EXECUTIVE SUMMARY

Corporate governance is at a watershed in much of East Asia. Since the financial crisis, more vigorous market forces and tougher regulations are slowly transforming the East Asian corporate governance environment. In many economies, the dominant business model is changing gradually from relationship to rules based, forcing change in corporate objectives and the way firms govern themselves. Even before the crisis, many East Asian corporations and economies had become too large, complex and exposed to international competition to continue to grow robustly with businesses relying on related parties for finance, inputs and distribution. While personal relations will continue to be important, only in a reliable, rules based business environment can business access the most efficient and profitable investment opportunities, input sources and distribution options. More mature economies like Hong Kong and Singapore are well advanced in creating a rules based system; most middle income regional economies operate elements of both relationship and rules based business models, while emerging regional economies have just begun the transition from a relationship based approach.

Traditionally, relationships underpinned much East Asian commercial activity; often weak legal and administrative systems made doing business with related parties the best way of ensuring contracts were honoured. In most South East Asian economies, the Republic of Korea, Hong Kong and Taiwan, family owned and run companies dominate the corporate sector and stock market listings. In some economies, a handful of families control up to 50 per cent of stock market capitalisation. In most cases, dominant family owners appoint family members to boards of directors and management positions, blurring the distinction between owners and managers. Many East Asian family owned companies form large diverse conglomerates, which include firms operating in many sectors and banks providing most group finance; many related business transactions occur between conglomerate member companies. Most other companies also have a close relationship with their bank; before the crisis, many banks undertook relationship based and collateral backed lending. Many Japanese firms also coalesce around key banks or large industrial enterprises, forming *keiretsu* groups that maintain long term supply and credit relationships.

However, the financial crisis undermined relationship based business viability and strengthened the forces encouraging a rules based system. To complete this transition successfully, many regional governments recognise they need to strengthen market forces and enact and enforce new corporate governance laws and regulations. In the lead up to the crisis, weak corporate disclosure, limited investor and creditor protection and consequent risky corporate investments inflicted serious damage on regional economies; in some economies these factors continue to inhibit recovery. Hence, since the crisis, many regional governments' commitment to improving corporate governance has grown, driving regulatory change now underway. However, commitment to change and hence progress is uneven across the region, making it important for business to know where change is occurring first. Eventually, all local and foreign businesses operating in East Asia should benefit from these changes, although as economies make this transition, risk management is important.

MARKET FORCES STRENGTHENING

Market forces and the fallout from the crisis are forcing changes on East Asia's relationship based business model. The crisis caused massive non performing loans and corporate insolvency, sparking widespread bank and corporate restructuring and severing traditional relationships between many corporates and their banks. These trends also are evident even in Japan and China, although caused more by local regulatory and corporate failings. Some conglomerates have sold less profitable affiliates introducing new, often foreign owners and breaking links within conglomerates. With fragile and cautious banks restricting lending, many family owned businesses have been forced to issue shares and bonds, requiring them to meet listing rules, obtain credit ratings and face share and bond market discipline. Increasingly in many economies, banks also must compete with share, bond and foreign financial markets for community savings; eventually this should encourage them to lend more carefully to corporates; many regional banks also are reviewing their corporate lending exposure as they seek to upgrade balance sheet quality. Tougher listing rules and market supervision protecting small shareholders eventually should make the share market a safer destination for East Asia's vast savings.

Fewer trade barriers and foreign ownership and investment restrictions also increase competition in East Asian markets, tightening discipline on firm management. Increasing exposure to global trade and investment is forcing firms to review relationships with traditional suppliers, distributors and banks to cut costs and maintain growth.

Regional governments play an important role in encouraging stronger market forces, thereby shaping more dynamic corporate sectors. Facing fiscal pressures, many regional governments are reviewing their role in the economy, privatising state enterprises and banks, deregulating controlled sectors and boosting regulation supporting markets and corporate transparency. Other priorities include maintaining the momentum of trade and foreign investment liberalisation and corporate restructuring following the crisis. However, in some economies, powerful indebted conglomerates are opposing restructuring, often with assistance from non transparent court systems. Governments can support corporate renewal by privatising the equity they hold in banks acquired during the financial crisis; to avoid new connected lending and moral hazard, they should avoid selling to previous owners. Finally, governments can reinvigorate market forces by continuing market deregulation and privatising state enterprises. Governments owning productive enterprises in potentially competitive markets undermine private sector competition and reduce share market liquidity, hampering the shift to equity financing and impeding rules based corporate governance.

REGULATIONS IN PLACE

Most East Asian governments now provide the basic institutional framework for rules based business, but in many emerging regional markets, implementation is still weak. In many economies, new reporting, accounting and auditing standards provide for company disclosure approaching international norms. In these economies revised company laws also define outside shareholders' rights to influence company decision making and protect outside investors from expropriation by powerful corporate insiders. Banks face greater regulation of how they use deposits, particularly when lending to businesses. In many economies, tougher bankruptcy laws give creditors more rights.

However, most middle income regional economies still find it more difficult to implement effectively bankruptcy and other new commercial laws and regulations. Until regulatory frameworks are enforced efficiently and reliably many companies will not feel confident in relying on the rules based system. Lack of institutional infrastructure such as strong courts and well trained and resourced regulators, powerful vested interests and a lack of political will to prosecute non-compliers often prevent new standards being applied consistently and fairly. New bankruptcy laws require effective courts to drive rapid corporate restructuring in Indonesia, the Philippines and Thailand. In several economies, poorly enforced listing rules and corporate governance standards reduce investor confidence, inhibiting share and bond market development. Even with strong political will, these issues will take several years to resolve as solutions often require a significant shift in the current corporate culture. Despite these ongoing problems, many regional regulatory authorities and non-government professional bodies now give high priority to enforcing better corporate governance standards and most are making real progress.

AID ASSISTANCE

To help avoid another financial crisis, development assistance can contribute both to encouraging market forces and strengthening relevant regulations, to help regional developing economy governments raise corporate governance standards. In the four years since the crisis, most corporate governance development assistance in East Asia has focused on developing and implementing corporate legislation. Projects to strengthen market forces and reduce the role of relationship based lending are scarcer. Multilateral agencies provide the bulk of corporate governance assistance to East Asian governments. Few bilateral programs apart from Australia's make corporate governance a priority.

Since the crisis, donors have learnt much about the best ways to help build corporate governance standards in developing Asia. Ensuring local stake holders feel they own a project without reducing conditionality is important. The large number of bilateral and multilateral initiatives increases the risks of duplication. Donors also should assess the relative merits of bilateral and multilateral approaches to assisting different areas of corporate governance.

Strong demand exists for ongoing Australian assistance with corporate governance reforms in East Asia. Opportunities for expanding Australian assistance exist in traditional areas of regulatory capacity building and in promoting markets forces as a means of disciplining corporate behaviour. Australia can help draft legislation for rules based business. Progressively, Indonesia, Vietnam and Thailand are developing legislation to deal with private and government owned corporations. Australian regulatory agencies, like the Australian Securities and Investments Commission and the Australian Competition and Consumer Commission have the expertise to support this type of activity. Also, in many developing economies, reasonable corporate legislation exists but authorities fail to implement it. For example, Indonesian securities laws, drafted in 1995, follow international best practice, but their poor implementation contributed to the financial crisis. Australian implementation experience is very relevant.

Market strengthening activities are as important as regulatory reform. Australia has the capacity to assist with a range of measures, including by assisting develop direct finance markets that can compete with banks, assisting governments in privatising banks or equity in companies as a result of debt restructuring and helping open markets to trade and investment competition. Developing civil society, especially professional bodies and an effective commercial media also are needed to increase scrutiny of corporate behaviour and authorities' capacity to enforce new regulations.

JAPAN LIFTING STANDARDS

More than ten years since its banking crisis began, Japan is progressing towards a rules based corporate governance environment. Before the crash, Japan's traditional relationship based business model was deemed a strength, but now the Government increasingly recognises regulatory and legal system weaknesses contributed to the bubble economy and the economy's failure to recover more rapidly from the late 1980s crash. Market forces and the long recession are increasing financial pressure on corporates and, with weak bank lending, have forced many firms to source investment finance from the share market, exposing them to regulations regarding financial reporting and minority shareholder treatment. Foreign firms now hold close to one quarter of listed equity, including large shares of well known companies such as Nissan and Sony. To boost shareholder value, conglomerates, especially foreign controlled ones, are shedding non-core assets and merging with firms with complementary skills. To strengthen their balance sheets, banks are reducing their stakes in corporates, weakening their incentives to lend to marginal group firms. Foreign and some domestic institutional investors are becoming more active shareholders, assisting sharemarket and corporate governance development. Trade and investment liberalisation and the long recession are sharpening goods and services market competition, reducing profits, increasing bankruptcies and forcing many firms to look beyond traditional suppliers and distributors to boost value for owners.

The regulatory framework governing Japan's corporates is generally sound, with recent reforms promoting a more rules based business model. However, implementing new accounting requirements and making corporate culture more transparent will take time. A new Commercial Code strengthens outside shareholder rights by permitting legal action against directors and reviewing supervisory boards' roles. New laws forming part of the accounting 'Big Bang' require consolidated reporting. Banks now must report their assets at market value, increasing their incentives to divest shares in weak companies. However, shareholders also would benefit from better representation rights at annual general meetings and clearly defined directors' roles and legal obligations.

CHINA IN TRANSITION

China's dynamic economy is making good progress in its transition from a centrally planned to a more market based economy, in large part because the Government recognises one of its highest priorities is to develop the legal and regulatory institutions to support a modern market economy. Over the past decade, it has strengthened listed firms' accounting and disclosure requirements, tightened prudential controls on banks, passed a new law to govern the securities industry and established an effective commercial arbitration system. Increasingly, a good range of corporate laws and regulations support the corporate sector, corporate ownership is more dispersed and equity and bank finance are more accessible.

Key to this strategy is reform of China's state owned enterprises, which still dominate large scale, capital intensive industries and infrastructure. By listing a minority of their shares on the stock exchange for sale to private investors and requiring listed firms to comply with higher accounting and corporate governance standards, the Government hopes to make state owned enterprise boards of directors and management more accountable to corporate owners, including the state. Now over 1 000 state owned enterprises are listed in China and some of the largest and most efficient state owned enterprises list on Hong Kong and international stock markets. However, state owned enterprises owe most of China's banks' huge and growing non performing loan portfolio, estimated at 30 to 50 per cent of outstanding loans; this reflects state owned enterprises' generally poor corporate governance standards and limited accountability. This serious problem makes resolving corporate governance problems in the state owned enterprises more urgent.

While the Government is readying the legal and regulatory system to support a market based economy, several key elements of this framework still are missing, including an impartial and efficient legal system to enforce commercial law, a comprehensive bankruptcy law, independent state owned enterprise boards of directors that direct management to act in shareholders' interests, widespread use of international accounting standards and adequate commercial bank credit analysis capacity. Until China develops these essential laws and institutions, state owned enterprise and banking sectors will continue to experience corporate governance problems, which could constrain growth.

REPUBLIC OF KOREA PUSHES REFORM FORWARD

Following the financial crisis, the Korean Government responded with stronger laws and regulations governing corporate and financial institution behaviour. With corporate and bank restructuring, old relationships between banks, massive conglomerates, *chaebol* and other corporates are weakening. Although the *chaebol* continue to dominate the Republic of Korea's corporate scene, market opening and financial restructuring have exposed them to more competition in product and finance markets, somewhat disciplining their management and levelling the playing field for new local and foreign entrants. In 1998, the Government announced several initiatives to force *chaebol* restructuring, curb their market power and improve corporate governance, including limiting their debt to equity ratios and restricting cross guarantees. The Government's 'Big Deal' initiative tried to reduce *chaebol's* excessive sectoral diversification, but its competition and corporate governance outcomes were mixed. Bank and corporate collapses and restructuring, as well as tighter prudential controls have made banks less willing to fund the *chaebol*, forcing them to seek more finance from bond and share markets.

The crisis also sparked other reforms of the corporate governance framework including requiring consolidated company accounts, upgrading 'generally accepted' accounting practices to international standards and reinforcing external auditors' independence. To increase management transparency, *chaebol* must appoint outside directors to their boards and independent auditors to scrutinise their affiliates. In 1999, the private sector Committee on Corporate Governance issued a voluntary Code of Best Practice for Corporate Governance for listed companies; several recommendations now are law. However, *chaebol's* continuing market power, resource constraints and cultural differences mean companies will take time to comply with the new standards.

TAIWAN CONTINUES REFORM

Taiwan's relatively closed financial markets and large reserves largely protected it from the financial crisis, but this has not prevented authorities from continuing to liberalise markets and reform the corporate governance regime. Taiwan's corporate structure is dominated by small and medium family owned enterprises; family owned companies often exhibit poor corporate governance. In the past, limited access to bank finance prevented the growth of family owned conglomerates and encouraged Taiwanese companies to seek share market listing more frequently. Hence, its financial markets are larger and more developed than many other East Asian economies, forcing banks to compete more for funds and imposing more market scrutiny on firms. At present, institutional investors play a relatively limited role in the share market, as high volatility reduces its attractiveness as a secure investment destination. Taiwan's many small and medium sized firms already compete vigorously and increasingly liberalised trade and investment regimes expose them to global competition as well.

Taiwan's mature regulatory framework is robust and improving. Moreover, regulations are generally well enforced and authorities are addressing remaining deficiencies. In recent years, the authorities kept pace with regional regulatory reforms, continued liberalising the economy and deregulated key sectors, improving incentives for sound corporate behaviour. The Ministry of Finance is strengthening supervision of accountants and amending the Securities and Futures Investors Protection Act and the Securities and Exchange Law. The Securities and Futures Commission, under the Ministry of Finance, plays a key role in supervising and enforcing standards. Areas requiring further reform include introducing independent directors to boards and enforcing transparency on private companies.

HONG KONG SETS THE STANDARD

Hong Kong's British derived legal system and efficient open markets make it, along with Singapore, an East Asian leader in establishing a rules based business environment. Most major banks are independent from other sectors and major conglomerate groups, so most firms compete for loans. Regulations governing corporations are amongst the best in the region and bank prudential control is sound and mainly disclosure based. Authorities continue to upgrade the regulatory framework to stay ahead of new developments. Authorities recently improved banking sector competition and are lifting listed company boards' independence. Non-government organisations, including professional organisations, play an important role in ensuring standards keep pace with world's best practice.

However, large family companies and groups dominate the corporate scene, concentrating ownership, ensuring relationships remain important for doing business and raising minority shareholder protection concerns. Family companies prefer debt to equity finance, increasing their riskiness. Also, most conglomerate owners hold their shares closely; only around 1 per cent of the large share market is traded daily, reducing its role in disciplining listed corporations. Relatively low liquidity encourages share price manipulation, eroding market efficiency and minority shareholder confidence.

However, Hong Kong's extremely liberal trade and investment regimes, competitive goods markets and to a lesser extent, service markets offset the concentrated corporate structure. Also, company ownership is likely to disperse as pension system reforms channel significant domestic savings into the share market, particularly via institutional investors. Sales of government share holdings acquired during the crisis also will disperse share ownership reducing family ownership dominance; first-time sharemarket entrants have bought most shares sold to date.

INDONESIA FACES MANY CHALLENGES

The financial crisis severely disrupted Indonesia's corporate and banking sectors, undermining its relationship based business environment, but also providing an opportunity to improve generally weak corporate governance standards. The Government now owns over 50 per cent of the banking sector, including many banks formerly owned by large family controlled conglomerates. More rigorous oversight by Bank Indonesia eventually should improve corporate governance within the banking sector. Planned bank privatisations and the Government's disposal of corporate assets acquired in collateral swaps for non performing loans is an important opportunity for Indonesia to diversify its corporate sector ownership and expand the fledgling equity market. With many banks weak, increasingly corporate financing will rely on share and bond markets. However, this requires major corporate interests to relinquish insolvent company assets.

While stronger laws and regulations eventually should support a rules based business environment, at present many legal and administrative weaknesses undermine their implementation. Before the crisis, many laws and regulations were not enforced adequately; since the crisis, bankruptcy laws and prudential controls are stronger, but accounting standards are not yet up to international norms and are enforced weakly. Despite new bankruptcy laws, the new commercial courts have made few major decisions in favour of creditors. As yet, few boards of directors are independent from family owners, and protection for minority shareholders remains limited. Delays in implementing the commercial and insolvency law framework inhibits the move to rules based business at the same time as the relationship based business approach is under threat. This failure undermines development of a more mature corporate sector and, if not addressed, could weaken medium term growth prospects.

THAILAND AT THE CROSSROADS

Family owned conglomerates dominate the Thai corporate sector, complicating corporate governance. Crisis induced bank collapses and corporate restructuring have weakened traditional relationships between banks and their corporate customers. Public and private asset management companies set up to dispose of non performing loans hold a sizeable share of corporate assets. If sold, these would introduce new owners, diluting ownership concentration. However, apart from extreme cases, banks and authorities generally prefer debt rescheduling to more thorough corporate restructuring; consequently, many insolvent owners will retain control of their assets. Nevertheless, following far-reaching bank restructuring, several formerly conglomerate owned banks now belong to new, often foreign, owners and other private banks have sought foreign joint venture partners. Tighter bank capital adequacy ratios and high non performing loan levels restrict loan growth. With lending stagnant, many companies must access alternative sources of finance, especially bonds and non-voting shares. This provides competition to banks and exposes firms to listing and rating regulations.

New commercial laws and regulations eventually should help guide the Thai business environment towards a more rules based business environment; however, implementing new laws and regulations remains a challenge. Since the crisis, upgraded accounting and auditing standards require listed companies to establish audit committees; many disclosure standards now match best practice. Firms now must appoint independent directors to their boards to protect outside investors' rights and firms must report connected transactions. However, the minimum number of shareholders who can initiate a public meeting still is well above the international norm.

While courts have had some success in protecting creditors' rights, high non performing loans and shallow debt restructuring make it difficult for firms to find new creditors, threatening growth. Contract enforcement in the courts is very slow and can be problematic, slowing the transition to a more rules based business environment.

GOOD PRACTICE IN MALAYSIA

Malaysia has sound regulations and generally open, flexible goods and to a lesser extent investment markets. The financial crisis prompted additional corporate governance initiatives and Malaysia now enjoys a regulatory regime that rivals those of Hong Kong and Singapore.

Families are an important source of ownership in Malaysia, but they use pyramid ownership structures less than elsewhere. The state's proactive role in initiating and financing major private sector projects can weaken market discipline and deter small investors and new market entrants.

Malaysia has a more independent banking sector than many in the region, a well-developed equity market and increasingly active institutional investors that force firms to compete for funds. Large financial markets allow a dynamic business culture; eventually this should help generate better corporate scrutiny and governance. Except in the financial and infrastructure sectors, Malaysia also enjoys relatively open trade and investment regimes, increasing discipline on the management of many companies. Malaysia's long history of relatively open trade and, to a lesser extent, investment regimes provides firms in most sectors with global market discipline; the Government also is gradually privatising state owned firms. Nevertheless, regulations prevent new local entrants in some markets and foreign investment restrictions limit foreigners' participation in several sectors, allowing some poorly run corporations to make high profits. Post-crisis regulations also restrict the free movement of foreign capital; this is deterring new investment and could reduce the discipline it brings. Comprehensive anti-monopoly laws still are required to boost competition levels, especially in several protected services sectors.

Malaysia was well advanced in upgrading its corporate regulatory environment by the time of the crisis. In 1994, authorities required listed companies to appoint independent directors to their boards and establish audit committees. In 1995, Malaysia committed to moving from a merit based to a disclosure based regulatory regime for listed companies. Since the crisis, key reforms include incorporating the Code of Corporate Governance into listing rules and improving overall compliance. The Government is also moving to a disclosure based system of corporate governance.

THE PHILIPPINES SLOWLY PURSUES BETTER GOVERNANCE

Ownership of the Philippine corporate sector is one of the most highly concentrated in East Asia, causing significant corporate governance issues; however, 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.

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.

Nevertheless, these features slowly are changing and eventually could deliver a corporate sector with more dispersed ownership facing greater competitive forces. For example, reforms allowing some foreign bank presence have increased banking industry efficiency to some extent and the merger of the two stock exchanges and prudential reforms have developed the equity market, somewhat reducing reliance on debt. Competition in goods and service markets also is more vigorous than 15 years ago when the Philippines started market opening; trade reforms are increasing manufacturing sector competition and the new administration has put privatisation and deregulation back on the reform agenda.

Despite these positive steps, 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. Also, a lack of crisis induced corporate restructuring means large families should retain their role in the Philippine corporate sector for some time. Remaining major challenges include curtailing dominant corporate families' excessive market power and promoting broader corporate ownership and liquidity of share markets.

On the regulatory front, following the crisis, authorities reformed regulations to strengthen corporate governance. An August 2000 Securities Regulation Code improved listing requirements and insider trading sanctions and in July 2001, the President announced the Governance Advisory Council would review corporate governance standards, reform key regulations and boost enforcement. Future challenges include closing regulatory framework gaps, formulating a best practice governance code, strengthening regulations and professional practices for accounting and improving enforcement.

VIETNAM STARTS THE TRANSITION

State owned enterprises, SOEs, dominate Vietnam's corporate sector and state banks provide most finance. The weak performance of many state owned enterprises has generated high non performing loan levels, affecting the banking sector.

Vietnam is slowly embarking on economic reforms, increasing the role of market forces. Growing commitment to binding international agreements, recently with the United States, and a desire to join the WTO increasingly should open markets and drive legal and institutional reforms. The stock exchange commenced operating only in July 2000; to date there have been few listings so it still has a limited influence on corporate behaviour. While Vietnam eventually may use stock exchange listings to drive corporate governance reforms, at present its strategy for achieving effective governance of SOEs is unclear.

Corporate governance standards within the SOE sector remain poor. However a series of reforms recently announced, including small SOE privatisation, liquidation of insolvent companies and equitisation of others, gradually may improve incentives for better corporate behaviour. Nevertheless, the Government clearly intends to retain ownership and control of the very large SOEs, the General Corporations. Recent bank reforms, including restructuring bad debts, reforming the state owned commercial banks and improving banking and financial regulations, also are designed to complement programs to improve SOE efficiency.

Foreign invested enterprises are playing an increasingly important role in the Vietnamese economy, boosting private sector development. An increasing share of foreign direct investment is in joint ventures and wholly foreign owned companies; these and business cooperation contracts with SOEs provide better corporate governance models for SOEs.

Vietnam's regulatory system is in its infancy. Separate regulatory regimes apply to enterprises with different ownership and to foreign and local firms. Minority shareholders and creditors have little legal protection and the underdeveloped court system needs assistance to effectively enforce the few laws governing corporates and debtors. Encouragingly, the newly established stock exchange is increasing public debate on corporate transparency, accounting and auditing standards and board and management accountability to shareholders. The Government is following international best practice to build institutions to establish and implement new regulations. Many new initiatives are likely in the few years remaining before WTO entry, when Vietnam must open its markets to international players.

SINGAPORE AIMS TO BE THE BENCHMARK

Singapore has one of the region's best corporate governance frameworks; its well developed financial markets and rules generally protect outside investors. A recent survey of institutional investors ranked Singapore as the second most desirable investment destination after Australia in the region.

High levels of international competition mean companies face strong market forces. Singapore's virtually free trade status means goods, other than alcohol and some agricultural products, attract no tariffs. Low foreign direct investment barriers mean foreigners have increased their investment in Singapore every year since 1990. Finance markets also are competitive; while local banks still significantly finance domestically oriented private corporates, Singapore's direct financing markets are well developed and deep.

The Government increasingly is reviewing its involvement in large pension funds and several services sectors to boost market incentives. Government linked companies, GLCs, constitute a large proportion of Singapore corporate sales and assets, possibly reducing the voice of minority shareholders and presenting barriers to new entrants in sectors they dominate. Encouragingly, the Government is partly responding to these concerns by selling its shares in some GLCs and is privately outsourcing some pension funds to develop institutional investor activity.

Singapore's corporate governance regulations are amongst the best in the region. Despite relatively sound pre-crisis standards, since 1997, the Government has further improved the corporate governance framework to insulate Singapore from contagion and strengthen its position as a regional financial centre. In January 2000, the Government established the Corporate Governance Committee, which recommended a new Code of Corporate Governance. New listing rules were introduced in April 2001 to require disclosure in relation to compliance with the Code. By 2003, companies must either comply with the new voluntary Corporate Governance Code, or publicly disclose in their annual reports any areas where they fail to comply.

COMPETITION DRIVES AUSTRALIAN COMPANIES

In the last two decades, two episodes of corporate failures spurred corporate governance reforms; Australia's corporate governance now largely accords with international best practice. Over the same period, Australia developed large and deep direct finance markets and highly open goods and service markets, disciplining corporations. The 2001 failure of several high profile listed corporates may test aspects of the current corporate governance framework and lead to its further evolution. These collapses and consequent shareholder and creditor losses are likely to increase market scrutiny of corporate management.

Large public companies dominate Australia's corporate structure; very few have significant family or government ownership. Corporates usually finance investment directly through the equity market and contract debt, producing modest debt to equity ratios by regional standards. Over recent decades, the Government has deregulated progressively; withdrawn from direct production in most sectors, increasing domestic competition; and reduced import barriers and direct assistance, exposing industries to international competitive pressure. Only auto, textile, clothing and footwear tariffs remain above 5 per cent; these are scheduled to fall to modest levels. The Government maintains pre-establishment screening of foreign investment but only limited restrictions on investment apply to a few sectors. Market conduct regulation, principally the Trade Practices Act 1974, promotes competition and fair trading.

Australia's robust regulatory framework represents international best practice in most areas. After corporate sector excesses in the late 1980s, successive governments implemented numerous reforms. Laws back internationally sound accounting standards and auditing standards reflect international norms. Increasingly, minority shareholders are prominent and institutional investors exercise their responsibility as large shareholders. Strong market discipline and effective regulation means most companies comply with most standards. However, recent corporate failures may provide impetus for further evolution in corporate regulation, including directors' duties and maintaining auditor independence.

IMPLICATIONS

If regional governments reinforce the momentum of change under way in East Asia's corporate sectors, market and regulatory reforms eventually should deliver a more predictable rules based business environment in the region. Such a system would let all business people, including existing players, new domestic entrants and foreign businesses, access the lowest cost and most efficient inputs, finance and investments, without relationships reinforcing contracts. However, if emerging regional economies cannot overcome vested interests and correct legal and regulatory system weaknesses, business may be forced to revert to the old relationship based approach. This could slow economic recovery and constrain long term growth prospects.

This report has many implications for East Asian and Australian governments. First, economies will benefit significantly if governments strengthen market forces shaping more dynamic corporate sectors. Second, high priority attaches to governments upgrading legal and regulatory frameworks governing corporate behaviour and matching these with enforcement. Third, strong official support for prosecuting cases involving powerful interests is crucial to demonstrate government resolve to enforce change.

Australia's development assistance program can continue to support regional governments to upgrade and enforce corporate governance regulations and laws. Australia has a strong corporate regulatory framework and capacity to assist regional governments achieve best practice levels through long term institutional partnerships between key Australian institutions and their regional counterparts. Scholarships for promising junior staff and secondments, short courses and visits for senior personnel within regional economy regulatory agencies could assist building such links. Assisting minority shareholder groups and non-government organisations that build awareness of directors' fiduciary duties would help boost corporate transparency and compliance. To increase competition in goods and services markets, development assistance can continue to support regional governments in developing and enforcing competition policy, deregulating markets and liberalising trade and investment regimes.

Finally, major developments in corporate Asia significantly affect Australian business. First, accounting, auditing, legal, business consulting and training firms offer valuable skills to implement the 'regulation revolution' under way across the region. Second, corporate rationalisation creates opportunities for consulting firms, underwriters, insolvency firms and information technology consultants. Third, new and better implemented securities market regulations gradually should protect minority investors more, reducing investment risks. Finally, as East Asian economies move from relationship to rules based business, they will remove significant entry barriers to all commerce, benefiting all Australian businesses operating in the region. Knowing which economies are making most progress in this transition is essential for Australian businesses operating in the region.