18 November 2020

THEMATIC

In this report:

Malaysia – Debt-for-sustainability swap to spur recovery

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Malaysia

Debt-for-sustainability swap to spur recovery

The Covid-19 pandemic is stretching companies to their limits. Many businesses have become overleveraged. They are battling with revenue losses, rising borrowing costs and declining cash flows. Amidst these challenging times, the government's stimulus packages and relief measures have provided some support for businesses, keeping them afloat. However, as businesses struggled to cope with the new normal, there are mounting concerns on what will happen when some of the government stimulus measures come to an end.

In this new, Covid-19 impacted reality, it is essential for companies to embed sustainability in their long-term recovery and growth plans. At the same time, significant obstacles need to be overcome to repurpose assets and capabilities for post-pandemic markets.

This is an opportune time for businesses seeking corporate restructuring to embark on a debt–for-sustainability swap. Focusing on a debt-for-sustainability swap may offer the companies an avenue to address corporate debt challenges while at the same time increasingly focus on sustainability.

A. The Covid-19 pandemic is stretching companies to their limits

- The Covid-19 pandemic is stretching companies to their limits. Many businesses have become overleveraged. They are battling with revenue losses, rising borrowing costs and declining cash flows. Amidst these challenging times, the government's stimulus packages and relief measures have provided some support for businesses, keeping them afloat.

- However, as businesses struggled to cope with the new normal, there are mounting concerns on what will happen when some of the government stimulus measures come to an end. Despite the banks' having proactively engaging with their customers and working with the businesses, concerns remained whether some of the borrowers will still be able to meet their obligations. Those severely inflicted by the pandemic virus will embark on a financial restructuring route while others may need to recapitalize their businesses.

- Coronavirus fears have consumed investors as warnings over the potential of a rising debt load that could push companies towards collapse are beginning to be tested. Even if policymakers put health concerns as the top priority, plans on how to deal with unsustainable corporate debt burdens should start almost immediately. Taking steps now will limit the number of bankruptcies and business closures. It can help speed up the recovery of the Covid recession.

B. Essential for companies to embed sustainability

- In this new, Covid-19 impacted reality, it is essential for companies to embed sustainability in their long-term recovery and growth plans. At the same time, significant obstacles need to be overcome to repurpose assets and capabilities for post-pandemic markets.

- As companies move towards a post-pandemic world, in order to mitigate risks, capture opportunities and shape their future, they need to reinvent their business models in favour of more sustainable options – an approach that will not only help them weather the current environment, but also provide a competitive advantage.

- Companies should rethink of their goals in an environment that increasingly values resilience, sustainability and inclusiveness. They should use the Covid-19 crisis as an opportunity to review how their business model fits into the broader context of Sustainable Development Goals (SDGs). Progressive companies already know that sustainability and profitability go hand in hand in the long run.

C. Opportune time to embark on debt–for-sustainability swap

- In a post-Covid-19 world, it will no doubt look different in many ways. Emphasis on sustainability as recovery takes place will continue. To survive and thrive in a post-Covid-19 environment, companies need to implement long-term sustainability strategies that allow them to capture new opportunities, broaden their horizon and shape their post-pandemic futures. In this new normal environment, survival alone is not enough.

- This is an opportune time for businesses seeking corporate restructuring to embark on a debt–for-sustainability swap. Focusing on a debt-for-sustainability swap may offer the companies an avenue to address corporate debt challenges while at the same time increasingly focus on sustainability.

- In pursuing the debt-for-sustainability swap in the context of corporate debt restructuring, an option is to have a government-sponsored corporate debt restructuring fund. This corporate debt restructuring fund would buy from the banks all non-performing loans from viable firms. The fund and firms would then exchange the loans at a prearranged discount from the purchase value of the debt with a new loan based on sustainability compliance in the firms' operations or supply chains.

- However, in this option, it is important for the government to take into consideration of its fiscal space – limitations as well as debt sustainability concerns. More so with the record spending over the past few months. Another alternative will be a well-designed approach that would leverage bilateral and multilateral development finance institutions, private investors and private equity funds. It is to reduce the use of limited government financial resources. In both scenarios, it could be done through a sustainability-linked loan (with measurable performance targets), a transition loan (supporting green business practices) or other green instruments (such as green bonds).

- In designing the debt-for-sustainability swap framework, it is important for the government to set objectives that will enable a timely restructuring of debt and access to sustainability financing for viable firms. The government should also facilitate the exit of non-viable businesses to avoid the rise of "zombie" firms. Identifying which firms are viable in the long run is no easy task, however. The government should work closely with banks — which are experienced in carrying out such assessments — to gather detailed data on firms and sectors.

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