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BANKING PRIVATIZATION IN THE PHILIPPINES:

COMMERCIAL BANK OF MANILA (COMBANK)

Final

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CASE I

I. Introduction

On June 12, 1987, Feliciano (Sonny) Belmonte, President of the Government Service Insurance System (GSIS) and Chairman of the Commercial Bank of Manila (ComBank), studied the newly received proposal to purchase 100% of ComBank. The proposal submitted by First National Bank of Boston (Bank of Boston) and a group of three Philippine investors represented the final step in a long negotiation process for the sale of ComBank. The 510 million peso bid was the highest price to be offered for ComBank.[1] As a fully owned subsidiary of GSIS, ComBank was one of 122 government corporations targeted for privatization since the Aquino Administration proclaimed and launched the Government's privatization program on December 8, 1986. Discussions with several other prospective buyers had not materialized into formal purchase proposals, and Bank of Boston had been persistent.

Belmonte knew that President Aquino and the Central Bank were eager to have a concrete example of the Administration's commitment to privatization. It had been a half year since the program's inception, and ComBank would represent the first full privatization. Bank of Boston had proposed swapping debt for equity, which would also represent a first for the Administration. However, Belmonte had reservations about selling the bank at this time. The Philippine economy was still struggling to recover from the aftermath of the 1986 revolution which forced President Marcos from power. Belmonte believed that greater political and economic confidence would enable GSIS to command a higher price for ComBank.

The proposal involved many important issues, and Belmonte had several decisions to make before responding. If he rejected this offer on the basis of price, Bank of Boston might refuse further negotiation. This could be risky, since there was great uncertainty about the level of interest from other potential buyers. GSIS might be forced to aggressively seek other investors and, even then, was not assured of realizing a better price. Additionally, walking away from this deal would cause the Administration to experience further delays in executing its commitment to privatization.

II. The Impetus for Privatization

Economic chaos following the assassination of opposition leader Benigno Aquino in 1983 and charges of widespread corruption within the Marcos regime led to rising discontent among the Philippine people. The declining GNP, mounting balance of payments deficit, large

[1]The exchange rate at the time was 20.47 Philippine pesos = U.S.$1.00.

government deficits, and rising foreign debt took their toll on the economic outlook (Exhibit 1). Under pressure, Marcos declared a snap election on February 7, 1986; he was defeated by Corazon Aquino in the popular vote. Marcos' dispute of the election results incited non-violent boycotts of businesses and institutions allegedly controlled by Marcos and his cronies. A series of bank runs occurred, and the value of the peso and stock prices plummeted. Interest rates rose from 9% to over 20% (Exhibit 2). Some prominent businessmen, frustrated with excessive election spending and steep increases in interest rates, resigned from government advisory positions in protest. A military mutiny and popular revolution ultimately forced Marcos to flee the country on February 25, 1986.

Aquino assumed the presidency in 1986 with the strong support of the Philippine people and the international community. Her immediate priority was to reverse the severe economic decline of the past few years, through which Philippine growth had lagged behind other East Asian nations. (Exhibit 3). The Administration's principal economic objectives were:

- greater attention to poverty alleviation and social justice;
- acceleration of growth and increased economic efficiency; and
- expansion of economic activity through increased private sector involvement.

One of Aquino's first initiatives was a program of economic reform which included a comprehensive plan to rationalize the government corporate sector. An assessment was undertaken for each of the government-owned or controlled operations (GOCCs). This study resulted in the identification of government corporations for retention, privatization, abolition, consolidation or commercialization. Out of 301 GOCCs in the government corporate sector when Aquino assumed office, 122 GOCCs were identified for privatization, including the Commercial Bank of Manila.

The Administration's privatization objectives were to:

- focus government resources to provision of basic public goods and services;
- create a favorable investment climate;
- broaden ownership and develop capital markets; and
- generate revenues for priority government expenditures (i.e., land reform, public infrastructure, and others).

When the privatization program was first announced, some officials complained that pressure from the international financial community was the real impetus behind the policy, due to the fact that an IMF stabilization program had introduced fundamental economic reforms to the Philippines and had targeted GOCCs. Charges that the World Bank and IMF had demanded privatization as a condition for future assistance caused some resentment. However, there was broad domestic political support for privatization: the right supported the advantages of

broader public ownership of the nation's industries and market oriented policies, while the left supported reform o increase accountability and corruption.

The Philippines has always recognized the importance of the private sector and free enterprise to national economic development. However, as the Marcos policies of martial law and heavy national borrowing took their toll on the Philippine economy, many private sector entities had been unable to meet their financial obligations. The government had taken an increasingly active role in business under Marcos through loans, subsidies and direct investment. Consequently, government indebtedness grew 27% annually from 1980-84 (Exhibits 4-5). Many of the enterprises receiving government loans failed and ultimately came under government control.

Managing non-performing assets worth over $7 billion was a huge drain on the economy. An article in the *ASEAN Economic Bulletin* stated that government corporations had consumed up to a quarter of the national budget in recent years. There was little pressure on GOCCs to return dividends to the government, and GOCC debt rose by 23% annually from 1980 to 1985, representing 70% of public external debt by 1985, as many firms developed an over-reliance on easily available credit. GOCC performance had been poor, with average rates of return on equity (ROE) and return on assets (ROA) of 2.9 and 3.7 percent respectively. [2]

III. Aquino's Privatization Program

The "Freedom" Constitution which Aquino adopted upon assuming the presidency expressly mandated government reorganization. Her commitment to privatization was announced early in her presidency and continued to be highlighted as a priority by the Administration. Proclamation 50, issued in December 1986, officially launched "a program for the expeditious disposition and privatization of certain government corporations and/or the assets thereof." This ruling established the policy and procedural framework for privatization and created the Committee on Privatization (COP) and the Asset Privatization Trust (APT) (Exhibit 6).

The COP was a cabinet-level committee responsible for overseeing the Philippine privatization program. It was an executive office reporting directly to the Office of the President of the Philippines. Pursuant to its mandate under Proclamation No. 50, the COP approved the sale of Government assets/corporations as to price and buyer. It also designated and supervised the disposition entities which are responsible for the actual marketing of GOCCs identified for disposition.

[2] Zinnia F. Godinex, "Privatization and Deregulation in the Philippines," ASEAN Economic Bulletin, March 1989, pp. 259-289.

The privatization plans recommended by disposition entities (DEs) were subject to COP clearance. The plans included the proposed timing, extent and mode of privatization for each asset. Once a plan was approved by the COP, the DE handled the actual marketing and implementation of the transaction. The COP reviewed the asset valuation and sale agreement between the DE and the proposed buyer, and endorsed the recommendation to the President to privatize. Vetoes by the COP were rare and occurred only when the proposed sale price was deemed too low. COP guidelines on valuation recommended the use of standard valuation methods such as appraised value, replication cost, and earnings and cash flow methods. The guidelines were intentionally broad, recognizing that the valuation method will depend upon the nature of the asset being sold.

The COP was comprised of five cabinet-level officials: the Secretary of Finance as Chairman, Secretary of Budget and Management, Secretary of Justice, Secretary of Trade and Industry, and the Director of the National Economic and Development Authority. A Technical Committee provided support to the COP. Immediately upon its inception, the COP was instrumental in obtaining presidential approval to privatize 122 GOCCs and 419 non-performing or transferred assets (TAs).

The APT was established to serve as the primary disposition entity for the privatization of the non-performing assets, which had previously been under the control of the Philippine National Bank and the Development Bank of the Philippines. Both government-owned banks had acquired a substantial portfolio of private-sector assets through loan default, and the Aquino Administration sought to centralize the disposition of these assets in a public trust entity.

As previously mentioned, disposition entities for the privatization of GOCCs are designated by the COP. The Government Service Insurance System (GSIS) was the COP-designated disposition entity for ComBank.

IV. Government Service Insurance System

GSIS was an independent operating body designated as the custodian of 1.5 million government employee pensions. Its primary function was the management of this pension fund and a lending program for teachers and government employees. With 1987 assets valued at P22.5 billion, GSIS rivaled the largest private sector banks in size and dominated the insurance sector. GSIS ranked 14th in revenues among over 5000 financial sector entities and earned P2.47 billion in 1987.

Officers of the GSIS were political appointees and held upper management and board positions within each of the companies in its portfolio. These powerful positions entitled the appointees to compensation through salary and other benefits, in addition to their GSIS salaries.

Companies in the GSIS portfolio, which included ComBank, Philippine Airlines, the Manila Hotel and the Philippine Plaza, were among the most prized assets targeted for privatization. The GSIS portfolio also included several corporations that had previously been privately held but were acquired during the Marcos years.

Government officials differed in opinion regarding the benefit of and justification for privatizing companies in the GSIS portfolio. Some openly stated that the government should not be in business. On the other hand, one GSIS official commented that "there is no valid case against the management of some government firms. GSIS portfolio firms were all profitable and the board was steering them properly." This official believed that it was important to distinguish between the GSIS assets and other GOCCs, since GSIS companies had been founded as competitive private enterprises, rather than by the government for development purposes.

V. The Philippine Banking Industry

In 1986, the banking sector was comprised of 29 commercial banks, 112 thrift banks, and 850 rural banks. Commercial banks represented the largest single group of financial institutions and included private domestic banks and foreign banks. Private domestic banks represented 70% of total commercial banking assets, and 25% of total banking assets (Exhibit 7). The Land Bank of the Philippines and Philippine National Bank were specialized government banks which competed in the commercial banking sector but were often segregated for statistical reporting purposes. Together, they held 1.7% of the sector's assets. Thrift and rural banks represented 4% of total banking assets. Non-bank financial institutions accounted for 15% of total banking assets.

In 1986, there were four foreign banks operating in the Philippines, representing 13% of total commercial bank assets and 5% of total banking assets. Citibank was the largest of the foreign banks, and it ranked fourth among all commercial banks. No foreign banking licenses had been issued since Philippine independence in 1946.

The commercial banking sector grew rapidly from 1980, when total assets for the sector were P144.5 billion, to a peak of P299.2 billion in 1984. The sector declined somewhat in the following two years, with total assets at P264.4 billion in 1986. Philippine National Bank commanded over 13% of total market share and, combined with the next three largest banks, represented about 40% of sector assets. Most banking activity was concentrated in Manila, with few banks expanding beyond urban areas. Branch distribution was important for deposit collection, but lending authority was typically highly centralized. Automation in the industry was limited and confined to back-office processing.

The Central Bank exercised administrative authority over commercial banking activity through

the approval of all banking and branch licenses. Branch licenses were issued by auction at prices ranging from P3-5 million, their value depending on the city or location. Under the Marcos administration, licenses fell into the hands of individuals who used newly formed banks to satisfy their personal financing needs. Mismanagement contributed to problems within the banking system. This prompted government support and, ultimately, government takeovers of some institutions during the economic crisis of the 1980s.

In the early 1980s, financial reforms were introduced to promote industry restructuring and increase interbank competition. The liberalization of interest rates was intended to better reflect market conditions and develop capital markets. Economic conditions exacerbated the financial instability of smaller banks, resulting in liquidity problems, collapse and industry consolidation.[3] This consolidation trend continued, as the Central Bank policy of raising capitalization levels and reserve requirements favored larger banks. Moreover, in 1985, the first universal bank ("unibank") licenses were granted to banks with capital bases of over P500 million. These banks were allowed to offer a full range of services through extensive branch networks and additionally had access to the equities markets, unlike traditional banks.

Retail deposits were the cheapest source of bank funds, with interbank borrowing used as alternatives if deposits failed to support operations. Savings deposits exhibited the most stable growth since 1980 and comprised the largest share of industry deposits (total deposits included demand, time, and savings). Savings deposits grew at an average annual rate of 20.5% from 1981-86, while total deposits grew by only 12%. Savings accounts did not require a minimum deposit, as was the case with other accounts. It was advantageous for a bank's cost structure to fund its operations with retail deposits, as observed in a CRC report.[4] However, while competition was fierce on the lending side of the business, banks cooperated in keeping the rates on deposits low. Thus, spreads between deposit rates/cost of funds and lending rates provided healthy margins (Exhibit 2).

VI. Commercial Bank of Manila (ComBank)

A. History

ComBank's roots date back to 1963 when Emerito Ramos, a real-estate developer, founded the

[3] Conditions contributing to these problems included the loss of potential saving to jueteng gambling operations in the provinces; the small share (10%) of the deposit base in rural areas; and displacement by cooperatives, non-government organizations, and self-help groups.

[4] Enrique P. Esteban and Francisco Hector M. Varela, "Unbruised Bottom Lines", CRC Annual Report, 1991, pp. 27-35.

Overseas Bank of Manila (OBM). After several difficult years and a bank run in 1968, the Central Bank stepped in to assume control of OBM. From 1968 to 1979, several groups worked with the Central Bank in unsuccessful attempts to rehabilitate the bank under new management. The Central Bank's transfer of OBM assets among these groups was covered by an agreement which assured Ramos of the return of millions of pesos that he had pledged to the bank's rehabilitation, as well as options to buy 10% of the bank. Herminio Disini, a close friend of Marcos', purchased the bank on May 25, 1979 through his firm, the Atrium Capital Corporation, despite the protests of Ramos, who still claimed original ownership rights to the bank. Marcos and the Central Bank authorized Disini to rehabilitate and reopen the virtually defunct bank within 120 days. He successfully restructured the bank, and opened it as the Commercial Bank of Manila in 1980. When Atrium was hit hard by the recession of the early 1980s, Disini looked for a buyer for ComBank. Marcos encouraged GSIS to consider ComBank, and in November 1982, GSIS purchased ComBank for P650 million, of which P500 million was equity and P150 million was advances.

Roman Cruz, then Chairman of GSIS and a former banker, felt that having a bank in GSIS' investment portfolio complemented its investment and operating objectives. Cruz also felt that the price he had negotiated had been fair. He intended to run ComBank as a private, competitive entity without direct subsidies. GSIS officials assumed direct responsibility for ComBank's performance through management and board positions, with Cruz becoming Chairman.

B. Operations

In 1986, ComBank held 0.5% of the market with assets valued at P1.8 billion and had 17 branches. Less than half of its deposits were derived from the general public. GSIS accounted for 40% of the deposits, and Philippine Airlines for 10%. Bank operations were unsophisticated, and the branch network was not computerized. ComBank's headquarters was a 14-story building located on a main thoroughfare in Makati, Metro Manila's primary business district. In 1987, real estate in Makati was at a premium, with properties selling for up to ten times book value. ComBank's building had a book value of P60 million and an estimated market value of P300 million.

ComBank employed about 550 people, 100 of whom were junior and senior officers. A union had recently been formed by non-officer employees in anticipation of privatization, although labor relations had never been problematic for the bank. Turnover was low except at senior levels, where positions were subject to board approval. Two changes in senior management and board composition in the last four years had caused some anxiety among these employees. Dennis Velasquez, a junior officer at ComBank during this time, recalled that GSIS was more focused on the "preservation of assets than expansion of the bank." The "competitive spirit was just not there," and senior officers often felt like "caretakers."

However, most junior employees welcomed the possibility of a new management which would focus on business considerations rather than GSIS priorities.

ComBank's products focused on deposits, foreign exchange, money transfers, credit, loans, trusts, and investments. Despite the volatile business environment, ComBank went from a loss of P1.2 million in 1982 to a net profit of P18.5 million in 1983. Within two years of the takeover by GSIS, ComBank had doubled its resources, becoming the most profitable of the GSIS group of companies. Increased deposit base and balance sheet restructuring were primarily responsible for the improved performance. Management cited the emphasis on rigid cost control and aggressive marketing of innovative services as additional factors. ComBank had also acquired a large stable deposit base in the form of GSIS funds. ComBank's financial statements are included in Exhibits 8-12.

ComBank opened five additional branches in 1984 and acquired 97% of Royal Savings Bank, a thrift institution which had closed in June after losing P100 million in deposit withdrawals in less than a month. The P30 million acquisition contributed to bringing ComBank's asset base to P1.56 billion. The newly acquired 23-branch network was reopened September 24 as Comsavings, offering the same deposit and loan services as before. Comsavings was fully absorbed into ComBank's management structure.

ComBank management indicated that ComBank's liquidity and leverage levels were better than the industry average in 1985. With a debt/equity ratio of 5.6, ComBank was among the least leveraged banks in the system. Profitability fell later that year due to a significant increase in interest expense when banking reforms were introduced. The political upheaval in early 1986 was especially difficult for the bank, as it was labeled a "crony bank" and targeted in the bank boycott led by Aquino. ComBank management refuted these charges, noting that the bank had been professionally managed and had demonstrated consistent profitability and growth since the GSIS takeover. However, GSIS had written off a significant portion of their original equity investment in ComBank.

In July 1986, Aquino's appointment of a new board at GSIS brought a change of management to ComBank. Feliciano (Sonny) Belmonte, a lawyer with no previous banking experience, became president and general manager of GSIS and replaced Cruz as ComBank chairman. Belmonte and his wife were strong supporters of Aquino. GSIS selected Dominador U. Aganon, a veteran banker, to become ComBank president. Upon assuming their positions, Belmonte and Aganon voluntarily reduced their ComBank salaries from previous levels as a cost-cutting measure. Belmonte cut his annual salary by 90% from P2.4 million to P240,000 while Aganon's salary went from P1.8 million to P800,000.

VII. Bank of Boston

Bank of Boston was an international multi-bank holding company ranked 15th largest in the U.S., with assets over $31 billion. The bank maintained a broad Asia/Pacific presence from its regional headquarters in Hong Kong. Bank of Boston entered the Philippine market with the establishment of an Offshore Banking Unit (OBU) in 1982. OBUs were branches of foreign banks offering limited services and serving the country's foreign currency needs. They were restricted from peso lending and specialized in correspondent banking and trade finance. Benjamin C. Sevilla, a Philippine-American banker with ten years experience in Europe and the U.S., was hired by Bank of Boston to open and direct the OBU.

The OBU had experienced several successful years with dollar-based transactions, but Sevilla felt that the key to Bank of Boston's growth in the Philippines was gaining access to peso deposits, trust, and lending activities. In his view, access to the Philippine domestic market offered greater profit potential and would complement the OBU operations. Sevilla began to consider how Bank of Boston could expand in the Philippines with minimal risk and capital investment. When several government-owned banks became available under the privatization initiative, Sevilla thought the time may be right to take a harder look at expanding Bank of Boston's presence in the Philippine market.

Like most international commercial banks, Bank of Boston was a creditor to many developing countries and held over $1.2 billion in outstanding loans to less developed countries. Its total exposure in the Philippines was approximately $82 million, with $25 million in long-term debt and the remainder in trade credit. The bulk of this debt was in the form of 10-year notes issued in 1982 upon Bank of Boston's entry into the Philippines, and the rest was an accumulation of years of small government loans dating back to the 1960s. A 1983 moratorium on debt repayment had frozen the non-trade debt with the Central Bank pending debt rescheduling. Pronouncements by Aquino Administration officials in 1986 suggested that principal repayment would probably not begin until 1994, at the earliest. While the Philippines did not have a formal debt conversion program, Sevilla thought the idea of converting the bank's exposure into an expanded base of operations could satisfy the new administration's privatization objectives. Additionally, the foreign exchange shortage offered a tremendous opportunity for banks which could access a portion of the available supply. With its international network, Bank of Boston could build this advantage.

In the spring of 1986, Sevilla met with senior management in Boston to discuss options for handling the bank's Philippine debt. He presented three alternatives: hold the debt notes until the moratorium was lifted and earn interest; sell the debt notes on the secondary market at a 50% loss; or swap debt for equity in a local bank and take the risk locally. He favored the third alternative in order to work the debt into something of greater value. Consensus within Bank of Boston favored debt conversion, and management supported further exploration of investment candidates.

VIII. Bank of Boston's Purchasing Strategy

A. Selecting ComBank

Among the government-owned banks targeted for privatization, ComBank had been most attractive to Sevilla. In 1986, ComBank had instituted a policy of lending only to borrowers with hard collateral, which resulted in a portfolio of highly secured loans and, therefore, lower-risk assets. Sevilla had a working relationship with ComBank, as ComBank was a correspondent bank for the OBU's letter of credit and check clearing services.

Sevilla felt that ComBank lacked a strong market identity but did not view the lack of brand equity as a negative. Compared to the other investment candidates, he perceived ComBank as a perfect "starter home."

> *[It was] not too old, which was good for flexibility, and did not have too many problems. We wanted to enter an institution which could be quickly changed. With ComBank, we didn't have to change systems, as they were not automated, and their uncomplicated balance sheet offered the potential of a quick turnaround.*

Through ComBank, Bank of Boston felt it could further develop its retail and wholesale operations in the Philippine market and enhance service to a wider base of customers through its extensive worldwide network. Sevilla felt the 17-branch network would be an ideal means of building a larger deposit base. A top priority would be seeking new sources of deposits to replace those currently provided by GSIS. Additionally, Sevilla planned to bring discipline to the organization, review and tighten the loan portfolio, and introduce Bank of Boston's automation to the bank. Sevilla felt that Bank of Boston's expertise could strengthen the bank, particularly in the areas of credit and automation.

However, despite his enthusiasm for ComBank's potential, Sevilla had some reservations. Bank of Boston's presence in the Philippines was limited to the foreign banking sector and virtually unknown to the local peso market. He wondered whether their reputation would be strong enough to support a full service bank. The firm's widespread success in Latin American full-service banks was based on decades of local operating experience. While Sevilla was strongly confident of his OBU management team, he was less secure about the local staff that he had assembled to direct this ambitious project.

B. Establishing a Price

Sevilla had reviewed the bank's financial performance in detail. He hired Sycip, Gorres, Velayo & Co. (SGV), a well respected private accounting firm, to conduct a due diligence review of ComBank for the purpose of concurring on a book value. Having served as

ComBank's auditors for several years, the firm was familiar with the bank's financial and operational condition. In addition to financial performance, Sevilla considered the branch network, brand equity and goodwill, core of customers, and quality of personnel in determining an appropriate premium above book value. SGV's value range was very similar to the range that Sevilla and Bank of Boston headquarters determined to be reasonable.

Attaching a premium to equity book value was a widely used method of valuing banks in the Philippines. Since ComBank stock was not publicly traded, the trading values of other banks were used in deriving an appropriate premium. Interbank, a bank with close to P500 million in net worth, had been partially sold to American Express several months earlier and had been valued at a 40% premium over book value. Sevilla determined that he was prepared to pay a 30% premium on June 30, 1986 book value of approximately P360 million, resulting in an offering price of P468 million.

In July 1986, Sevilla contacted Belmonte to express interest in buying ComBank. He proposed joining with local investors to purchase the bank by swapping Philippine national debt held by Bank of Boston for equity. Sevilla assured Belmonte that he could pull together a list of investors who would pass Central Bank scrutiny. Belmonte was not entirely receptive to the price. He demanded a 50% premium on adjusted book value but was amenable to further negotiation.

C. Attracting Local Partners

Sevilla was eager to pursue negotiations and began to focus on lining up Philippine investors. Bank of Boston ideally preferred maximum control without local management interference, but it was restricted to a maximum of 30% ownership control under current banking and foreign investment regulations. With special presidential approval, this could be raised to 40%, so Bank of Boston sought local investors to purchase a 60% controlling interest of common (voting) stock. At the time, there were 3,218,195 shares of common stock outstanding. In addition, 470,000 preferred shares had been authorized since 1982, but none had been issued. While Bank of Boston could only control 40% of the bank's voting equity, it was not prohibited from owning non-voting preferred stock in addition to 40% of the common stock. Therefore, Bank of Boston planned to reallocate the common stock outstanding, such that 70% would become non-voting preferred stock and 30% would remain as common stock. With this change, Sevilla could keep the capital requirements for local investors at a lower level, and Bank of Boston could convert more debt into equity.

According to Sevilla, some local investors were suspicious of investing in ComBank because of previous allegations of bank ties to Marcos cronies. Sevilla asked Edgardo Tordesillas, a local businessman, friend and former head of the Board of Investments for 20 years, to assist in attracting prospective investors while talks with GSIS continued. During their discussions,

Sevilla offered Tordesillas the chairmanship of the new bank. Under local law, this position had to be filled by a Philippine citizen.

Ultimately, three local investors were assembled to invest in ComBank. Hermenegildo R. Cabilao was a retired Nestle official whom Sevilla knew well. ComBank also brought in Domingo P. Uy, a businessman and bank client. Tordesillas had performed consulting work for Elena Lim, a prominent businesswoman and, knowing her well, convinced her to join the investor group. None of the investors had banking experience, though all believed this to be a good long-term investment opportunity.

Sevilla presented the business plan and financial projections to the three investors before gaining their commitments. Investors also agreed with the appointment of Tordesillas as Chairman and Sevilla as Vice Chairman. While the Philippine investors would control 60% of the bank through voting common stock, the investors agreed that Bank of Boston would assume effective control of the bank. Renato A. Claravall, a Bank of Boston OBU officer involved in packaging the deal, explained the situation to *Business World*, a Philippine newspaper.

> *We had a clear understanding with the local investors when they came. We asked them to let FNBB run the bank professionally for at least two years. Once it was strong enough, we or they could then sell to institutional investors.*

Cabilao, Uy and Lim would each hold 20% of the voting common stock, or 6% of total equity (Exhibit 13). They agreed to buy dollar-denominated Philippine debt paper from Bank of Boston, which would be converted to pesos and transferred to GSIS in payment for the bank. Each of the three investors intended to establish a separate bank stock holding company for tax and administrative purposes.

D. Negotiations

The priority for GSIS was maximizing sales price. Ownership structure, method of sale, and the mechanics of the deal were of little concern, as these were considered COP and Central Bank responsibilities. Since late 1985, GSIS officials had discussed ComBank with several prospective buyers, but a transaction had never materialized due to GSIS' price threshold of a 50% premium. Salvador Enriquez, controller of GSIS, had been key in formulating GSIS' position on the deal. GSIS' asking price for ComBank was determined by "knowing what the market could bear and adding a premium." As justification for this approach to valuation, one GSIS official cited unreliable economic indicators and the bank's recent poor performance as impediments to valuing ComBank by projecting future income.

GSIS and Sevilla met every few weeks to talk about the sale. Sevilla stressed the quality of

Bank of Boston's local management team and the potential for transferring valuable management and technological expertise from Bank of Boston to ComBank. Negotiations continued to focus on the premium to be paid. Fresh capital requirements were also a point of discussion, but Bank of Boston felt that swapping dollar debt for peso equity was sufficient and objected to investing non-debt derived capital. One of Bank of Boston's conditions required the resignation of all 25 senior officers above the vice president level, which GSIS had resisted. Sevilla felt that GSIS lacked a sense of urgency to act on the ComBank sale. Discussions continued into the fall, as differences over the premium to be paid continued. In a September 19 article in *Business Day*, Belmonte commented on the status of discussions:

> *We are negotiating, and proposals and counterproposals have been submitted, but we believe a 50% premium is justified since ComBank is really worth more than that. We of course would like to sell the bank as soon as possible in line with President Aquino's privatization program, but we are not in a fire sale.*

E. The Administration's Debt-Equity Program

In December 1986, the Administration announced a program that encouraged converting national debt into equity investments in an effort to reduce the country's $27.8 billion foreign debt. Patterned after efforts of Latin American countries like Mexico and Chile, which had successfully reduced their foreign debt by hundreds of millions of dollars, the debt-equity program was designed to complement the privatization program by encouraging foreign investment through the purchase of GOCCs. Debt-equity swaps were intended to be a catalytic force for economic recovery.

Central Bank Circular 1111 delineated the process for converting debt to equity. Debt holders would present dollar-denominated Philippine government debt paper to the Central Bank for payment in pesos which would then be invested in the Philippines. A 1983 Philippine debt moratorium had frozen most foreign loans, postponing principal repayment until the mid-1990s. The debt-equity program gave creditor banks the option of converting loans directly into peso investments or selling debt on the secondary market to others wanting to invest in the Philippines. Repatriation of capital was permitted after three years at a maximum rate of 20% a year.

Some bankers were optimistic, estimating that the program would encourage $200-$500 million in new investments in the Philippines over the next 18 months. Others were more skeptical, citing the 5-10% Central Bank debt conversion fee, continued domestic instability, and the precedent-setting risk of debt discounting as obstacles to the program's success. By mid-1987, one debt-equity transaction had been proposed.

IX. Privatization Progress

In addition to the Central Bank's debt-equity initiative, several other Administration actions improved the negotiating position of Bank of Boston and the Philippine investor group. In March 1987, the Philippine Government signed an economic recovery loan with the World Bank, which committed the Aquino Administration to the privatization of five government-owned banks by September 1987. Additionally, the Administration had become more open to foreign investments in the banking sector. "We absolutely welcome the participation of foreign banks. We don't want to be in the banking business," said Finance Minister Jaime Ongpin in *American Banker*.[5]

In June 1987 the privatization program was still in its initial phase of development, with the COP and APT in the process of setting up the organizational structure and finalizing guidelines. In general, however, the privatization program was not progressing as quickly as planned. The non-performing status of many of the assets failed to attract investors, many of whom took a wait-and-see attitude until economic conditions improved. In addition, the high price demanded by some GOCCs, lack of clear title to many of the assets, and capital constraints affected the progress of privatization. Moreover, as one government agency official noted in a 1986 *Wall Street Journal* article, ". . . some guys are enjoying their positions. They're bankers now, when they were never bankers before. They're chairmen. And they don't want to give that up."[6]

X. The Decision

In early 1987, the economic outlook was positive. Single-digit inflation, record foreign exchange reserves and a balance of payments surplus led Philippine officials to predict a major economic recovery for the year after three years of contraction. Bank of Boston and its Philippine partners were tiring of the protracted negotiations. On June 11, they offered P510.8 million for ComBank, which represented a 40% premium over the May 31 adjusted book value of P365 million. This offer excluded Comsavings, as Sevilla had decided that its poor financial condition and the difficulty of managing its widely dispersed branches made the savings bank an unwise investment. Comsavings' book value was approximately P50 million.

The proposal was contingent upon GSIS' repurchase of about P80 million in loans, which consisted of P50 million to Ramos, the bank's founder, and P25-30 million to several other sources. The new owners wanted to avoid the litigation risks associated with Ramos' continued claims of bank ownership rights. Additionally, the proposal placed limits on current management's decision-making authority during the period from proposal acceptance to

[5] Jonathan Friedland, American Banker, February 26, 1987.
[6] Anthony Spaeth, "Sale of Philippine State Firms," Wall Street Journal, October 30, 1986.

closing. Bank of Boston would have the authority to review and veto all loans, capital expenditures in excess of P1 million, as well as all hiring decisions. Recognizing the significance of GSIS funds to ComBank's deposit base, the proposal also required GSIS to remove its deposits from the new bank in a phased approach. By maintaining a P200 million balance over six months, GSIS would prevent the bank from facing the potential shock of an immediate withdrawal.

As he read the latest correspondence from the investor group, Belmonte considered his options. He knew that officials at the Central Bank and the COP were eager for concrete examples of the Administration's commitment to privatization. On the other hand, he was pleased with ComBank's improved performance over the last few years and felt that ComBank was a valuable component of the GSIS portfolio. GSIS had lost money on the bank, and Belmonte wondered whether several more years of profitability would provide a greater return to GSIS than selling the bank now at the proposed price. While he was not directly concerned with the investor partnership or the use of the debt-equity swap, he knew that he must address these issues in the privatization plan that he would submit for COP approval. The COP favored the use of an auction or sealed bidding process over the negotiated sale approach that GSIS and Bank of Boston had used, and Belmonte wondered how the COP would respond if he approved the sale. Taking the time to identify other potential buyers may have implications for GSIS' reputation as a disposition entity, as well as for ComBank's performance. The bank had been functioning under the prospect of privatization for quite some time, and Belmonte was not sure when this level of operational uncertainty might take its toll on employees and customers.

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 1

SELECTED MACROECONOMIC INDICATORS

	1980	1981	1982	1983	1984	1985	1986	1987
Selected Indicators as Percent of Nominal GNP:								
Overall Budget Surplus/Deficit	-1.28%	-4.00%	-4.29%	-1.70%	-1.58%	-1.97%	-5.60%	-2.37%
Current Account Surplus/Deficit	-5.41%	-5.36%	-8.15%	-8.07%	-3.53%	-0.32%	-3.16%	-1.30%
Overall BOP Surplus/Deficit	-1.00%	-1.42%	-4.25%	-6.21%	0.77%	7.16%	4.12%	0.77%
External Debt Service Burden	4.18%	4.57%	5.73%	5.61%	6.04%	5.23%	6.85%	6.04%
Nominal GNP (peso billions)	264.5	303.6	335.4	378.7	527.3	597.7	614.7	703.4
Nominal GNP growth rate		14.8%	10.5%	12.9%	39.2%	13.4%	2.8%	14.4%
Avg Peso/U.S. Dollar Rate	7.51	7.90	8.54	11.11	16.70	18.61	20.39	20.57
Nominal GNP (U.S. $ billions)	35.2	38.4	39.3	34.1	31.6	32.1	30.2	34.2
Population (millions)	48.3	49.5	50.8	52.1	53.4	54.7	56.0	57.4
GNP per capita (peso billions)	5475	6131	6605	7276	9884	10934	10976	12263
Annual GNP per capita growth		12.0%	7.7%	10.2%	35.8%	10.6%	0.4%	11.7%
Consumer Price Index	138.9	157.1	173.2	190.5	286.4	352.6	355.3	368.7
Average Inflation Rate	18.2%	13.1%	10.2%	10.0%	50.3%	23.1%	0.8%	3.8%
Constant GNP (peso billions)	92.5	95.7	97.5	98.6	91.6	87.9	89.5	94.7
Constant GNP (U.S. $ billions)	13.9	14.3	14.6	14.8	13.7	13.2	13.4	14.2
Constant GNP growth rate		3.4%	1.9%	1.1%	-7.1%	-4.1%	1.9%	5.8%
BALANCE OF PAYMENTS: (in billions of U.S. dollars)								
Merchandise Trade Balance	-1.9	-2.2	-2.6	-2.5	-0.7	-0.5	-0.2	-1.0
Current Account, Total	-1.9	-2.6	-3.2	-2.8	-1.1	-0.1	1.0	-0.4
Overall BOP Surplus/Deficit	-0.4	-0.5	-1.7	-2.1	0.2	2.3	1.2	0.3
NATIONAL GOVERNMENT CASH OPERATIONS: (in billions of pesos)								
Revenues	34.7	35.9	38.2	45.6	56.9	69.0	79.2	103.2
Expenditures	38.1	48.1	52.6	53.1	66.9	80.1	109.8	119.9
Overall Surplus/Deficit	-3.4	-12.1	-14.4	-7.3	-10.1	-11.1	-30.6	-16.7

Source: Central Bank Statistics

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 2

SELECTED DOMESTIC INTEREST RATES

	1980	1981	1982	1983	1984	1985	1986
Interbank Call Loans (IBCL)							
Average			12.50	17.35	28.88	16.15	12.39
High			33.00	55.00	80.00	60.00	43.00
Low			4.00	1.00	12.00	4.00	4.50
Treasury Bill Rates							
91-Days	12.14	12.61	13.81	14.17	30.53	26.81	14.43
182-Days	12.50	13.06	14.48	14.75	42.10	30.77	15.44
364-Days	12.77	13.19	14.95	14.92	41.50	35.21	13.15
All Maturities	12.32	12.91	14.42	14.54	36.99	27.05	16.04
Weighted Average Interest Rates on Deposits:							
Deposit rates							
Savings Deposits	9.00	9.81	9.81	9.73	9.85	10.84	7.99
Time Deposits		16.74	15.81	15.30	24.16	21.83	14.77
Lending Rates on Secured Loans		**17.12**	**18.22**	**19.33**	**26.74**	**28.23**	**17.35**

Source: Central Bank Statistics

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 3

GDP GROWTH RATES IN EAST ASIA

Southeast Asia:	1980-86	Northeast Asia:	1980-86
Philippines	0.3	China	7.8
Indonesia	4.8	Hong Kong	7.2
Malaysia	4.8	Japan	4.0
Singapore	6.1	South Korea	6.3
Thailand	5.2	Taiwan	6.7

Source: IMF, official country sources

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 4

PHILIPPINE PUBLIC DEBT
(Millions of Pesos)

	1980	1981	1982	1983	1984	1985	1986	1987
Total	**41,182**	**49,365**	**57,563**	**62,790**	**86,077**	**116,287**	**144,352**	**161,100**
National Government	21,876	28,657	35,344	43,470	59,666	75,972	104,910	150,751
Local Governments	336	362	432	427	174	182	161	116
Government Corporations	4,979	6,656	9,856	12,157	13,206	14,004	14,881	9,313
Guaranteed	3,754	4,561	7,270	9,314	10,156	9,948	10,987	7,256
Non-Guaranteed	1,225	2,095	2,586	2,843	3,050	4,056	3,894	2,058
Monetary Institutions	13,992	13,690	11,932	6,736	13,031	26,128	24,399	920

Source: Central Bank Statistics

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 5

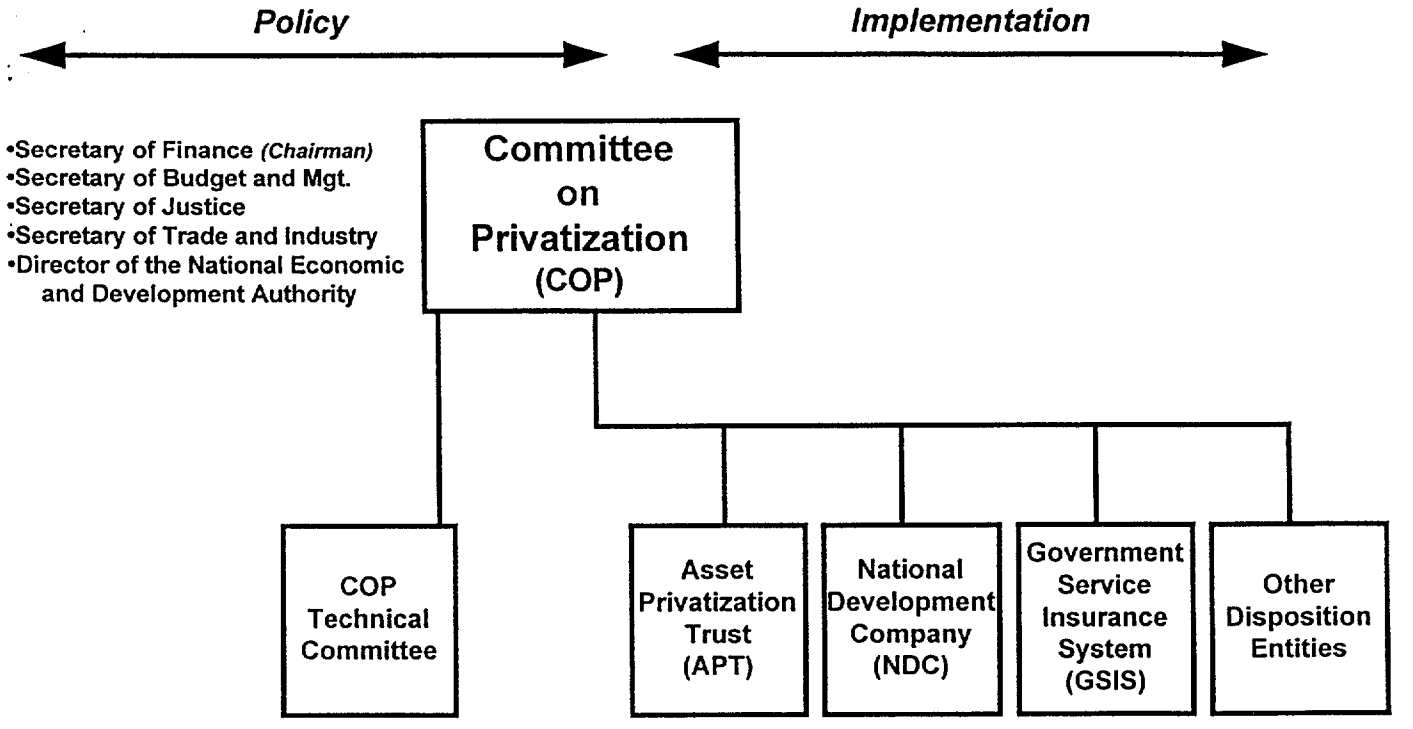
BUDGETARY SUPPORT TO GOVERNMENT CORPORATIONS
(Millions of Pesos)

	1981	1982	1983	1984	1985	1986	1987
Equity	10,759	8,517	4,623	9,297	2,474	1,190	3,200
Subsidy	592	541	614	539	884	1,235	2,000
Net Lending	929	2,218	2,393	10,086	12,734	28,777	14,400
Total	**12,280**	**11,276**	**7,630**	**19,922**	**16,092**	**31,202**	**19,600**
Budgetary Support as Percent of Total Budget	**25.5**	**20.1**	**12.3**	**22.0**	**19.8**	**26.2**	**15.2**

Source: Benjamin E. Diokno, "Budgetary Implications of Privatization of Public Enterprises," Conference Papers, Philippine Economic Society Annual Meeting, 1986.

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 6

PROCLAMATION 50 INSTITUTIONAL STRUCTURE



Source: Committee on Privatization

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 7

ASSETS AND LIABILITIES OF THE BANKING SYSTEM
(Billions of Pesos)

	1980	1981	1982	1983	1984	1985	1986
Assets	**313.2**	**360.9**	**430.9**	**561.3**	**693.3**	**754.0**	**731.0**
Central Bank	65.4	71.6	91.7	130.4	206.0	251.6	313.9
Commercial Banks	144.5	171.7	198.9	256.5	299.2	296.6	264.4
Thrift Banks	10.6	11.6	12.6	16.1	15.0	15.1	17.7
Rural Banks	5.6	6.6	8.1	9.5	9.0	8.8	9.4
Specialized Govt. Banks	28.1	36.1	45.4	56.8	68.5	74.7	12.4
Non-Bank Fin. Institutions	58.9	63.3	74.2	92.0	95.5	107.3	113.0
Liabilities	**264.6**	**302.7**	**362.6**	**478.4**	**603.3**	**656.0**	**622.0**
Central Bank	64.9	71.0	91.2	129.8	205.4	251.0	313.2
Commercial Banks	132.0	155.7	179.6	233.7	271.4	271.4	232.4
Thrift Banks	9.3	10.3	11.1	14.3	13.1	13.3	15.9
Rural Banks	4.8	5.6	7.0	8.1	7.5	7.2	7.7
Specialized Govt. Banks	23.1	30.4	38.6	49.5	62.2	67.8	7.2
Non-Bank Fin. Institutions	30.3	29.7	35.2	42.9	43.6	45.3	45.7
Net Worth	**48.7**	**58.2**	**68.3**	**82.9**	**90.0**	**98.0**	**109.0**
Central Bank	0.5	0.5	0.5	0.6	0.6	0.6	0.7
Commercial Banks	12.5	16.0	19.3	22.8	27.8	25.2	32.2
Thrift Banks	1.2	1.3	1.5	1.9	1.9	1.8	1.8
Rural Banks	0.9	1.0	1.2	1.4	1.5	1.6	1.7
Specialized Govt. Banks	5.0	5.7	6.9	7.3	6.3	6.8	5.3
Non-Bank Financial Institutions	28.6	33.6	38.9	49.1	51.9	62.0	67.3

Source: Central Bank Statistics

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 8

STATEMENT OF INCOME-COMBANK
(Thousands of Pesos)

	1982	1983	1984	1985	1986	CAGR %*
REVENUE: INTEREST						
Deposits with other banks						
Loans and discounts						
Trading and investment securities						
Bills and acceptances						
TOTAL INTEREST**	**42,199**	**64,080**	**142,690**	**231,808**	**140,481**	**35.1%**
Sale of acquired assets	11,372	13,666	10,173	7,613	23,621	
Service charges, fees, and commissions	7,741	32,851	55,416	31,220	54,192	
Other	1,977	7,925	36,993	50,785	49,150	
Trust income						
TOTAL REVENUE	**63,288**	**118,523**	**245,271**	**321,426**	**267,444**	**43.4%**
EXPENSE: INTEREST**	**29,400**	**47,609**	**96,208**	**168,662**	**107,988**	**38.4%**
Compensation and fringes	11,257	16,552	23,555	32,296	32,714	
Depreciation/amortization	6,123	6,895	9,291	11,832	9,834	
Taxes and licenses	3,461	6,464	17,652	14,360	13,572	
Provision for loan loss	4,372	3,555	10,733	16,267	24,721	
Professional fees	1,006	1,556	990	1,757	1,586	
Security and maintenance	855	1,405	3,069	5,684	6,372	
Occupancy expense	696	1,232	2,042	2,472	2,540	
Litigation expense	1,552	1,445	927	1,105	1,668	
Other operating expenses	5,748	13,313	26,755	40,684	34,219	
TOTAL EXPENSE	**64,470**	**100,026**	**191,223**	**295,119**	**235,215**	**38.2%**
INCOME BEFORE TAX	(1,182)	18,497	54,049	26,307	32,229	
NET EARNINGS	**(1,182)**	**18,497**	**54,049**	**26,307**	**32,229**	**60.4%**
EPS	-0.51	6.47	16.39	7.98	9.77	

* CAGR = Compound Annual Growth Rate

**Breakdown of interest revenues and expenses not available for some years.

Source: ComBank Annual Reports

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 9

STATEMENT OF CONDITION-COMBANK
(Thousands of Pesos)

	1982	1983	1984	1985	1986
RESOURCES:					
Cash and Cash Items	2,574	6,373	33,531	49,684	63,940
Due from Central Bank	20,159	94,797	310,582	59,919	138,885
Due from other banks	10,468	18,664	48,369	23,393	10,290
Trading Account Securities					
Investments In Bonds and other Debt Instruments- Net	41,206	118,244	233,040	391,488	206,298
Loans					
Loans and discounts	307,449	315,020	426,768	749,776	797,677
Bills purchased	8,292	13,413	25,243	20,940	13,529
Customer acceptance liabilities	65,187	45,334	27,445	27,843	21,311
Total Loans	380,928	373,767	479,455	798,558	832,517
Unearned discount					
Allowance for doubtful accounts	(28,089)	(11,084)	(11,774)	(17,581)	(29,800)
Net loans	352,839	362,684	467,681	780,977	802,716
Equity Investment in an Allied Undertaking*			30,000	30,000	30,000
Due from Subsidiary			168,820	189,511	187,217
Bank Premises, Furniture, and Equipment	62,444	61,675	110,145	113,514	106,099
Real and other Properties (Net Allowance for Probable Losses)	30,176	23,909	23,716	36,700	40,292
Sales Contract Receivable	28,374	33,398	27,441	18,526	16,009
Other Resources	70,134	107,676	113,066	115,365	200,628
Allowance for doubtful accounts	38,634	24,609	4,496	7,932	7,870
Net	31,499	83,067	108,570	107,433	192,758
TOTAL RESOURCES	**579,740**	**802,810**	**1,561,896**	**1,801,146**	**1,794,504**

* Investment in Comsavings

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 9 (continued)

STATEMENT OF CONDITION-COMBANK
(Thousands of Pesos)

	1982	1983	1984	1985	1986
LIABILITIES AND CAPITAL FUNDS:					
Deposit Liabilities					
Demand deposits	20,529	28,539	40,060	56,942	47,507
Savings deposits	86,259	151,560	247,658	401,864	525,146
Time deposits	192,154	142,122	159,641	232,693	325,132
Total Deposit Liabilities	**298,943**	**322,221**	**447,359**	**691,499**	**897,785**
Bills and Acceptances Payable	90,335	202,719	308,713	621,635	376,215
Marginal Deposits	12,476	8,994	38,199	18,928	12,954
Manager's and Cashier's Checks	1,010	2,353	4,752	7,920	11,857
Accrued Taxes, Interest, and Expense	16,095	10,677	22,394	51,470	63,291
Deferred Credits and other Liabilities	8,373	21,045	415,300	62,817	59,368
Income Tax Payable			681	5	64
Unrealized Profit on Installment Sales	16,299	22,946	17,704	12,117	8,666
Unearned Income	650	2,115	3,073	4,727	2,046
Total Liabilities	**444,181**	**593,069**	**1,258,174**	**1,472,117**	**1,432,247**
Capital Funds	135,559	209,741	303,722	330,029	362,258
TOTAL	**457,740**	**802,810**	**1,561,896**	**1,801,146**	**1,794,504**

Source: ComBank Annual Reports

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 10

STATEMENT OF CAPITAL FUNDS-COMBANK
(Values shown in Thousands of Pesos)

	1982	1983	1984	1985	1986
CAPITAL STOCK					
Preferred stock-P100 par value	470,000	470,000	470,000	470,000	470,000
Authorized shares					
Issued and outstanding					
Value issued and outstanding					
Common stock-P100 par value	5,530,000	5,530,000	5,530,000	5,530,000	5,530,000
Authorized shares	2,221,345	2,778,195	3,218,195	3,218,195	3,218,195
Shares issued and outstanding	222,134,500	277,819,500	321,819,500	321,819,500	321,819,500
Value issued and outstanding	**222,135**	**277,820**	**321,820**	**321,820**	**321,820**
SURPLUS RESERVES					
SURPLUS/DEFICIT					
Balance, beginning of the year	(85,394)	(86,575)	(68,078)	(18,097)	8,209
Net income	(1,182)	18,497	54,049	26,307	32,229
Transfer to surplus reserves					
Cash dividends:					
Preferred					
Common					
Write-off of accrued interest receivable			(4,068)		
Balance, end of year	**(85,394)**	**(68,078)**	**(18,097)**	**8,209**	**40,438**
YEAR-END CAPITAL FUND BALANCE	**135,559**	**209,741**	**303,722**	**330,029**	**362,258**

Source: ComBank Annual Reports

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 11

STATEMENT OF CHANGES IN FINANCIAL POSITION-COMBANK
(Thousands of Pesos)

	1982	1983	1984	1985	1986
FUNDS PROVIDED FROM:					
Operations:					
Net income	(1,182)	18,497	54,049	26,307	32,229
Depreciation and amortization of bank premises, furniture and equipment, and deferred charges	6,123	3,555	9,291	11,832	9,834
Provision for probable losses	4,372	6,895	10,733	16,267	24,721
Total from Operations	9,313	28,947	74,073	54,405	66,784
Increase in:					
Deposit liabilities	248,880	23,278	125,138	244,140	206,285
Other liabilities	5,503	12,672	394,255		
Bills and acceptances payable		112,383	105,994	312,923	
Due to Central Bank of Philippines					
Marginal deposits			29,206		
Income tax payable			681		60
Managers' checks		1,343	2,399	3,168	3,937
Accrued interest and other expenses	4,487		11,717	29,076	11,821
Unearned income		1,465	958	1,654	
Unrealized profit on installment sales	10,515	6,647			
Issuance of capital stock			44,000		
Decrease in:					
Cash and other cash items					
Due from Central Bank of Philippines	1,436			250,663	
Due from other banks		24,976		24,976	13,103
Trading account securities					
Investment in bonds/debt instruments					185,190
Loans					
Equity investment in allied undertaking					
Due from subsidiary					2,294
Real & other properties owned or acquired	10,721	6,267	193		
Sales contract receivable			5,957	8,915	2,517
Other resources					
Payment on subscriptions of common shares	15,000	55,685			
TOTAL	**305,854**	**248,687**	**794,569**	**929,921**	**491,992**

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 11 (continued)

STATEMENT OF CHANGES IN FINANCIAL POSITION-COMBANK
(Thousands of Pesos)

	1982	1983	1984	1985	1986
FUNDS WERE USED FOR:					
Payment of cash dividends					
Increase in:					
Cash and cash items	598	3,799	27,158	16,154	14,256
Due from Central Bank of Philippines		78,193	215,785		78,966
Due from other banks	8,487	8,196	29,705		
Investment in bonds and other debt instruments	1,617	77,038	114,797	158,748	
Loans	137,312	9,844	114,848	323,317	46,460
Trading account securities					
Equity investment in allied undertaking			30,000		
Due from subsidiary			168,820	20,691	
Bank premises, furniture and equipment	9,626	6,126	55,365	55,365	2,419
Real & other properties owned or acquired				12,984	3,592
Other resources	5,510	51,567	32,850	4,809	85,325
Sales contract receivable	17,941	5,124			
Decrease in:					
Bills and acceptances payable	112,258				245,420
Managers' checks	4,180				
Accrued taxes, interest and expenses		5,418			
Deferred credits and other liabilities					
Marginal deposits	433	3,482			5,974
Income tax payable				676	
Other liabilities				352,483	3,449
Unrealized profit on installment sales			5,242	5,588	3,451
Unearned income	2,530			19,272	2,681
Reversal of appraisal increment on assets sold	5,362				
TOTAL	**305,854**	**248,787**	**794,569**	**929,921**	**491,992**

Source: ComBank Annual Reports

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 12

SUMMARY FINANCIAL STATISTICS AND RATIOS-COMBANK

	1982	1983	1984	1985	1986
STATEMENT OF INCOME					
Profit Margin	1.9%	15.6%	22.0%	8.1%	12.0%
Return on Equity	8.7%	8.8%	17.8%	8.0%	8.9%
Interest Revenue/Interest Expense	1.44	1.35	1.48	1.37	1.30
Annual Growth in:					
Revenue		87.3%	106.9%	31.0%	-16.8%
Expenses		55.2%	91.2%	54.3%	-20.3%
Interest Revenue		51.9%	122.7%	62.5%	-39.4%
Interest Expense		61.9%	102.1%	75.3%	-36.0%
Net Earnings		1770.0%	192.0%	-52.0%	22.5%
STATEMENT OF CONDITION					
Return on Assets	0.2%	2.3%	3.5%	1.5%	1.8%
Annual Growth in:					
Loans		-1.9%	28.3%	66.6%	4.3%
Deposit Liabilities		7.8%	38.8%	54.6%	29.8%
Resources		38.5%	94.6%	15.3%	-0.4%
Liabilities		33.5%	112.1%	-17.0%	-2.7%
Capital		1446.0%	45.0%	8.7%	9.8%

Source: ComBank Annual Reports

COMMERCIAL BANK OF MANILA (I)
EXHIBIT 13

PROPOSED OWNERSHIP STRUCTURE
(Values shown in millions of pesos)

		Preferred	% Equity	Common	% Equity	Total	% Equity
Boston World Holdings Corporation	shares	2,252,735	70%	386,184	12%	2,638,919	82%
	value	357.56		61.30		418.86	
Ace Solid Holdings (Lim)	shares			193,092	6%	193,092	6%
	value			30.65		30.65	
Cabien Corporation (Cabilao)	shares			193,092	6%	193,092	6%
	value			30.65		30.65	
Three Eight Corporation (Uy)	shares			193,092	6%	193,092	6%
	value			30.65		30.65	
TOTAL	shares	2,252,735	70%	965,460	30%	3,218,195	100%
	value	357.56		153.24		510.8	
	per share	158.72		158.72		158.72	

Source: Committee on Privatization

CASE I: EPILOGUE

I. ComBank Privatization

On June 17, 1987, the GSIS board approved the signing of a memorandum of agreement to sell ComBank for not less than P510 million to Bank of Boston and the Filipino investor group (Ace Solid Holdings, Cabien Corporation and Three Eight Corporation).[7] The board also authorized GSIS Chairman Dante Santos and President Feliciano Belmonte to negotiate improvement of the offer in GSIS' favor. The board was particularly concerned about closing loopholes which might allow Bank of Boston to back out and require earnest money in light of the operating restrictions that Bank of Boston had proposed from the date of signing until closing of the sale.

The Memorandum of Agreement, signed on June 22, 1987, established the intent of both parties to execute the sale and included the following conditions binding each party during the period leading up to closing:

- the seller was obliged to purchase from ComBank all outstanding loans and receivables of Mr. Emerito M. Ramos, Sr. valued at P54.7 million and to execute a document holding ComBank and buyers free from all present or future claims from Ramos;
- no dividends could be declared or paid without buyers' consent;
- no personnel could be hired without buyers' consent;
- no loans and/or credit facilities over P1 million and no unsecured loans over P100,000 could be granted or altered without buyers' consent;
- no capital expenditure or contractual commitments in excess of P100,000 could be made without buyers' consent; and
- no acquisition or divestiture of branches could be made without buyers' consent.

Delays in executing the sale continued even after the Memorandum of Agreement was signed. An injunction filed by Emerito Ramos in late June refuted the bank's 1980 sale to Disini and claimed original ownership rights to ComBank. The process was again stalled by legal action and floundered throughout the summer. GSIS still referred to opportunities with other interested buyers and indicated that they would prefer to sell only 30-40% of ComBank.

In an October speech to local business leaders at the Manila Hotel, President Aquino referred to ComBank in addressing the progress of her privatization program. Following the speech, her press secretary stated that she had approved ComBank as one of the GOCCs for

[7]The peso/dollar exchange rate at the time of the transaction was P20.57 = US$1.00.

privatization.
By November 5, 1987, GSIS informed the Committee on Privatization (COP) of its proposed privatization plan for ComBank and submitted to the COP a copy of its June 22, 1987 Memorandum of Agreement highlighting details of the proposed sale to the First National Bank of Boston, Ace Solid Holdings, Cabien Corporation and Three Eight Corporation, at a price of P510.8 million. COP's approval was issued on November 25. The Monetary Board of the Central Bank also approved Bank of Boston's investments in a domestic bank.

President Aquino granted her approval of the privatization in early December, during the visit of Bank of Boston Chairman, Clark B. Miller. The sale was executed December 18, 1987, eighteen months after Sevilla first approached Belmonte and GSIS, and six months from the time GSIS received the binding offer from Bank of Boston.

Bank of Boston's head office approved the acquisition and debt conversion. Bank of Boston converted $25 million in long-term debt to pesos through the Central Bank and conveyed payment of P510 million directly to GSIS. The remaining peso debt was converted to trade debt. Bank of Boston advanced money to the local investors to cover their portions of the equity investment. These short-term loans were to be repaid as soon as ComBank demonstrated financial viability and shares were advanced to the three holding companies set up by Lim, Cabilao and Uy.

Several conditions were attached to the sale by Aquino and the Central Bank. Bank of Boston's ownership of preferred stock representing 70% of total equity was dependent upon the bank's performance. In a letter to the Central Bank, Aquino stated that Bank of Boston "shall dispose of all or a portion of preferred shares as soon as it has achieved a record of sustained viability as monitored by the Central Bank."

II. Boston Bank of the Philippines

In early 1988, Cesar U. Querubin, an attorney, was appointed President and CEO of the bank. Sevilla felt that Querubin's experience as the number two officer at CityTrust bank, a Citibank joint venture, made him the best candidate for the job. Elena Lim was named chairman in place of Edgardo Tordesillas, as originally intended, and ComBank's name was changed to Boston Bank of the Philippines (BBP).

Management objectives focused on improving operations, systems, and lending and on recruiting top quality personnel. Despite their initial agreement, Querubin and Sevilla began to differ in philosophy as to the priorities of the bank. Querubin favored rapid expansion, while Sevilla felt that it was most important to improve the quality of existing branches. In September 1989, after all senior officers had signed a petition denouncing Querubin, the

board asked him to leave. These management differences also affected the relationship between Lim and Sevilla. Lim was removed as board chairman in December, when Bank of Boston notified her of foreclosure on her shares: Ace Solid Holdings had sold Lim's 6% equity ownership to another individual without her knowledge and consent. Lim sued Bank of Boston, charging that it had loaned pesos to Filipinos without the required Central Bank approval.

The board appointed Philippine investor Cabilao as president. The board was not concerned about his lack of banking experience, since he had dealt extensively with local banks in his capacity as chief financial officer for Nestle. Sevilla stated that what the bank needed was someone with "professional management capability." With the chairmanship still vacant, Sevilla, as vice chairman, became the *de facto* senior member of the board.

The bank's performance improved considerably following privatization. Profitability increased fourfold in the first year of operations, with ROE increasing from 2.8% to 13.3% from 1987 to 1988 (Exhibits 1-4). BBP declared and paid dividends of P11.20 per common share and P5.00 per preferred share in 1988-1990. Partial back-office automation was achieved by 1989 and remained a high priority. Branch expansion continued, with the addition of three new locations in 1989. BBP's prime objective was to reach P500 million in capital by 1991 in order to become a unibank.

III. BBP Ownership Changes

In late 1989, the Central Bank determined that Bank of Boston had achieved "sustained viability" and sent a letter requesting a divestment plan for its preferred share ownership in BBP. Bank of Boston began to explore alternatives for altering their stake in the bank. Agreement was reached among existing investors by spring 1990 regarding the transfer of ownership to a new group. Investors arranged independently to sell their shares, but a price of P250 was generally used by everyone. As book value per share was approximately P113 at the time, investors earned a premium of more than 100%. Much of this was attributable to the value of the building that BBP owned and occupied as headquarters. The building's market value was estimated at P319 million, with a book value of P71 million.

Sevilla insisted that price was only half of the deal package, and that "this second time, getting the right partnership combination was more important." Although the Central Bank's divestment requirement pertained only to preferred stock, Bank of Boston elected to sell half of its common stock as well. In December 1990, Bank of Boston sold 2,445,828 shares of preferred and common stock at a price of P250. Cabilao and Uy also sold out.

The new group of investors was comprised of five investment entities with ownership divided

evenly among them. The Bank's new owners were Antonio O. Cojuangco, Ramon O. Cojuangco and Miguel O. Cojuangco of Philippine Long Distance Telephone Company (20%); Antonio L. Go and Genevieve Wan Jun Go, representing Equitable Bank Corporation (20%); Boston World Holdings, USA (20%); College Assurance Plan (20%); and Professional Bankers Group (20%). All were from the Philippines except for Bank of Boston, which also held the shares being disputed by Lim. Lim continued to pursue her suit against Bank of Boston, Cabilao, and Uy. In addition, the SEC began investigations into charges that the ComBank privatization had violated anti-dummy laws.

In January 1991, the new board eliminated the preferred share category and declared cash dividends of P62.15 per common share for all stockholders of record as of December 18, 1990. On November 28, 1991, the bank increased its authorized capital stock from P600 million to P1.2 billion, to further boost its capital base. Mr. Joselin G. Fragada was named chairman of the Board. Sevilla retained his position as vice chairman, with the other vice chairmanship given to Mr. Antonio Cojuangco. The new board adopted a Corporate Mission Statement affirming that "We will grow to be among the top performing banks in terms of profitability, efficiency, and product delivery--reaching out to all markets."[8] To keep pace with the demands of more challenging times and to reflect its new ownership, the bank changed its name to Bank of Commerce (BC).

[8]Bank of Commerce Annual Report, 1992.

COMMERCIAL BANK OF MANILA (I) - Epilogue
EXHIBIT 1

STATEMENT OF INCOME - COMBANK
(In Million Pesos)

	1987	1988	1989	1990	1991	1992	1993
Interest income	149.6	147.4	219.9	348.8	479.5	480.5	466.0
Interest expense	86.2	77.5	106.8	169.2	228.4	263.9	221.4
Net Interest Income	**63.4**	**69.9**	**113.1**	**179.6**	**251.1**	**216.6**	**244.6**
Provision for probable loan losses	8.7	7.6				3.0	11.2
Net Interest income after provision for loan losses	54.7	62.3	113.1	179.6	251.1	213.6	233.4
Other income	71.4	104.5	86.7	235.6	135.7	161.3	179.5
Other expenses	115.6	115.2	133.2	227.4	193.7	248.9	310.8
Income before income tax	10.5	51.6	66.6	187.8	193.1	126.0	102.1
Provision for income tax	0.3	0.2	6.3	46.0	29.0	37.1	20.9
Net Income	**10.2**	**51.4**	**60.3**	**141.8**	**164.1**	**88.9**	**81.2**

Source: ComBank Annual Reports

COMMERCIAL BANK OF MANILA (I) - Epilogue
EXHIBIT 2

STATEMENT OF CONDITION-COMBANK
(In Million Pesos)

	1987	1988	1989	1990	1991	1992	1993
RESOURCES							
Cash and other cash items	77.2	75.5	71.0	53.6	72.2	72.2	64.8
Due from Central Bank	112.9	161.4	150.0	173.9	252.5	232.4	502.8
Due from other banks	7.7	863.7	1,079.4	1,129.1	355.1	513.8	375.2
Interbank loans receivable					846.6	779.8	152.3
Trading account securities	414.0	93.7	28.7	194.1	644.6	644.6	1,361.1
Investment in bonds/debt instruments	49.0	84.8	2.8	30.6	49.1	147.6	146.0
Receivables from customers	639.3	597.6	823.6	1,260.3	1,201.8	2015.0	3277.0
Bank premises, furniture, and equipment	101.5	105.4	118.4	109.6	145.1	220.8	241.1
Other resources	240.2	97.5	93.1	202.6	288.0	339.3	273.8
Total Resources	**1,641.8**	**2,079.6**	**2367.0**	**3,153.8**	**3855.0**	**5,069.8**	**6,394.1**
LIABILITIES AND CAPITAL FUNDS							
Deposit liabilities	1016.0	1,533.8	1,713.3	2,077.8	2,293.7	3,292.3	3,682.2
Interbank loans payable					592.0	385.5	785.4
Bills and acceptances payable	146.6	25.5	82.6	100.1	93.4	192.0	335.8
Due to Central Bank			42.5	46.6	52.3	114.7	81.4
Manager's checks	9.7	33.4	13.0	13.0	21.6	21.6	68.2
Accrued taxes, interest, and other expenses	19.9	19.5	19.4	72.1	30.5	38.0	36.3
Deferred credits and other liabilities	77.1	65.7	56.3	251.0	85.6	220.9	389.3
Total Liabilities	**1,269.3**	**1,677.9**	**1,927.1**	**2,572.1**	**3,169.1**	**4295.0**	**5,378.6**

Capital Funds	372.5	401.7	439.3	581.7	685.9	774.8	1,015.5
Total Liabilities and Capital Funds	**1,641.8**	**2,079.6**	**2367.0**	**3,153.8**	**3855.0**	**3855.0**	**6,394.1**

Source: ComBank Annual Reports

COMMERCIAL BANK OF MANILA (I) - Epilogue
EXHIBIT 3

STATEMENT OF CAPITAL FUNDS-COMBANK
(In Million Pesos)

	1987	1988	1989	1990	1991	1992	1993
CAPITAL STOCK							
Preferred stock - P100 par value[a]	225.3	225.3	225.3	225.3	225.3		202.7
Common stock - P100 par value[b]	96.5	96.5	96.5	96.5	96.5	477.8	561.4
SURPLUS RESERVES		*	*	*		2.5	9.1
SURPLUS							
Balance, beginning of year	40.4	50.6	79.9	118.1	259.9	208.0	294.5
Net Income	10.2	51.4	60.3	141.8	141.8	141.8	81.2
Transfer to surplus reserves		*				(2.4)	(6.5)
Cash dividends							
Preferred		(11.3)	(11.3)				(7.3)
Common		(10.8)	(10.8)				(35.8)
Stock dividends on common shares							(83.6)
Balance, end of year	**50.6**	**79.9**	**118.1**	**259.9**	**208.0**	**294.5**	**242.3**
YEAR-END CAPITAL FUND BALANCE	**372.5**	**401.7**	**439.9**	**581.7**	**685.9**	**774.8**	**1,015.5**

[a] 7.5 million shares authorized.
[b] 12.5 million shares authorized in 1993 and 12.0 million in 1992.
* Negligible

Source: ComBank Annual Reports

COMMERCIAL BANK OF MANILA (I) - Epilogue
EXHIBIT 4

STATEMENT OF CHANGES IN FINANCIAL POSITION
(In Million Pesos)

	1987	1988	1989	1990*
FUNDS PROVIDED FROM:				
Operations	30.2	70.0	73.6	159.3
Increase in:				
Deposit liabilities	118.2	517.8	179.4	364.5
Other liabilities			6.8	194.7
Others		26.8	83.4	85.8
Decrease in:				
Cash and other items		1.6	4.5	17.5
Trading account securities		320.3	65.1	
Loans	155.6	34.1		
Others	265.5	142.3	100.3	
Total	**569.5**	**1112.9**	**513.1**	**821.8**
FUNDS WERE USED FOR:				
Payment of cash dividends		22.1	22.1	
Increase in:				
Due from other banks		856.1	215.7	49.7
Investment in bonds/debt instruments	256.7	35.7		27.8
Loans			226.0	436.7
Trading Account Securities				165.4
Other liabilities	34.7	62.9	28.8	142.2
Decrease In:				
Bills and acceptances payable	221.6	122.5		
Other resources	56.5	13.6	20.5	
TOTAL	**569.5**	**1112.9**	**513.1**	**821.8**

*Comparable data not available for 1991-1993
Source: ComBank Annual Reports

CASE II

I. Introduction

In mid-1994, the chairman of ComBank (now known as the Bank of Commerce, BC), Mr. Joselin Fragada, faced a serious dilemma that required an immediate response. A multi-million peso Treasury Bill scam perpetuated by the now-defunct BanCapital Development Corporation had come to light, resulting in major losses which shareholders were forced to cover. The College Assurance Plan--one of BC's major shareholders--had withdrawn P200 million from its accounts in reaction to the scandal. An additional 300 million pesos were withdrawn by other customers of the bank. BC's reputation in the financial community, both domestic and international, had been seriously tarnished.
The scandal had come in the wake of major structural changes in the Philippine banking sector following industry deregulation, which had intensified competition within the industry. Technological and financial innovations, at home and abroad, had also opened the way for increased competition as well as for increased opportunities. During this period, BC had seen its margins squeezed, and its growth had slowed significantly since 1991.

Fragada realized that his challenge went far beyond immediate actions to respond to the fallout from the scandal. If BC was to survive in the long-term and become a key player in the industry, it had to develop a strategy for competing in what was a radically different business environment from what had existed when the bank was privatized in 1987.

II. Changes in the Philippine Commercial Banking Sector in the 1990s

The growth of the commercial banking sector between 1988 and 1994 outpaced the rest of the economy. Despite narrow margins (Exhibits 1 and 2), returns on net worth were enviable through 1990, although they declined in subsequent years (Exhibit 3). Commercial banks enjoyed the benefits of economies of scale through their advantages in marketing, technology, and access to a wide range of financial products. These institutions remained at the forefront of the Philippine banking industry and were expected to lead the country's financial system and economy into the next century.

Despite the formidable performance of the commercial banks, ratios indicated that they had yet to maximize their efficiency (Exhibit 4). This could be attributed not only to changing economic trends, but also to the structure of the banking industry as well as the banks' internal operations.

A number of important changes took place in the commercial banking sector in the early 1990s which significantly affected the competitive environment in the industry, forcing bank managers to look closely at their strategies for growth. These included:

- significant improvements in remittance services offered by commercial banks for Filipino overseas contract workers, resulting in increased revenues for those banks which provided such services and increased competition for the market;[9]
- a decrease in Treasury Bill rates, which forced banks to seek markets for lending operations (e.g. innovative customer loans);
- an increase in fee-based trust and treasury operations[10]
- liberalization of branching regulations, resulting in accelerated urban and provincial bank branching and expanded automated teller networks, which increased the depositor base and provided banks with easier access to low-cost funds;[11]
- increased foreign exchange holdings in the wake of liberalized foreign exchange policies, resulting in a stronger peso and lower inflation; [12] and
- more effective and concerted efforts on the part of regulators to bring about a stable and financially sound banking system, resulting in fewer bank closures.

These developments resulted in lower cost of risk assets compared to previous years. To sustain these gains, banks began to explore opportunities brought about by developments in the economic and financial environments:

1. *Growth*: As the recession waned, many commercial banks began to pursue the goal of acquiring unibanking status. Avenues open for banks ranged from fresh capital

9 With 700,000 Filipinos deployed overseas in 1994, increasing by an average of 15% per year, fees from services provided to these workers represented a significant potential revenue source for commercial banks. Total remittances from overseas workers in 1990 were US$1.2 billion; in 1993, they had increased to US$2.7 billion. The deregulation of foreign exchange further facilitated the flow of these funds through the commercial banks. As of December 1994, 26 of the 38 commercial banks offered remittance services, with competition based upon factors such as security, promptness, reliability, and convenience.

10 ComBank's trust assets increased by 12% in 1993, reaching P3.2 billion. This growth came mainly from fee-based accounts, such as Traditional trust, Retirements funds, and Investment Management Accounts. The bank's trust asset holdings in government securities increased from P30 million in 1992 to P35 million in 1993.

11 By the end of 1994, there was a total of 500 ATM facilities in the Philippines. Consistent with ComBank's commitment to expand its presence in provincial areas, sixteen new branches were opened between 1991 and 1994. This brought the Bank's total network of 41 branches, of which 10 were linked into an Automated Teller Network. The completion of the expansion program and the refurbishing and relocation of some branches, coupled with intensified marketing efforts and improved service delivery, brought ComBank's total deposits to P3.7 billion (US$140 million) and common trust funds to P1.8 billion (US$68 million) by the end of 1994. Pilipinas Bank opened two new branches in 1994, bringing its total network to 188 branches nationwide, each equipped with an ATM. The "Big Five" commercial banks--Metropolitan Bank & Trust Company, Far East Bank & Trust Company, Philippine Commercial Bank, United Coconut Planter's Bank, and Bank of the Philippine Islands--each opened five new branches in 1994.

12 For example, ComBank's foreign currency deposits doubled in late 1994, from P500 million to P1 billion, and the average balance of its dollar-denominated loans more than doubled from the previous year.

infusion to inviting new investment partners, going public, and seeking mergers. Given their economies of scale, unibanks were able to diversify their products and services and effectively withstand the economic uncertainties of market forces, thereby enabling them to set the stage for further growth.

2. *Gradual Global Integration*: The formation of trade and financial blocs, the collapse of the Soviet Union, and the proliferation of Filipino overseas contract workers expanded opportunities as well as risks. Based on the South-East Asian experience, access to foreign markets and expanded trade and investment opportunities across borders depended upon a strong local business presence abroad and the consequent integration of the Philippine banking system into the global economy. Business tie-ups between local financial service institutions abroad and their foreign counterparts were good indicators of this. Such arrangements helped to mitigate the business risks in a foreign environment. In the 1990s, European and American businesses were making a beeline for the Asia-Pacific region. By 1994, initial indicators of globalization and its positive impact on the Philippine financial system included the following: customers of commercial banks in the Philippines had access to 10 international credit cards; 150 Filipino-Chinese businessmen had restored their contacts with Taiwan, Hong Kong, and mainland China; and remittances from overseas contract workers had reached US$2.7 billion.

3. *The Regulatory Tide*: There was a movement towards creating a regulatory environment more conducive to competition, allowing banking institutions greater flexibility in funding their operations. The following were major trends:

   a. Continued liberalization: Regulatory constraints on branching and foreign exchange operations were scheduled to be eased. Furthermore, foreign commercial banks were expected to enter the domestic market, given the liberalized regulations.

      In addition, financial innovations and technology promoted diversification of banking products and services. As a result, Philippine banks were increasingly able to venture into non-traditional areas such as intermediation, becoming underwriters of commercial papers rather than merely wielders of depositors' funds. Such new ventures were expected to increase banks' demand for credit information and rating bureaus, since there were increased risks associated with the new opportunities made available as a result of deregulation.

   b. Lowered reserve requirements: In late 1993, the Central Bank reduced reserve requirements from 24% of deposits and deposit-substitute to 22%.

This would have freed P9 billion of the financial system's assets; however, as these funds were to be placed in government securities, the result was lowered intermediation costs for banks rather than increased domestic liquidity. The net effect of the regulatory shift was a reduction in the banks' lending rates. Although the Central Bank placed no restrictions on where banks could make their loans, it encouraged development projects or value-added ventures such as housing.

c. Social consciousness: The Urban Land Reform Act and the Magna Carta for Small-and Medium-Scale Enterprises (SME) focused attention on low-cost housing and SMEs. Many banks were considering extending credit to non-government organizations with successful track records in these endeavors, as well as to priority industries such as energy and utilities. The government's "Social Pact" with the private sector and the Church was an additional incentive for banks to move in this direction.

Given the performance of the commercial banks in the prevailing economic and regulatory environment, the next step was to increase their efficiency and competitiveness. There was reason to be confident that the potential for growth of the commercial banking industry in the 1990s would be far-reaching, especially with the Ramos administration committed to having the Philippines spearhead the next economic takeoff in South-East Asia.

III. ComBank's Developments Post-Privatization

In the first four years after privatization, ComBank/BC posted consistent growth in revenues (Exhibit 5). Although income was down in 1992 and 1993, the bank's total assets increased by an annual average of 25% between 1987 and 1993, from P1.6 billion (US$78 million) to P6.4 billion (US$236 million) (Exhibit 6).[13] During the same six-year period, the bank's deposit base increased from P1.0 billion (US$48 million) to P3.6 billion (US$133 million).

In the wake of liberalized policies announced by the Central Bank in late 1993, BC foreign exchange holdings increased significantly. Between August and October 1994, foreign currency deposit accounts (including savings and current account deposits) doubled, from P500 million (US$19 million) to P1 billion (US$38 million). Dollar-denominated loans also more than doubled from the previous year.

Consistent with BC's commitment to expand its presence in provincial areas, sixteen new branches were opened between 1991 and 1994. This brought the bank's total network to 41

[13]The average peso-dollar exchange rate in 1987 was P20.57 to US$1.00. In 1993, the average exchange rate was P27.12 to US$1.00.

branches: 24 in Metro Manila, and 17 in provincial areas. Its branch locations included key regional urban growth centers such as Cebu, Davao, Cagayan de Oro, and General Santos. It had 10 on-site and two off-site automated teller machines.

The bank also expanded its manpower base. From a pre-privatization level of 540 regular employees consisting of 98 officers and 442 staff, post-privatization employment increased to 667 bank-wide, consisting of 24 senior officers, 168 junior officers and 475 rank-and-file personnel.

As part of its efforts to upgrade the quality of its services, ComBank automated its operations. In September 1988, it became the first Philippine bank to acquire an IBM AS/400 system, and it continued to expand its computer systems thereafter. In March 1992 the bank gained access to a shared ATM network, when it signed with the Megalink consortium to become its 11th member bank. By September 1993, all branches were fully computerized under a stand-alone mode. The bank's Central Operations Group computerized the front-end and backroom transaction processing functions for major deposit products to ensure a more timely and more efficient delivery of service.

IV. Corporate Strategy

Following the divestiture of the Bank of Boston in 1991, BC's strategy focused on expanding its capital base and attaining unibanking status. To accomplish these objectives, it targeted exporters, mid-level and retail customers, and the corporate market. By late 1994, individual accounts represented 40% of the bank's total deposits of P3.7 billion (US$140 million), with corporate accounts representing 60% of deposits.

A. Exporters

To increase its services to exporters, the bank expanded the range of its trade finance products, including participation in a pre-shipment export finance guarantee program. Under this program, the bank serviced import letters of credit guaranteed by the Commodity Audit Corporation under the Export Credit Guarantee Program of the U.S. Department of Agriculture, with other Offshore Banking Units (OBUs). The bank also provided loans for exporters, discounting of receivables, and an export rediscount facility.

B. Mid-level and Retail Customers

In the mid-level and retail market, the bank focused on consumer financing, particularly the credit card business and auto and home financing. It entered the highly profitable market of credit card services by introducing a Blue card in 1992. In June 1992 the bank became a Visa card participant of Equitable Cardnetwork, Inc., which gave its customers access to

the ATM Megalink Network and Automatic Travel Insurance. A year later, the bank launched an international VISA credit card, which doubled its local credit cardholder base of 5,000 customers. It introduced several new products for consumer financing, including margin financing for stock investments, inventory financing for automotive dealers, and salary loans for corporate clients. In 1994, it expanded its auto loan program to include financing of fleets, passenger utility vehicles, and equipment for industrial use.

In the fourth quarter of 1993, BC launched a new program to provide remittance services for overseas contract workers. Its specially designed computerized system offered much faster remittance processing. The bank's new service also allowed the remitter to send a short message (up to 200 characters) to the beneficiary free of charge. This program generated revenues of P10 million (US$378,000) in the first year. (By comparison, annual revenues from OCW remittances prior to launching the new program were less than P800,000). With this service, ComBank captured approximately 15% of the OCW market.

The bank's trust services included products for both the retail and institutional markets, such as individual and corporate retirement funds and corporate trust indenture. To maximize its income from these fee-based operations, BC expanded the products it offered to include mortgage trust indenture, living trusts, estate planning, and life insurance trusts.

C. Corporate Clients

To service its corporate clientele and attract new customers, BC increased lending to the manufacturing, finance, transportation, construction, and real estate sectors. This was enhanced by product innovations such as receivables discounting and asset-based loans for working capital, designed to meet the demand for more flexible financing schemes. Additional funds were channeled to small- and medium-scale enterprises through the bank's participation in credit enhancement programs such as Philguarantee and the Small Business Guarantee Financing Corporation.

V. The Bank's Position in the Industry

Following the divestiture of the Bank of Boston in 1991, it was the goal of the new owners to see the bank emerge as a key player in the industry within the next five years and to achieve unibank status.

However, despite the expansion of its branch network, services, and client base, BC still lagged far behind other key players in the Philippine banking industry in 1994. Of the country's 38 major commercial banks, it ranked third from the bottom. It paled in comparison to the Philippine National Bank, with 118 domestic branches, 40 overseas branches and offices, over 770 international correspondent banks, and assets of over P127 billion in 1994.

VI. The Treasury Bill Scam

In mid-1994, BC's management learned that the defunct BanCapital Development Corporation (not affiliated with the bank) could not produce the corresponding Treasury Bill certificates for which the bank had paid 600 million pesos. BanCapital's owners allegedly fled the country a few weeks before the anomaly became apparent, thus evading possible conviction. To make matters worse, the vice-president of BC's Funds Management Group, Mr. Reynaldo Feliciano--an officer who was knowledgeable about the bank's treasury operations and had supervised the transactions with BanCapital--committed suicide shortly thereafter, allegedly due to his involvement in the scandal.

The scam resulted in significant negative repercussions for BC. Shareholders were forced to put additional capital into the bank to cover the losses. The College Assurance Plan Group, a major shareholder which held a 20% equity stake in the bank, withdrew P200 million of its accounts. An additional P300 million was withdrawn by other customers in the days following the announcement of the scam. Moreover, the bank's reputation within the local financial community was seriously at risk.

VII. Charting a Course for the Bank

As he reflected on the trends in the banking industry, Fragada knew he must develop a sound strategic plan in order to enable BC to remain competitive and to tap the potential for growth. This was all the more critical in the wake of the T-Bill fraud. Fragada understood that immediate action was necessary to recoup the financial losses and regain public trust. In addition, measures had to be taken to insure against future problems of this nature.

Given the increased competition in the industry following liberalization, Fragada also knew that he had to address a number of long-term issues if the bank was to improve its standing within the industry and achieve the goals set forth by the board. He was determined to increase BC's capital base and to attain universal banking status. In addition, the bank needed to effectively re-position itself in the market to provide banking services to a growing, yet more sophisticated, banking clientele.

With these key issues in mind, Fragada began to formulate a strategy to manage the current crisis and to strengthen the bank's ability to compete in the changing business environment.

The challenges were great, but Fragada was committed to seeing Bank of Commerce emerge as a leader in the Philippine banking industry by the end of the decade.

COMMERCIAL BANK OF MANILA (II)
EXHIBIT 1

PHILIPPINE COMMERCIAL BANKING SYSTEM
Statements of Condition and Results of Operations
(In Million Pesos)

	1987	1988	1989	1990	1991	1992
Assets	**247,236**	**299,618**	**394,366**	**501,140**	**560,308**	**644,896**
Net Loans	118,496	142,466	183,738	239,124	264,089	306,469
Liabilities	**216,720**	**263,253**	**351,698**	**446,850**	**491,260**	**572,170**
Deposits	153,336	195,898	253,368	312,979	384,158	415,811
Net Worth	**30,516**	**36,385**	**42,668**	**54,290**	**69,048**	**72,726**
Net Interest Income	**6,569**	**9,192**	**12,966**	**17,052**	**23,269**	**17,714**
Interest Income	14,660	23,499	34,803	50,614	61,149	41,923
Interest Expenses	8,091	14,307	221,837	33,562	37,880	24,209
Net Operating Income	**3,029**	**5,435**	**8,127**	**12,876**	**14,650**	**10,707**
Operating Income	19,767	30,831	44,259	66,991	73,953	54,450
Operating Expenses	16,738	25,396	36,132	54,115	59,303	43,743
Net Income (Loss)	**9,598**	**14,627**	**21,093**	**29,928**	**37,919**	**28,421**

Source: Philippine Deposit Insurance Corp.

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COMMERCIAL BANK OF MANILA (II)
EXHIBIT 2

PHILIPPINE COMMERCIAL BANKING SYSTEM
Annual Growth Rates

YEAR	REVENUE/ASSETS (Interest & Operating Income/Total Assets)	COST/LIABILITIES (Interest & Operating Expenses/Total Liabilities)
1986/87	14%	11%
1987/88	18%	15%
1988/89	20%	16%
1989/90	23%	20%
1990/91	24%	24%
1991/92	15%	12%

Source: Philippine Deposit Insurance Corp.

COMMERCIAL BANK OF MANILA (II)
EXHIBIT 3

RETURN OF NET WORTH OF COMMERCIAL BANKS

YEAR	NET INCOME/NET WORTH
1987	31.45%
1988	40.22%
1989	49.44%
1990	55.13%
1991	54.92%
1992	39.08%

Source: Philippine Deposit Insurance Corp.

COMMERCIAL BANK OF MANILA (II)
EXHIBIT 4

EFFICIENCY RATIOS OF THE PHILIPPINE COMMERCIAL BANKING SYSTEM

YEAR	INTEREST EFFICIENCY (Interest Income/ Operating Expense)	OPERATING EFFICIENCY (Operating Income/ Interest Expense)
1987	1.81	1.18
1988	1.64	1.21
1989	1.59	1.22
1990	1.51	1.24
1991	1.61	1.25
1992	1.73	1.24

Source: Philippine Deposit Insurance Corp.

COMMERCIAL BANK OF MANILA (II)
EXHIBIT 5

STATEMENT OF INCOME - COMBANK
(In Million Pesos)

	1987	1988	1989	1990	1991	1992	1993
Interest income	149.6	147.4	219.9	348.8	479.5	480.5	466.0
Interest expense	86.2	77.5	106.8	169.2	228.4	263.9	221.4
Net Interest Income	**63.4**	**69.9**	**113.1**	**179.6**	**251.1**	**216.6**	**244.6**
Provision for probable loan losses	8.7	7.6				3.0	11.2
Net interest income after provision for loan losses	54.7	62.3	113.1	179.6	251.1	213.6	233.4
Other income	71.4	104.5	86.7	235.6	135.7	161.3	179.5
Other expenses	115.6	115.2	133.2	227.4	193.7	248.9	310.8
Income before income tax	10.5	51.6	66.6	187.8	193.1	126.0	102.1
Provision for income tax	0.3	0.2	6.3	46.0	29.0	37.1	20.9
Net Income	**10.2**	**51.4**	**60.3**	**141.8**	**164.1**	**88.9**	**81.2**

Source: ComBank Annual Reports

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COMMERCIAL BANK OF MANILA (II)
EXHIBIT 6

STATEMENT OF CONDITION-COMBANK
(In Million Pesos)

	1987	1988	1989	1990	1991	1992	1993
ASSETS							
Cash and other cash items	77.2	75.5	71.0	53.6	72.2	72.2	64.8
Due from Central Bank	112.9	161.4	150.0	173.9	252.5	232.4	502.8
Due from other banks	7.7	863.7	1,079.4	1,129.1	355.1	513.8	375.2
Interbank loans receivable					846.6	779.8	152.3
Trading account securities	414.0	93.7	28.7	194.1	644.6	644.6	1,361.1
Investment in bonds/ debt instruments	49.0	84.8	2.8	30.6	49.1	147.6	146.0
Receivables from customers	639.3	597.6	823.6	1,260.3	1,201.8	2015.0	3277.0
Bank premises, furniture, and equipment	101.5	105.4	118.4	109.6	145.1	220.8	241.1
Other resources	240.2	97.5	93.1	202.6	288.0	339.3	273.8
Total Assets	**1,641.8**	**2,079.6**	**2367.0**	**3,153.8**	**3855.0**	**5,069.8**	**6,394.1**
LIABILITIES AND CAPITAL FUNDS							
Deposit liabilities	1016.0	1,533.8	1,713.3	2,077.8	2,293.7	3,292.3	3,682.2
Interbank loans payable					592.0	385.5	785.4
Bills and acceptances payable	146.6	25.5	82.6	100.1	93.4	192.0	335.8
Due to Central Bank			42.5	46.6	52.3	114.7	81.4
Manager's checks	9.7	33.4	13.0	13.0	21.6	21.6	68.2
Accrued taxes, interest, and other expenses	19.9	19.5	19.4	72.1	30.5	38.0	36.3
Deferred credits and other liabilities	77.1	65.7	56.3	251.0	85.6	220.9	389.3
Total Liabilities	**1,269.3**	**1,677.9**	**1,927.1**	**2,572.1**	**3,169.1**	**4295.0**	**5,378.6**
Capital Funds	372.5	401.7	439.3	581.7	685.9	774.8	1,015.5
Total Liabilities and Capital Funds	**1,641.8**	**2,079.6**	**2367.0**	**3,153.8**	**3855.0**	**3855.0**	**6,394.1**

Source: ComBank Annual Reports

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CASE II: EPILOGUE

In developing its future operational strategies, the Commercial Bank of Manila--now the Bank of Commerce (BC)--had to contend with the challenges that lay ahead for Philippine commercial banks in a liberalized business environment, as outlined in Case II. The bank needed to increase its capital base and attain unibank status, and it was essential that it reposition itself in the market to provide banking services to a growing, yet more sophisticated, banking clientele. In addition, having been marred by the Treasury Bill scam, BC also had to salvage its reputation within the financial community and take appropriate measures to increase its monitoring, control, and supervision of treasury operations.

To respond to these challenges, BC took a number of steps:

- The bank considered taking a foreign partner: Dharmala Philippines, Inc. (DPI), the local investment arm of the Dharmala Group of Indonesia. A Dharmala Group official stated that the company wanted to invest in a strong commercial bank in the Philippines, such as BC, and they felt there was synergy between the two companies. The Dharmala Group, which was expanding its operations in Asia, was keen on making its presence felt in the local capital market in the Philippines. BC, on the other hand, deeded additional capital to prepare for the competition from foreign banks and to achieve unibank status. DPI's anticipated purchase of a 30% equity interest in BC would boost the bank's capital base from P986 million to P1.5 billion. DPI also expressed interest in increasing its stake to 60%, which was the maximum permitted under the new law governing the entry of foreign banks.

  An article on the potential partnership in the *Philippine Daily Inquirer* on October 8, 1994 reported that Dharmala was apparently unconcerned about the T-Bill scam and that the Dharmala Group and BC were poised to finalize the purchase agreement the following week. As of the December 1994, however, the transaction had not materialized.

- In the wake of the T-Bill scam, the bank acted quickly to improve the bank's short-term liquidity needs. Approximately P500 million was required to service heavy withdrawals following the scam. To address this problem, the bank accessed a P1.5 billion emergency loan from the central bank. Moreover, the governor of the central bank assured BC of continued financial support until its liquidity position improved. By August 1994, half of the emergency loan had been repaid.

- To restore public confidence and regain its reputation within the local financial community, the bank spent approximately P70 million on a public relations campaign, through the local media (print, radio, and television) and direct communications with

its customers. The government made statements to the press in support of BC, and several major clients took out paid advertisements in the Manila Bulletin.

By the end of 1994, BC's position had significantly improved. The P500 million withdrawn by customers in the wake of the scandal was redeposited once the bank became more stable--including the P200 million withdrawn by the College Assurance Plan, which was redeposited in October 1994.

- To avoid future problems of this nature, BC's management instituted more stringent internal controls to monitor the bank's treasury operations.

- To more effectively position itself to meet the needs of the changing market, BC planned to move aggressively into financing and leasing options. It also considered establishing a separate foreign exchange trading subsidiary.

TECHNICAL NOTE

Banking Sector Privatization in the Philippines

I. The Philippine Privatization Program

The Philippine Government was strongly committed to privatization. The privatization program was governed by Proclamation No. 50 issued by President Corazon C. Aquino on December 8, 1986. This law created the Committee on Privatization (COP) to oversee the Government's privatization program.

President Fidel V. Ramos reaffirmed the Philippine Government's commitment to privatization with the issuance of Executive Decree No. 37 in December 2, 1992. The law encouraged government corporations and agencies to identify assets or activities which might be more efficiently, effectively, and economically undertaken by the private sector.

II. Objectives

The privatization program had several important objectives:

- to focus government energies and resources on provision of basic public goods and services;
- to create a favorable investment climate;
- to broaden ownership base and develop capital markets; and
- to generate revenues for priority government expenditures.

III. Techniques

Among the privatization schemes utilized were sale of shares of stocks, sale of assets, leasing, management and maintenance contracts, and build-operate-transfer schemes. Public offering of shares of stocks was the preferred disposition method. If the nature of the asset being sold made this unfeasible, then sale of assets/shares was pursued through a bidding process.

In the event of a failed bid, negotiated sales could be undertaken, in accordance with guidelines issued by the Commission on Audit (COA) in 1989. This arrangement helped to ensure transparency in the process.

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IV. Players

The central agency in charge of privatization in the Philippines was the COP. It was assisted by the Asset Privatization Trust (APT) and other disposition entities (DEs), which handled the actual bidding or marketing of specific government assets.

The COP was a cabinet-level committee under the Office of the President responsible for overseeing the Philippine privatization program. Its responsibilities included: formulating policies and general guidelines on privatization issues; approving the sale and disposition of GOCCs, TAs, and other assets; and monitoring the progress of privatization activities. It designated and supervised the DEs, which were responsible for the actual marketing of the GOCCs identified for disposition.

The COP was comprised of five cabinet members representing the following departments of the Government: the Department of Finance (Chair); the Department of Justice (Ex-officio Legal Counsel); the Department of Budget and Management; the Department of Trade and Industry; and the National Economic and Development Authority.

Each DE was responsible for drawing up privatization plans for the GOCCs assigned to it for disposition. The privatization plan indicated the extent of privatization of the company, the mode and method of disposition, and timetable for implementation. If the plan was approved by the COP, it was then implemented by the DE. The DEs dealt directly with potential bidders and drew up bidding guidelines and other documents relevant to the sale of the company. Once the bidding or negotiated sale took place, the DE went back to the COP for final clearance regarding the price and buyer.

V. Accomplishments

From its inception in 1987 through August 1994, a total of 130 GOCCs and 419 TAs had been earmarked for privatization. Of these, over 400 were divested, generating gross revenues of P111 billion (US$4.2 billion)--nearly three times the government's original target figure of P41.12 billion for the privatization program.[14]

Out of 130 GOCCs slated for privatization, 83 were divested as of August 1994. Among the big ticket GOCCs privatized during this period were Petron Corporation, Philippine Airlines, Inc., and the Philippine National Bank. Sales of these three entities alone accounted for P29.3 billion (US$1.1 billion), or 26% of the cumulative gross revenues of the privatization program through August 1994.

[14]The average peso-dollar exchange rate in 1994 was P26.42 to U.S.$1.00.

The privatized companies included all six banks covered by the privatization program (see Table 1). Divestiture techniques utilized in the bank privatizations included negotiated sale (ComBank), public share offering (Philippine National Bank), and public bidding (International Corporate Bank, Union Bank of the Philippines, Republic Planters Bank, and Associated Bank).

Table 1

BANK	DATE	PRICE EXTENT OF PRIV.	(Million)	ACQUIRER
1. Philippine National Bank (PNB)	1989 (30%); 1992 (13%)	43%	P 4,603 US$172	Public Offering
2. International Corporate Bank	1987 (40%); 1993 (60%)	100%	P 2,189 US$83	UBP Consortium and others
3. Union Bank of the Phil.	1988 (40%); 1991 (30%); 1992 (17%)	87%	P 1,357 US$52	Aboitiz Group of Cos. Insular Life; Ramcar; and others
4. Commercial Bank of Manila	1987	100%	P 510 US$25	First National Bank of Boston, et. al.
5. Republic Planters Bank	1991	43%	P 150 US$6	Philippine National Bank
6. Associated Bank	1993	100%	P 50 US$2	Leonardo K. Ty Group
TOTAL (6 Banks)			**P 8,860** US$334	

Source: Committee on Privatization

Besides generating substantial revenues for the government, the program succeeded in expanding private economic activity, improving the investment climate, broadening the ownership base, and developing capital markets.

In addition, privatization freed enterprises from political intervention and government bureaucratic procedures. As a result, they were able to implement more competitive business practices, which generally resulted in increased profitability. This in turn helped to mitigate labor problems, since employees' salaries can potentially be higher in a privatized company.

The privatization program also improved the investment climate in the Philippines. A number of foreign investors participated, as shown in the following examples:

- 40% of Petron Corporation to Aramco Overseas Co., for P14 billion (US$530 million);
- 100% of Marina Properties, Inc. to the Tan Yu Group of Companies, for P1.8 billion (US$68 million);
- 100% of Philippine Plaza Holdings Inc. to Allied Kajima Ltd., for P1.5 billion (US$57 million); and
- 100% of PNOC Marine Corp. to the Keppel Corp. Consortium for P0.7 billion (US$26 million).

VI. Obstacles to Implementing the Transactions

A. Institutional

Some parent companies found it difficult to dispose of their subsidiaries, especially if the entity in question was a profitable GOCC. A notable example of this conflict of interest was the privatization of Philippine Airlines (PAL), where the GSIS was reluctant to give up control of the company and used political leverage to stall the transaction. In most cases, however, parent companies were thought to be in the best position to draw up the privatization plans for their subsidiaries, since they were familiar with the strengths and weaknesses of each company.

B. Political

When the privatization program was first announced, some officials complained that pressure from the international financial community was the real impetus behind the policy, due to the fact that an IMF stabilization program had introduced fundamental economic reforms to the Philippines and had targeted GOCCs. Charges that the World Bank and IMF had demanded privatization as a condition for future assistance caused some resentment. However, there was broad domestic political support for privatization: the right supported the advantages of broader public ownership of the nation's industries and market oriented policies, while the left supported reform to increase accountability and reduce corruption.

Since its inception, privatization in the Philippines was strongly supported by the President of the Philippines and by legislators from the House of Representatives and the Senate. With such political will, implementation of privatization transactions was vigorously pursued.

C. Technical

Valuation and pricing were the most critical aspects in privatization. An offering price that was too high could result in a failed bid, whereas a price that was too low could jeopardize the government's ability to recover its investments. In the Philippines, private, independent consultants were generally retained to conduct appraisal reports or valuation studies which

could serve as a basis for determining the price at which a company could be offered for sale.

Some companies also presented legal impediments or required financial restructuring before they could be privatized. PAL can again serve as an example of these issues: to improve the company's balance sheet, the government assumed US$521 million of PAL's debts, in exchange for shares owned by the GSIS. This transaction served two purposes: it gave PAL a positive net worth, thereby enhancing its attractiveness to prospective investors, and it gave the government control of the airline, thereby circumventing the GSIS' opposition to the privatization.

D. Social

The privatization of GOCCs significantly affected the job security of workers in a number of public corporations and ultimately the employment scenario in the Philippines. Section 27 of Proclamation No. 50 issued by President Aquino in 1986 to officially launch the privatization program provided for the "automatic termination of employer-employee relations upon the sale or disposition of government corporations." This provision ignited significant controversies within the labor sector during the initial stages of the privatization program. In 1986, unemployment in the Philippines was already at 6.7%. There was significant concern about the social and political implications of adding to this number the workers that would be laid-off as a result of privatization.

The labor sector was worried about the potential effect of this provision on the job security of workers in privatized companies, and they were also concerned that it could be used to circumvent the recognition of existing unions and collective agreements. Employers, on the other hand, viewed this provision as necessary for them to exercise management prerogatives upon assuming ownership of the entities. The problem was exacerbated by the absence of a law requiring a purchaser of the assets of an on-going concern to absorb the employees of the firm. Courts in the Philippines maintained that the purchaser was only required to give preference to qualified separated employees of the acquired entity. It was therefore left to the parties involved to work out ways to reduce the negative impact of the sale or transfer on employees.

The position of the Department of Labor and Employment (DOLE) on the matter was to let labor dispute pass through the normal procedures of dispute settlement. However, given the fact that the court system did not sufficiently protect workers, particular emphasis was placed by DOLE on the resolution of disputes. In some instances, DOLE took it upon itself to enter into a memorandum of understanding with GOCCs stating that, in the event that they were privatized, the security of employees' tenure and the status of unions and collective agreements would be respected. DOLE also tried to open lines of communication between parties through its National Conciliation Mediation Board.

The APT, for its part, made it a precondition to bidding, on a case-by-case basis, that the employment force of the TAs slated for privatization be absorbed by the purchasing party. In so doing, many potential labor problems were avoided during the privatization process.

While labor-related problems did arise in the privatization of some GOCCs, such problems did not have an adverse impact on the privatization process in general. The government avoided many labor problems through open and continued dialogue with the employees of the GOCCs earmarked for privatization. Collective bargaining agreements were respected throughout the process. In the absence of such agreements, statutory requirements concerning the welfare of employees were followed.

To minimize the impact on the labor sector, Philippine privatization law subsequently incorporated provisions stating that "in the disposition of assets in corporate form, there shall be no undue dislocation of labor unless all benefits as provided by existing laws or Collective Bargaining Agreements shall be complied with; and provided that the old qualified personnel shall be given preference in the hiring of new personnel by the new owners."

VII. Impact of the Banking Sector Transactions

A. Impact on Employees

For the reasons cited above, most employees were at first largely apprehensive of the effect of privatization on their job security and tenure. However, once the policy was carried out, there were no major shake-ups among bank personnel except at the top levels, since the new owners generally placed their own people in management positions.

B. Impact on Government

The primary benefit to the government was in the form of revenues from the transactions, which amounted to nearly P8.9 billion (US$334 million). Moreover, the privatization of these banks relieved the government from unnecessary management responsibilities and eliminated subsidies which had been paid to certain financial institutions.

C. Impact on Competitors

The privatization of local government-owned banks entailed significant capital infusions in most cases. This enabled the banks to automate their operations, expand their branching networks, and increase their services, which enhanced their competitive advantage in the marketplace.

ComBank--renamed Bank of Commerce (BC) in 1991--opened sixteen new branches between

1991 and 1994, bringing the bank's total network to 41 branches; ten of these were linked into an Automated Teller Network. Pilipinas Bank opened two new branches in 1994, bringing its total network to 15 branches, five of which were linked to an ATM network. Philippine National Bank, through its acquisition of the 36 branches of Republic Planters Bank in 1994, brought its total network to 118 branches nationwide, each equipped with an ATM. The "Big Five" commercial banks--Metropolitan Bank & Trust Company, Far East Bank & Trust Company, Philippine Commercial Bank, United Coconut Planter's Bank, and Bank of the Philippine Islands--each opened five new branches in 1994. By the end of 1994, there were a total of 500 ATM facilities in the Philippines.

D. Impact on Suppliers

The upgrading of management information systems and the expansion of bank services led to an increased demand for office equipment and supplies on the part of the privatized banks. Following privatization, ComBank acquired an IBM AS/400 computer system in order to convert all of its branches from a manual to an automated system. It also made significant purchases of equipment when it linked ten of its Manila branches into an ATM network. Pilipinas bank also upgraded its system in 1994, with the computerization of its current and savings accounts. Between 1992 and 1994, the bank's expenses for furniture, office equipment, and supplies increased nearly 10% between 1992 (P221 million) and 1993 (P241 million). PNB also experienced a 10% average annual increase in its expenditures for office supplies between 1992 and 1994.

E. Impact on Customers

Most of the banks expanded their operations after privatization, establishing new branches throughout the country. The banks also increased the scope of services offered, on both the liability and the asset side of the balance sheet. One bank was able to obtain a unibanking license after privatization, thus providing greater service for its customers.

F. Impact on Corporate Governance Structures

The corporate governance of these banks changed substantially after the new owners assumed control and new boards of directors were elected after privatization. Moreover, the new owners introduced internal controls and monitoring systems which largely corrected previous operational inefficiencies.

VIII. Vignettes of Philippine Banking Privatization Transactions

A. Commercial Bank of Manila (ComBank)

Commercial Bank of Manila was the first major transaction in the Philippine Government's privatization program. It was implemented in 1987, barely a year after President Corazon C. Aquino took office. The sale was handled by the Government Service Insurance System (GSIS), the parent entity of ComBank. Gross revenues derived from the full sale of GSIS shares reached P510 million (approximately US$24.8 million)[15]. The buyers were First National Bank of Boston and three Filipino investors: Three Eight Corp., Ace Solid Holdings, and Cabien Corp. Eventually, the bank was renamed as Boston Bank of the Philippines.

B. Philippine National Bank (PNB)

The privatization of the Philippine National Bank in 1989 represented the largest public offering in the history of the Philippine stock market. A total of 10.8 million shares, representing 30% of the government's total outstanding shares, were offered for sale, generating gross revenues of P1.8 billion (US$83 million)[16]. Approximately 25,000 investors participated in the public offering, thereby giving the bank the widest ownership base of any Philippine financial institution. The share offering also contributed significantly to the development of the country's equities market. According to a report issued by the PNB, the June 1989 listing in the country's two stock exchanges added approximately P4.7 billion (US$216 million) to total market capitalization in just two months. It also brought a large number of new participants into the market and pioneered the way for public stock offering to be considered as a privatization modality for other government corporations.

In 1992, an additional 13% of the PNB's total outstanding shares were made available through a public offering. This was very well received by the market, resulting in gross revenues of P2.8 billion (US$100 million).[17] It extended the private ownership of the bank to 43%, with cumulative gross revenues generated of P4.6 billion (US$165 million).

C. International Corporate Bank (Interbank)

Interbank was the first major privatization transaction to take place under the administration of President Fidel V. Ramos. The bank was fully privatized in mid-1993, generating total revenue of P2.2 billion (US$81 million).[18] The highest bidder was a consortium led by the

[15] The average peso-dollar exchange rate in 1987 was P20.57 to US$1.00.
[16] The average peso-dollar exchange rate in 1989 was P21.74 to US$1.00.
[17] The average peso-dollar exchange rate in 1992 was P25.51 to US$1.00.
[18] The average peso-dollar exchange rate in 1993 was P27.12 to US$1.00.

Union Bank of the Philippines. In addition, 10% of the shares were offered to small local investors. The sale was successfully handled by Interbank's parent company, the National Development Company.

D. Pilipinas Bank

Pilipinas Bank (PB) was organized in October 1964 by Don Alfonzo Calalang (former NEDA chairman and Central Bank governor) and several other prominent individuals. In December 1975, the bank was merged with Manufacturers Bank and Trust Co. in response to the Central Bank's requirement that capitalization of all commercial banks be increased to a minimum of P100 million (US$14 million). Manufacturers Bank, the older of the two institutions, was formed in August 1957 by three prominent individuals. Following the merger, the bank was renamed Pilipinas Manufacturers Bank.

In 1980, the bank ran into difficulties and requested financial assistance from the Central Bank. The CBP granted the request in the form of a P200 million capital infusion through the Philippine National Bank (PNB) and P100 million in emergency loans. President Panfilo Domingo of PNB then assumed chairmanship, and PNB officers were seconded to the bank. The bank was renamed Pilipinas Bank in June 1980.

Pilipinas Bank was subsequently sold to the Prudential Bank group and Bank of Tokyo on March 28, 1988 for P38.6 billion (US$18 million).[19] The Prudential Bank, controlled by the Santos family, purchased all PB shares held by the PNB, representing 84.69% of the bank's equity. The Bank of Tokyo, one of the world's largest commercial banks, acquired 30% of the capital stock. Its stake in PB represents the largest percentage of ownership by a Japanese bank in any Philippine commercial bank.

The terms of the purchase required the infusion of new capital in the amount of P300 million and the complete implementation of the Bank's quasi-reorganization, as approved by the Securities and Exchange Commission of the Philippines and the Monetary Board of the CBP (under MB Resolution No. 595, dated April 8, 1983).

One year after its privatization, PB posted net income of P103.7 million (US$48 million) for 1989, nearly tenfold its 1988 earnings of P11.4 million ($5.4 million). This represented a 47.8 percent return on its capital of P217 million (US$10 million) at the beginning of the year.
Following privatization, PB broadened its customer base from its traditional niche of middle-market and prime corporate accounts to include multinational accounts. Its affiliations with Bank of Tokyo and Prudential Bank were instrumental in securing new business from

[19]The average peso-dollar exchange rate in 1988 was P21.09 to US$1.00.

Japanese multinational firms operating locally. Likewise, the Bank of Tokyo's financial expertise and worldwide branch network enabled PB to service the banking needs of Japanese companies with worldwide operations.

X. Lessons Learned from Implementing the Transactions

A. Managing the Implementation Process

The process of bank privatization in the Philippines has largely focused on the successful public bidding for the assets identified for disposition. There were few instances of negotiated sales, and only one case of a public share offering. Managing the privatization experience has highlighted the need for complete transparency of the bidding regulations and final evaluation of the bids. A swift resolution of any legal impediments involving the assets for sale has also contributed to the ease and simplification of asset disposition.

B. Managing Expectations

A well explained briefing on the type of assets to be disposed, the dissemination of clear-cut bidding rules and guidelines, and the setting of a minimum bid price served to reduce any negative expectations regarding the disposition of the assets. A provision for negotiated sale also helped to address the problem of failed public bidding.

C. Addressing Tradeoffs

The experience of privatization in the banking sector demonstrates that one of the most difficult of all tradeoffs--labor displacement--was successfully addressed in these cases. This was accomplished through ensuring the payment of appropriate severance pay and the implementation of re-training schemes for those who were affected by displacement.

D. Technical Issues: Valuation

Valuation of the assets for disposition was approached in a professional manner. Professional appraisers, leasing companies, and local accounting firms were consulted to determine the book value of the assets. Once this figure was obtained, the agency tasked with implementing the transaction added an appropriate premium over book value to arrive at the minimum bidding price for each entity.

XI. Other Developments in Privatization

With the successful privatization of ComBank, GSIS proceeded to dispose of the remaining GOCCs in its portfolio. Hotel Enterprises of the Philippines was sold in 1988 for P325 million. In 1991, GSIS fully divested its shares in Philippine Plaza Holdings, Inc. in public bidding for P1.5 billion.

The country's flag carrier, Philippine Airlines (PAL), was privatized in January 1992. The GSIS, however, was reluctant to give up control of the company and was not committed to the privatization, thereby compromising its effectiveness as a disposition entity. To overcome this obstacle, the government created an *ad hoc* PAL Privatization Committee, whose members included the Secretary of Finance, the governor of the Central Bank, and the president of the GSIS. The government, through the Committee, offered to assume US$521 million of PAL's debts in exchange for GSIS' shares in the airline. Given PAL's negative net worth, the GSIS was in no position to refuse this offer. Following the transaction, control of the airline passed to the Committee, which took over as disposition entity. The privatization was accomplished by offering two-thirds of the company's shares at public bidding to a consortium of private investors. The sale price of P9.64 billion (US$363 million) was 15% higher than the P8.4 billion (US$317 million) hurdle price set by the government, making the PAL privatization the single largest financial transaction in Philippine history.[20]

GSIS General Manager Belmonte supervised all four transactions (ComBank, Hotel Enterprises, Philippine Plaza, and PAL) prior to leaving GSIS to run for Congress. His successor, Cesar Sariño, pursued the privatization of Manila Hotel in 1994. Between 20-30% of GSIS' shares in the company were offered for sale, with bidding to take place by year-end 1994. Additional shares were to be offered for sale to employees and the general public.

In addition to the GSIS divestitures, many other privatization transactions were successfully concluded by mid-1994. One interesting case was the divestiture of 60% of the shares held by Philippine National Oil Co. (PNOC) in Petron Corporation, which was accomplished in two phases: a 40% block sale bidding in December 1993, followed by a 20% initial public offering (IPO) in August 1994. These two transactions generated cumulative gross revenues of P25 billion (US$946 million).[21]

[20] The peso-dollar exchange rate at the time of the transaction was P26.527 to $1.00.
[21] The average peso-dollar exchange rate in 1994 was P26.42 to U.S.$1.00.

TEACHING NOTE

I. Case Overview

COUNTRY:	Philippines
INDUSTRY:	Banking
DECISION-MAKERS:	GSIS President (Case I), ComBank Chairman (Case II)
ISSUES:	Privatization process; sale negotiation; investor partnerships; debt-equity swaps; post-privatization

Sonny Belmonte, President of GSIS and Chairman of ComBank, must decide whether or not to accept a proposal from Bank of Boston and three local investors to purchase ComBank. GSIS was a government entity responsible for managing the pension fund of over 1.5 million government employees. As a subsidiary of GSIS, ComBank has been targeted for privatization under the Aquino administration's plan to rationalize the government corporate sector. Belmonte has overseen ComBank operations since GSIS acquired the bank in 1982. Corazon Aquino has been President of the Philippines for just over a year. The economy has been highly volatile during the early 1980s, and recovery is her top priority. Privatization is seen as a key element of Aquino's economic strategy. The ComBank transaction is significant, as it would represent the first full conversion of a government corporation to private ownership.

The prospective buyers have proposed to finance the purchase through a debt-equity swap. This would be one of the first uses of this transaction mechanism, which was sanctioned by the Central Bank in late 1986. ComBank has been profitable under GSIS management, and Belmonte sees little practical reason to sell. However, the political pressure to privatize is strong, and Belmonte values his leadership positions at GSIS and the other GSIS portfolio companies. The P510 million purchase price represents a 40% premium on book value of P365 million as of May 31, 1987. Throughout the negotiations, Belmonte has insisted on a 50% premium. The proposal excludes Comsavings, which has a book value of P50 million, thus the price offered exceeds Belmonte's book value-plus-premium threshold.

The Epilogue to Case I presents the actual outcome of the ComBank privatization. Ideally, this would be distributed to students after discussion of the main case.

Case II presents information on the bank's post-privatization performance and raises pressing issues and concerns faced by the bank's stakeholders several years after the privatization. It also provides students with an opportunity to identify key challenges facing the Philippine banking system in the 1990s.

Case II concludes by posing four questions to be addressed by the bank's management. The actual steps that were taken by the bank's management to address these questions are presented in the Epilogue to Case II. Students should therefore be given time to discuss Case II before the Epilogue is distributed.

II. Learning Objectives

Primary case lessons concern privatization asset disposition authority, sale negotiation, investor partnerships, and debt-equity swaps. The specific learning objectives are:

1. To provide students with practice in the application of various methods used in establishing a selling price for banking assets to be privatized.
2. To provide a practical exercise in negotiation, including the identification of the stakeholder objectives of the Philippine government, GSIS, ComBank employees, Bank of Boston, and Philippine investors and the formulation of bargaining strategies and negotiating positions for privatization transactions.
3. To provide students with an illustration of the practical application of the debt-equity swap purchase mechanism in privatization.
4. To increase students' understanding of the privatization process and institutional structures.
5. To provide students with an illustration of how a privatized bank deals with the problem of getting entangled with a treasury bill scam.
6. To enhance students' appreciation of how a privatized bank serves the interests of its corporate stakeholders.
7. To provide students with a glimpse of the efforts of bank management to continuously improve its services from one year to the next.

III. Discussion Questions

1. What are the key issues involved in the ComBank privatization and why? What players have an interest in each of these issues? What players have decision-making authority on each of these?
2. How do you think Sevilla arrived at a 30% premium over book value? Why do you think he should be willing to increase it to 40%? Would he be willing to increase it to 50%?
3. What are the advantages of the proposed debt-equity swap for Bank of Boston? For the government?
4. What should Belmonte's negotiating position be?
5. What lessons does the case provide on the type of role governments should play in privatization transactions?
6. What measures should be implemented to lessen the impact of the treasury bill scam?
7. How did the banks' restructuring program with the Central Bank of the Philippines help achieve the objectives of privatization?
8. What prospects does this privatized Philippine commercial bank have in a liberalized banking environment?
9. How did the bank serve the interests of its corporate stakeholders in the midst of the crisis?

IV. Teaching Plan and Case Analysis

The case audience is expected to understand the concept of privatization and to be

knowledgeable in interpreting financial statements and ratios. The case may be used both for mid-level technocrats and high level policy makers.

1. *What are the key issues involved in the ComBank privatization and why? What players have an interest in each of these issues? What players have decision-making authority on each of these?*

This initial question helps students clarify priorities and identify key decision makers. The instructor may wish to allow all issues to surface before asking the follow on question of who is responsible for each. Then, responsibility for all issues could be discussed at one time. See Exhibit 1 for a sample board layout. The following issues can be flagged for discussion:

Price

The P510 million price represents a 40% premium over book value of P365 million. GSIS has been demanding a 50% premium. Students may explore why GSIS established the 50% premium as a target price and what premium level is warranted. This leads to questions of how ComBank was valued and provides an opportunity to discuss the valuation technique of net book value plus premium, as well as alternatives methods. Instructor may wish to delay launching into a valuation discussion at this point in order to fully explore the first question. See Valuation section later in note. Pricing is the responsibility of GSIS but is subject to the approval of the Committee on Privatization.

Purchase Mechanism: Debt-Equity Swap

This issue should be raised for question 1, but will be discussed more extensively under question 3.

Exclusion of Comsavings from the Deal

The exclusion of Comsavings enables Bank of Boston to approach Belmonte's 50% premium range. Comsavings' book value of P30 million brings book value for ComBank from P365 to P335 million. Therefore, the P510 million price represents a premium of 52%. The biggest issue for GSIS should probably be whether it makes sense to retain management responsibility for a portion of ComBank when the entire bank could potentially be sold to one buyer. Since a goal of privatization is to reduce government's management burden, why would GSIS want to keep the most questionable and management intensive portion of ComBank? Students may point out that an advantage to keeping Comsavings is maintaining access to financial and deposit services, where GSIS could continue to exercise control over its financial resources.

Investor Partnership

This issue affords the opportunity to explore the relevance of certain transaction

conditions to the privatization decision. Opinions are likely to differ on the degree to which GSIS should be concerned with the prospective new owners of ComBank. There are two basic tenets to this argument:

1. GSIS should focus strictly on selling ComBank, regardless of investor composition and intention.
2. GSIS should consider the longer term viability of the investor partnership to maximize the potential for preserving ComBank's status as a going concern.

The stated goals of Philippine privatization largely support the first position, but the debate can be valuable to officials charged with establishing a privatization policy and assigning process responsibilities.

Ownership Structure

The case states that foreign ownership is limited to 40% in the Philippines and that foreign investment in the banking sector has been very limited. Exhibit 13 in the case shows the proposed breakdown of ownership interests. Bank of Boston will own 82% of the total equity in ComBank, although its control of voting shares will be limited to 40%. The instructor might ask students what they think of the proposed arrangement and whether they believe this is what the Philippine government intended with the 40% foreign ownership limit. The Central Bank will ultimately approve or disapprove the ownership situation, but Belmonte needs to be comfortable that whatever he proposes will pass further scrutiny.

Timing

This issue relates to all others because dissatisfaction over any components of the transaction means further delaying privatization. How important should speed be to Belmonte? Ask students to identify why they feel he has not chosen to act quickly. Since Belmonte's primary concern seems to be the price realized for ComBank, he may be waiting for improved economic conditions in order to command a higher price. What implications does this have for privatization programs in general? How long is too long to postpone privatization when national goals have been publicized and a sense of urgency pronounced? What makes ComBank different from other GOCCs is that it is profitable and is not a drain on the government. However, this does not warrant delaying the sale. Under the privatization law (Proclamation No. 50), privatization should be pursued in the soonest possible time while generating the maximum cash recovery for Government.

Focusing on the costs and benefits of continuing to manage profitable GOCCs and concluding privatization transactions may help frame the timing issue. Costs and benefits are financial, political and operational. This discussion is important because most government officials will be constrained by unstable economic and/or political conditions and must be prepared to defend the timing of their decisions.

Method of Sale

Auctions and bids are the preferred methods of selling GOCCs. GSIS may have pursued a negotiated sale with Bank of Boston for lack of additional options. This issue is closely linked to timing because GSIS may not have the luxury of waiting for additional bidders. The COP approved the negotiated sale for ComBank in 1987 since there were no limitations yet, at that time. However, on January 27, 1989, the Commission on Audit (COA) issued circular 89-296 which requires that a negotiated sale may be pursued only after one failed bidding.

Other Factors Affecting Proposal: Potential Conflicts of Interest

The management constraints linked to the proposal and demand for senior officer resignations are other issues that warrant discussion. Their significance depends upon whether they are viewed as unreasonable and how eager GSIS is to sell. How concerned should the disposition entity be about ongoing operations at the privatized company? Will these conditions have a negative impact on operations until the sale is closed?

Many of these issues touch on the dilemma of Belmonte's divided loyalties. It is very important to demonstrate that the concentration of management responsibility and disposition authority with one individual or entity causes inherent inefficiency and potential conflict of interest.

2. *How do you think Sevilla arrived at a 30% premium over book value? Why do you think he should be willing to increase it to 40%? Would he be willing to increase it to 50%?*

Pricing is analyzed by looking at GSIS's original investment in terms of inflation and expected return. Additionally, a rough five-year cash flow discounted at various rates of return could be considered. These are benchmarks which the instructor may find useful in discussing ComBank's value. They also provide some insight into Belmonte's and Sevilla's positions on the premium negotiation.

The market value of ComBank's headquarters should certainly be cited in explaining Sevilla's willingness to pay book value plus a premium. The instructor should solicit student suggestions for a better method of valuing ComBank. Some may favor a more scientific method. Others may argue that the subjectivity of underlying assumptions makes it difficult to say one method is more accurate than the next.

3. *What are the advantages of the proposed debt-equity swap for Bank of Boston? For the government?*

Bank of Boston holds $25 million in Philippine government long-term debt and seeks to convert most of this liability into equity in ComBank. Logically, Bank of Boston would only seek equity in a business related to their own. Therefore, being confined to the banking sector which has been fairly protected from foreign investment, there are limited options for

Bank of Boston to execute a debt-equity conversion. Central Bank Circular 1111 was issued to govern the process of converting debt to equity.

It is important for students to understand the differences between debt and equity and that dollar denominated debt paper owned by Bank of Boston would be surrendered to the Philippine Central Bank for an equivalent amount of pesos using the official exchange rate. Pesos will, in turn, be paid to GSIS to acquire ComBank. In this case, the difference between the conversion amount and the purchase price was converted to peso denominated short term trade debt. This is an attractive deal for Bank of Boston, as they are unlikely to realize any principal repayment on this dollar denominated long-term debt before 1991. Additionally, with no fresh capital required in conjunction with the debt-conversion, the transaction is technically a paper exchange and Bank of Boston incurs no outlay.

Class discussion should also address the advantages and disadvantages of privatizing through debt-equity from the Philippine government's perspective. Advantages are reducing the national debt and speeding the privatization process by facilitating investment. However, in this case, no additional capital is infused in the economy as government debt is simply exchanged for a government bank. Thus, profitable government assets are potentially traded without maximizing the return to the government.

The effectiveness of debt-equity conversion is clearly linked to the issue of valuation. A higher price implies greater debt forgiveness and therefore, a greater willingness to forego fresh capital. At a lower price, the government may demand fresh capital and conversion fees to avoid the appearance of underpricing government assets.

The COP and Central Bank gives the clearance on the debt-equity issue. Belmonte's main concern is maximizing return for GSIS, but he wants the privatization plan submitted to the COP and the Central Bank to satisfy its objectives.

4. *What should Belmonte's negotiating position be?*

At this point, the instructor may consider dividing the class into two sections representing Belmonte's and Sevilla's positions. An alternative is to ask one student to present Belmonte's position and then have others offer what they would do differently and why. The first approach provides an opportunity to involve more students in the discussion. The issues raised in discussing question 1 should serve as a framework for developing negotiating positions.

There is no "correct" negotiating position. What is important is that students are able to justify their positions and that positions are realistic. Students should address the implications, obstacles and contingencies of their proposed actions. There are additional opportunities for role-playing the positions of COP and ComBank employees to incorporate multiple perspectives on the deal. Another alternative is to begin class discussion with question 5 and work back to questions 1-4.

5. *What lessons does the case provide on the type of role governments should play in privatization transaction?*

This question provides a vehicle for students to reflect over lessons learned in preparing and discussing the case and should be used in concluding the case discussion. Case II may be distributed toward the end of the session to inform students of the actual course of events in ComBank's privatization. If time permits, it may be useful to ask students what they thought of the transaction outcome at the beginning of the next teaching session. A brief discussion of the post-privatization situation may enhance the key teaching points of the previous session.

6. *What measures should be implemented to lessen the impact of the Treasury Bill scam?*

This question enables the students to delve into issues facing the bank in the wake of this problem. As described in the Epilogue to Case II, the bank took a three-pronged approach to resolve this problem:

a. The bank addressed its short-term liquidity needs by gaining access to a P1.5 billion funding facility from the Central Bank to service heavy withdrawals following the scam.
b. The bank instituted more stringent controls in its treasury operations.
c. The bank implemented a public relations campaign to revive customer confidence and trust in the stability of the bank.

7. *How did the bank's restructuring program with the Central Bank of the Philippines help achieve the objectives of the privatization?*

This question emphasizes the importance of restructuring programs to a privatized bank. The students can be asked to comment on what they think would have happened if the bank did not pursue the debt-to-equity conversion program.

8. *What prospects does this privatized Philippine commercial bank have in a liberalized banking environment?*

This question provides a chance for the students to compare the growth of ComBank vis-à-vis the Philippine banking system as a whole. The students can also speculate on the strengths and weaknesses of the bank in a liberalized setting. Given the trends toward deregulation of the banking sector described in Case II, banks in the Philippines--including ComBank--faced eight major challenges in the 1990s:

1. *The number of participants was limited, relative to the entire population.* There were fewer than 40 major banks in a country whose population numbers about 60 million. The industry definitely has room for expansion.
2. *Entry is limited, and regulated.* Domestic banks were insulated from some types of competition from new entrants, given the restrictive government policies on entry.

3. *Barriers to entry are high.* Economies of scale were an integral part of the entry barriers, necessitating a significant outlay of shareholder capital. Differentiation from well-entrenched banks could prove difficult because client loyalty may be high. Capital requirements imposed by the government also limited casual entrants into the industry. Moreover, existing participants could have the edge in other key aspects in addition to economies of scale, such as proprietary products or technology, monopolization of favorable locations, and more advanced experience curves.
4. *Entry barriers change over time.* The entry barriers to the banking industry were not static. They would change as government policies changed, as innovation within the industry occurred, and as knowledge and expertise become more widespread in the banking industry.
5. *Competition among banks is active.* Given the homogenous nature of banks and their products in the early 1990s, competition was based mainly on price and service. Furthermore, bank saturation of urban areas limited industry growth in those areas, while the potential for rural expansion was virtually ignored.
6. *Industry returns are high, but volatile.* As a consequence of high entry and exit barriers, banks enjoyed high margins on their services. However, their profitability was affected by fluctuations in interest rates and other fiscal and monetary factors.
7. *Substitute products and services do exist.* Investments houses and other financial institutions offered clients a menu of services similar to those of commercial banks. In an increasingly liberalized environment, these institutions could become credible threats.
8. *Clients were expected to have increased bargaining power.* While banks in the Philippines still enjoyed a position of power relative to their clients in the early 1990s, with increased competition clients would be free to choose from among a wide range of services provided by a variety of banks and other financial institutions. Should clients begin to exercise their power of choice, bargaining power could be expected to shift from the banks to the customers.

Short-Term Prospects for Commercial Banking in a Liberalized Environment

In response to the foregoing challenges, growth in the commercial banking sector in the Philippines was expected to be vigorous in the mid-1990s. This heightened activity would most likely be manifested in several areas, including capital formation and lending rates.

1. *Increased Competition:* The government's efforts to deregulate the banking sector would most likely translate to keener competition among commercial banks, particularly in three areas:
   a) bank branching, where banks would position themselves in order to be more accessible to their customers;
   b) pricing, where the cost of financial services would be placed within the range that customers could afford and were willing to pay; and
   c) quality of services, in which automation and the human factor would combine to make the delivery both more efficient and effective.

2. *Capital Build-up:* As banks sought to strengthen their capital base, more mergers and acquisitions were likely to occur. This could result in larger, stronger, banks.
3. *Decline in Lending Rates:* The T-Bill rate, which was the barometer for lending rates, declined in the first six months of 1993, resulting in reduced margins in the loan portfolios of commercial banks.
4. *Liberalized Entry of Foreign Banks:* The law liberalizing the entry of foreign banks was expected to further increase competition within the banking system. Under this law, ten foreign banks would be allowed to come in, of which six would be permitted to open full-service bank branches, while the remaining four could buy into existing commercial banks.[1] This heightened competition was expected to prompt existing commercial banks to intensify their retail banking presence and expand their branch networks in regional urban centers.

9. How did the bank serve the interests of its corporate stakeholders?

Class discussion at this point should address the specific needs of the corporate stakeholders. The corporate stakeholders are as follows: the government, bank management and employees, bank owners, bank suppliers, and institutional establishments such as the Bankers Association of the Philippines and the Committee of Privatization. The class can work to complete the table in Exhibit 2.

[1]As of October 1994, the Central Bank had already received letters of intent from 28 foreign banks wishing to operate in the Philippines. Priority would be given to those which were the largest in their country of origin and those that could bring new investments into the country. Four foreign banks already had operations in the Philippines: Citibank N.A., Hong Kong and Shanghai Banking Corporation, Bank of America, and Standard Chartered Bank.

EXHIBIT 1
COMBANK TEACHING NOTE

BOARD PLAN

STRATEGIC ISSUE	RESPONSIBILITY
PRICE	
PURCHASE MECHANISM	
COMSAVINGS	
INVESTOR PARTNERSHIP	
OWNERSHIP STRUCTURE	
TIMING	
METHOD OF SALE	
OTHERS	

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NEGOTIATING POSITIONS

STRATEGIC ISSUE	BELMONTE	SEVILLA	COP	EMPLOYEES
PRICE				
PURCHASE MECHANISM				
COMSAVINGS				
INVESTOR PARTNERSHIP				
TIMING				
METHOD OF SALE				
OTHERS				

-B

EXHIBIT 2
COMBANK TEACHING NOTE

INTERESTS OF CORPORATE STAKEHOLDERS

CORPORATE STAKEHOLDERS	INTERESTS
BANK OWNERS	
BANK MANAGEMENT	
BANK EMPLOYEES	
BANK SUPPLIERS	
BANK AFFILIATES	
BANKERS ASSOCIATION OF THE PHILIPPINES	
COMMITTEE ON PRIVATIZATION	
NATIONAL GOVERNMENT	
FOREIGN PARTNERS	
INTERNATIONAL FINANCIAL INSTITUTIONS	
OTHERS	