

ENVIRONMENTAL SCANNING PRACTICES DURING PERIODS OF HIGH UNCERTAINTY

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Abstract

The research on environmental scanning practices of medium sized finance companies in Thailand, during and after the 1997 economic crisis, shows that companies with well-organized and managed environmental scanning process have steered through the turbulent environment and have become highly competitive in their posture. As companies focus on short and long term horizons and look at a broader set of factors they are able to better foresee changes in the environment and respond towards these movements more pragmatically. The multi tier environmental scanning process inside these organizations helps in identifying opportunities for new products and services. However, companies who base their decisions on imitating competitors are vulnerable to the turbulent changes in the environment and are on the horns of a dilemma. They have not only to recover their non-performing loans but also need big effort to improve their products and services to face stiffer competition.

Introduction

The 1997 economic crisis in South East Asian countries posed a highly turbulent and continuously changing environment. In Thailand, immediately after the economic crisis, the business environment was characterized by a large drop in the exchange rate of Thai currency in relation to the US dollar, a steep rise in interest rates and large scale demand contraction in all the sectors of the economy. Between mid 1997 and mid 1998, on account of bad debts and non performing loans, a large number of finance companies faced bankruptcies and as many as 56 finance companies were delisted by regulators.

To mitigate the adverse impact of the 1997 economic crisis, the Thai government has implemented a number of measures to revive domestic consumption and stimulate new investments. A key measure is setting up of institutions to channel resources to restructured firms. The Bank of Thailand (BOT) has set up the Thailand Asset Management Corporation (TAMC) as a vehicle for speeding up debt restructuring and reducing non-performing loans. TAMC's main objective and responsibility are to purchase, manage and dispose of the distressed assets acquired from 56 closed finance companies and other financial institutions whose operations have been taken over by the Financial

Institution Development Fund (FIDF) and the Property Loan Management Organization (PLMO). To speed up the process of debt restructuring, the Corporate Debt Restructuring Advisory Committee (CDRAC) was set up for establishing corporate debt restructuring policies and to facilitate negotiation between the private sector and financial institutions. CDRAC encourages faster re-negotiations of overdue debts, ensures time bound framework for implementing debtor-creditor agreements, and provides services of professional mediators to expedite difficult cases. The other measures for the medium-term structural changes in Thailand include tax reform, trade liberalization, strengthening education and improving the statistical databases for refining decisions.

Finance companies have difficulties in recovering bad debts and have to be more cautious about lending fresh loans. The liberalization and opening of the financial services sector to foreign investors has resulted in an influx of foreign financial and banking institutions which have been acquiring stakes in private and nationalized financial institutions. Introduction of new financial instruments as well as advanced technology has further intensified competition in finance and banking sector. Moreover, while raising new capital and debt restructuring remained top priorities for local finance companies over the past year, internal reforms also made

significant progress as these companies took steps to slash costs and prepare for stiffer competition in the future.

Thus, the restructuring and liberalization measures taken by Thai government for restoring the health of the financial services sector have created a very complex and uncertain business environment. The finance companies have to be more watchful of the trends in the external environment in order to craft successful strategies. In this paper we present our analysis of how three successful finance companies which survived the crisis analyze the external environment for adopting an appropriate strategy and healthy performance.

Objectives

This paper intends to analyze the various aspects of environmental scanning policies and practices amongst finance companies in Thailand. Specifically, the issues covered are: -

- What are the environmental scanning objectives of companies during the periods of high uncertainty?
- What is the organizational set up for environmental scanning in these companies?
- What is the process of environmental scanning?
- What are the environmental factors that are analyzed by companies?
- How do these companies judge the effectiveness of the environmental scanning process used by them?

Methodology

This study is based on case research methodology. In order to map the environmental scanning practices in the firms under study, a series of interviews were conducted amongst the CEOs and managers who were directly or indirectly involved in environmental scanning in their companies.

Environmental Scanning Practices

This research focuses on three finance companies in Thailand. These companies have survived the 1997 economic crisis by adopting different patterns of environmental scanning practices.

1. *Ayudhya Investment and Trust Public Company Limited (AITCO)*

AITCO is a medium sized finance company with an authorized capital of 3.9 billion Baht (1 US\$ = 44 Baht). The foreign share holding in the company is 0.75

percent. AITCO has two subsidiary companies in which it holds 99.99 and 10 percent shares respectively. The company services comprise - financing for commerce, development, housing, leasing; managing provident funds and guarantee business. The company is a cautious player and can be described as a follower. The loan quality is vital to the company's operations because of the uncertainties in the business environment. Therefore, AITCO has adopted a policy to periodically review its loan portfolio and has established the risk management department independently from the lending department to ensure the good credit risk management, transparency and good corporate governance.

In preparation for meeting intense competition from domestic and international companies, AITCO has taken many strategic initiatives that include establishing a risk management department, developing human resources, exploring new market segments to expand business, and adopting flexible strategies to cope with changing economic environment.

In scanning external environment the company has several objectives. The key objective is to raise awareness of top management and operating level managers about potential developments in the direction of rules and regulations and enable them to design strategies that will be in compliance with the guidelines recommended by International Monetary Fund.

Since the credit department of the company is engaged in restructuring increasing volumes of bad debts, the credit officers have to analyze the trends in various industry in order to offer mutually workable solutions to borrowers. AITCO management has to be continuously aware of the potential developments within the industry in clearing out remaining bad debts resulting from the 1997 economic crisis. The company has to be accurate in its analysis to be able to claim rehabilitation of its non-performing loans from Thai Asset Management Corporation (TAMC). As mentioned earlier in this paper, the Thai government has established the TAMC as a key instrument for alleviating bad debts in the financial sector.

The environmental scanning processes within the company are carried out at the level of the top management, product teams and front line managers. The top management analyses the overall changes in the external environment. In a bottom up manner, the product management teams analyse industry specific trends by consulting their clients. Based on the holistic analysis done by top management and the industry specific analysis carried out by product management teams, the front line managers prepare client specific reports that

are used for designing and advancing fresh loans to creditworthy customers. In case of debt restructuring, the written reports including environmental scan of the relevant industry are prepared by front line managers and are first sent to supervisors and then to top management for their consent and approval. For resolving specific issues which can not be dealt with by the product management teams and the front line managers, consultations are carried out with top management. The front line managers collect direct feedback and bring to the notice of the top management the issues related to client dissatisfaction. The three key areas of dissatisfaction are interest rates, exchange rates and the lending terms.

The choice of scanning factor is driven by the nature and needs of clients and the increasing regulatory nature of the financial sector in Thailand. Since the client portfolio of AITCO comprises healthy as well as weak customers, the company is not concerned with developing new financial instruments for the clients at the moment. The company tries to understand the economic and technological trends in the industries in which its clients operate and also identifies the emerging opportunities and help available to clients under the new rules and regulations. The main objective of exploring these factors is to improve the performance of clients at the industry level, comply with legislation and assist in clearing the bad debt and give loans only to the creditworthy customers.

AITCO taps many alternate sources of information that include discussions with customers, board members, officials, friends, batch mates and ex-colleagues of AITCO's managers at the previous working place, for example, Citibank Corporation, Thailand. The front line managers collect information about customers mainly through direct interactions. The customers are the most important source of information on competitors as they continuously compare AITCO's offer with competitors' offer and lodge their complaints to the front line managers. The front line managers transmit this vital client feedback to their supervisors and to top management. The top management discusses the feedback with board members and is able to offer customized solutions within a given horizon of risk and return. This bottom up scanning process helps AITCO in catching up with local and foreign competitors.

In addition to tapping customer as a source of information, AITCO's top management refers to publications that include research from other investment houses, academic institutions, financial and investment

magazines both local and foreign and government reports and public announcements. Industry reports, both prepared internally and externally, are discussed during board meetings. The President, in consultation with the board, is responsible for lending new direction to the company and he scans the new regulations and macro policy trends in the financial sector.

2. Tisco Finance Public Company Limited (TISCO)

TISCO operates through a network of four hire purchase and leasing companies that it has acquired since 1999. A large proportion of the company's shares is held by several foreign investors. The network of acquired companies has helped the parent company in increasing the business potential of the TISCO Group in terms of customer base utilization, a larger market share and increased economies of scale. In the financial service sector, TISCO offers broad range of financial instruments and advisory services to various state-owned enterprises, financial institutions, fund managers and individual customers. Their services include consumer lending, corporate lending, financial advisory services, fixed income products and funding. The company has been very successful in improving the quality of loans and in accelerating debt recovery.

TISCO has short and long-term environmental scanning objectives. The company considers 3 years as "short-term" and 5 years as "long-term". In the short-term, the first objective of environmental scanning is to analyze industry trends on time as an early warning system. Immediately after the 1997 economic crisis, the company was able to restructure bad debt very efficiently because it was prepared to meet the risks on the basis of its understanding of environmental trends. The second short-term scanning objective of the company is to analyze competitors and improve the competitiveness of various business units by scaling down assets, promoting fee-based business, and taking cost controls measures including rationalizing interest rates. The long-term objective for environmental scanning is to predict future driving forces, mainly economic, that will shape the financial service sector in the region. The company prefers to be a leader in innovating new products and services. The company is credited with offering innovative risk management instruments to its clients after 1997 economic crisis. Furthermore, TISCO uses environmental scanning to gain long term competitive advantage by investing in building new sources of competitive advantages such as information technology.

The company invested in the SAP software system to monitor and control operations on a real time basis.

The President and the Senior Executive Vice President of the company are responsible for scanning the environment. By combining in-house research and outside opinions from academics, industry experts, government officers and external consultants, the top management develops alternate scenarios and based on these, they propose new products and services to the Board for final approval. The members of the Board engage in unstructured discussions to arrive at future strategic directions. The final decision to launch new products and services is made by the President and the Board. The scanning and planning functions are highly centralized and the top management team formulates and implements strategic decisions down to various departments and subsidiaries of the company.

The senior executive vice president uses information collected through feedback from customers, surveys conducted by market research agencies, reports prepared by academic research institutions and articles in local and foreign economic journals and magazines. Special attention is paid to research reports prepared by Thai academic institutions that mainly focus on Thai financial markets and give customized solutions for the local markets. Based on deep insights, the company has developed a model for risk management in the context of the Thai financial market. As for foreign sources of information, TISCO regularly analyses reports coming from foreign banks, for example Banker Trust from Germany and Dai-ichi Kanyo Bank from Japan.

Since the 1997 economic crisis, the local economic and regulatory factors are considered as major environmental scanning factors as these factors play a key role in influencing the incremental and major changes in the design of the strategy of the company. The second most important scanning factor of TISCO is the competitive trends. To stay ahead of its competitors, the company monitors them and often collaborates with foreign banks and finance companies to expand scope of its business within the financial sector. For identifying growth opportunities the company specifically analyses the economic growth rate and trends in private consumption. Specific growth industries, for example agrobusiness and retailing, are studied carefully to explore market opportunities for loans to small and medium sized enterprises. The market risk is assessed by analysing the difference in the interest rates for assets and liabilities, the price risk arising out of changes in the

value of portfolios of financial products and foreign exchange fluctuations.

With serious attention paid by top management to understanding the local market conditions, the company, from time to time, collaborates with TAMC in issuing new rules and regulations for the regulation of the market. This provides a "time advantage" to the company and helps it in developing expansion strategies on pro active basis.

The environmental scanning practices of the group and the consequent strategic changes in the business have helped TISCO to achieve a remarkable recovery from the impact of economic crisis. The TISCO Group has substantial competitive advantages over other competitors in terms of scope and scale of financial business products and services. Despite increased competition from foreign firms and commercial banks, TISCO has maintained its competitive position.

3. Asia Credit Public Company Limited (ACL)

ACL with its high profile international partner Societe Generale focuses on providing credit facilities to export and import businesses along with providing foreign exchange related services. The company is now expanding its financial advisory business especially in the direction of mergers and acquisitions. ACL is supported by its overseas shareholder in providing technology transfer and know-how in offering new instruments that are adapted to suit local needs of investors in Thailand. Recently the company was granted a license to provide risk management services in telecommunications, energy and manufacturing sectors.

Being a medium company, it is highly vulnerable to turbulent environment and therefore the environmental scanning system of the company must operate well. Within the framework of rules and regulations set by regulators, ACL began to restructure its cost and capital holding by buying out smaller partners and selling their share to Societe Generale. Thus, the key environmental scanning objective of the company is to learn from the strategic behavior of other companies and, thus improve its own business model including cost and capital structure.

Another objective of environmental scanning is to identify new opportunities in the securities trading business. In this segment the company faces stiff competition and constantly adjusts its strategy to increase its market share.

A third objective of environmental scanning is to analyze emerging needs of existing customers and identify new customer segments to expand the customer base. For example, the company analyzes new trends in financing of export and import business including providing support in the foreign exchange operations.

The board of directors and chairman of the company is the nodal point for aligning latest environmental trends and the strategies at the corporate and business levels. The views of the operational level staff are incorporated for smooth implementation of strategies.

The head of divisions has formal meetings with board of directors on weekly basis. Sometimes, when there are quick shifts in the environment, these meetings are also organized on a more frequent basis and informal discussions are conducted on the telephone. The members informally share with each other whatever information they can receive from their personal channels. The personal sources are mainly government officials. The head of divisions also brings to the notice of the board of directors the feedback they receive from their customers. The key mode of analysis is intense discussions amongst the members of the board and head of divisions. For analyzing broad indicators and for advance warning on potential threats the company might face from changes in international context the company depends on Societe Generale - its major shareholder for information. Any information on changes in the European financial system is instantly transmitted to the company.

In terms of environmental factors the company mainly focuses on legislation and competitors. This follows from the immediate challenges the company faces, that is firstly, to comply with new guidelines imposed by International Monetary Fund (IMF) and rules and regulations issued by regulators and secondly to compete successfully against local and foreign competitors.

Corresponding to rivalry with competitors, the company is internally focused and has placed strong emphasis on human resources development. The strategy of the company is to train its staff through in-house and outside training to sharpen their skills and broaden their knowledge. Furthermore, the company is recruiting new employees with high profile education and relevant work experience.

As a result of environmental scanning practices that are narrowly focused the company is still struggling to restructure its debts. ACL has to rewrite its past and has to take measures to respond to the future. They

company has been sheltered by investments made by Societe Generale.

Conclusions

1. Companies that are struggling to restructure large amounts of bad debt on one hand and facing stiffer competition on the other, are pursuing short-term approach for environmental scanning. Their main objectives are first, to follow the new rules and regulations and take opportunities and easier terms for debt restructuring offered by TAMC and second, to benchmark competitors activities, new products and services. The longer these companies take to restructure bad debts the less is the chance that they will adopt a long term view of the environment and thus a long term strategy.

2. Companies that have managed to restructure bad debts are now focused on two time horizons. They scan environment for both short and long term view. The short-term scan helps the company in analyzing client's industry portfolios and its impact on the lending programs of the companies. The long-term view of environment on the other hand allows companies to predict future driving forces and thus help them to design new products and services and maintain their leading position. A faster recovery of bad debts is the result of these companies having a superior system for scanning environment even prior to the 1997 economic crisis.

3. All finance companies scan economic and legal factors. The economic trends, such as industry growth rates, inflation, interest rates, import and exports, currency exchange rates, foreign direct investment and level of non-performing loans in different industries are used for designing balanced loan portfolios and deciding on interest rates. The legal factors scanned include the bankruptcy, corporatisation and alien business laws and regulations for debt restructuring. The companies with large amounts of bad debts take a defensive view of these factors whereas the companies that have successfully overcome all their bad debts take a more proactive view of these factors. Changes in economic factors have been the most important environmental scanning factors even before 1997 economic recession in Thailand. After the economic crisis the importance of legal factors increased because of the International Monetary Fund (IMF) driven policies implemented by the Ministry of Finance.

4. Since the environment is highly turbulent, the top management in companies plays an active role in performing various tasks associated with environmental scanning. The senior managers and

members of the board collect information from a variety of sources and process it in informal as well as formal meetings of the board. The sources of information include personal contacts in government, friends and relatives in banks and companies, academic institutions and information services agencies, advisors and experts. The information is received mainly through conversations and in the form of reports. Given the pace at which the environmental factors change in finance sector, the direct involvement of the top management in scanning ensures that the decisions will be made without much delay. In companies whose management style is centralized, top management act as the center of environmental scanning sources of information while companies whose management style leans towards decentralization give greater authority to senior managers, experts, and consultants. The decentralization broadens scanning scope to a greater extent while ideas under centralization

have been held onto only top management and their connections.

5. In companies, which are still laden with large debt from the pre 1997 days, there is a convergence in the top down and bottom up scanning approaches. The front line staffs collect feedback from clients and transmit it to top management for modifying products and services to make them more attractive to clients. Based on the analysis of environmental practices, finance companies can be categorised into leaders and followers. The success of leaders in foreseeing environmental trends has influenced innovations in products and services and has given a lead to these companies over domestic and foreign competitors. The followers are less fortunate, they are not able to foresee opportunities and are mainly involved in modifying services and improving performance through debt restructuring.

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