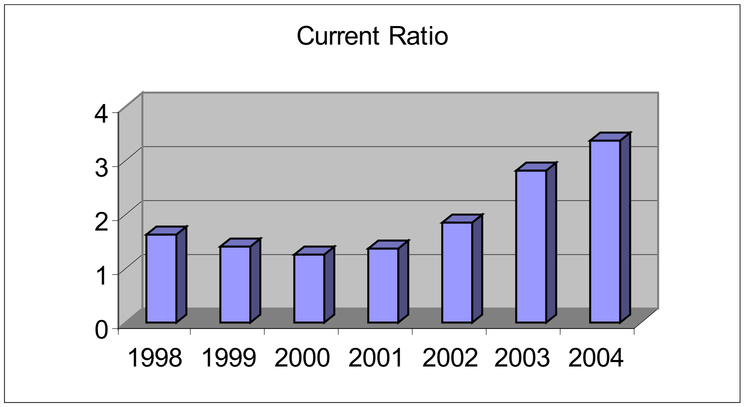
Liquidity ratios of a company basically deal with the short-term debt paying ability of a company, whether it is strong or weak can be determined by considering the following basic ratios,

1. Current Ratio
2. Quick Ratio
3. Inventory Turnover
4. Accounts Receivable Turnover
5. Total Asset Turnover

These ratios carryout a comparison of current assets with current liabilities. A comparison of the firm's liquidity ratios with prior periods or with industry averages helps in determining whether the ratio is high or low. As no industry averages were available while carrying out this analysis, the focus of our study will be mainly on comparison with prior periods.

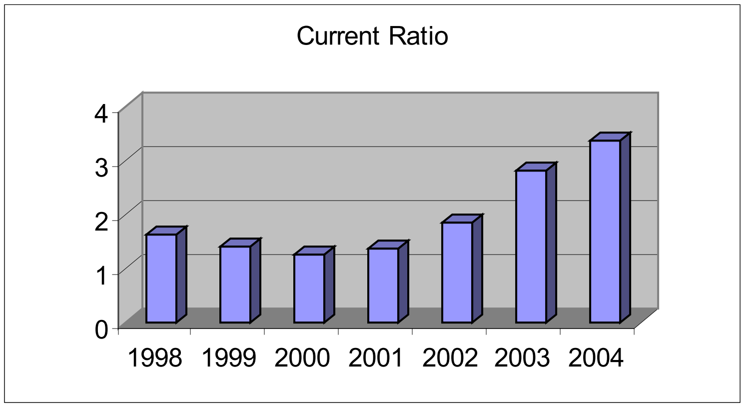
Liquidity Ratios	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**	**1998**
Current Ratio	3.35	2.8	1.86	1.36	1.27	1.42	1.64
Quick Ratio	1.84	1.83	1.33	1.01	0.68	0.86	0.83
Inventory Turnover	62	50	40	32	44	49	61
Accounts Receivable Turnover	50.51	29.87	-	-	-	-	-
Total Asset Turnover	1.62	1.29	1.22	1.42	1.99	1.46	0.9

1. **Current Ratio**



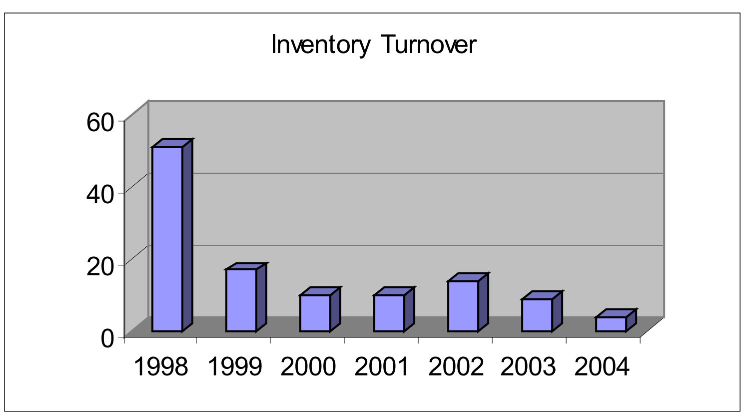
The current ratio shows the relationship between the size of the current assets and that of current liabilities. The ratio should not fall below 1 no matter what, even though a ratio of 2 is considered to be a good industry standard. A ratio below 1 indicates a position in which the firm cannot even cover its current liabilities with its current assets as seen in most of the defaulter companies. An indicator such as this points to a very low liquidity position of a firm, which will not give a healthy outlook of the company in the eyes of the lenders or the shareholders and investors. As seen from the table above, Bolan Casting has improved its position considerably in regards of this ratio. As already mentioned the company was facing a default crisis by the year 1998 and needed to revive itself or else face bankruptcy. However, it seems that the company realizing this threat has taken appropriate measures as can be seen by its improved current ratio from 1.64 in 1998 to a safe 3.35 by the year 2004. One might wonder why the ratio further declined in the years after the default status was granted to the company. The reason could be that the company tried to fulfill its debt obligations due to which current assets may have declined in the early years. However the improved liquidity position proves that the company is on the right track and has been able to successfully restructure its debt.

2. Quick Ratio



A more conservative ratio than the current ratio is the Quick Ratio. It takes in to account the more liquid current assets. These include cash, marketable securities and accounts receivables. Current assets like inventory and supplies are not taken in to consideration while calculating this ratio. Some of the reasons for removing inventory are that inventory may be slow moving or possibly obsolete and parts of the inventory may have been pledged to specific creditors. Quick ratio can therefore be said to calculate or assess a more immediate position than that indicated by the current ratio. The usual guideline for the quick ratio is 1 however it may vary from industry to industry. Industries which deal with high numbers of credit sales should have a ratio more close to 1 or even greater than 1. Similar to the current ratio, the quick ratio has also improved substantially which shows that the company's assets on hand are quite comfortably coverings its short-term liabilities.

3. Inventory Turnover

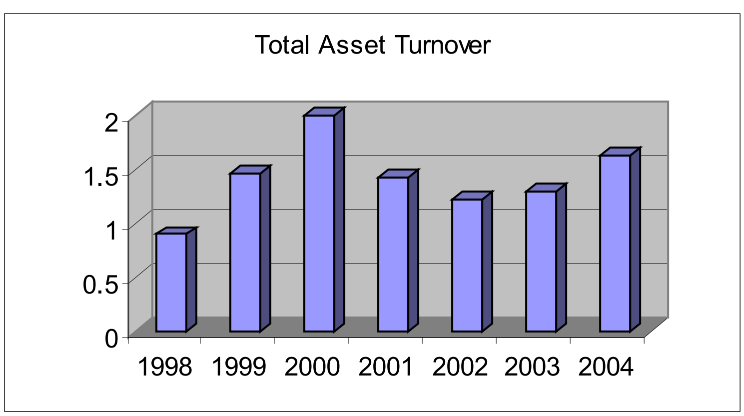


Inventory Turnover ratio indicates the liquidity of the inventory. This ratio basically explains how fast inventory is being converted in to sales. A high ratio indicates a more efficient firm. That is, the firm is converting more and more of its inventory in to sales and at a much faster pace. The company's inventory was never a problem as can be seen by the trend in the table. In fact the inventory turnover ratio was quite stable. It started decreasing at the turn of the century, mainly due to fluctuating sales, which caused the inventory either to lie around or in other cases be depleted at a fast rate, while sales were taking an upward trend. However, one thing that needs to be mentioned over here is that even though the sales were decreasing, profits were increasing at a very fast pace. For example, sales in 2002 were the lowest as compared to any other year, but profit after tax in that year was the highest reaching a total of approx. Rs.75 million.

4. **Receivable Turnover**

Another ratio, receivable turnover, indicates the liquidity of the receivables. Similar to the Inventory Turnover Ratio, this ratio shows the relation between sales and average receivables. The higher the ratio, the better. It shows the efficiency of the company as sales are being converted into accounts receivable and those in to cash. The ratio increased considerably in the last two years and has improved from 29.87 in 2003 to 50.51 in 2004. This shows that the company is well managing its receivables and credit sales in that neither are they forcing their clients to pay their due unnecessarily fast but are also managing to en-cash them on time.

5. **Total Asset Turnover**



Total Asset Turnover measures the activity of the assets and the ability of the firm to generate sales through the use of the assets. This is basically a measure of how efficiently the organization is utilizing its assets. The higher the ratio, the better as more sales would be generated by fewer assets, indicating that either the same assets are being used more efficiently to generate higher volumes of sales or more efficient assets are being introduced in to the operations of the company to enhance sale by a higher percentage. In this regards as well, the company has been able to improve its financial position as compared to prior years. The ratio has improved form 0.9 in 1998 to 1.62 by 2004. If we look at the trend of total assets over the years we can see that in the years after 1998, the company was involved in disposing of its assets as the total assets figure is seen to be declining. This is mainly due to reduction in fixed assets. However, after 2000 this trend changed and the assets of the company started increasing again. This was mainly attributed to increases in current assets as well as investments in fixed assets. This shows that the company, in its restructuring efforts was at first disposing of obsolete assets and than for purposes of expansion, increases in sales and ultimately higher profitability, the company started reinvesting its funds more efficiently and smartly in state of the art assets.

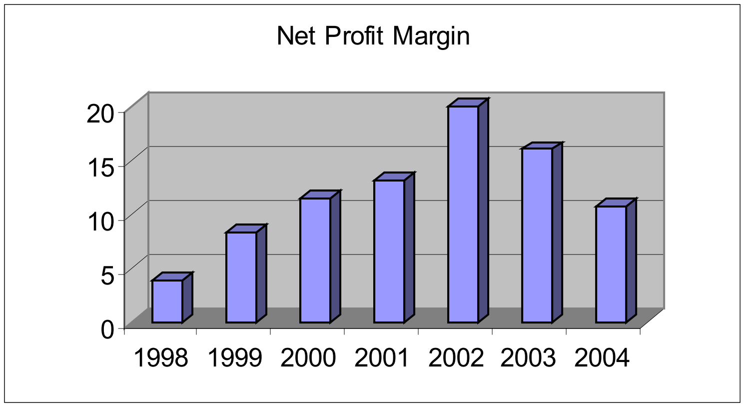
- **Operating Performance Ratio**

The operating performance of the company is analyzed to estimate the profitability of the company i.e. the firm's ability to generate earnings. Analysis of profit is of vital concern to stockholders since they derive revenue in the form of dividends. Further increased profits can cause a rise in market price, leading to capital gains, as we will see later on. The operating performance can therefore be analyzed by considering the income generation along with the income producing assets and sales of the firm. For this purpose we consider the following ratios.

Profitability Ratios	**2004**	**2003**	**2002**	**2001**	**2000**	**1999**	**1998**
Net Profit Margin	10.79	16	19.91	13.12	11.55	8.32	3.91
Return on Assets	17.45	20.7	24.37	18.66	22.97	12.13	3.54
Return on Common Equity	22.92	28.5	39.61	41.66	46.33	40.55	12.74

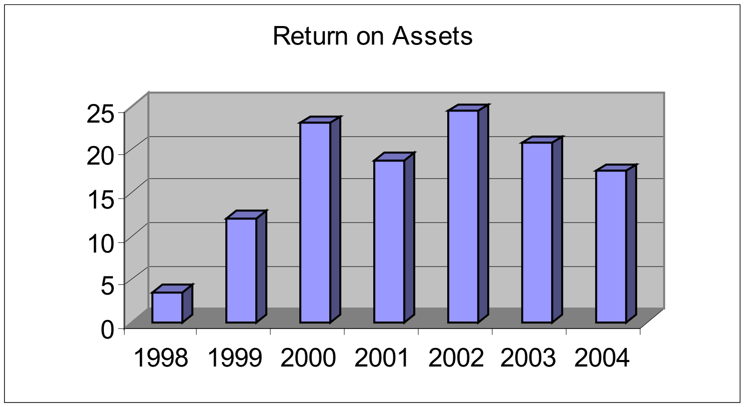
Earnings per Share	10.52	11.43	13.63	11.16	9.56	6.11	1.46

1. Net Profit Margin



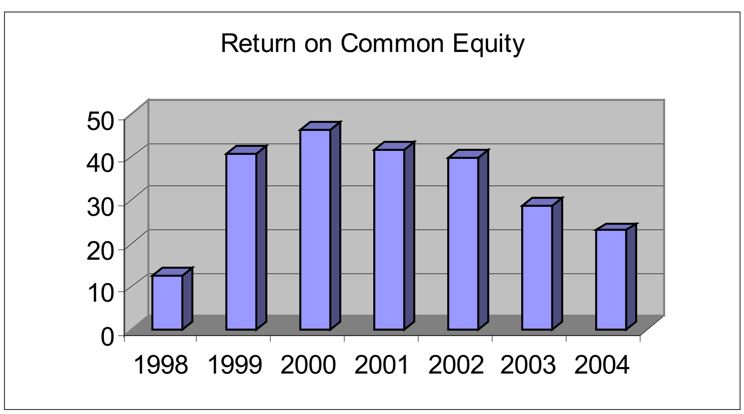
Net Profit Margin also known as the return on sales gives a measure of net income dollars generated by each dollar of sales. While it is desirable for this ratio to be high, competitive forces within the industry, economic conditions, use of debt financing and operating characteristics such as high fixed costs will cause net profit margins to decrease. From the table showing the Profitability ratios, we can see that the Net Profit margin has changed dramatically. Increases in sales have no doubt contributed to this, however as previously mentioned, the sales in 2002, which reports the highest profit margin, were the lowest in the period under consideration. This shows that the company was not only putting efforts in to increasing its sales but also reducing its costs and expenses. One of the prominent reduction in expenses seen in its annual reports is that of financial expenses which have been reduced considerably along with not only a reduction in long term-debt but complete elimination of it which further point towards minimum financial charges.

2. Return on Assets



Return on Assets ratio measures the activity of the assets and the ability of the firm to generate income rather than sales only through the use of the assets. This is basically a measure of how efficiently the organization is utilizing its assets and is a more conservative approach as compared to Asset turnover ratio. The higher the ratio, the better as fewer assets would generate more net income. The company has come a long way in terms of this ratio. In 1998, when the company was placed on the default counter, the company ROA was only 3.54%. However, following its restructuring, this ratio reached its highest ever in 2002 to 24.37% which is definitely a vast improvement for the company. The company, no doubt, was able to achieve this through better utilization of its resources; selling of those that were obsolete, and when required investing in more efficient assets.

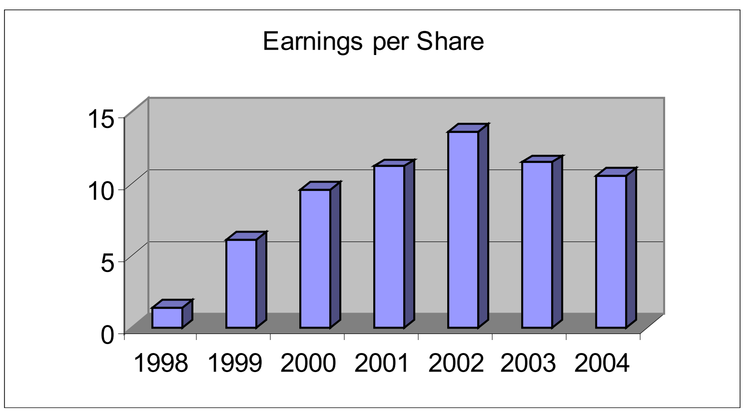
3. Return on Common Equity



The return on common equity is a measure of the returns expected by the common stockholders of the company. The difference between this ratio and the Return on Total

Equity ratio is that it does not take in to account the preferred stockholders. Unlike the other ratios, which have consistently shown signs of improvement, this ratio has been decreased over the years. This may seem as a negative sign for the company as equity holders are not getting higher returns. However a more astute investor may see a different picture by looking at its balance sheet. If we take a look at the shareholders equity portion of the balance sheet, we can see that the equity contribution has increased steadily over the years. This is a very good sign for the company as its shows the seriousness and commitment of the owners of the company towards the efficient running of the company. This also shows the willingness of the existing shareholders to invest more in this organization giving potential investors confidence that the company is in a strong financial position or if the case was otherwise the shareholders would in fact be withdrawing their invested amount rather than investing more. Also the increased equity injection has helped the company as the profitability of the company has improved significantly.

4. Earnings per Share



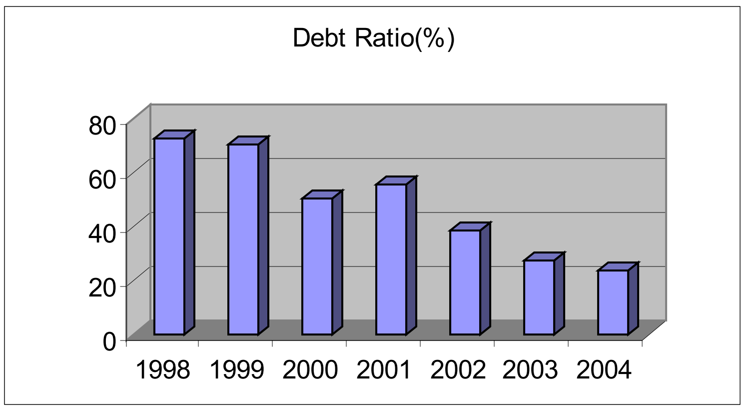
In regards to the EPS, Bolan Castings has shown dramatic improvement. This is a very good and positive sign for the investors as they are the one's who hold the shares. The higher the earnings that the company is receiving per share, the better.

- **Solvency Ratios**

Another category of ratios, which is extremely important while carrying out an analysis of the firm, is the return that the investors and shareholders are getting for the investment that they have made. These include the debt as well as the equity holders. These types of measures are widely used to evaluate enterprise performance. Two of the most prominent ratios in this category are calculated over here.

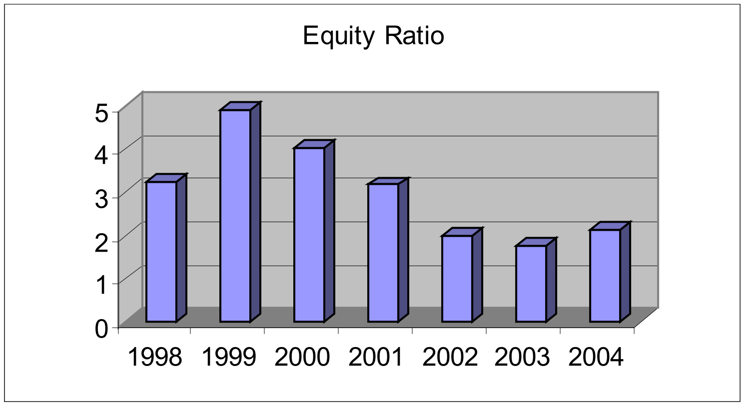
Solvency Ratios	2004	2003	2002	2001	2000	1999	1998
Debt Ratio (%)	23.86	27.38	38.48	55.19	50.42	70.07	72.21
Equity Ratio	2.14	1.78	1.99	3.17	4.01	4.88	3.25

1. **Debt Ratio**



The Debt Ratio is a measure of the total liabilities as compared to the total assets of the company. The ratio is preferred to be as low as possible, keeping in mind the leverage effect. A high ratio would indicate that a large portion of the liabilities are covering the assets while a smaller ratio would indicate that less assets are being used to cover the liabilities of the company. The Debt ratio has been decreasing since 1998, which is mainly due to the decrease in long-term debt on one hand and an increase in assets on the other. Due to this the liquidity as well as the debt paying capacity of the company has greatly been enhanced. This ratio especially, shows that the company has come a long way since being listed in the defaulter companies.

2. **Equity Ratio**



The return on total equity measures the return to the shareholders of the company. It is a basic measure of what the shareholders are getting in return for their investment in the company. Two measures have to be considered while calculating this ratio; the Net Income as through this the shareholders will be distributed their earnings, and the total equity that is a measure of what the shareholders be it preferred or common are contributing. The ratio, therefore measures the increase in income relative to the injection in the company. As long as it is increasing the shareholders will be satisfied and the company will be regarded as profitable. The ratio had been declining initially, which was due to increase in equity contribution as compared to increase in Net income. However as the company started stabilizing, the effects of injections made by shareholders started showing, the sales and thus Net Income started increasing. This resulted in the equity ratio to rise again, proving that the company was indeed on the right track and the restructuring efforts adopted by the management had indeed been successful.

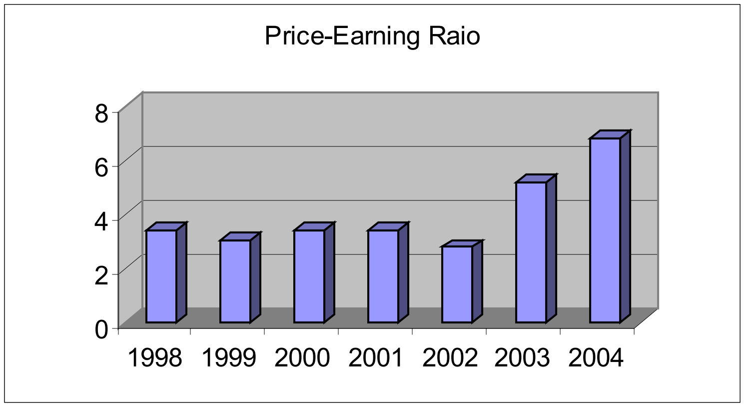
- **Market Ratios**

Another category of ratios considered in this analysis is that of Market Ratios. These ratios help potential as well as existing shareholders to analyze the financial standing of the company through its market price of shares, the earnings per share as well as the dividends declared by the company for its shareholders. Two ratio calculated in this category are discussed here.

Market Ratios	2004	2003	2002	2001	2000	1999	1998

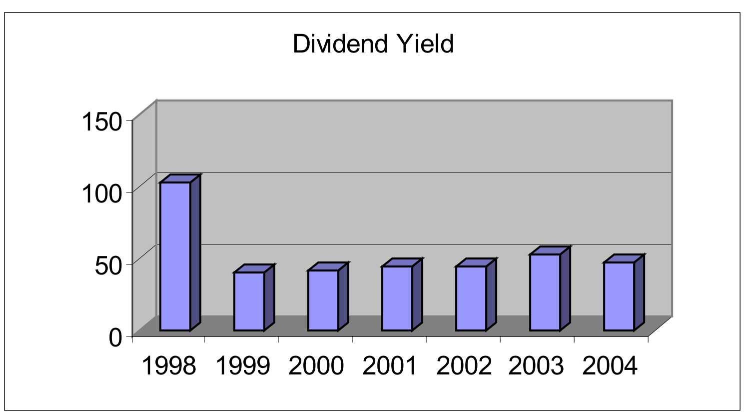
Price-Earning Ratio	6.8	5.2	2.78	3.42	3.4	3.03	3.42
Dividend Yield	47.54	52.49	44.03	44.82	41.86	40.91	102.79

1. **Price-Earning Ratio**



The price/earnings ratio is another indicator of the company's attractiveness for potential investors. It is a measure of the market price as compared to the earnings per share. A high ratio is taken as a healthy sign. As seen from the table above, the ratio has been increasing over the years. The fall in 2002 is due to the fact that the EPS in that particular was quite strong while the market price of share, even though improved was not in comparison to the increase in EPS. Due to this the P/E ratio decreased. However, this should not be given much thought as changes in market price are sometimes subject to speculation, which has no basis at all. However, by 2004 the ratio has improved considerably which shows the strength of the company.

2. **Dividend Yield**



Another important indicator from the point of view of the investor is the Dividend Payout ratio. This is a measure of the dividends that are being paid to satisfy the shareholders. The ratio is obviously preferred to be high. However, this Ratio has been decreasing for Bolan Castings. This is not usually a good sign for the company in the eyes of the investor, however more patient investors are sometimes willing to wait if the company is retaining the earnings for growth purposes or improving its weakening operations, which is definitely the case in this particular example. Therefore if the ratio is decreasing, investors should look at the strong performance of the company and assess it on that basis rather than on the dividends alone. Also the fact that the company is still paying its shareholders dividends and fair enough amount as well should further redeem the company in the eyes of the investors.

5.2. Suhail Jute Mills – A Debt Restructuring Example!

5.2.1. Company Profile-Present Scenario

The company was incorporated in Pakistan in 1981 as a public limited company under the Companies Act, 1913. Its shares are quoted on all stock exchanges of Pakistan. The company is principally engaged in the business of manufacturing and sale of Jute products.

The company was first listed by the stock exchanges as a default company in the year 1998. It remained in the defaulter's list till 2001, after which the company was successfully able to remove itself from the crisis that it faced. How the company was able to achieve this is analyzed through the ratios explained in the following pages.

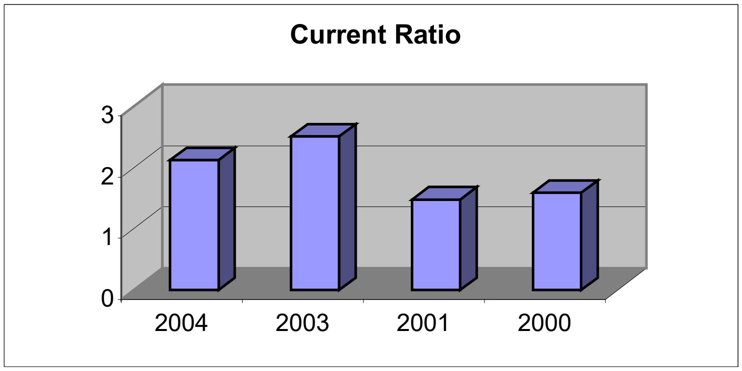
5.2.2. Financial Analysis

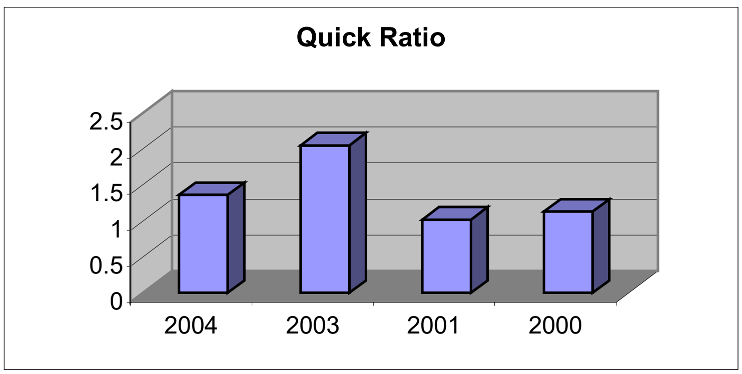
- **Liquidity Ratios**

Liquidity Ratios	**2004**	**2003**	**2001**	**2000**
Current Ratio	2.12	2.51	1.48	1.59
Quick Ratio	1.36	2.05	1.02	1.13

Inventory Turnover	0.55	3.18	2.68	2.82
Accounts Receivable Turnover	4.44	8.48	4.33	4.67
Total Asset Turnover	0.13	0.33	0.33	0.35

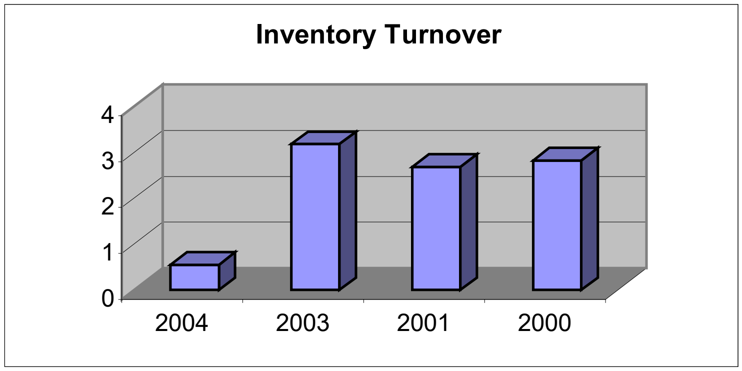
1. **Current & Quick Ratio**





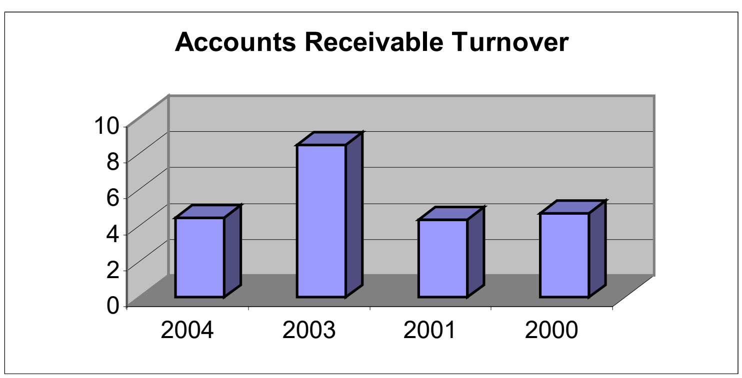
If we take a look at the liquidity position of the company since its emergence from the default status we can see that the company if not as good as Bolan Castings, is still good enough in its category. One of its redeeming qualities is that even when it was listed in the defaulter companies, its Current Ratio was quite safely above 1. Since than it has further improved its liquidity position. The same is true in the case of the quick ratio, which has registered an overall increase (a more conservative approach towards measurement of liquidity). This shows that at least in terms of its short-term debt paying capacity, the company is quite self-sufficient. Its current assets have been increasing while to current liabilities have showed a decreasing trend, which has resulted in a positive trend in the liquidity position of the company. Another point worth mentioning over here is that the increase in current assets is not because of increase in cash on hand or accounts receivables but due to higher inventory levels as well as short-term investments. It is therefore due to this reason that the quick ratio as compared to the current ratio has decreased rather than increasing.

2. **Inventory Turnover Ratio**



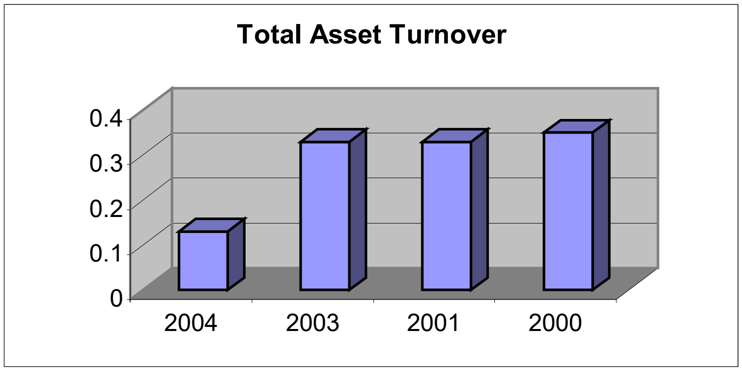
Inventory Turnover Ratio has shown a fluctuating trend in the past few years. This is mainly due to changes in inventory levels. In the year that the inventory held by the company is high, the ratio is low and vice versa. Even its highest ratio is not good enough. The company's sales have also been fluctuating causing an adverse effect on other financial indicators. The company therefore not only needs to restructure its debt paying ability but its operations as well.

3. **Accounts Receivable Turnover**



The receivables of the company have also shown a decreasing trend. This could be attributed to slowing of sales of the company as well. The receivable fell from Rs.36.4 million in 2000 to Rs.16.8 million in 2004. The sale in turn fell from Rs.169.8 million in 2000 to Rs.64.5 million by the year 2004. This shows that the company needs to increase its sales through better products, more efficient business operations as well as more efficient cost management. If the present trend continues, the company is likely to move towards the default counter again.

4. Asset Turnover Ratio

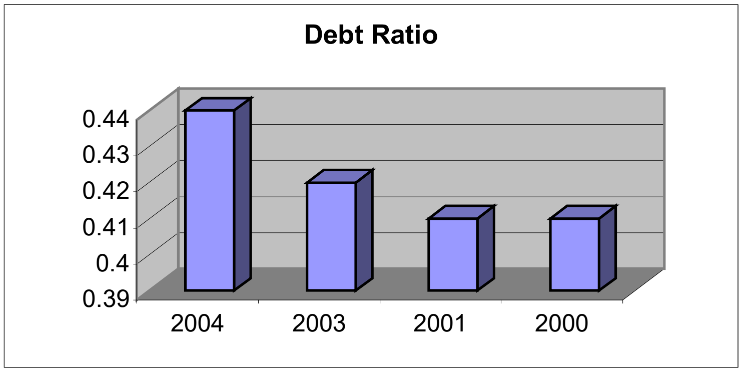


Similar to the other ratios, this ratio has not shown signs of much improvement, rather it has decreased consistently over the years. The reason for this is quite obvious. The company has been increasing its asset base in hopes of earning more revenues. However, the sales being generated are not supporting this asset enhancement being carried out by the company. In fact the sales have decreased substantially in the fiver year period since 2000. This shows the company's failure in utilizing not only its existing asset base but irrelevant and unjustified investment in other assets as well. From this ratio as well as the ones discussed above, it is clear that the company needs not only solve its present debt problem but needs to address its operational weaknesses as well.

- **Solvency Ratios**

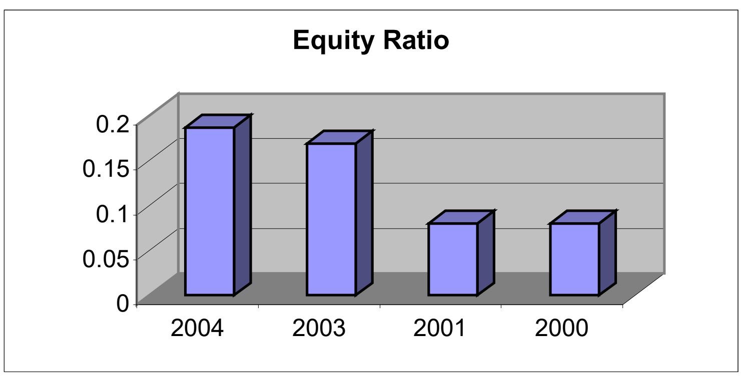
Solvency Ratios	2004	2003	2001	2000
Debt Ratio	0.44	0.42	0.41	0.41
Equity Ratio	0.187	0.169	0.08	0.08

1. **Debt Ratio**



The debt ratio for the company has not shown many changes and has in fact increased slightly. Keeping in mind its default status, and the fact that it has been removed from the defaulter list, one wonders why the ratio has increased instead of decreasing. This can be explained if we consider the long-term debt and the short-term debt separately. The company has able to reduce its long-term debt from Rs.43 million in 2000 to only Rs.19 million in 2004. On the other hand its current liabilities have shown an upward trend. Due to this the net effect on the debt ratio has been an increase rather than a decrease.

2. **Equity Ratio**

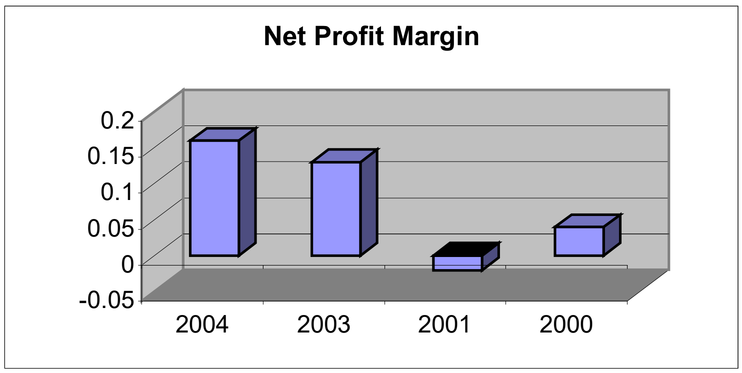


The Equity ratio has improved over the years. This is mainly due to increase in shareholder equity along with an increase in total assets. However, the changes are few and not so substantial as to have an impact on the welfare or turnaround of the company. Therefore, while analyzing the performance of the company not much emphasis should be given to this particular ratio.

- **Profitability Ratios**

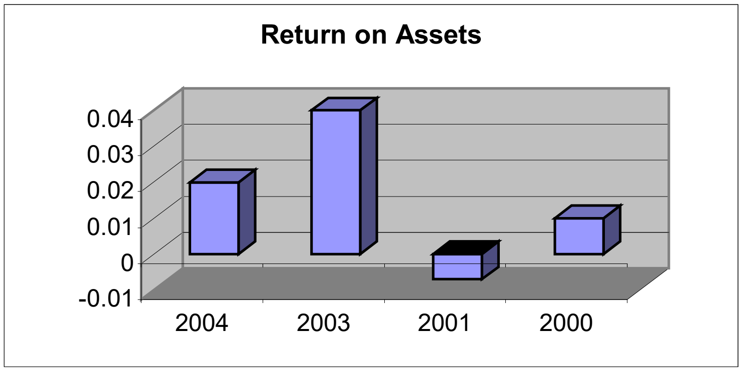
Profitability Ratios	2004	2003	2001	2000
Net Profit Margin	0.16	0.13	-0.02	0.04
Return on Assets	0.02	0.04	-0.007	0.01
Return on Common Equity	0.11	0.26	-0.09	0.16
Earnings per Share	3.08	6.13	-0.92	1.76

1. **Net Profit Margin**



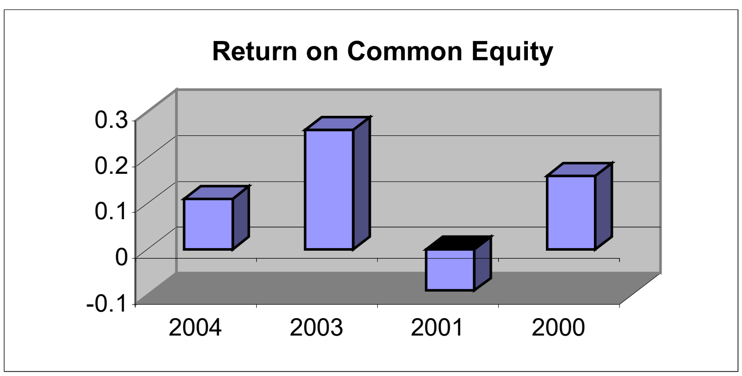
Unlike other ratios, the Net Profit Margin has shown signs of improvement, however not much. Considering the fact that the sales have shown a generally declining trend, the increase in this ratio can be attributed to a more efficient cost management strategy being followed by the company. If we take a look at its cost of good sold we can support this argument. Furthermore, the company registered a capital gain income as well as large increases in the form of other incomes, which caused the Net Income figure to rise. Other than this the financial charges have also declined considerably since 2000 causing a smaller deduction from the over all revenue figure.

2. **Return on Assets**



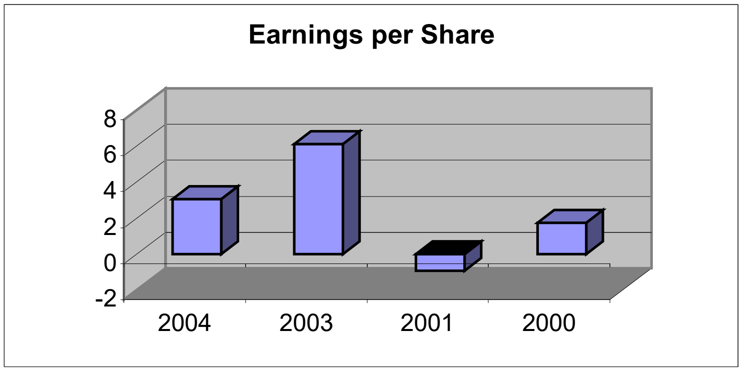
The return on assets, which is a measure of the sales being generated by the assets of the company, has not improved much. In fact it declined in the last fiscal year. This was mainly due to a substantial increase in assets, which was not support by the sales generated by the company for the year. This ratio further proves that the company's assets are not being managed in an efficient manner and the company, which has been more interested in reducing its long-term debt only, should move its attention towards the operational side of the business as well.

3. Return on Common Equity



The overall trend in the return on common equity has been a decrease. Due to large increases in equity contribution by the shareholders, the denominator value increased significantly. The increase in Net Income was not as notable, thus causing the numerator to rise slightly. This caused the ratio to decrease rather than increase. This shows that the equity contribution has failed to bring about the required or desired changes in the company.

4. Earnings per Share



The EPS for the company increased up till 2003. This was due to the high operating profit figure as compared to the prior years. The year 2004 reported an operating loss before taxes. This caused the EPS to fall for that particular year. If the company had not registered a capital gain of Rs.20.67 million as well as income form other sources of up to Rs.11.36 million, the company would have ended up with a negative EPS. This clearly shows the true financial standing of the company.

- **Market Ratios**

Market Ratios	2004	2003	2001	2000
Price-Earning Ratio	0.129	-	-0.53	0.88
Dividend Yield	78.51	-	0.00	1.41

1. **Price-Earning Ratio**

The P/E ratio has decreased from 0.88 in 2000 to 0.129 in 2004. This is another indicator of the company weak financial position.

2. **Dividend Yield**

The dividend yield has vastly improved for the company. The company is giving out its income to shareholders in the form of dividends so as to keep them satisfied. This is not an intelligent move by the company as at present the company needs all available funds to survive in the long run. For example if we look at the year 2004, the company actually registered an operating loss if the capital gain is to be taken out from the picture. However, no thought was given to this issue and a substantial amount was laid aside as dividend payment. A more astute investor may take this as a warning sign and perceive correctly that the company is trying to manipulate the market by gaining investor interest through giving out false signals and may actually be on the run.

5.3. Bela Engineers Ltd - A Liquidation Example!

5.3.1. Company Profile-Present Scenario

Bela Engineers was incorporated as a private limited company in 1970 and named as "Ghandhara Diesels Limited". It was nationalized in 1972. A year later, the company sought listing at the Karachi Stock Exchange. It now stands on the 'defaulters' counter' of the Exchange - the company having been marked for default on at least four counts. There is no trading in the Bela scrip, but the last quoted value for the 10-rupee share carried nearly 90 per cent discount.

It could have been nearly 15 years ago at the end of June 30, 1986, when a pre-tax profit of Rs1.5 million was made and a dividend at 10 per cent was paid. That was perhaps the last of the profit and dividend that the shareholders were to see. In all the years since, the company has continued to post losses beginning with a deficit of Rs11.2 million in the year ended June 30, 1987. Against the paid-up capital of Rs34 million, the company now carries massive sums in debts and deficit.

Bela Engineers is understood to be in liquidation under the Court. It is also clear that being the owners, small shareholders would stand last in the queue, when the proceeds from sale of assets get to be distributed. Small shareholders who may still be holding on to their stake in Bela would be lucky if anything trickles down to them after all other interests including those of the major creditors, have been satisfied.

The negative net worth of Rs159.389 million against the paid up capital of Rs34 million and the company's inability to discharge its liabilities, including the decreed amount of Rs68.6 million arising out by decree granted by the SHC against the company in favor of Habib Bank and United Bank Limited prompted the management to consider liquidation.

5.3.2. Financial Analysis

- **Liquidity Ratios**

Liquidity Ratios	1999	1998
Current Ratio	0.21	0.18
Quick Ratio	0.03	0.02
Inventory Turnover	0.12	0.12
Accounts Receivable Turnover	1.42	1.1
Total Asset Turnover	0.11	0.09

The company as studied through the Altman model was declared bankrupt in the early 90s. According to the model the company should have been liquidated at that time instead of waiting till now so that more looses could be accumulated and the net worth of the assets to further decrease. In the last available annual reports of the company, it is fairly obvious that the company is in no condition to continue with its operations. Its current and quick ratios are way below the minimum requirement of 1.

The inventory turnover as well as the receivable turnover was at a stand still. Sales of the company had not improved and were unable to cover even the expenses. Losses were being registered consistently since the last decade or so. The company assets had been decreasing while its liabilities were piling up. The slight increase in the asset turnover ratio is due to a further decrease in total assets while a slight increase in sales was registered for the company.

- **Solvency Ratios**

Solvency Ratios	1999	1998
Debt Ratio	3.83	4.6
Equity Ratio	0.6	0.58

The Debt ratio of the company for the year decreased somewhat mainly due to the higher decrease in short term liabilities as compared to the decrease in assets. By this time, the company was well aware of its deplorable condition and knew that other than liquidation no other alternative was available. The management was, therefore trying its best to pay off as many liabilities as possible through sale of its assets as well as through the minimal revenues that it was still able to generate.

Its equity ratio had not changed much. Its equity remaining constant, the change was solely due to decrease in the total assets, which caused to the denominator to decrease causing the ratio to improve lightly. However this has no impact what so ever on the company financial position.

- **Profitability Ratios**

Profitability Ratios	**1999**	**1998**
Net Profit Margin	-33.73	-47.41
Return on Assets	-3.66	-4.39
Return on Common Equity	-6.05	-7.55
Earnings per Share	-	-

From the table above its profitability situation is quite self-explanatory. All the ratios are negative due to the net losses being registered by the company through out the last decade. Keeping in mind its weak liquidity position as well as lack of investor interest and its reputation in the market, the company has very few options left to it. It is quite obvious that it will not be able to get additional funding from either creditors or the equity market. Furthermore, the sizeable funds required to revive this organization, not to mention a completely new management and infrastructure requirements, will be extremely difficult, if not impossible to find. Therefore, it is quite obvious through studying its financial statements that the only option left for the company is to opt for liquidation.

The research up till now has dealt mainly with the local market and its experiences. However to give a broader outlook it is necessary that we take in to account experiences from other countries as well. At some time or another countries like Mexico, Chile, Indonesia, Poland, Thailand etc. have gone through the same phase that Pakistan did in the 90's. In fact Thailand and Indonesia experienced bankruptcy status in the years similar to Pakistan. An analysis of how countries similar to Pakistan coped with issues of corporate and debt restructuring, will give us a better understanding as how to go about the restructuring process.

There is enormous diversity in the specifics of restructuring approaches employed. While a few countries have assigned an active role to State banks in the enterprise restructuring process such as Poland most countries have established several private or government institutions, to initiate pre-privatization programs, consolidate and/or privatize enterprises, and/or liquidate enterprises with no hope of recovery. Some countries have emerged victorious through government led restructuring with the government playing a crucial role in the restructuring process. Others have succeeded with a minimum level of government intervention. The use of Bank Rehabilitation Agencies (BRAs) in a few countries to coordinate bank loan recovery efforts represents a mix of "centralized" and "decentralized" approaches. To a lesser extent, bankruptcy procedures have been used. All have led to the financial restructuring of enterprises and their debts.

Experiences have shown that the type of approach adopted is country specific, with very few generalized rules. However some of the few common grounds that have emerged through various research studies include strong government support, written down policies and procedures as well as a powerful and transparent authoritative body. These are some of the most important participants of any restructuring process.

(I) Corporate Restructuring Experience in Thailand

6.1. Introduction

Since the severely economic crisis hit Thailand in 1997, Thai government has applied and implemented many measures to improve the economy. To-date, the economic recovery has been confirmed in various sectors. One of the important measures is the financial sector reform to strengthen the financial system in general and to reduce the non-performing loans (NPLs) in particular. Some of the measures are as follows,

- Upgrading supervision and regulatory standard in March 1998 to strengthen the soundness of financial institutions,
- Announcing a comprehensive financial restructuring package on August 14, 1998 to provide resolute and forceful actions to address the outstanding weaknesses in the financial sector as well as provide the framework for the provision of public funds to re-capitalize the viable financial institutions,
- Encouraging financial institutions to set up, capitalize, and fund private Asset Management Companies (AMCs) to provide maximum flexibility to deal with their bad assets,
- Determining the framework for financial sector consolidation,
- Facilitating corporate debt restructuring.

6.2. Supporting Authorities

Corporate debt restructuring is quite complicated. Thus, it is necessary to have efficient authorities, supportive legal and regulatory infrastructure, as well as willingness on the parts of creditors and debtors.

As the first step, the Bank of Thailand, in cooperation with 5 associations, set up the Corporate Debt Restructuring Advisory Committee (CDRAC) and established the framework for corporate debt restructuring—the so-called Bangkok Approach. The CDRAC, then established other 3 frameworks to facilitate corporate debt restructuring which are the Debtor-Creditor Agreement on Debt Restructuring Process, Inter-Creditor Agreement on Restructure Plan Votes, and Simplified Debtor-Creditor and Inter-Creditor

Agreement. Each framework has its unique feature, but the same objective of reducing NPLs.

6.2.1. CDRAC

In order to facilitate the process of debt restructuring, the Joint Public-Private Consultative Committee (JPPCC) had a resolution on June 2, 1998 to establish the Corporate Debt Restructuring Advisory Committee (CDRAC). It was chaired by the Bank of Thailand's Governor, with representatives from the Thai Bankers' Association, Foreign Bank's Association, Association of Finance Companies, Board of Trade, and Federation of Thai Industries. CDRAC's mandate is to help push ahead the complicated debt restructuring through establishing a framework for negotiation and eliminating legal and tax obstacles to the restructuring process. It also closely monitors the progress in restructuring at large.

6.2.2. Sub-Committee

Accordingly, CDRAC has set up the Sub-Committee with the main responsibility is to succeed CDRAC policy. It assists the main committee in solving the problem up front, and also monitors the progress in more detail.

6.2.3. Provincial Debt Restructuring Sub-Committee

To expand corporate debt restructuring throughout the country, JPPCC established Provincial Debt Restructuring Sub-committees chaired by provincial governors.

6.2.4. The Office of CDRAC*

This Office is a part of the Bank of Thailand. It is an operational unit of CDRAC. To facilitate debt workouts, apart from helping solve the restructuring problem, officials and case managers will coordinate and assist in contacting between debtors and creditors, and analyze, facilitate and mediate as well as monitor each debt restructuring case.

6.3. Tools for Expedition the Debt Restructuring Process

6.3.1. Bank of Thailand's Notification on Debt Restructuring

At first, the Bank of Thailand issued the regulations for debt restructuring for financial institutions. The regulations had been drawn up with the purpose of introducing a formal strategy, which financial institutions can refer to when restructuring troubled debts. The important principle is that the highest level of management should participate directly in formulating the debt restructuring strategy as follows:

1. Policy and procedures are clearly defined and written
2. The strategy should cover every stage of the restructuring process from start to finish including clear time-bound objectives, the approach and methodology for evaluating and granting loans, measures for monitoring and reporting on performance against those objectives to ensure that the restructuring has been carried out correctly in terms of its objectives and its accounting principles
3. When the debt-restructuring contract is signed, financial institutions must closely monitor debt payment schedule and always evaluate debt service capability.

Regarding the debt restructuring procedures and documentation, financial institutions must draw up action plans and prepare the relevant document in each stage of the debt restructuring as follows:

a) Preliminary Analysis and Documentation

The following information and documents must be included to evaluate the restructuring of a loan agreement.

1. Details of the cause of debtor’s credit difficulties and delayed payments of the principal and/or interest.
2. The extent of the problem or cause of the debtor’s credit difficulties, the borrower’s financial risk, taking account of the borrower’s financial statements, cash flow statements, and financial forecasts, as well as an assessment of market conditions and other factors relevant to the debtor’s business and financial prospects.
3. The expectations or likelihood of full repayment (principal and interest) under the original loan and under the restructured loan contracts.

4. An evaluation of the borrower's management focusing on their efficiency to ascertain if there is a need for an external expert's help in organizational restructuring—for example, the changing of shareholders, directors, managing directors, or the managerial approach.
5. The completeness and adequacy of the documents and loan criteria used in the restructuring process.
6. The methodological approach and assumptions used to project future cash flows and calculate present values.

b) Follow-up Procedures and Documentation

Financial institutions must have follow-up procedures to monitor restructured loans, which are in accordance with the regulations set out. This is to ascertain whether debtors are able to repay their debts as agreed in their revised contracts.

1. Progress reports must be prepared monthly by the designated officer detailing the latest developments the firm, current action plans, and the likelihood of full payment.
2. Financial institutions must require debtors to provide them with financial statements, and to report the effects of the measures to undertake as part of the restructuring process such as capital write-downs, re-capitalization, and the withholding of dividends.
3. Financial institutions must set out guidelines for actions to be taken if debtors have further difficulties with repayment after restructuring.

6.3.2. Bangkok Framework

Fundamentally, CDRAC is guiding out-of-court debt restructuring negotiation. It established the framework for Corporate Debt Restructuring—the so-called **Bangkok Approach** modeled along the London Approach.

Bangkok Framework is a guideline for debt restructuring between creditors and debtors, especially in the case of the large corporate debtors with multi-creditors, (was premised on the basis of the general accepted practice and voluntary workouts with an aim to maximize benefits of creditors, debtors, shareholders, and employees.) The Framework is a market-based approach and has no legal binding for concerned parties. It is a guideline for coordination between debtors and creditor, and focuses on the corporate restructuring with the aim for business viability rather than pure debt restructuring. (For details refer to the appendix).

6.3.3. Debtor-Creditor & Inter-Creditor Agreements

Such a non-statutory approach of Bangkok Framework was further complemented by the establishment of the Debtor-Creditor Agreement on Debt Restructuring Process and Inter-Creditor Agreement on Restructuring Plan Votes and Executive Decision Panel Procedures. These two agreements were cooperative drafted by 3 creditors' associations, namely the Thai Bankers' Association, Association of Finance Companies and the Foreign Bank's Association and approved by the CDRAC. On March 19, 1999, 63 financial institutions had made signatories to the agreement in this first Signing Ceremony. Subsequently, other financial institutions decided to sign the agreements, bringing to the total number of 84 institutions. Debtors, on the other hand, have to submit the Debtor Accession to creditors or CDRAC to participate in these agreements.

The Debtor-Creditor Agreement and the Inter-Creditor Agreement are on a voluntary basis, but with legal binding. The agreement has set out the limit timeframe for debtors and creditors to complete debt restructuring. In addition, Inter-Creditor Agreement has enforcement mechanism for non-complying creditors. Other features include the roles of mediator and Executive Decision Panel. The former will resolve the dispute between debtor and one or more creditors during the workout process while the latter will make a final decision on proposed plan, if any.

Nonetheless, the process will come to a conclusion between 5-7 months extendable by up to 2 months. In sum, all these mechanism will expedite the restructuring process and help in achieving the core objectives of the restructuring process.

6.4. Incentives

To persuade parties to enter into the corporate debt restructuring process voluntarily, many governmental agencies have provided incentives, beneficial for them. Some measures in effect are as follows,

1. Tax concessions for the financial institutions' debt in case of debt restructuring.
2. Financial institutions may use the amount of debt forgiven in debt restructuring as a tax-deductible expense in calculations of taxable income.
3. The establishment of reasonable grounds for which the Revenue Department deems it appropriates to collect certain types of tax.
4. Registration fee concessions reduced to 0.01 percent until 31st December 2001 on the transfer of land and property ownership in support of debt restructuring
5. The exemption of stamp duty for the import of machinery for debtors under the BOI assistance scheme in cases where the machinery is transferred to the creditor as part of a leasing or hire-purchase contract. Allowance of financial institution and third parties to receive the transfer of permits to undertake business operations of industrial works, other permits and concession granted in order that the financial institution may continue its operations to restructure. The transfer of BOI privileges to a new investor in the debtor company.
6. The amount of debt forgiveness granted by creditors under court reorganization shall be deductible in the calculation of taxable income.
7. Tax concession for debts restructuring for debtors whose creditors are not financial institutions.
8. Allowance of financial institutions to hold foreclosure assets transferred to it during 1st January 1997 - 31st December 2001 up to 10 years.
9. Financial institutions are allowed to write off the debtors classified as doubtful and loss with 100% provision from the account. The amount can also be treated as expenditure for tax deduction.

A more detailed list of incentives provided by the government to facilitate the process, is given in the appendix section.

6.5. The Progress of Debt Restructuring

The CDRAC initially accepted 200 target cases of debt workouts proposed by the member associations. These target cases involved 351 companies with debt and overdue obligations totaling 674.3 billion baht. The cases have been proposed and accepted as they involve complicated multi-creditor-type of debt restructuring that requires outside mediator role. Subsequently, 370 additional target debtors were selected to join the Committee's monitoring program with credit outstanding of 831 billion baht. Thus, the total CDRAC target cases as at 15 December 1999 involved 721 companies with debt and overdue obligation totaling 1,505.3 billion baht. In addition, in November 1999, CDRAC has approved 973 additional target debtors to join the Committee's monitoring program with outstanding about 600 billion baht. This new list has been monitoring since 15 December 1999. In sum, there are presently 1,694 companies as at 31st December 1999 under the CDRAC restructuring process with the credit outstanding totaling approximately 2.1 trillion baht. The progress of debt restructuring of total target cases under DCA and ICA can be summarized as follows:

	No. of Cases	Credit Outstanding (billion baht)
1. Completed cases as at 31/12/99	110	249.7
2. Agreement on Plan, in process of documentation and signing as of 31/12/99	68	245.8
3. Cases in process of debt restructuring as at 31/12/99	370	524.4
4. Cases in process of signing Debtor Accession	870	557.1
5. Cases in process of legal action as at 31/12/99	216	404.5
6. Normal Loans as at 31/12/99	60	159.7
Total CDRAC target cases as at 31/12/99	**1,694**	**2,141.2**

It is worth noting that, CDRAC not only monitors the debt restructuring for the complicated multi-creditor companies under the DCA and ICA but also monitors the small and medium cases under Simplified Agreement. The progress of target debtors under Simplified Agreement approved by CDRAC during June-December 1999 are as follows:

	No. of Cases	Credit Outstanding (billion baht)
1. Target debtors	3,876	184.1
2. Stage of development		
2.1 Debtors in process of signing SA	1,240	8.8
2.2 Creditors to take legal action against non-signatory	688	73.9
2.3 Debtors in restructuring process	1,948	101.4
– Completed cases	910	16.3
– Restructuring in process	842	81.0
– Creditor to take legal action	196	4.1

For the overall picture of debt restructuring reported by financial institutions (i.e., commercial banks, finance companies and international banking facilities) as at the end of December 1999, the completed debt restructuring has increased by 23,604 cases to 173,709 cases with a corresponding increase in credit outstanding of about 17.82% or 162.1 billion baht to 1,072 billion baht. Financial institutions with a key role in debt restructuring are the Thai commercial banks, which have completed debt restructuring of 945.5 billion baht as at end-December signifying an increase of 152.6 billion baht since November. The increase in completed debt restructuring is composed of 94.1 billion baht by private commercial banks, and 58.5 billion baht by public commercial banks.

Throughout the 12 months of 1999, completed restructuring case have increased by 164,694 cases with corresponding increase in credit outstanding of 915.2 billion baht or about 76.0 billion baht monthly. Cases in process of restructuring have increased by 7,405 cases to 26,199 cases with credit outstanding increases 430.0 billion baht to 1,120.5 billion baht.

(II). The Indonesian Experience

6.6.Introduction

In late 2000, after a slow start, the pace of corporate debt restructuring is accelerating somewhat. Some debtors and creditors have started to reach agreements under the Indonesian Bank Restructuring Agency, IBRA, and the Jakarta Initiative Task Force, JITF. IBRA also has started winning some important bankruptcy cases in the courts, increasing incentives for debtors to negotiate debt restructuring. While taxation, regulatory and bankruptcy system weaknesses continue to impede efforts to accelerate restructuring, the Government is attempting to address these problems. Nevertheless, concerns exist about the depth of recent debt restructuring agreements, as superficial workouts are likely to leave the corporate sector over leveraged and exposed to future default. Government policy makers recognize they must ensure massive non-performing corporate debt is restructured, as restoring corporate sector health is key to sustaining economic recovery in 2001 and beyond. The Government acknowledges the weak legal system has impeded the progress of key government initiatives, particularly IBRA and JITF. Hence, since the crisis, Indonesia has upgraded significantly its bankruptcy system and corporate governance framework. Reducing barriers to entry for new firms, selling government assets to foreign and domestic investors, and introducing anti-trust legislation also will boost competition and corporate sector efficiency. Together, these reforms eventually should create a business environment able to sustain strong economic growth and improve Indonesia’s attractiveness as a destination for foreign business.

Restructuring non-performing corporate debt is important for many reasons. First, firms with non-performing loans usually cannot borrow new funds or invest; this constrains economic growth. Second, high levels of unrestructured debt and the expectation much collateral will be sold makes assets less attractive to potential investors, and inhibits the Government from selling assets it holds to reduce public debt. Finally, the banking system cannot recover until corporate debts are restructured or written off. Hence completion of corporate debt restructuring is essential for Indonesia’s recovery. Improving macroeconomic conditions are likely to expedite negotiations on outstanding debts. As the economy recovers, asset sales will be more feasible and rewarding, and companies will need new loans to fund investment.

6.6.1. Level of Indebtedness

In the aftermath of the crisis, analysts estimated a majority of Indonesia's corporate sector was technically insolvent. The sector still carries debts of about US$120 billion. Large corporations owe US$85 billion of this, and state enterprises and small firms owe the remainder. Of the total debt, 49 per cent is owed to foreign creditors and 72 per cent is denominated in foreign currencies. Three quarters of large corporate debt is distressed and needs restructuring. Most of these debts are not being serviced.

6.7. Supporting Authorities

6.7.1. IBRA's Asset Management Unit

The Asset Management Unit, Credits, AMC within IBRA is the largest creditor in the economy, managing all non-performing loans transferred to IBRA from banks the Government took over. AMC presides over total debts with a face value of Rp.281 trillion (US$32 billion), mainly owed by large debtors. Its stated objective is to restructure or auction these non-performing loans or dispose of collateral backing them by court initiated liquidation proceedings, so as to maximize returns to the taxpayer.

6.7.2. The Jakarta Initiative Task Force

The JITF coordinates debt restructuring when IBRA is not a majority creditor. The initiative, established in September 1998, facilitated out-of-court voluntary corporate debt restructuring. Mainly private sector, officers staff it and since January 2000, the Government has boosted significantly its resources to improve its capabilities. Initially, each debtor has to form a steering committee with major creditors to agree on a debt restructuring strategy. The debtor submits a financial rescue plan to the steering committee that all creditors must accept. If a minimum number of creditors and the debtor cannot agree, a 'pre-negotiated' plan, which new bankruptcy laws define, then comes into force. A task force of senior representatives from relevant ministries and agencies, and advised by a private Advisory Restructuring Committee, removes regulatory and tax obstacles, and provides a one stop shop to approve filings.

In April 2000, debt restructuring delays caused the Government to initiate time-bound processes under JITF, and improve incentives and sanctions to encourage debtor participation. Reforms included establishing the Financial Sector Policy Committee. The committee now oversees corporate and bank restructuring, and refers major cases to the JITF for action, instead of relying on debtors to volunteer for the scheme. The committee also can refer uncooperative debtors to the Attorney General's office to initiate bankruptcy proceedings. Where necessary, the task force now assists debt restructuring on IBRA's behalf. Government tax incentives for debt forgiveness, debt to asset and equity swaps, and easier requirements for banks to swap non-performing debts for equity also assist task force debt restructuring.

These new government initiatives have markedly improved JITF outcomes. The task force now carries a case load of close to US$10 billion (Rp.87.6 trillion), projected to increase to over US$15 billion (Rp.131 trillion) by the end of 2000, due to eight cases with debts totaling Rp.48 trillion (US$5.5 billion) that the Financial Sector Policy Committee referred. After restructuring debts worth US$5 billion (Rp.26 trillion) by July 2000, it should complete restructures worth a further US$3 billion by December 2000 and a total of US$12 billion by April 2001.The task force aims to restructure each debt within three to six months, depending on the complexity of the case, and releases quarterly surveys monitoring the progress of corporate restructuring

6.8. Tools for Expedition the Debt Restructuring Process

6.8.1 Asset Quality And Restructuring Strategies

IBRA assessments indicate debtors with good business prospects and intending to participate in debt restructuring comprise 32 per cent of all debtors and hold 30 per cent of debts by value. IBRA is restructuring these debts, with shareholders injecting new equity to improve debt to equity ratios. Debt equity swaps provide IBRA with an asset it can sell later. Creditors, including IBRA, are expected to hold 20 to 40 per cent of equity in many well known corporations as a result of ongoing restructuring. Debtors with poor business prospects but intending to cooperate in debt workouts comprise 53 per cent of all debtors and hold 56 per cent of debts by value. IBRA intends to sell these firms' assets and encourage voluntary liquidation, helping these firms to exit and repay a portion of their debts to IBRA.

IBRA intends to force debtors with poor business prospects and little intention of cooperating into bankruptcy and liquidation. These cases comprise 13 per cent of all debtors and hold 11 per cent of debts by value. The 3 per cent of commercially sound firms not willing to cooperate with IBRA face litigation and foreclosure through the court system. Cooperating debtors enter meetings with creditors, led by IBRA, and sign a letter of commitment to participate in negotiations. Often debtors agree to sign a 'stand still agreement' that freezes the firm's operations, although this is optional. Once IBRA and its private sector subcontractors conduct due diligence, debts can be restructured. Negotiations with viable businesses culminate in debtors and creditors signing a debt restructuring agreement.

6.8.2. Asset Sales

The Government's and IBRA's break up and sale of large corporate conglomerates should reduce substantially the degree of concentration within the corporate sector, improving the level of competition. Removing banks from large-scale conglomerate structures should stop the channeling of funds to related companies. Asset sales to new domestic and foreign company entrants promise to increase competition across most sectors. In particular, foreign companies entering the market should offer price, product innovation and marketing competition, as well as generally higher standards of corporate governance. Increasingly, markets should discipline firms in their use of credit and other scarce resources.

6.8.3. Developing Capital Markets

Developing corporate equity and bond markets provide new sources of corporate credit; they will also enforce commercial discipline. As corporates and banks compete more for savings, funds are more likely to be allocated to more viable investments, reducing the risks of a new banking crisis. Increasing share ownership should increase turnover in corporate ownership, discipline corporate investment practices and separate ownership from management. With so many government bonds issued as part of bank restructuring, a deeper government bond market eventually should emerge, providing a benchmark yield curve that supports corporate bond market development.

6.8.4. Fewer Entry Barriers

Many other post crisis reforms should reduce market entry barriers, increase competition and strengthen market discipline on corporate behavior. Lower tariffs and improved access to import licenses should increase competition from foreign suppliers. In reforming and privatizing state enterprises, the Government has removed monopolies in several sectors, reduced subsidies to inefficient state enterprises and improved access for new entrants.

6.8.5. Anti- Trust Legislation

The anti-monopoly and unfair competition law passed in 1999 aims to prevent anti-competitive business activities and agreements. The Business Supervisory Commission, which enforces the law, is accountable to the President. The commission concentrates on listed companies; up until October 2000, it had investigated 29 companies for manipulating prices and insider trading, and exonerated 11 of these.

6.9. Incentives

6.9.1. Legal System Constraints on Restructuring

Despite changes in 1998 to the bankruptcy laws, only around one third of debtors appeared before the commercial courts by late 2000 had been found bankrupt. This has shown that the threat of bankruptcy has been minimal, and debtors had little incentive to enter debt restructuring processes. By mid 2000, frustrated by these outcomes, the Government and IBRA demanded the commercial court assign cases to ad hoc judges, leading to the replacement of around 70 per cent of judges in Jakarta courts. Commercial court judges' dissenting opinions now are published to improve the court system's credibility and transparency. Four new commercial courts will open in regional areas to accelerate the corporate debt restructuring process. Finally, the President is appointing well regarded judges to the Supreme Court, including a new Chief Justice.

To improve legal outcomes, the Government and IBRA threatened to invoke government Decree 17 of 1999 and seize the assets of recalcitrant debtors. In mid 2000, it established the inter-ministerial Committee for Resolving the Cases of Recalcitrant Debtors to coordinate a strategy for IBRA's difficult debtors, including prosecuting them and imposing administrative sanctions on their firms. The Government also issued a regulation providing IBRA staff with indemnity from personal lawsuits filed against them for restructuring bad debts.

6.9.2. Taxation Constraints on Restructuring

The taxation law also hampers effective debt restructuring, by taxing any capital gains debtors make in reducing their liabilities under debt workouts. Recognizing this, in late 2000, the Government approved amendments to the taxation law, effective January 2001, which should reduce debtors' tax burdens on debt equity swaps and debt forgiveness agreements by about Rp.600 billion (US$70 million). Measures also include removing withholding taxes on accrued but unpaid interest, transferring duties on debt/asset swaps involving real estate and reducing limits on the carry-forward of net operating losses.

The Government has committed to address capital market regulations that impede debt restructuring, including rules that prevent new equity raising and par value restrictions on the issue of new equity. Regulators also have waived some regulations on new issues to expedite IBRA's equity sales to strategic investors. Together, these government reforms should improve the quality of debt restructuring outcomes.

6.10. The Progress of Debt Restructuring

By late 2000, the pace of debt restructuring was accelerating. IBRA reported it tentatively had resolved 40 per cent of its credits with the top 21 debtors, which totaled Rp.87 trillion (US$10 billion) through agreed restructuring or legal action. By mid September 2000, the

JITF also had restructured 25 cases involving around US$5 billion of debt, out of 51 cases worth US$10 billion actively engaged in JITF mediation. In 1998 and 1999, macroeconomic instability and political uncertainty deterred many debtors and creditors from participating in debt restructuring, or preparing for restructuring by assessing asset values and cash flows. In early 2000, to accelerate the pace of debt restructuring, the Government increased political and resource support for the operations of the two agencies responsible for restructuring domestic debts, IBRA and the JITF. These agencies now have more resources to track debtors and creditors, and more legal sanctions to increase debtor incentives to participate in restructuring. The corporate sector's domestic debts mainly were owed to troubled domestic banks, but the bank restructuring program transferred many of these loans to IBRA. IBRA therefore negotiates directly to restructure debt or liquidate firms for which it is the main creditor. In other cases, including firms in which IBRA is a minority creditor, negotiations occur under the JITF.

Large Private Corporates Are Major Debtors

Liabilities and Assets of Major Debtors and Creditors, 1999, US$ billion

	State banks	IBRA Asset Management Credit Unit	Other local banks	Foreign banks	Securities holders	Total
State enterprises	3.5	1.7	0.5	5.3	1.0	12.1
Large private corporations	4.0	22.9	3.4	50.7	4.1	85.0
Small and medium enterprises	7.2	4.2	8.3	2.4	0.5	22.6
Total	14.7	28.8	12.2	58.4	5.6	119.7

The main focus of the study was to see, firstly whether the company future financial standing can be predicted by the use of models such as the Altman Z-Score Model and secondly when a company default status has been predicted can we analyze through the help of its financial statement, which option of restructuring would be best suitable for it. Considering the corporate sector of Pakistan over the last decade has given us a brief insight in to the possibilities of corporate structural reforms before any significant losses have been incurred or a full-blown crisis is in our midst.

The companies analyzed for their restructuring efforts show that a particular strategy is best suitable for a particular situation only. For example, if we consider Suhail Jute mills, the company is going, at present, towards debt restructuring only. However, the company needs to focus its efforts towards managing its operations in a more efficient manner or no matter what they will be faced with a financial crisis in the near future. It is quite obvious from the various financial indicators that the company is lacking in its profitability if not in its liquidity and until and unless they do not improve their profitability, all their debt restructuring efforts will go to waste. On the other hand if we take Bolan Castings, the strategy they have adopted keeping in mind not only their default status but also the performance of the company, has helped them to cover its liabilities as well as steer the company towards a more profitable and secure future. The strategy they opted for was more towards corporate restructuring rather than debt restructuring only and they were far better off than their counterparts, Suhail Jute Mills.

Even though the progress of debt restructuring has significantly gained momentum through CIRC and more stringent policies adopted by the State Bank, many problems still exist. Most debtors and some creditors lack of experience in debt restructuring is a major obstacle in managing the workouts. For example, debtors mistakenly enter the process with expectation of reducing of loan repayments while creditors turn down the loss-sharing concept in fear of capital fund deterioration, which causes a wide difference in negotiations. When the negotiation comes to the disputes between creditors and debtors, there are less qualified mediators to help solve their disputes. The debtors whose ways of fleeing away from loan repayment—a so-called strategic NPL—are not cooperative and create a dark-side of restructuring culture which is harmful to credit system. Some debtors are not cooperative in providing complete and accurate information in preparing the debt-restructuring plan. The financial advisor and/or the steering committee cannot assess the company's actual financial position in order to draft a workable restructuring plan. This also leads to a delay and incompleteness of the proposed plan within a timeframe. In addition, some companies are not transparent in explaining a number of questionable transactions including their off-balance sheet loan, the collectability of the account receivables and the total amount of debt. Some cases involve quite a number of creditors both domestic banks and international banks. Thus, they need time to agree on term sheet proposed by the debtors due to their different policies and collaterals.

However the saying that "*prevention is better than cure*" is most suited in this situation. If the government along with credit organizations is careful and more stringent in their loan facilities, such a situation can be avoided. In terms of restructuring, which itself is an extremely difficult process to implement some recommendations are listed as follows,

1. The important principle is that the highest level of management should participate directly in formulating the debt restructuring strategy. Until and unless the interest of the top management is widely known amongst the company as well as the creditors, everyone related in the restructuring process is bound to think of it as another energy spurt, which will wear of eventually. It is therefore necessary for the top management to not only take the initiative but intervene positively wherever possible.
2. Policy and procedures should be clearly defined and written down. A comprehensive strategy for restructuring, encompassing both the corporate and financial sectors, should be drawn up as soon as possible once the crisis is judged to be systemic in scope. The involvement of all interested parties in the formulation of the strategy enhances its credibility, as does transparent presentation of its objectives, tasks, and methods of implementation.
3. The strategy should cover every stage of the restructuring process from start to finish including clear time-bound objectives, the approach and methodology for

evaluating and granting loans, measures for monitoring and reporting on performance against those objectives to ensure that the restructuring has been carried out correctly in terms of its objectives and its accounting principles

4. When the debt-restructuring contract is signed, financial institutions must closely monitor debt payment schedule and always evaluate debt service capability. Whether the objectives being set for that particular defaulter company are feasible/possible or not. A general objective is not enough. Each and every company in the restructuring process needs to considers its strengths and weaknesses and than on theses basis analyze what is the most appropriate mode for it to follow.
5. A binding commitment from each debtor to provide information, prepare a business plan and otherwise negotiate on a fixed, pre-determined schedule. Other than this, binding agreements amongst creditors on how to handle non-viable or non-cooperative debtors is also necessary. It is extremely necessary for the creditors involved as well as the authoritative bodies to distinguish the viable debtors from the non-viable debtors before any steps towards restructuring are taken. It is often seen in Pakistan that things are done before thinking over the right procedure to choose. CIRC, which is already playing a key role in this, needs to determine those companies which can be restructured form those that are beyond restructuring. It is than necessary to adopt a procedure as discussed previously, most suitable for that company based on its viability.
6. Standardization of the basic business and financial information required for a proposed workout is also a must for the restructuring process to be successful. This would not only make the work of the restructuring members easier but will also become a standard format for any future references. If this is achieved, prevention form such a situation will also be made possible as companies can be regularly analyzed on the basis of this format and see their current default status.
7. Inter-creditor agreement to support (including during court proceedings or otherwise) a plan that achieves approval by a majority of creditors holding the percentage of all outstanding credit needed to pass a special resolution of creditors under the Bankruptcy Act as in the case of Thailand.

8. Corporate governance must be brought up to international standards to provide incentives for viable firms to restructure their balance sheets and maximize their value. Improved governance is needed not only to push managers to restructure the existing debt stock, but also to operate profitably and improve future profit flows.
9. Experience has shown that large-scale corporate restructuring requires the government to take a leading role so as to establish priorities, limit the economic and social costs of crisis, address market failures, and deal with the obstructions posed by powerful interest groups. It is therefore necessary that the Government of Pakistan play an active role in the implementation of these restructuring efforts by setting up legal and monitoring authorities that ensure transparency in the process of debt restructuring. So far, the Government of Pakistan has taken some measures to improve the legal and regulatory framework needed to support voluntary debt settlement arrangements. In particular, it has now promulgated a new bankruptcy law and established a separate organization to take care of the NPLs that have accumulated over the years, namely Corporate and Industrial Restructuring Corporation.

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Annual Reports of the companies considered in the Thesis

Appendix

The Bangkok Framework

This guideline contains 19 principles for the parties concerned to observe as follows:

1. Any corporate debt restructuring should achieve a business rather than just a financial restructuring to further the long-term viability of the debtor.
2. Priority must be given to rehabilitate assets to performing status on full compliance with Bank of Thailand regulations.
3. Each stage of the corporate debt restructuring process must occur in a timely manner.
4. From the first debtor-creditor meeting, if the debtor's management is providing full and accurate information on the agreed schedule and participation in all creditor committee meetings, creditors shall "Stand Still" for a defined, extendable period to allow informed decision to be made.
5. Both creditors and debtors must recognize the absolute necessity of active senior management involvement throughout.
6. A lead institution, and a designated individual within the lead institution, must be appointed early in the restructuring process to actively manage and coordinate the entire process according to defined objectives and deadlines.
7. In major multi-creditor cases, a steering committee representative of a broad range of creditor interests should be appointed.
8. Decisions should be made on complete and accurate information, which has been independently verified to ensure transparency.
9. In cases where accountants, attorneys and professional advisors are to be appointed, such entitles must have requisite local knowledge, expertise and available dedicated resources
10. While it is normal practice to request the debtor to assume all the costs of professional advisors, lead institutions and creditors committees, creditors have a direct economic interest, and hence a professional obligation, to help control such costs.
11. The Ministry of Finance and the Bank of Thailand should be kept informed on the progress of all debt restructuring to aid the review and regulatory and supervisory framework and to facilitate corporate debt restructuring.
12. The roles of the corporate debt restructuring advisory committee are as follows,
    - Follow-up developments in debt restructuring.
    - Review and implement policies to facilitate debt restructuring for the public good.
    - May also act as an independent intermediary in the restructuring process where cases are particularly difficult or where other efforts have failed. The committee may well be a catalyst to activate sluggish negotiations.
13. Creditors existing collateral rights must continue.
14. New credit extended during the restructuring process above existing exposures as of the standstill date on reasonable terms in order that the debtor may continue operations must receive priority status based on title orientated security, inter-creditor agreements or indemnities.
15. Lenders should seek to lower their risk and hence their requisite returns, through an improved security package and profitability-based benefits rather than increased interest rates and imposition of restructuring fees.

16. Debt trading is appropriate under certain conditions but the selling creditor has the professional obligation to ensure the buyer does not have a detrimental effect on the restructuring process.
17. Restructuring losses should be apportioned in an equitable manner, which recognizes legal priorities between the parties involved.
18. Creditors retain the right to exercise independent commercial judgment and objectives but should carefully consider the impact of any action on the Thai economy, other creditors and potentially viable debtors.
19. Any of the principles or implementing policies contained in this framework can be waived, amended or superceded in any particular restructuring with the consent of all participating creditors.

Incentives provided by the Thai Government

1. Tax concessions for the financial institutions' debt in case of debt restructuring.

   a. Income arising from debt forgiveness between 1st January 1998 to 31st December 2001
   b. Income arising from actions in the debt restructuring process between 1st January1998 to 31st December 2001.
2. Financial institutions may use the amount of debt forgiven in debt restructuring as a tax-deductible expense in calculations of taxable income.
3. Financial institutions may stop using the accrual income recognition principle in the calculation of taxable income with regards to debtors who have failed to make repayments for over 3 cumulative months instead of 6 months.
4. The establishment of reasonable grounds for which the Revenue Department deems it appropriates to collect certain types of tax.
5. Creditors may deduct the Input Tax paid on the construction of a building from the Sales Tax on sale of the building.
6. Registration fee concessions reduced to 0.01 percent until 31st December 2001 on the transfer of land and property ownership in support of debt restructuring in the following cases.
   a. Financial institutions for the transfer of property to a debtor, or the receipt of a return transfer of property from a debtor.
   b. Financial institution debtors for the transfer of property to a third party for repayment of debt owed to a financial institution.
   c. Financial institutions for the registration of additional mortgage of property from the debtor.
   d. Creditors other than financial institutions and creditors with common debtors to financial institutions, for the transfer of property to or from a debtor.
   e. Creditors for the transfer of property to or from a debtor under the Bankruptcy Act.
   f. Tax exemptions regarding the transfer of assets to a third party in order to make debt repayment to the creditor (s).
   g. Tax and registration fee concession for the ownership transfer of land from a new investor to a creditor.
7. The exemption of stamp duty for the import of machinery for debtors under the BOI assistance scheme in cases where the machinery is transferred to the creditor as part of a leasing or hire-purchase contract. Allowance of financial institution and third parties to receive the transfer of permits to undertake business operations of industrial works, other permits and concession granted in order that the financial institution may continue its operations to restructure. The transfer of BOI privileges to a new investor in the debtor company.
8. Tax concessions for debt restructuring following court reorganization of the debtor under the Bankruptcy Act.
   a. Income arising from debt forgiveness
   b. Income arising from court reorganization of the business
9. The amount of debt forgiveness granted by creditors under court reorganization shall be deductible in the calculation of taxable income.
10. Tax concession for debts restructuring for debtors whose creditors are not financial institutions.

a. Income from debt forgiveness between 1st January 1998 to 31st December 2001.
b. Income arising from actions in the debt restructuring process between 1st January 1998 to 31st December 2001.

11. Non-financial institution creditors may use the amount of debt forgiven in debt restructuring as a tax-deductible expense in calculations of taxable income.
12. The allowances of financial institutions to undertake hire purchase or hire purchase leasing business in the process of debt restructuring.
13. The acceptance of BOT regulation allowing the phase-in of loan loss provision from loan classification and present value calculations over 5 accounting periods.
14. The reduction of registration fees for the ownership transfer of condominiums to 0.01 percent.
15. Allowance of financial institutions to hold foreclosure assets transferred to it during 1st January 1997 - 31st December 2001 up to 10 years.
16. Exemptions or concession regarding the transfer of rental rights over crown property.
17. Financial institutions are allowed to purchase or hold share of any limited company in an amount exceeding limits prescribed by laws.
18. Financial institutions are allowed to grant concession on guaranteed limits to the debtor who is the bidder in government's construction project.
19. Financial institutions are allowed to write off the debtors classified as doubtful and loss with 100% provision from the account. The amount can also be treated as expenditure for tax deduction.
20. Financial institutions are allowed to immediately change asset classification to "Pass" without having to wait for 3 months or 3 accounting periods for debtors undergone successful debt restructuring under BOT requirements who meet one of the following criterion:
    a. Debtor can pay the interest no less than the market rate without requiring the grace period on interest payment.
    b. Debtor with debt restructuring loss of no less than 20% of debt outstanding.
    c. Debtor with loan syndication or with more than one creditor.
    d. The court approved the debtor's request for debt restructuring or rehabilitation plan.