PHILIPPINES

KEY POINTS

- **Following the crisis, authorities initiated several useful reforms, introducing the new Securities Code and establishing a Governance Advisory Council to review corporate governance.**

- **Since the early 1990s, significantly reduced trade barriers, a freer foreign investment environment, privatisation and deregulation, increasingly disciplined Philippine corporate managers.**

- **However, regulatory reform and increased enforcement would alleviate the risks which concentrated firm ownership and markets impose on small investors.**

- **Diverse mainly family controlled conglomerates dominate the corporate sector. The Philippines' top five families account for a higher proportion of share market capitalisation than do the same sized group in any other East Asian economy.**

- **Cartel arrangements and concentrated ownership guarantee a few firms high profit rates in many markets and weaken commercial discipline.**

- **To retain control, firms favour debt finance and concessional official lending over equity, inhibiting sharemarket development. Boosting equity financing and the role of institutional investors would improve significantly corporate governance.**

- **Sales of government shares in some important banks could introduce new owners who are independent of conglomerates, improving lending quality.**

While the Philippine corporate sector exhibits many of the same characteristics of other East Asian economies, authorities are attempting to move towards a rules based business environment. After 1997, the Government reviewed many aspects of the corporate regulatory framework and increased market openness, improving incentives for sound corporate behaviour. Remaining major challenges include curtailing dominant corporate families' market power, promoting broader corporate ownership and liquidity of share markets, closing regulatory framework gaps, formulating best practice governance codes, strengthening regulations and professional practices for accounting and improving enforcement.

CORPORATE SECTOR STRUCTURE

Many Philippine markets lack competition, with diverse, family controlled conglomerates operating alongside large government owned firms. Private individuals own most firms and rely almost exclusively on private and bank debt financing. Even listed firms retain close to 70 per cent of their equity in private hands and draw their finance mostly from banks. Relatively weak competition in finance, goods and services markets shelters managers from external discipline. Conglomerates form cartels, which guarantee high profit rates in many markets, despite often poor management.

Family Ownership Dominant

The Philippines' top five families control almost 43 per cent of total listed corporate assets, the highest proportion in East Asia (Claessens et al,1999) (Figure 2.6). In total, families control 48 per cent of publicly listed firms, where control is defined as 20 per cent of equity; this is the second highest rate of family ownership in East Asia after Hong Kong (Figure 14.1). Families tightly control most boards, minimising outside minority shareholders' influence. Business groups often comprise a complex mix of listed and private companies, producing opaque ownership structures (Naughton, 2001). Of the major banks, only Far East Bank is not owned by a family, a single firm or the Government (Montes, 2001).

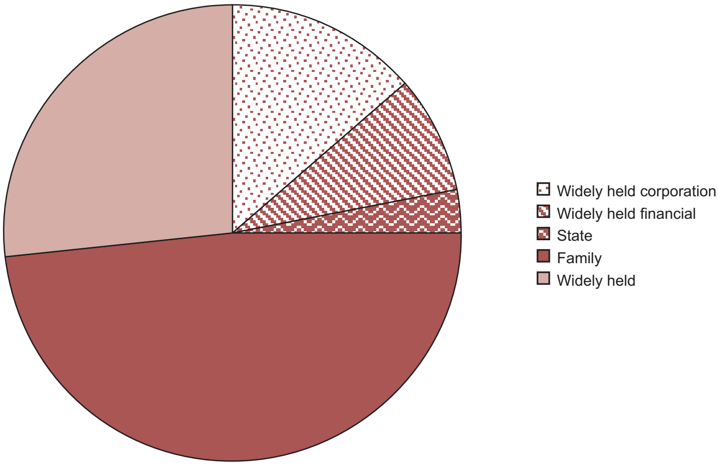
Conglomerates Diverse

Philippine corporates cross-hold more equity, creating larger conglomerates, than do corporates in any other East Asian economy except Japan (Naughton, 2001). They operate in a wide range of sectors, including real estate, services, banking, infrastructure supply, manufacturing, retail, telecommunications and mass media. While this can often reduce their economies of scale and raise costs, entry barriers maintain high profits at consumers' expense. Corporate groups with affiliated banks and finance companies can access cheap finance, reducing their need for direct financing (De Ocampo, 2000).

Figure 14.1

Family Ownership Significant

Share of Listed Companies Key Groups Own, 1999, Per cent [1]



Notes: 1 'Widely held' refers to firms whose shares are held by many individuals and companies; 'Widely Held Corporation' and 'Widely Held Financial' refer to firms whose stock is held by a company or financial institution whose stock is widely held.

Source: Institutional Analysis, 2001.

AYALA GROUP OPERATES ACROSS THE ECONOMY

The Ayala family, through a web of complex structures, owns the Philippines' largest conglomerate, the Ayala Group. The Ayala Group's 48 companies control local telecommunications companies, real estate, food, agribusiness and industrial interests, and own the Bank of the Philippine Islands, one of the country's largest banks. The family wholly owns Mermac, which owns 59 per cent of Ayala Corporation, a conglomerate member and second largest listed company in the Philippines. Ayala Corporation effectively controls Ayala Land, AYC Overseas, Ayala Foundation, IMicro Electronics, Pure Foods and Globe Telecom. Those companies then own substantial proportions of other firms in the group. Despite this, Ayala Group is relatively more exposed to international competition, and therefore greater management discipline, than other large family owned conglomerates.

Source: Claessens et al., 2000.

State Ownership Still Prominent

Despite a decade of privatisation, the Government still owns and manages 179 state owned enterprises in the power, agriculture, railways, water, high technology and financial sectors. The government owned Development Bank of the Philippines is a significant source of concessional finance. The government pension fund also holds equity in private banks and other firms, potentially influencing their lending decisions and other outcomes affecting outside investors (Cruz, 2001). The Government can direct private banks to lend to state owned firms, providing implicit guarantees for state firms to borrow, increasing the risk of unviable investment.

Bank Financing

Commercial banks largely finance firms, especially those belonging to the same industrial group. However, banks' roles in corporate governance are much less clear than, for example, in Japan, under the 'main bank' system. Philippine banks are not represented in management positions, nor do they monitor corporate activity in the way Japanese 'main banks' do (Naughton, 2001).

Like elsewhere in East Asia, corporates prefer bank financing to equity financing, as it does not dilute ownership. Close bank-corporate connections remove the need for managers to compete for equity market finance; only 80 of the Philippines' top 1 000 companies are publicly listed. Bank ownership also is concentrated amongst powerful family shareholders, hindering prudential supervisors' regulatory capacity (De Ocampo, 2000).

Direct Financing Markets Immature

Banks and corporates are reluctant to dilute ownership by issuing equity; this inhibits share market development. Companies often issue minimal shares to secure a listing (De Ocampo, 2001). Large blocs of controlling shareholders hold tightly most shares in most Philippine companies and often dominate decision making in public companies. Regulations require firms to list a certain minimum of their equity in initial public offers, deterring private companies from listing. Central bank regulations also deter securitisation, with reserve requirements preventing banks from selling commercial paper. On the demand side, the middle class mostly prefers to hold US dollar deposits, which represent 60 per cent of all bank deposits, rather than local shares, also inhibiting the share market developing. Hence, share market capitalisation is a relatively modest 60 per cent of GDP; furthermore low share market turnover increases price volatility and deters investors.

Outside the banking sector, mergers and acquisitions, hostile takeovers and corporate raiders are rare, limiting discipline on management by protecting managers from the consequences of poor decisions. When corporates change owners, they normally do so behind closed doors (Wells, 1999). In 2000, no cross-border acquisitions of Philippine companies occurred and an investor group's acquisition of Coca-Cola Bottlers Philippines, for a modest US$1.27 billion, was the sole domestic takeover (Naughton, 2001).

Cartels Common

Competition in some sectors is weak, featuring a small number of firms. Within industries, companies' price movements are similar, suggesting cartels prevail, especially regionally (Zhuang, 2001). For example, monopolies dominate telecommunications, and the top five banks control 50 per cent of total assets (*Far Eastern Economic Review*, www.feer.com, 13 May 1999).

MARKET FORCES STIRRING

Despite this rather closed corporate culture, trade and investment opening in the late 1980s and 1990s increasingly expose Philippine corporates to market forces. Reforms allowing some foreign bank presence have somewhat increased banking industry efficiency, and merger of the two stock exchanges and prudential reforms have developed the equity market, somewhat reducing reliance on debt.

However, many areas would benefit from further market and regulatory reform. Equity financing and institutional investors' roles remain underdeveloped. Also, while large tariff reductions boosted goods and service market competition, cartels and foreign direct investment restrictions keep competitive pressures in many sectors relatively weak.

FINANCE MARKETS SLOWLY IMPROVING

The IMF's involvement in the economy after financial crises in the 1980s, and lower growth due to limited reforms helped Philippine authorities protect the financial sector from the worst of East Asia's mid 1990s excesses. However, more prudential reforms are needed to develop financial markets so they are more active in corporate financing and disciplining corporates. Although the Philippine banking sector needed less restructuring than elsewhere in the region after the crisis, since then, bank led restructuring has converted many non performing loans to equity. Sales of these shares could diversify corporate ownership and increase share market liquidity.

The Securities and Exchange Commission has proposed four financial market development bills: the *Corporate Recovery Act* to fast track the rehabilitation of distressed companies, the *Special Purpose Vehicles Act* to create asset management companies and to provide them incentives to buy banks' non performing loans, the *Revised Investment Companies Act* to stimulate mutual fund industry development, and the *Securitisation Act* to encourage public and private companies to borrow against a pool of existing assets and/or receivables. However, there is concern over how long these laws will remain stalled in Congress. Furthermore, the taxation system currently favours debt over equity finance.

Bank Restructuring

Although post crisis bank restructuring was less aggressive than elsewhere in East Asia, its role in corporate sector reform was important. After the crisis, several banks merged, with some large corporate shareholders divesting their shares in local banks (De Ocampo, 2000).[1] However, some

[1] Three banks, Orient, Prime Bank and Monte de Piedad, failed during the crisis.

mergers may prove risky in the long run because acquisitions were done in haste and without parties undertaking a due diligence study. Although most banks had relatively healthy balance sheets in the lead up to the crisis, after the crisis, the Government took up shares in several banks.[2] Selling these to new entrants would increase bank independence. A further deterioration of banks' balance sheets in 2002 may lead to the need for further injections of public capital and eventual sale of this equity to new owners. In 2001, banks non performing loans reached 19 per cent, and those of the third largest bank, Philippine National Bank, reached over 50 per cent.

Foreign bank entry

Since the 1990s, ten foreign banks have received joint venture licences for wholesale banking, joining long established banks like Citibank which have operated in the Philippines since Independence. Citibank has had an important influence on Philippine banking, training many of the chief executives of local banks. Other foreign banks gradually may help lift competition and standards, but onerous branching restrictions limit their capacity to compete with local retail banks. Foreign banks in the wholesale market cater mainly to foreign companies, but with domestic bank balance sheets weak, they eventually may seek a greater share of domestic business, increasing competition for funds. Foreign banks provided capital for some failing banks during the crisis. For example, Keppel Bank of Singapore acquired the failed Monte de Piedad Bank. The market share of foreign banks branches and subsidiaries comprised 14.7 per cent of total assets of the banking sector in 2000, up substantially from pre crisis levels (Securities and Exchange Commission, 2001).

Increasing Direct Financing Difficult

The weak state of bank balance sheets may force corporates to seek finance from direct markets. However, families' desire to preserve corporate control, government financial institution lending at concessional rates and deposit guarantees discourage increased use of equity finance. As in many East Asian economies, total share market capitalisation is modest as a ratio to GDP and remains below pre-crisis levels (Figure 14.2).

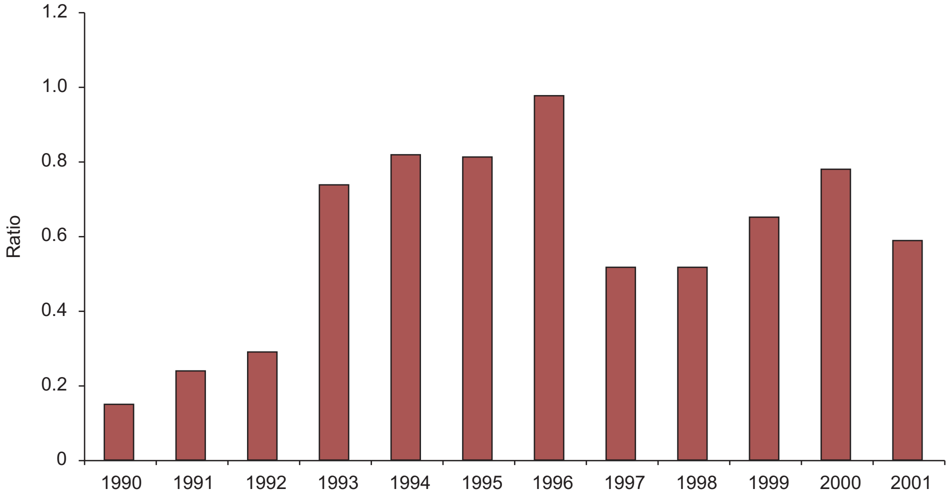
Since the crisis, the number of listed firms has risen only slightly; in August 2001, 231 firms were listed, up from 216 at the end of 1996. No major new private or state company has listed in recent years, inhibiting market capitalisation growth (Figure 14.3) (Naughton, 2001). The Securities and Exchange Commission has set a target of 24 initial public offers for 2002, based on the expectation that oil companies will list as mandated by the *Oil Deregulation Law* and that Board of Investments registered firms will go public (*Philippines Daily Inquirer*, 7 January 2002).

[2] For example, the Government owns around 15 per cent of Philippine National Bank and has committed to sell its stake (*Far Eastern Economic Review*, www.feer.com, 12 October 2000).

Figure 14.2

Share Market Recovering, but below Pre-crisis Highs

Market Capitalisation to GDP, Ratio, 1990-2000

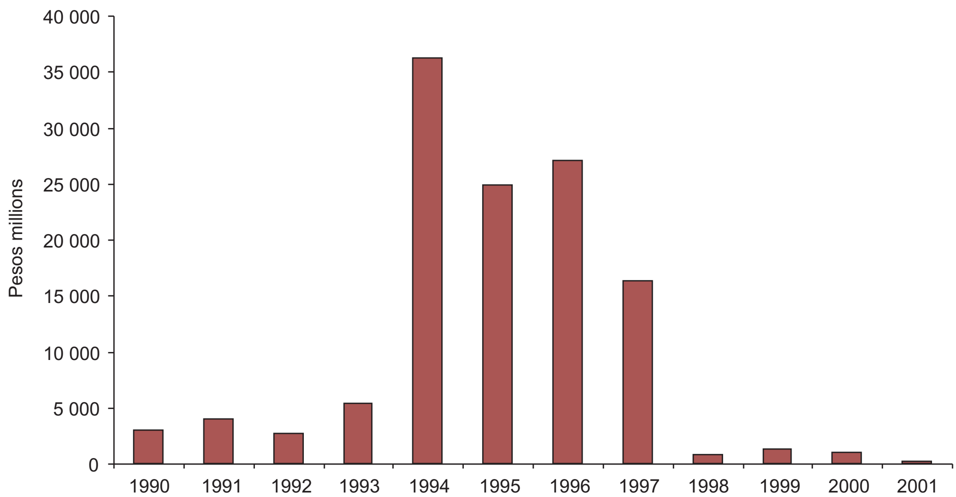


Source: CEIC, 2002.

Figure 14.3

Initial Public Offers Remain Weak

Initial Public Offers, Pesos millions, Annual, 1990-2000



Source: CEIC, 2002.

Corporate bonds can raise funds without diluting control, but floating rate instruments and macroeconomic instability increase their cost. The small bond market also reduces liquidity and increases costs relative to bank financing (Wells, 1999). In addition, lack of adequate ratings and investor protection and concerns about corporate governance standards reduce investors' demand. Hence, few companies tap publicly-issued debt market instruments, including commercial paper; the number of commercial papers on the market declined from 50 in 1996 to only 29 in 2000.

Institutional Investors May Yet Develop

Over the medium term, institutional fund managers provide the best means of developing financial markets; already the Philippine analyst and broker community imposes discipline on large listed firms (Asian Corporate Governance Association, 2000). However, the Government owns many institutional investors, possibly inhibiting the growth of a private funds management industry. Government pension funds, including the Government Service Insurance System and the Social Security System, control 20 to 40 per cent of the bank sector. Also equity investment limits restrict public institutional investors' role in encouraging improved corporate governance. Instead pension funds invest mainly in bank deposits, housing loans and government bonds (Wells, 1999). Privatising government institutions and liberalising controls on their portfolio holdings would boost share market liquidity and private institutional investor activity in it.

At present, no regulatory framework exists for private pension funds.[3] Nevertheless, private insurance companies investing in listed and private companies exert some direct control over management. Large holdings, usually 10 to 25 per cent of equity, guarantee the funds representation on boards and allow close monitoring of management. Interestingly, companies once partly owned by a private insurance company are more likely to list (Wells, 1999).

PRODUCT MARKETS

Competition in goods and service markets is more vigorous than 15 years ago when the Philippines started market opening; however, some family conglomerates face only limited competition, especially in services markets, where foreign entry barriers remain high. For example, the Ayala Group profits from its globally competitive firms in international markets but faces limited competition in domestic markets. Nevertheless, trade reforms are increasing manufacturing sector competition and the new administration has put privatisation and deregulation on the reform agenda.

Deregulation

In the 1990s, significant deregulation reduced entry barriers to shipping, banking and retailing. Slowly, the large state owned sector is being privatised, often involving strategic foreign partners, such as in National Steel's sale to a Malaysian group. The Government intends to sell around half of its 180 state enterprises including in the power, agricultural, railway and water sectors. Furthermore, WTO induced reforms eliminated monopoly licences in many sectors including telecommunications.

[3] Companies operating retirement schemes use banks' common trust funds.

However, vested interests frustrate deregulation. Family owned monopolies in power distribution and telecommunications are difficult to break and powerful commercial interests can influence regulatory bodies.

Trade Reforms

Since the crisis, Uruguay Round commitments and the Government's unilateral tariff reform program reduced Philippine tariffs more than any other East Asian economy (World Trade Organization, 1999). When the peso depreciated sharply in 1997 and 1998, the Philippines took the opportunity to progressively reduce tariffs to under 5 per cent, except for sensitive agricultural products, by 2004. By 2001, the simple average nominal tariff rate was 7.7 per cent, down from 13.4 per cent in 1997 (Philippine Tariff Commission, 2001). These reforms increase competition in goods markets, curb the market power of large conglomerates and reduce costs for consumers and producers' inputs.

However, significant non-tariff barriers remain for agricultural products. For example, sensitive agricultural products are subject to minimum access volume tariff-rate quotas until at least 2005. Products covered include live animals, fresh, chilled or frozen beef, pork, poultry and goat meat, potatoes, coffee, corn and sugar. The National Food Authority retains its exclusive authority to import rice and issue import quotas and permits for rice and corn. The Government currently is moving to privatise rice importation, but indications exist the authority will retain significant administrative control even after the privatisation. Although the application of sanitary and phytosanitary rules has become more predictable, difficulties in obtaining import permits persist (World Trade Organization, 1999).

Foreign Direct Investment Reforms

Since the early 1990s, foreign direct investment reforms have opened Philippine manufacturing to foreign investment, but restrictions remain in many other key sectors including mining and infrastructure (East Asia Analytical Unit, 1998). In 1996, further reforms increased foreign participation in the economy; remaining restrictions include the media, various professional services, some infrastructure sectors and small scale mining. Since the 2000 passage of the *Retail Trade Liberalisation Act*, several foreign companies have entered the retail sector (PricewaterhouseCoopers, 2001). However, the Philippine constitution still limits foreign ownership of land, mining and infrastructure projects and a majority of Philippine residents must sit on listed company boards, deterring foreign investment.

JOLLIBEE RESPONDS TO FOREIGN ENTRY

In 1980, McDonald's entered the local fast food market, increasing competition for local firm, Jollibee. Jollibee responded by heavily investing in staff training and new capacity. In 1993, it listed on the stock exchange to finance more outlets and rebuilt its image. Jollibee introduced several external directors to the board and lifted corporate governance standards, satisfying minority shareholder needs. Jollibee's market share now is sizeable, acquiring related firms Greenwich Pizza in 1994 and Chowking in 1999.

Source: Lim, 2001.

Antitrust Laws

Philippine anti-trust laws need upgrading; no agency implements the laws or prosecutes firms (World Trade Organization, 1999). In mid 2001, in an example of collusion, the two largest mobile phone companies, Globe Telecoms of the Ayala group and Smart Communications of the Metro Pacific group, almost simultaneously announced a reduction in free short messaging services by 60 per cent. The National Telecommunications Commission lodged a temporary restraining order questioning its legality, but it was lifted almost immediately due to lack of sufficient evidence. Since the crisis, the Government has initiated moves to formulate a national competition policy framework, reviewing existing competition laws and statutes (Asia Pacific Economic Cooperation, 2000).

REGULATIONS STRENGTHENING

After the crisis, authorities reformed regulations to strengthen corporate governance.[4] An August 2000 Securities Regulation Code improves listing requirements and insider trading sanctions, and the government Securities and Exchange Commission regulates corporations. In July 2001, the President announced the Governance Advisory Council would review corporate governance standards, reforming key regulations and boosting enforcement. This poses a major challenge to regulators.

TRANSPARENCY

Although formal regulations ensuring transparency broadly are adequate, enforcement proves difficult.

Financial Reporting

Philippine financial reporting requirements are reasonable by regional standards, but do not conform to international best practice levels. Listed companies must provide annual reports with balance sheets and profit and loss statements to the Securities and Exchange Commission. They also must report any event affecting investors (PricewaterhouseCoopers, 2001). The Bureau of Internal Revenue also requires all companies with gross revenues over Pesos 150 000 (US$2 800) to submit audited financial statements with their income tax returns.

In 2001, the Securities and Exchange Commission began implementing a new regulatory framework based on international standards. The commission also is developing IT software so analysts, investors and others can access data on firms' financial performance (*Manila Bulletin*, www.mb.com.ph, 29 July 2001).

The Corporation Code sets corporates' legal framework, specifying company registration and shareholder rights. Companies must detail all transactions and provide the minutes of meetings to directors and shareholders. At regular or special shareholders' meetings, shareholders representing at least a majority of the outstanding capital stock must approve transactions that benefit directors (PricewaterhouseCoopers, 2001). The code is unchanged since its inception in 1980.

[4] William Bailey, Jerry Isla, George Lavadia, Edith Tuason, Cristina Delizo, Jo Lennox and Michelle Narracott, PricewaterhouseCoopers and PricewaterhouseCoopers Legal, contributed to this section.

Consolidated reporting is not mandatory, but when companies merge or acquire assets, both parties must provide the Securities and Exchange Commission with annual reports.

Accounting Standards

In 1997, the Government announced it would gradually adopt international accounting standards by 2004; since then Philippine accounting standards have moved closer to international norms.[5] Areas most affected include the preparation and presentation of financial statements, reporting by sector and interim financial reporting. However, disclosing the fair value of financial assets and liabilities, treatment of impaired assets and accounting for issuer's financial instruments still need reforming. Draft standards awaiting Board of Accountancy approval cover consolidating financial statements and reporting related party disclosures.

At present, compliance with standards generally is weak; many firms maintain up to three sets of books, for banks, regulators and owners. Weak penalties and certified public accountants' lack of a stringent code of ethics hinders compliance. The Securities and Exchange Commission and the Philippine Institute of Certified Public Accountants recognise the need to penalise independent auditors for poorly prepared audited financial statements (Asian Development Bank, 2001).

Auditing

Audit requirements are generally sound and follow the US system, although enforcement is weak. In addition, where the US system is not specific, Philippine firms often prepare inadequate investment information. Where resources permit, the Securities and Exchange Commission supervises listed companies' independent audits. Audit boards are not compulsory and rarely used (PricewaterhouseCoopers, 2001).

MINORITY SHAREHOLDERS' RIGHTS

New rules related to listing, shareholder representation, board structure and legal action against directors offer minority shareholders increasing protection. However, enforcement remains a concern.

Listing Rules

Recent changes under the new Securities Regulations Code may offer better protection to minority shareholders through mandatory tender offers and deter market abuses and fraud through prohibiting insider trading, affiliated broker and dealer transactions and segregating broker and dealer functions (PricewaterhouseCoopers, 2001). Listing companies must demonstrate their financial stability, ongoing viability and sustainable projected earnings. Applicants also must assure the Securities and Exchange Commission of the integrity of key personnel. Before a company makes an initial public offer, a licensed underwriter must conduct due diligence on the prospectus.

[5] Philippine accounting standards are based on the Statements of Financial Accounting Standards the Accounting Standards Council issue, and Rule 68 (Special Accounting Rules) of the Securities Regulation Code. The Securities and Exchange Commission and the Philippine central bank, Bangko Sentral ng Pilipinas, recognise new accounting standards that become mandatory after the Professional Regulation Commission approves them (PricewaterhouseCoopers, 2001).

The Securities Regulation Code defines listing rules for public companies and the Securities and Exchange Commission implements them. Although adequate in numbers, Securities and Exchange Commission staff sometimes lack resources. Exchange membership requirements are not particularly stringent; many local brokers are small and under-capitalised and a few large foreign firms dominate the market (Institutional Analysis, 2001).

Representation

On paper, laws ensure minority shareholders can influence company decisions, but often implementation is weak. Proxy and cumulative voting is allowed and a two thirds majority vote must pass resolutions, but concentrated ownership generally makes it easy for the board to obtain the majority needed to approve deals (Asian Development Bank, 2001). In theory, if large related transactions occur, dissenting shareholders may demand payment of the fair value of shares. Also, regulations specify minority shareholders may examine all business transactions and minutes of meetings, voice concerns at the annual general meeting without needing a minimum quorum and call a shareholders' meeting when directors act against their interests. However, these events are rare. Non-voting shares are not permitted except 'preferred' or 'redeemable' ones, although these offer voting rights in key decisions (PricewaterhouseCoopers, 2001). Rules require tender offers to minority shareholders following any third-party offer to buy in excess of 15 per cent of stock (*Manila Bulletin*, www.mb.com.ph, 7 August 2001).

In January 2002, Unitrust Development Bank failed, reportedly as a result of conflict of interest between dominant and minority stockholders. The bank suffered heavy withdrawals in 2001 after a change in ownership when shareholders accused the new owner of using the bank as a financing arm of a sister company that also was closed.

Board Structure

A board must have between five and 15 directors and, even for wholly foreign owned firms, a majority must be Philippine residents. For listed companies, at least two directors or 20 per cent of the board, whichever is greatest, must be independent (PricewaterhouseCoopers, 2001).

Interlocking directorships are common and legal, although shareholders must approve transactions between directors within the same group. Representatives of minority stockholders cannot be removed without cause. The Securities Regulations Code prohibits insider trading and applies strict liability for director violations (PricewaterhouseCoopers, 2001). However enforcing insider trading laws proves difficult. For example, the Philippine Stock Exchange and the Securities Exchange Commission are investigating several cases of insider trading, including the case of BW Resources. While investigations are ongoing, to date, no one has been prosecuted for insider trading. Failure to resolve this case has delayed the return of investor confidence in the Philippine stock market.

The Corporate Code holds directors who act negligently or in bad faith liable for damages and shareholders can launch a class action or file a derivative suit against company directors, although not on behalf of the corporation. However, such cases are lengthy, costly and rare (PricewaterhouseCoopers, 2001).

CREDITORS' RIGHTS

Creditors' rights, including bankruptcy laws and banking system supervision, are improving. However, lack of enforcement resources, some inadequate provisions and weak enforcement in the courts undermine outcomes.

Bankruptcy

Bankruptcy laws are sound but application is weak. The *Insolvency Law* establishes procedures for temporarily suspended payments, voluntary and involuntary liquidation. Post crisis reforms empower the Department of Justice to administer insolvency and simplify its administration. A new specialised commercial court system encourages stakeholder activism by canvassing insolvency alternatives and developing substantial insolvency procedures (PricewaterhouseCoopers, 2001). In 2001, the Supreme Court promulgated a resolution designating regional trial courts to sit as special courts to handle corporate rehabilitation cases. However, grey areas exist regarding which agency should accept petitions for involuntary and voluntary dissolutions where creditors are affected (*Business World*, 4 January 2001). Nevertheless, the number of corporate rehabilitation cases has risen sharply (PricewaterhouseCoopers, 2001). Under Presidential Decree 902-A, authorities can replace corporate management in rehabilitating corporates.

Despite these reforms, lack of court resources and training hinder insolvency proceedings, undermining creditor protection. Creditors cannot vote on rehabilitation programs developed under new reforms and sometimes the legislation is contradictory (PricewaterhouseCoopers, 2001).

Bank Supervision

Prior to the crisis, significant reforms and IMF involvement since the 1983 banking crisis gave the Philippines a higher level of prudential standards than in many other East Asian economies; however, implementation of bank supervision is still lacking in some areas. The *General Banking Law* passed in May 2000 clarifies the central bank's prudential responsibilities and imposes tough criteria on bank auditors. It also institutes consolidated banking supervision, formally adopts risk-based capital requirements, increases allowable foreign bank ownership of local banks to 100 per cent, clarifies the legal basis for determining unsafe banking practices and increases bank transparency and disclosure standards. This puts the Philippines at the forefront of prudential standards.

In the early 1990s, prudential caps and sectoral qualifications on foreign borrowing limited corporate and bank access to foreign debt markets and their exposure during the financial crisis (Asian Development Bank, 2000). After the Asian financial crisis, the central bank raised capital adequacy ratios, tightened provisioning requirements and adopted stricter loan classifications (Gochoco-Bautista, 1999). However, retail banking remains relatively closed to new foreign bank entrants. Freer foreign financial institution entry could strengthen banking industry prudential standards, competition and corporate governance. Promoting mergers and acquisitions of the many smaller local banks and privatising and public listing of government banks would help promote efficiency and disperse bank holdings (Gochoco-Bautista, 1999).

COMPLIANCE

The Government is aware compliance and enforcement of corporate governance and prudential standards need improving. Some judges lack training in corporation law and court transparency remains a concern. Accounting standards are improving but as yet are implemented poorly and often audits are weak. In addition, public ombudsmen face many obstacles in pursuing justice.

Press

Although the media have the freedom to scrutinise corporations independently, powerful politically connected families can influence reporting. Family groups frequently own media outlets, creating conflicts of interest. For example, industrial conglomerates own the *Manila Chronicle*, *Manila Times*, *Manila Bulletin* and *Manila Standard*.

IMPLICATIONS

Despite concerted official attempts to improve and enforce the Philippine's reasonably good corporate governance legislation, checking the market power of large well connected family owned conglomerates and enforcing corporate laws is proving difficult. Regulators need more financial and human resources and training to build institutional capacity. Australian development assistance projects have assisted in many of these areas and have the capacity to continue institutional strengthening in future. The new Arroyo administration is less willing than its predecessor to tolerate cronies and more serious about strengthening market forces. Such reforms are needed urgently to boost the Philippines' lagging economic prospects. At the National Economic Summit in December 2001, good governance was identified as a major area needing reform. However, this will be a lengthy process, requiring strong political will, private sector cooperation and vigilance from public interest groups.

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