



Changing Corporate Asia

What Business Needs to Know

Presentation on report, September 2002.

- How often do Australian business people return from a trip to Asia feeling they missed out on a contract, not because they had the wrong product, service or price, but because they lacked the vital insider relationships?
- Is this key aspect of the Asian business scene changing, and if so, where is change occurring first?
- This report aims to answer these questions.
- It finds the pace of change varies considerably around the region, but overall East Asia is making a gradual but discernible shift from a relationship to a more rules based business model.
- However, in some emerging regional economies, the pace of change risks being too slow to help restore growth.

Why Does Asia Operate on Relationships?

- Relationship based business, or preferring to do business with people you know, is a natural response to a lack of laws and institutions to enforce contracts.
- In the past, now developed economies also did business in this way, but as our economies became larger and more complex, for business to operate efficiently we found it essential to enforce contracts legally and require corporate disclosure.
- Most regional governments and analysts now recognise relationship based business contributed to the crisis and is failing to deliver new growth.
- Relationship based business results in East Asian markets being dominated by a few family owned corporates, reducing competition, inflates profit margins
- and often causes poor corporate governance and minority shareholder treatment.

- Relationship lending also compromised bank lending standards and eroded corporate investment quality.

Forces Driving Change

The report finds at least four major forces are encouraging the move to rules based business.

Slide 1 – Forces driving change

- Relationships are under strain
- Domestic and global competition is strengthening
- Corporates need new finance sources
- Governments are tightening corporate rules.

The first major driver of change is strained relationships

- Throughout East Asia, key corporate and financial institution relationships are under strain.
- The crisis made many major banks and companies insolvent
 - many companies are not repaying creditors or suppliers
 - so many regional firms can no longer rely on relationships to do business.
- Slide 2 – high non performing loans levels indicate the extent of this breakdown in relationships
- Slide 3 – Also, bank lending is still contracting five years after the crisis began, in part because banks are unwilling to lend to corporates
- Anecdote; For example, in 2000, the new foreign owners of the Long Term Credit Bank of Japan, now called Shinsei, ended the bank's long relationship with the insolvent Sogo department store, finally bankrupting the 170 year old retailer.
- Weakening relationships can also benefit Australian firms, increasing opportunities for exporters to supply into the region on a more level playing field.

- For example, weakening Japanese *keiretsu* group relationships are increasing opportunities for foreign financial institutions, including Australian ones, to supply financial services
- and for Australian exporters to supply other inputs to group firms.

The second driving force for change is increasing competition

- Markets discipline corporates better than regulations, and since the crisis competition is increasing throughout the region.
- Competition forces corporates to source inputs and finance from the lowest cost supplier, irrespective of old relationships
 - and to protect minority shareholders, creditors and consumers interests better
- Slide 6: Tariffs have continued to fall in most regional economies since the crisis and import penetration is increasing in many.
- Slide 7 Foreign direct investment also is increasing, due to lower barriers in most regional economies.
- Most regional economies are privatising state enterprises and deregulating though all, including Australia, would benefit from more competition.
- Anecdote: For example, Japanese car makers like Nissan, Mitsubishi and Subaru are now 20 to 50 per cent foreign owned. Foreign ownership has spurred cost cutting and innovation, significantly boosting profits.
- In the Thai financial sector, four of the 13 banks and the majority of securities companies now are wholly or partially foreign owned, increasing pressure on local banks to boost service and risk management.
 - Banks like Thai Farmers Bank and Bangkok Bank are making significant efforts, including using foreign professionals, to reach international banking standards.
- Australian benefit: Many Australian accounting and banking professionals are assisting local companies responding to growing competitive pressures throughout the region.

The third force driving change is corporates need for new finance sources

- many banks unwilling to lend to corporates, they are seeking to access equity and bond markets.
- Slide 6; New IPOs are increasing deepening share markets
- eventually this should impose market discipline on corporates who have to comply with listing rules and satisfy to shareholders and increase competition with banks.
- Anecdote: For example, in 2000, Korean manufacturer Hynix Semiconductor's was too highly leveraged to borrow, so instead issued over US\$1 billion in shares on international equity markets.
 - But before doing so it undertook major corporate governance reforms. Its majority family owners resigned from the board and relinquished all voting rights.
 - All ten board members now are outside directors.
- Benefit to Australia: Australian securities firms are now operating throughout the region assisting firms with IPOs
 - and Australian professionals are helping companies meet listing and bond rating standards.
- ***The fourth driver of change is tighter regulations***
- Since the crisis, most governments have tightened disclosure and insolvency rules and are boosting enforcement to protect shareholders and creditors.
- In many more advanced regional economies new company reporting, accounting, auditing and disclosure standards approach international norms.
- Eventually these reforms should make regional share markets and banks a safer destination for East Asia's vast savings.
- Slide 7 - Formal accounting standards also are improving
- According to this survey, Singapore and Malaysia's accounting practices are actually ahead of the United States'
- However, emerging regional economies still have a long way to go to meet international disclosure and insolvency standards.

- Benefit for Australia: Tighter disclosure and accounting rules and improved minority shareholder rights will help make such markets a safer for Australian portfolio investors.
- and Australian professionals are helping companies meet higher standards.
- ***Pace of Reform, Progress in Transition Varies***
- Generalisations can only go so far.
- So the second volume of our report details recent regulatory and market reforms in all 11 major regional economies and Australia.
- Australia and Hong Kong and Singapore, now have essentially best practice rules based systems.
- Slide 8 – Regional Map – Best corporate governance economies
- For example, a recent institutional investors survey ranked Singapore second after Australia as a desirable investment destination in the region
- Slide 10 – Regional Map – Middle income economies, Japan and China progressing
- More recently Japan and middle income Taiwan, Malaysia and the Republic of Korea are making good progress in lifting corporate governance standards. China also is developing a rules based framework, from a lower base.
- Slide 11 – Regional Map – Emerging economies’ progress slower
- Emerging regional economies, the Philippines, Thailand, Indonesia and Vietnam also are undertaking significant regulatory reform,
 - But in some cases, strong resistance to implementing new laws and regulations is slowing progress.
- The report finds that unless governments act quickly, some of these economies risk falling into limbo, with neither relationship nor rules based systems functioning effectively.
 - This will undermine their growth prospects.
- Australia’s aid program already helps strengthen corporate governance in these emerging economies, the report identifies many opportunities to extend this assistance.

- Promoting long term relations between counterpart Australian and regional regulatory agencies and non government institutions, like professional bodies and institutes of directors,
 - is a promising way to develop help these economies move to a rules based system and change corporate culture.

- ***Summing up***
- Slide 11 – Business implications
- the report draws three major implications for Australian business:
- First, Australian businesses will be well advised to focus more effort on those high and middle income regional economies identified as making the fastest progress towards rules based business
 - they are likely to be the first to return to robust growth
 - and will offer the fairest and most efficient environment for traders and investors.
- Second, those economies implementing stronger securities market regulations and insolvency regimes eventually should protect minority investors and creditors better
 - reducing risks for Australian portfolio investors and financial institutions.
- Third, Australian accountants, lawyers and other business consultants already access significant opportunities helping East Asian corporates comply with the ‘regulation revolution’ under way across the region
 - but these opportunities should continue to expand
- Speakers from PWC at today’s seminar will discuss how their offices around the region are helping local corporates lift accounting and corporate governance standards.

- ***Summing Up Overall***
- Side 12 – So summing the report finds:
- At least in more advanced and middle income regional economies, relationships are set to decline as a basis for doing business

- **The crisis, competition, financing needs and governments are driving the transition to more rules based business**
- **However, slower progress to rules based business in emerging economies could undermine long term growth**
- **In these economies Australia's aid program could usefully expand existing assistance**
- **Finally the corporate governance changes underway in East Asia have significant commercial implications for Australia.**