

*Journal of Applied Economics. Vol X, No. 2 (Nov 2007), 309-335*

## **ROLE OF DEBT MATURITY ON FIRMS' FIXED ASSETS DURING SUDDEN STOP EPISODES: EVIDENCE FROM THAILAND**

**MARIA PIA IANNARIELLO**

*MGM International*

**HANAN MORSY**

*International Monetary Fund*

**AKIKO TERADA-HAGIWARA\***

*Bank of Japan*

Submitted August 2004; accepted August 2006

This paper studies the detrimental effect of sudden stops on the growth of Thai firms' fixed assets. We focus on the fixed assets adjustment that firms undertake at times of financial constraints. We derive our results from balance sheet data for 284 nonfinancial Thai listed firms. Our data demonstrate that Thai firms faced severe declines in the growth of their fixed assets starting in 1996. Regression results demonstrate, after controlling for firms' characteristics and lagged dependent variables, that a longer-term debt maturity structure is the factor that works in the firms' favor during sudden stop episodes, while it is their profitability that matters during tranquil periods.

*JEL classification codes:* F32, F41, G3

*Key words:* sudden stops, Thailand, debt maturity structure, Asian financial crisis

### **I. Introduction**

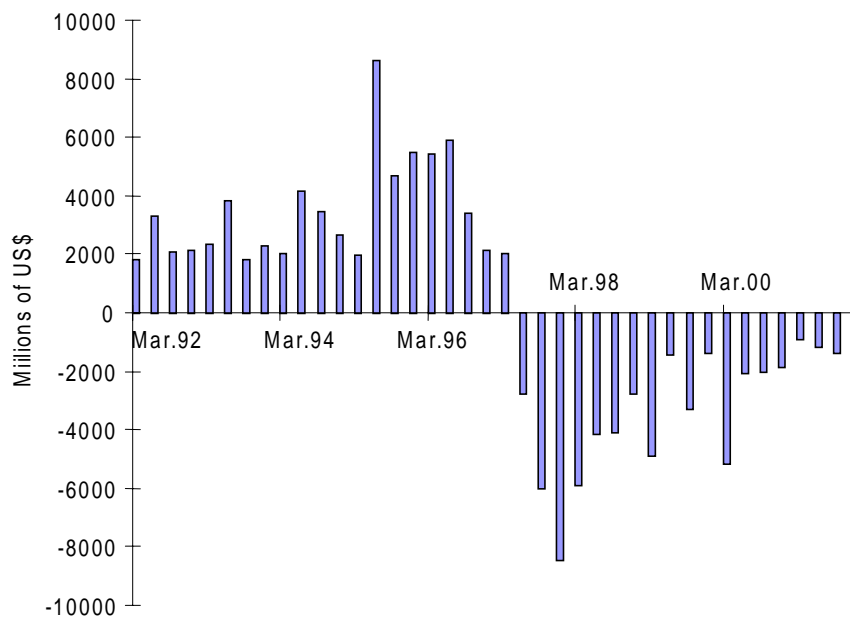
“Sudden Stops” or reversals of capital inflows and the subsequent withdrawal of international capital are considered to be the spark that set off several of the recent

---

\* Akiko Terada-Hagiwara (corresponding author): Bank of Japan, akiko.hagiwara@boj.or.jp. Maria Pia Iannariello: MGM International, mariapi@mgminter.com. Hanan Morsy: International Monetary Fund (IMF), HMorsy@imf.org. The authors are highly indebted to Graciela L. Kaminsky and Holger Wolf for their continuous guidance. They would like to thank David Ribar, Jesus Felipe, Herman Kamil, participants of the seminar at the Institute for Monetary and Economic Studies (IMES), the Bank of Japan, and an anonymous referee for very useful comments and suggestions. The view expressed in this paper is those of the authors and does not necessarily reflect the official views of the Bank of Japan, IMES, or IMF.

crises in countries such as Thailand and South Korea. The IMF asserts in the *World Economic Outlook* (1998) that the ensuing declines in asset prices and exchange rates caused by sudden stops during the late 1990s went well beyond what was justified by any reasonable assessment of economic fundamentals. Of all crisis countries, Thailand faced one of the largest capital inflow reversals seen to date, and Figure 1 demonstrates this graphically. Furthermore, Calvo and Reinhart (2000) estimated that the country had cumulative inflows as a percent of GDP of approximately 51.5% between the period 1988 and 1994 and that it suffered from reversals of 26% between 1996 and 1997.

**Figure 1. Behavior of Thai capital flows**



Sudden stops in capital inflows such as that seen in Thailand need to be offset by either reserve losses or lower current account deficits, and in general lead to contractions in output because of large and unexpected swings in relative prices. Reserve losses tend to increase a country's financial vulnerability, whereas contractions in the current account tend to have serious effects on production and employment. Moreover, the interest rate increases following a sudden stop episode—due to country and exchange rate risk, for example—lead to a higher

incidence of nonperforming loans (NPLs) because the cost of servicing the debt rises and debt burdens surge if debt is denominated in foreign currency. Firms in this situation tend to face a decline in net worth. The effects on the exchange rate of the sudden stop, accompanied by a likely currency mismatch between liabilities and income at the firm level, cause creditors to require higher rates of return or limit the amount of new debt issued to these firms (Bleakley and Cowan 2004). In this situation banks become more cautious and cut lending, especially to small- and medium-size firms, giving rise to what the literature has labeled a “credit crunch” (Ito and Pereira da Silva 1999).<sup>1</sup>

As Thailand faced one of the most abrupt sudden stops of capital inflows, highly leveraged firms as compared with those in other regions of the world found themselves credit constrained and with increasingly damaged balance sheets.<sup>2</sup> Consequently, they found themselves forced to cut investment and/or undertake distress sales of physical capital to fulfill their debt obligations. Thailand was particularly characterized by a large number of firms having to engage in distress sales of physical capital or fire sales as they became popularly known. Figure 2 depicts the decline that begins in 1996 and does not reverse until mid 1999. By mid 1999 that trend gradually reverses, revealing signs of growth at a relatively slower rate.<sup>3</sup>

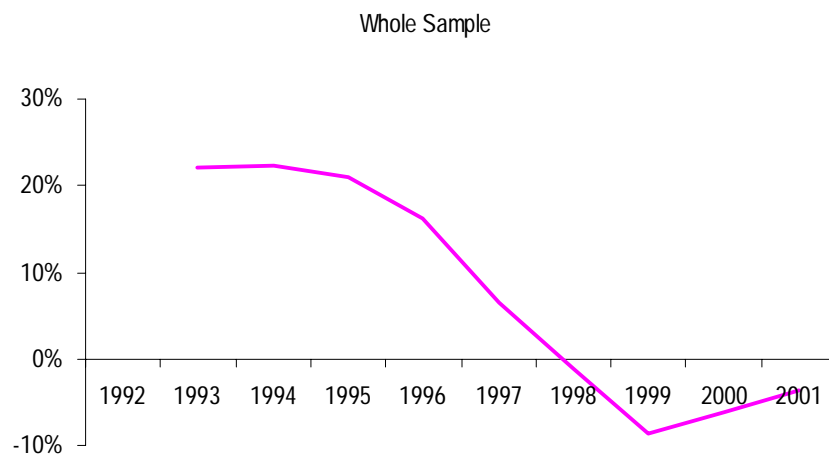
In spite of this dramatic event, very little is known about the precise determinants of investment at the microeconomic level during this sudden stop period. Our paper aims at shedding some light in this direction by characterizing the factors that exacerbated financial constraints—proxied by adjustment of fixed assets—experienced by Thai firms due to sudden stop episodes. Our goal is to analyze, in particular, various balance sheet and firm-level characteristics that induced firms to meet debt obligations through the adjustment of fixed assets.

---

<sup>1</sup> Ito and Pereira da Silva (1999), using a survey of 15 Thai banks, demonstrate empirically the existence of a credit crunch in Thailand during the period between 1997 and 1998 characterized by the factors described above.

<sup>2</sup> According to Pomerleano (1998), the debt–equity ratios seen in Asian firms, particularly Thai and Korean, were substantially larger than those seen in Latin American, German and US companies. Debt–equity ratios of US firms averaged 90% by the end of 1996, Latin American firms averaged 31%, while Thai firms averaged 155%.

<sup>3</sup> Given that substantial declines in the growth of firms' fixed assets occurred around the time of the capital inflow reversals and abrupt devaluation, we argue that a large portion of sales must have been the result of increasing levels of uncertainty and financial constraints, which forced firms to sell their assets at a discount by engaging in fire sales.

**Figure 2. Growth rate of firms' fixed assets**

There are particular firm characteristics that in general contribute towards determining how constrained a firm might be, and consequently, how likely it would be to engage in distressed sales of physical capital. Some of those characteristics include the level of internal resources that would allow a firm to finance its production internally, the size of the firm, the issuance of American Depository Receipts (ADRs), the type of commodity a firm produces (tradable/nontradable), the degree of foreign ownership, the fact that a firm might be a multinational company or not, the degree of macroeconomic instability, and the industry to which the firm belongs. The degree of deterioration of a firm's balance sheet in terms of profitability and debt maturity structure is also considered. We pay particular attention to the short-term debt exposure to gauge the level of obligations that the firm must fulfill in a short time frame, while we also consider fluctuations in domestic demand because they affect revenues from sales and consequently influence financing needs.

Data analysis reveals that Thai nonfinancial firms suffered from a significant decline in their fixed assets throughout the capital outflow period.<sup>4</sup> Furthermore, descriptive statistics and graphic analysis demonstrate that sector-macro and firm-specific variables behaved significantly differently during sudden stop and non-sudden stop episodes. At the firm level, the tradable sectors were taking significant amounts of short-term debt—about 80% of total debt prior to the crisis period, which significantly worsened their balance sheets once capital inflow reversals took place.

This study relates to a growing literature on currency crises that stresses shocks to firm balance sheets, and, more broadly, on the effect of balance sheet health on investment, where much work has been done on the role of financing constraints in investment decisions. Examples include Fazzari et al. (1988) and Hoshi et al. (1991) among others. It is a classic but still an unsettled question (Gomes 2001). In the context of the Asian crisis, Kim and Stone (1999) is one of the few studies that examine this subject theoretically. As for empirical investigation, there are a handful of studies—some focusing on mergers and acquisitions activities (Aguiar and Gopinath 2002, and Mody and Megishi 2001), others such as Aguiar (2004), and Bleakley and Cowan (2004), similar to ours, working on the adjustment of physical capital.

This paper provides new evidence on balance sheet effects on Thai firms' investment adjustments, an addition to existing work such as Aguiar (2004), and Bleakley and Cowan (2004). Our findings reinforce and extend the results for Mexico given in Aguiar (2004), who finds a significant effect of weak balance sheets—as captured by heavy exposure to short-term foreign currency debt—on investment. Our analysis of fixed asset adjustment by Thai firms similarly suggests that the substantial shares of short-term debt were translated into subsequent slow growth of investment during the sudden stop episode.

More importantly, this paper contributes by adding extra findings on tranquil periods and on nontradable sectors. Comparison across the sudden stop and tranquil periods reveals that debt maturity structure matters only during the sudden stop period, and it is profitability that explains most during the tranquil period. The rest of the paper is organized as follows. Section II describes the data and provides summary statistics. Section III discusses the empirical evidence. Finally, Section IV concludes. The Appendix provides detailed definitions of variables used and their sources.

## II. Data description and analysis

Our primary data source for the empirical analysis is *Datastream*, which contains historical data for a variety of securities markets worldwide, covering equity, index, commodity, currency, bond and economic data. For our sample, we use annual corporate balance sheet and income statement data for 284 nonfinancial Thai firms

---

<sup>4</sup> As in other papers in the field, we concentrate on the nonfinancial sector of the economy, because it is in these sectors that investment decisions are undertaken.

publicly listed on the local stock market between the years 1992 and 2001.<sup>5</sup> Table 1 provides a detailed description of the composition of the sectors that we have identified and divided between tradable good producers and nontradable good producers. Services and real estate are categorized as nontradable sectors while primary commodities, manufactures, household products and food are classified as tradable sectors.<sup>6</sup>

The service sector is the largest, represented by 68 firms, while the real estate sector is the smallest, consisting of 28 firms<sup>7</sup>. Furthermore, it is interesting to note that the primary product sector has the highest level of sales on average while the real estate sector has the lowest (see Table 2). The real estate and primary product sectors tend to be largest in terms of asset size, while the food and household product sectors are the smallest.<sup>8</sup> When it comes to after-tax profits, the food sector has the highest profitability levels.

In terms of tradable and nontradable sectors, Table 2 reveals that the tradable sector is characterized by having higher profits than the nontradable sector and by being more exposed to short-term debt. The nontradable firms, in turn, tend to be of relatively larger size.

Table 3 reveals that the Sudden Stop episode (defined as years 1997 and 1998) led to a significant decline—of close to 50%—in the average growth of firms' fixed assets. Table 3 also reveals that macro and firm-specific variables behaved significantly differently during sudden stop and non-sudden stop episodes. GNP growth in Thailand averaged 5.6% during the non-sudden stop episode but declined to an average growth rate of -4.2% during the sudden stop period. Average consumption growth averaged 6.2% during the 1990s, except during the sudden

---

<sup>5</sup> Because of data limitations, sample firms are limited to those that remained in business (bankrupt/de-listed firms are not included) during the period of analysis, so it could be argued that we are capturing the behavior of "high quality/best performing" firms in Thailand. Furthermore, the actual number of firms varies per year as new firms are listed in the Thai stock market and incorporated in the database. The actual number of firms per year in the dataset is: 1992=150, 1993=183, 1994=225, 1995=249, 1996=275, 1997=278, 1998=275, 1999=273, 2000=266, and 2001=250.

<sup>6</sup> The food sector is one of the major exporting sectors in Thailand, e.g., frozen seafood, noodles, rice, etc.

<sup>7</sup> "Software and computer services" is categorized as nontradable service, as one firm, "DATAMAT, Thailand", that falls into this category mainly engages in retail sales of the software products of other companies, such as Infosys from USA.

<sup>8</sup> We use market capitalization as a proxy for size.

**Table 1. Summary statistics of listed firms, by industry**

Description	No. firms	% total	No. observations	Tradable
Generators and distributors of electricity	1		7	No
Provision of water and removal of sewage.	1		3	No
Gas distribution	1		8	No
Software & computer services	1		10	No
Telecom services	7		57	No
Hospital management & long term care	11		92	No
Support services	1		10	No
Food & drug retailers	1		9	No
Retailers, general	8		69	No
Leisure, entertainment & hotels	14		123	No
Media & photography	13		97	No
Transport: Airlines & airports, rail, road & freight, shipping & ports	9		73	No
<b>Service sector</b>	<b>68</b>	<b>23.9</b>	<b>558</b>	
House building	3		30	No
Other construction	1		8	No
Real estate	24		187	No
<b>Real estate sector</b>	<b>28</b>	<b>9.9</b>	<b>225</b>	
Mining	4		33	Yes
Oil – integrated	1		8	Yes
Oil & gas - exploration & production	1		9	Yes
Services, including drilling, for oil and natural gas exploration and production	1		10	Yes
Building & construction materials	20		169	Yes
Steel & other metals	5		40	Yes
Producers, converters and merchants of paper <sup>13</sup>			111	Yes
<b>Primary sector</b>	<b>45</b>	<b>15.8</b>	<b>380</b>	
Chemicals	19		154	Yes
Information technology hardware	6		49	Yes
Engineering & machinery	5		38	Yes
Automobiles & parts	9		79	Yes

**Table 1. (Continued) Summary statistics of listed firms, by industry**

Description	No. firms	% total	No. observations	Tradable
Diversified industrials	4		38	Yes
Electronic & electrical equipment	13		106	Yes
Manufacturing sector	56	19.7	464	
Household goods & textiles	42		394	Yes
Personal care & household products	5		44	Yes
Household sector	47	16.5	438	
Soft drinks	2		20	Yes
Food producers & processors	38		338	Yes
Food sector	40	14.1	358	
Total	284	100.0	2423	

**Table 2. Listed firms' characteristics, by sector**

Sector	Total sales (millions of bahts)	Total asset size (millions of bahts)	After tax profit (millions of bahts)	Profitability	Maturity structure (short-term borrowing / total debt)	% Thai ownership	Multi-national (1 if multi-national)
Food	4,101,828	2,851,679	154,925	0.05	0.80	55	0.07
Household	2,536,282	3,084,162	120,493	0.04	0.77	48	0.06
Manufacturing	3,882,950	8,079,078	32,380	0.02	0.73	58	0.12
Primary	5,705,389	11,655,857	152,857	0.00	0.64	55	0.10
Real estate	2,368,471	11,102,006	-292,876	-0.05	0.56	52	0.08
Service	3,926,990	10,380,353	153,309	0.02	0.57	46	0.16
Non-tradable	3,866,412	10,591,635	23,604	0.00	0.57	48	0.13
Tradable	3,978,272	6,432,733	110,760	0.03	0.73	54	0.09
t-test Ho: mean (tradable) - mean (non tradable) = 0	0.82	0.00	0.20	0.00	0.00	0.00	0.00



stop episode when it declined to an average negative growth rate of -9%. Alternatively, the average growth rate of exports and sectoral inflation increased during the sudden stop period as a consequence of the devaluation of the Thai baht. Export growth across tradable industries increased from an average of 3.3% during tranquil periods to 5.7% after the devaluation. Sectoral inflation rates also increased from an average of 2.8% during tranquil times to 5.9% after the devaluation.

At the firm level, the average interest coverage ratio, which describes the ability of the firm to fulfill debt obligations with its earnings, declined from an average ratio of 21.9 during good times to 7.3 during the sudden stop period (see data Appendix for the definition).<sup>9</sup> An important sign of increasing levels of firm financial distress was either decreasing earnings or increasing interest payments as debt rose, or a combination of both.

Furthermore, graphical analysis in Figure 3 shows that there are particular firm characteristics that behave differently during sudden stop episodes and consequently increase/decrease the chances that a firm might be forced to engage in the sale of its fixed assets. The literature also demonstrates that these characteristics tend to be highly correlated with the likelihood that a firm will face financial constraints.

**Table 3. Tranquil vs. sudden stop episodes (1997 and 1998)**

	Tranquil	Sudden stop	t-test (p-value)
Growth of fixed assets	0.07	0.03	0.064
Sector inflation	0.03	0.06	0
Sector output growth	0.06	-0.04	0
Sector export growth	0.03	0.06	0.035
Sector consumption growth	0.06	-0.09	0
Sector capital formation growth	0.03	-0.37	0
Profitability growth	-0.06	0.21	0
Interest coverage ratio	21.9	7.34	0.3006
Maturity	0.68	0.69	0.3574

Note:  $H_0$ : mean (tranquil) - mean (sudden stop) = 0

<sup>9</sup> The differences in the interest coverage ratio between tranquil and sudden stop episodes are not statistically significant at conventional levels.

For example, we see that those firms that had a relatively shorter debt-maturity structure suffered from a steeper decline in their fixed assets as a consequence of the sudden stop episode (Figure 3.A). This is intuitive and goes hand in hand with the literature describing the characteristics of a liquidity crunch, which demonstrates that firms with short-term liabilities tend to face higher degrees of financing constraints and consequently more pressing needs to find either renewed financing or liquidity to fulfill debt obligations. Moreover, financing is scarce and extremely costly in situations of capital inflow reversals, thus leaving firms with two alternatives, defaulting and/or entering into bankruptcy proceedings or selling assets, probably at a discount, to cover the cost of the maturing debt.

Alternatively, the adjustment of fixed assets by multinational firms seemed less significant than their domestic counterparts. The multinational firms, however, did not show a clear recovery in investment during subsequent years, at least during our sample period (Figure 3.E). A likely explanation is that these firms may not feel as financially constrained after a drastic sudden stop episode, but may withhold new investment until macroeconomic uncertainty recedes and stability is regained. However, generally speaking, multinationals can cover their financing needs by channeling funds from their subsidiaries located in countries not affected by the downturn. Moreover, multinationals tend to be larger and better known than domestic firms and as a consequence enjoy greater financing alternatives at the domestic and international level. Work by Samphantharak (2003) demonstrates that belonging to a business group in Thailand, which would imply a higher likelihood of resorting to intra-firm financing, has a similar effect.

In addition, Figure 3.C reveals that small firms suffer from a steeper decline in the growth of their fixed assets than larger ones. Current work demonstrates that small and medium enterprises in Thailand have had relatively less access to formal financing, as lending was skewed towards large firms, and the cost of financing limited their growth potential. Furthermore, Figure 3.F demonstrates that having access to external financing through the issuance of ADRs allows firms to have a higher growth rate of fixed assets during tranquil times and a faster recovery during downturns.<sup>10</sup>

There also seems to be a difference between tradable and nontradable sectors when it comes to fluctuations in the growth of firms' fixed assets during the sudden

---

<sup>10</sup> ADRs, which stand for American Depositary Receipts, are certificates evidencing ownership in one or several American Depositary Shares (ADSs). ADSs are a US dollar denominated form of equity ownership in a non-US company—a Thai company in our case ([www.adr.com](http://www.adr.com)).

stop episode. Figure 3.D reveals that nontradable firms suffered from a more pronounced and longer decline in the growth of their fixed assets after 1997 relative to that felt by tradable firms. A plausible explanation is that while nontradable firms are severely affected by declines in demand due to economic fragility and uncertainty, tradable firms partially compensate for this situation by being able to sell their products abroad. The possibility of selling products abroad allows them to gain foreign exchange, which is particularly desirable during devaluation episodes, thus preventing them from having to engage in the sale of fixed assets to curb liquidity constraints.

This data analysis revealed interesting trends and characteristics of firm behavior during sudden stop vs. non-sudden stop episodes, clearly revealing that across sectors, firms tended to be significantly hurt by the sudden stop episode in terms of profitability, ability to repay debt, and debt structure. Furthermore, what seems evident is that the tradable and nontradable sectors behave significantly different. In the next section, we explore in greater detail the investment adjustment of Thai firms as a response to increasing financial constraints during times of financial distress.

### III. Empirical estimations and results

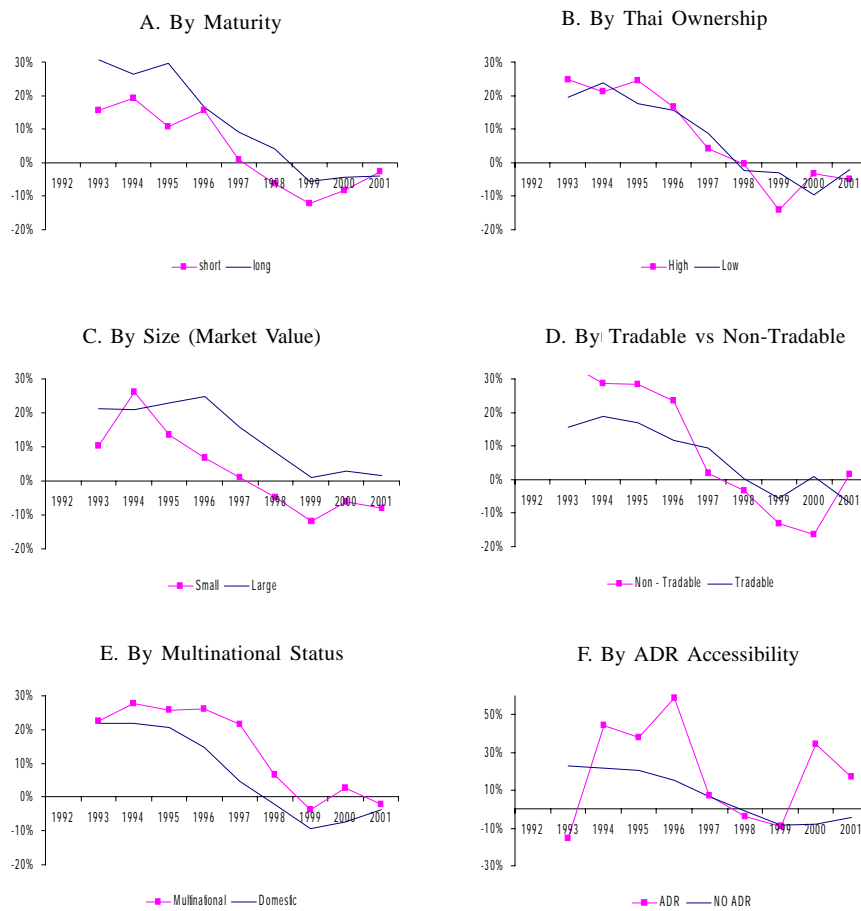
In this section, we gauge the importance that shocks to firms' balance sheet play on the adjustment of fixed assets using a random effects model.<sup>11</sup> We estimate a reduced form investment equation (1) where lagged investment, profitability, and financing costs (or shocks to balance sheet) account for fixed asset growth (see Blanchard et al. 1993):

$$I_{ijt}/K_{ijt-1} = \beta_1(C + X) + \zeta_{ijt}, \quad (1)$$

where  $I_{ijt}/K_{ijt-1}$  stands for the adjustment of fixed assets of firm  $i$  in sector  $j$  at time  $t$ ,  $\zeta_{ijt}$  is the error term and  $C$  represents the constant.  $X$  represents a vector of firm-specific variables, which vary by firm or sector and over time; the variables include balance sheet health, domestic demand as captured by sectoral consumption, as

---

<sup>11</sup> The random effects estimator fits cross-sectional time-series regression models using a GLS estimator. Breusch-Pagan and Lagrange multiplier tests attest to the appropriate selection of the random effects estimator.

**Figure 3. Growth rate of fixed assets by firms' characteristics**

well as lagged dependent and other firms' characteristics variables.<sup>12</sup> For the balance sheet variables capturing shocks to net worth, values in profitability and debt maturity structure are used with one lag as they could be affected by current investment opportunity variables.<sup>13</sup> As for profitability, unlike Aguiar (2004), which looked at "exports", we use "profit" instead as our sample includes non-tradable sector firms.

<sup>12</sup> We tested for a potential two-way direction of causality between firm-specific variables and the dependent variable (percentage changes in fixed assets) in order to determine if right-hand-side variables need to be lagged in order to avoid potential endogeneity. We test if the lagged dependent variables are jointly zero in explaining the firm-specific variables. The tests strongly rejected the hypothesis of causality for all firm-specific variables in the system.

<sup>13</sup> To control for investment opportunities, a proxy such as total market value to its book value—a rough proxy for Tobin's Q—could be introduced. However, the variable may not be

Firms' characteristics that we consider include firm size (as measured by market capitalization), degree of Thai ownership (dummy variable),<sup>14</sup> whether firms are tradable goods producers or not (dummy variable), whether firms are multinational or not (dummy variable), and whether an ADR issuer or not (dummy variable).

The analysis distinguishes between periods of sudden stops of capital inflows, tradable and nontradable sectors, and short- and long-term maturity holders.<sup>15</sup> The benchmark model to be estimated is of the following form:

$$I_{ijt}/K_{ijt-1} = \beta_1(C+X) + \gamma_1 SS(C+X) + \zeta_{ijt}. \quad (2)$$

$SS$  is a dummy variable that identifies the Sudden Stop episode (1997 and 1998),<sup>16</sup> and is interacted with a constant and the vector  $X$  to determine whether the variables behaved differently during the sudden stop episode. The  $\beta_1$  coefficient captures the average effect of variables considered on a firm's fixed assets growth, while the  $(\beta_1 + \gamma_1)$  coefficient captures the effect during the sudden stop episode.

#### A. Main results — tranquil vs. sudden stop episodes

Results in Table 4, columns (1)-(3), reveal that shocks to net worth —profitability and maturity structure, variables of our interest— exhibit interesting regularities in affecting fixed assets adjustment. The two variables, however, appear important in different periods —profitability in a tranquil period but maturity structure in a sudden stop period.

As Table 4, column (3), reveals, aside from the lagged dependent variables and sectoral consumption, during tranquil periods, fluctuations in a firm's fixed assets depend primarily on its profitability and size. Two other variables that matter —though to a lesser extent— are whether it is multinational, and whether

---

very relevant in our case as the asset markets in Thailand are not very liquid. Further, the sample includes the period of excessive speculation, thus the market valuation may have deviated from fundamentals. Nonetheless, we consider the variable in an alternative specification as part of the robustness analysis to test if it is binding in Thai firms' decision on investment.

<sup>14</sup> For the degree of Thai ownership, we tried using a continuous variable reflecting the actual percentage of ownership. For the size of the firm in addition to market capitalization, we tried a proxy asset size. None of them change our main results.

<sup>15</sup> Exact variable descriptions and sector descriptive statistics are in the Appendix.

<sup>16</sup> For the sudden stop dummy variable we tried identifying those periods of negative capital inflows (after 1997quarter 1) vs. just 1997 and 1998, as the current sudden stop dummy depicts. Both yield similar results.

it is an ADR issuer. Alternatively, during sudden stop episodes, firms' characteristics such as holding long-term maturity debt and being a tradable goods producer become the factors that reduce the chances of having to postpone new fixed asset investment, or sell fixed assets to reduce financing constraints.

As one would expect, Thai firms will be less likely to feel financially constrained if the firms experienced high profitability—defined as after-tax profit divided by total assets—in the previous period. Our results in Table 4, column (3), reveal that during tranquil periods a unit increase in profitability leads to a 0.4% increase in fixed assets growth in the following period. Firms' fixed asset growth is also accentuated when firms are of larger size. This is reinforced by the regression results, which reveal that when a firm becomes on average larger than the median, its fixed assets tend to grow by about 0.1%. This effect is significant even during sudden stop episodes and is of practically similar magnitude, which clearly demonstrates that being better known provides apparently more financing alternatives. Additionally, being multinational is found to have negative effect in firms' fixed assets growth during tranquil times. This result is counterintuitive as being multinational represents additional financing alternatives, one would expect positive effects. A possible explanation of the negative effect might be the fact that multinational firms' fixed assets did not recover following the Sudden Stop episode.

Alternatively, having a longer-term debt maturity structure seems to play an important role at times of crisis and when there are severe liquidity constraints, i.e., when interacting with the dummy variable that represents sudden stop episodes. This is certainly intuitive during times of liquidity constraints, as was the case in Thailand during the crisis. Having more time to repay debts saves firms from having to postpone desired investment or resort to sales of assets to fulfill maturing debt obligations or to find expensive financing, if at all available, to roll over maturing debt. A shorter-term debt maturity structure led Thai firms during the sudden stop episode to a 0.2% decrease in their annual fixed asset growth.

Further, Table 4, column (4), presents an estimation result for tradable goods producers by including lagged growth of sectoral exports. The possibility of selling products abroad could allow tradable sector firms to gain foreign exchange, which is particularly desirable during devaluation episodes thus preventing them from having to engage in forced fixed assets to curb liquidity constraints. Contrary to Aguiar (2004), however, our results reveal that the sectoral export growth does not matter for the growth of fixed assets both during tranquil and sudden stop periods.<sup>17</sup>

---

<sup>17</sup> Note that Aguiar (2004) considers firm-level exports/sales while our data is at the sectoral level.

**B. Tradable vs. nontradable producers**

Descriptive statistics revealed significantly different behavior between tradable and nontradable good producers, also apparent in the previous regression results, which are worth exploring further. The different behavior could arise because tradable firms partially compensate for the declines in demand, during a sudden stop/crisis episode, by being able to sell their products abroad. Nontradable firms, alternatively, could find themselves more constrained due to the slowdown in domestic sales, economic fragility and uncertainty.

The benchmark model is slightly modified to incorporate differences between tradable vs. nontradable firms during tranquil and sudden stop times:

$$I_{ijt}/K_{ijt-1} = \beta_1(C+X) + \gamma_1 SS(C+X) + \eta_1 Nontradable(C+X) + \lambda_1 Nontradable SS(C+X) + \zeta_{ijt} \tag{3}$$

As before,  $C$  is the constant. In this case, the  $\beta_1$  coefficient captures the average response of sector- and firm-specific characteristics on tradable firms' fixed assets during good times, while  $(\beta_1 + \gamma_1)$  captures their average response during the sudden stop episode. Alternatively,  $(\beta_1 + \eta_1)$  captures the average response of sector- and firm-specific characteristics on nontradable firms' fixed assets during good times, while  $(\beta_1 + \gamma_1 + \eta_1 + \lambda_1)$  captures the average response of sector- and firm-specific characteristics on nontradable firms' fixed assets during the sudden stop episode (see Table 5).

Results reinforce the outcome of the previous specification in that profitability matters only during a tranquil period while exposure to short-term maturity debt becomes a significant factor in a Sudden Stop period—both after controlling for persistency with lagged dependent variables. These relationships appear quite robust. Additionally, an intuitive finding from this estimation is such that for both profitability and maturity structure, the impacts are much larger for nontradable sector firms. This result supports our prior suggestion of nontradable firms being more sensitive to balance sheet fluctuations.

Further, in the case of nontradable goods producers, increases in domestic consumption are important. Annual percentage increases in consumption lead to increases in the growth of firm fixed assets of 1.8% (2.0%) during tranquil (sudden stop) periods. Such impacts are more significant and almost four times larger than those for tradable firms. The strong influence of the domestic variable on nontradable producers is intuitive, as revenues of nontradable goods producers

**Table 4. Regression results – Entire sample**

Variables	(1)		(2)		(3)		(4)	
	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value
<i><math>\beta_i</math></i>								
Lagged fixed assets	-0.05	0.00	-0.04	0.00	-0.10	0.00	-0.11	0.00
Lagged growth of fixed assets	-0.03	0.36	-0.04	0.16	-0.04	0.16	0.00	0.98
Lagged profitability	0.71	0.00	0.69	0.00	0.40	0.00	0.26	0.03
Lagged maturity structure	-0.07	0.10	-0.06	0.22	-0.03	0.58	-0.01	0.90
Lagged growth of sectoral consumption			0.50	0.00	0.39	0.00	0.26	0.05
Lagged growth of sectoral exports							-0.05	0.52
Tradable sector dummy					0.03	0.33		
Size (market value)					0.09	0.00	0.08	0.00
Ownership dummy					0.01	0.79	0.02	0.47
Multinational dummy					-0.11	0.05	0.01	0.85
ADR dummy					0.13	0.09	0.01	0.95
Constant <i>C</i>	0.78	0.00	0.60	0.00	0.03	0.87	0.39	0.06
<i><math>(\beta_i + \gamma_i)</math> Sudden stops</i>								
Lagged fixed assets	0.00	0.84	0.00	0.80	-0.05	0.01	-0.07	0.01
Lagged growth of fixed assets	-0.47	0.00	-0.47	0.00	-0.45	0.00	-0.59	0.00
Lagged profitability	0.42	0.05	0.37	0.09	-0.17	0.49	-0.23	0.36
Lagged maturity structure	-0.17	0.02	-0.16	0.03	-0.17	0.03	-0.20	0.03
Lagged growth of sectoral consumption			0.34	0.15	0.05	0.04	0.59	0.01



**Table 4. (Continued) Regression results – Entire sample**

Variables	(1)		(2)		(3)		(4)	
	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value
Lagged growth of sectoral exports							-0.07	0.23
Tradable sector dummy					0.12	0.02		
Size (market value)					0.08	0.00	0.10	0.00
Ownership dummy					0.06	0.16	0.10	0.03
Multinational dummy					-0.03	0.74	-0.01	0.95
ADR dummy					-0.02	0.90	0.00	0.99
Constant <i>C</i>	0.12	0.66	0.10	0.72	-0.32	0.27	-0.22	0.52
No. of observations	1791		1648		1648		1113	
R squared: within	0.16		0.17		0.25		0.30	
between	0.02		0.01		0.01		0.08	
overall	0.12		0.13		0.17		0.24	

are largely determined by domestic consumption.

As for firm characteristics, size continues to be significant in all cases, but there are some other variables that come into effect. For tradable sector firms, having a high degree of Thai ownership helped to increase fixed assets growth by 0.1% during the Sudden Stop period. Meanwhile, for nontradable firms, being multinational reduces the growth of fixed assets during tranquil times. That is to say that the significant effect with the multinational variable previously found in Table 4, column (3), was due to the nontradable sector firms.

### C. Debt structure, long- vs. short-term maturity

Since having a longer debt maturity structure seems to be beneficial at times of economic fragility, we explore this relationship further. We divide the sample between those firms that have a longer-term maturity structure of debt and those that have a shorter one, to analyze how they are affected by certain sector- and firm-specific characteristics during tranquil and tumultuous episodes.<sup>18</sup>

We adjust the benchmark model as follows:

$$I_{ij} / K_{ij-1} = \beta_1(C+X) + \gamma_1 SS(C+X) + \eta_1 LongMaturity(C+X) \quad (4)$$

$$+ \lambda_1 LongMaturity SS(C+X) + \zeta_{ij}$$

In this case, the  $\beta_1$  coefficient captures the average response of sector- and firm-specific characteristics on the fixed assets of firms holding debt with a short-term maturity structure during tranquil times, while  $(\beta_1 + \gamma_1)$  captures their average response during the sudden stop episode. Alternatively,  $(\beta_1 + \eta_1)$  captures the average response of sector and firm characteristics on fixed assets of firms holding debt with a long-term maturity structure during good times, while  $(\beta_1 + \gamma_1 + \eta_1 + \lambda_1)$  captures their average response during the sudden stop episode (see Table 6).

Firms that have a longer-term debt maturity structure should be less financially constrained than those holding debt with short-term maturity. Consequently, in general terms they should be less likely to rely on constrained physical capital adjustment to fulfill debt obligations because they have more time to look for alternative ways of finding either financing or other means to repay debt.

There are certain firm-specific characteristics that influence decisions regarding

---

<sup>18</sup> The sample is divided based on a median value of a ratio, short-term borrowing over total debt.

**Table 5. Regression results – Tradable vs. nontradable sectors**

	Coefficient	p-value	Coefficient	p-value
	$(\beta_1)$ Tradable producers		$(\beta_1 + \eta_1)$ Nontradable producers	
Lagged fixed assets	-0.11	0.00	-0.08	0.00
Lagged growth of fixed assets	0.00	1.00	-0.13	0.00
Lagged profitability	0.26	0.05	0.60	0.00
Lagged maturity structure	-0.01	0.90	-0.06	0.41
Lagged growth of sectoral consumption	0.31	0.01	1.78	0.00
Size (market value)	0.08	0.00	0.12	0.00
Ownership dummy	0.02	0.57	0.00	0.98
Multinational dummy	0.00	0.95	-0.27	0.00
ADR dummy	0.04	0.63	-0.17	0.72
Constant <i>C</i>	0.40	0.08	-0.58	0.04
	$(\beta_1 + \gamma_1)$ Tradable producers		$(\beta_1 + \gamma_1 + \eta_1 + \lambda_1)$ Nontradable	
	during sudden stops		producers during sudden stops	
Lagged fixed assets	-0.08	0.02	-0.04	0.94
Lagged growth of fixed assets	-0.13	0.00	-0.72	0.00
Lagged profitability	-0.25	0.38	0.09	0.80
Lagged maturity structure	-0.20	0.05	-0.26	0.07
Lagged growth of sectoral consumption	0.52	0.05	1.99	0.00
Size (market value)	0.10	0.00	0.15	0.00
Ownership dummy	0.11	0.02	0.09	0.22
Multinational dummy	0.01	0.94	-0.27	0.07
ADR dummy	-0.11	0.42	-0.33	0.51
Constant <i>C</i>	-0.27	0.48	-1.24	0.02
No. of observations	1648			
R squared: within	0.27			
between	0.02			
overall	0.20			

these firms' fixed asset growth. For example, firms holding mostly short-term debt tend to focus primarily on firm size during both good and bad times to make decisions regarding the fixed assets adjustment. Both during good and bad times, being a large firm leads to positive fixed asset growth rates in spite of the shorter debt maturity structure. Furthermore, during tranquil periods being a tradable producer also works favorably, leading to fixed asset growth and consequently to a lower likelihood of having to resort to the sale of fixed assets to fulfill financing constraints.

Though still a significant factor, firm size matters less for firms holding long-term debt—significant at 9% as opposed to 0% for short-term debt holders. During tranquil times, with a less financially constrained macroeconomic environment in general, our results demonstrate that for firms with long-term debt maturity structures, additional factors such as being a multinational firm or an ADR issuer matter in firms' fixed assets adjustment. Having additional sources of financing, such as through the issuance of ADRs, reduces the likelihood of having to resort to adjustment of fixed assets, but this is so only in tranquil times. This is very intuitive especially during good times. During crisis times, alternatively, fixed assets adjustments of firms holding long-term debt depend solely on firm size.

#### **D. Robustness tests**

To assess the robustness of these findings, we conducted extensive sensitivity analysis by incorporating some variables of interest. They are market-to-book value, firm age, and the quadratic sector macroeconomic variable (consumption), which will be discussed in this section.<sup>19</sup> Reassuringly, however, this analysis revealed that the significance of variables did not change given alternative specifications. Table 7 presents the results.

We first test the significance of market-to-book value as this could be an important factor affecting firms' incentive to invest. Myers (1977) noted that high market-to-book ratios indicate the presence of growth opportunities, which can be thought of as real options. Hence, we can possibly expect a positive impact on the

---

<sup>19</sup> Another important investment relationship is the one with "uncertainty". Uncertainty as measured by standard deviation of monthly growth in the equity price was also tested. Both current and lagged values were incorporated. Results reiterate the importance of profitability in tranquil time, and debt maturity structure during the sudden stop period, though slightly smaller magnitude than that with the benchmark specification. We left the variable out of the benchmark equation because of limited data availability.

**Table 6. Regression results – Long- vs. short-term debt maturity structure**

	Coefficient	p-value	Coefficient	p-value
	$(\beta_1)$ Short-maturity holders		$(\beta_1 + \eta_1)$ Long-maturity holders	
Lagged fixed assets	-0.11	0.00	-0.07	0.00
Lagged growth of fixed assets	-0.14	0.00	0.05	0.16
Lagged profitability	0.39	0.00	0.52	0.00
Lagged growth of sectoral consumption	0.43	0.01	0.37	0.04
Tradable sector dummy	0.13	0.01	-0.17	0.09
Size (market value)	0.11	0.00	0.07	0.00
Ownership dummy	0.00	0.95	0.01	0.77
Multinational dummy	-0.06	0.55	-0.11	0.10
ADR dummy	-0.06	0.70	0.18	0.05
Constant <i>C</i>	-0.04	0.89	0.03	0.88
	$(\beta_1 + \gamma_1)$ Short-maturity holders during sudden stops		$(\beta_1 + \gamma_1 + \eta_1 + \lambda_1)$ Long-maturity holders during sudden stops	
Lagged fixed assets	-0.10	0.00	-0.06	0.13
Lagged growth of fixed assets	0.11	0.45	0.30	0.05
Lagged profitability	-0.32	0.29	-0.20	0.59
Lagged growth of sectoral consumption	0.14	0.67	0.09	0.84
Tradable sector dummy	-0.04	0.37	-0.17	0.09
Size (market value)	0.10	0.00	0.07	0.09
Ownership dummy	0.09	0.13	0.10	0.22
Multinational dummy	0.00	0.97	-0.05	0.78
ADR dummy	-0.08	0.72	0.16	0.59
Constant <i>C</i>	0.01	0.98	0.08	0.89
Number of observations	1666			
R squared: within	0.28			
between	0.00			
overall	0.20			

balance sheet, and hence an increase in fixed assets growth. Meanwhile, past empirical studies assert that the relationship is mostly negative (Booth et al. 2001) due to agency costs attached to the real options as well as to short-run market movements, and a lack of immediate reaction by corporations. Probably due to these conflicting elements, we find the variable to be insignificant (Table 7, column 1), and exclude it from our benchmark specification.<sup>20</sup>

Further, firm age is an important factor in firms' fixed assets adjustment. Intuitively, younger firms may have more need to invest in fixed assets when they set up their business, but then as firms age, the need for more fixed assets may lessen. Estimation results (Table 7, column 2) support the prior that firm age and fixed asset growth has a negative relationship, with one year of aging decelerating firms' fixed asset growth by 0.01% during tranquil times. Interestingly, this negative relationship holds only during the tranquil period, and is an insignificant factor during a sudden stop period. Although this is potentially an important variable, we do not include it in the benchmark specification given the limited data availability.

Lastly, growth in consumption is replaced with a quadratic form in the benchmark specification. This treatment is used to control for any nonlinear responses to the recession that interaction terms (with Sudden Stop) may be picking up. Our main conclusions are unaffected by this inclusion. Estimation results (Table 7, column 3) virtually remain the same, supporting the main results. Maturity structure continues to show significant explanatory power during the sudden stop period. The only distinction might be that the impact of quadratic consumption growth on firms' fixed asset growth is about half that of the benchmark specification, leaving all other parameters the same.

---

<sup>20</sup> Additionally, interest coverage ratio —as a factor affecting balance sheet— is also tested for its explanatory power, but does not turn out to be a significant factor in our sample.

**Table 7. Robustness analysis**

Variables	(1)		(2)		(3)	
	Coef.	p-value	Coef.	p-value	Coef.	p-value
$\beta_1$						
Lagged fixed assets	-0.05	0.00	-0.05	0.02	-0.04	0.00
Lagged growth of fixed assets	-0.03	0.36	-0.04	0.53	-0.04	0.16
Lagged profitability	0.71	0.00	0.93	0.00	0.69	0.00
Lagged maturity structure	-0.08	0.10	-0.27	0.00	-0.06	0.22
Lagged growth of sectoral consumption (quadratic form)					0.25	0.00
Market-to-book value	0.00	0.19				
Firm age			-0.01	0.05		
Constant <i>C</i>	0.78	0	0.95	0.00	0.60	0.00
$(\beta_1 + \gamma_1)$						
Lagged fixed assets	0.00	0.84	-0.02	0.53	0.00	0.80
Lagged growth of fixed assets	-0.47	0.00	-0.11	0.19	-0.47	0.00
Lagged profitability	0.42	0.06	0.22	0.68	0.37	0.09
Lagged maturity structure	-0.17	0.02	-0.23	0.16	-0.16	0.03
Lagged growth of sectoral consumption (quadratic form)					0.17	0.15
Market-to-book value	0.00	0.98				
Firm age			0.00	0.77		
Constant <i>C</i>	0.12	0.657	0.48	0.44	0.10	0.72
Number of observations	1791		413		1648	
R squared: within	0.16		0.11		0.17	
between	0.02		0.04		0.01	
overall	0.12		0.09		0.13	

#### IV. Conclusion

We have explored the relationship between fluctuations in firms' fixed assets growth and financial constraints in the context of the capital inflow reversals and devaluation of the late 1990s in Thailand. We looked at data from 284 nonfinancial firms in tradable and nontradable industries listed in the Thai stock market between 1992 and 2001. Some of the most important patterns that emerged revealed that Thai nonfinancial firms suffered from large declines in the growth of their fixed assets of approximately 30% during the Sudden Stop episode. This finding supported our initial belief that a large portion of the decline in firm fixed assets could have been in the form of distressed sales.

Regression results enhanced broad trends, initially identified through graphical analysis, by detailing what were the particular firm-specific factors that accentuate fixed asset fluctuations. The main results are that shocks to net worth—profitability and maturity structure—exhibit striking regularities in affecting fixed assets adjustment. The rate of Thai firm's fixed asset accumulation is reduced if firms have more short-term debt or firms are less profitable. Interestingly, the two variables appear important in different periods—profitability in the tranquil period but maturity structure in the sudden stop period.

Additionally, there are firms' characteristics that matter for fixed assets adjustment. The size variable appears most important among the characteristics by significantly affecting the fixed asset adjustment at all times—with smaller firms having to reduce fixed assets. Being multinational or not affects nontradable firms, while tradable firms' decisions were affected by the degree of Thai ownership during the sudden stop period. The economic significances of these are less so than the size variable, however.

The results are intuitive and in line with the literature that describes situations of financial constraints, the behavior of firms in distress, and, to some extent, the characteristics of fire sales. Future research should aim at detailing forced investment adjustments with price pressure to capture directly the phenomenon of fire sales of fixed assets. Furthermore, our findings are testable in other regions or markets that have undergone similar episodes and some have already been initiated.



## Appendix

**Table A1. Variable descriptions and sources**

Variable	Construction	Source
Investment	Growth of total fixed assets, $(K_{ijt} - K_{ijt-1})/K_{ijt-1}$	Datastream
Capital flow	Current account (line 78ALD) + exceptional finance (line 79DAD)	International Financial Statistics, IMF
ADRs	Dummy variable denoting 1 if ADR is issued by the Thai firm in question and zero otherwise. Our dataset includes all ADRs outstanding as quoted in the NYSE as of 9/2002	JP Morgan's www.adr.com
Sectoral consumption	Percentage change of variable in local currency	National Economics and Social Development Board of Thailand.
Sectoral exports	Percentage change of variable in local currency	Customs Department, Bank of Thailand
Profitability	After-tax profit/total assets	Datastream
Interest coverage ratio	Earnings before interest and taxes divided by net interest charges (nm1300/nm2408)	Datastream
Debt maturity structure	Short-term debt divided by total debt	Datastream
Tradable vs. nontradable	Dummy variable based on the sector classification (tradable: food, household, manufacturing, and primary, nontradable: real estate and service)	Datastream
Size	Total market capitalization (=1 if greater than median, =0 otherwise)	Datastream
Market-to-book ratio	Stock price divided by book value per share	Datastream
Firm age	Number of years after establishment	Firms' websites
Ownership	Percentage of Thai ownership (100% being highest Thai ownership)	Thailand's Department of Commerce
Multinational	Dummy variable (1 if multinational, 0 otherwise)	Financial Times Multinational Index, Directory of Multinationals, and Worldwide Branch Locations of Multinationals

**Table A1. (Continued) Variable descriptions and sources**

Variable	Construction	Source
Total fixed assets	The net total (after deducting accumulated depreciation) of land and buildings, plant and machinery, construction in progress and other fixed assets. Assets leased out are excluded.	Datastream (nm339)
Total assets	The sum of tangible fixed assets, intangible assets, investments (including associates), other assets, total stocks & WIP, total debtors & equivalent and cash & cash equivalents.	Datastream (nm392)
Total sales	The amount of sales of goods and services to third parties relating to the normal industrial activities of the company. It is net of sales-related taxes and excludes any royalty income, rental income and other operating income.	Datastream (nm104)
Total debt	The total of all long- and short-term borrowings, that is, the total of: Bank overdrafts and other short term borrowings; Loan capital, including debentures; Finance leases and hire purchase agreements (short and long term); Obligations under capital leases (short and long term); Loans from associated companies; Notes payable - finance companies.	Datastream (nm1301)
Published after-tax profit	The profit after tax for the financial period as reported by the company, before minority interest, pre-acquisition profits, and provision for preference and ordinary dividends. The after-tax share of profits of associated companies is included, where applicable.	Datastream (nm623)
Net interest charges	The aggregate value of interest paid (after capitalized interest) less interest received. It includes interest on hire purchase and leasing.	Datastream (nm2408)
Earnings before interest and tax	The earnings of a company before interest expense and income taxes. Calculated by taking the pre-tax income and adding back only the total interest expense on debt. Net interest charges (total interest expense minus interest income) is used for Thailand.	Datastream (nm1300)

## References

- Aguiar, Mark. (2005), "Investment, devaluation, and foreign currency exposure: The case of Mexico", *Journal of Development Economics* **78**: 95-113.
- Aguiar, Mark and Gita Gopinath (2005), "Fire sale foreign direct investment and liquidity crises", *Review of Economics and Statistics* **87**: 439-452.
- Blanchard, Olivier, Changyong Rhee, and Lawrence Summers (1993), "The stock market, profit, and investment", *Quarterly Journal of Economics* **108**: 115-136.
- Bleakley, C. Hoyt and Kevin Cowan (2004), "Maturity mismatch and financial crises: Evidence from emerging market corporations", Discussion Paper 2004-16, San Diego, CA, University of California at San Diego.
- Booth, Laurence, Varouj Aivazian, Asli Demirguc-Kunt, and Vojislav Maksimovic (2001), "Capital structures in developing countries", *Journal of Finance* **56**: 87-130.
- Calvo, Guillermo A. and Carmen A. Reinhart (2000), "When capital inflows come to a sudden stop: Consequences and policy options", in P. Kenen and A. Swoboda, eds., *Reforming the International Monetary and Financial System*, Washington, DC, International Monetary Fund.
- Fazzari, Steven M., R. Glenn Hubbard, and Bruce C. Petersen (1988), "Financing constraints and corporate investment", *Brookings Papers on Economic Activity* **1**: 141-195.
- Gomes, Joao F. (2001), "Financing investment", *American Economic Review* **91**: 1263-1285.
- Hoshi, Takeo, Anil Kashyap, and David Scharfstein (1991), "Corporate structure, liquidity, and investment: Evidence from Japanese panel data", *Quarterly Journal of Economics* **106**: 33-60.
- International Monetary Fund (1998), *World Economic Outlook*, Washington, DC.
- Ito, Takatoshi and Luiz A. Pereira da Silva (1999), "The credit crunch in Thailand during the 1997-1998 crisis: Theoretical and operational issues with the JEXIM Survey", *EXIM Review* **19**: 1-40.
- Kim, Se Jik and Mark R. Stone (1999), "Corporate leverage, bankruptcy, and output adjustment in post-crisis East Asia", Working Paper 99, Washington, DC, IMF.
- Mody, Ashoka and Shoko Negishi (2001), "The role of cross-border mergers and acquisitions in Asian restructuring", in *Resolution of Financial Distress: An International Perspective on the Design of Bankruptcy Laws*, Washington, DC, World Bank Institute.
- Myers, Stewart C. (1977), "Determinants of corporate borrowing", *Journal of Financial Economics* **5**: 147-175.
- Samphantharak, Krislert (2003), "Internal capital markets in business groups", unpublished manuscript, University of Chicago.