

Is Excessive Regulation Hurting Investors?

Record changes are taking place at the top of US corporations. 103 CEOs were shown the door in February alone. This was 11 more in January which was a record in itself. Sacked CEOs include high profile people such as AIG's Maurice "Hank" Greenberg, HP's Carly Fiorina and Boeing's Stonecipher. A great mutiny is raging at Morgan Stanley.

This is both good news and bad news. The good news is that the boards are ultimately breaking the umbilical cord that has so far tied them to the company managements. They are beginning to cast off their sleepy images and holding the management rightly accountable for their performance. This is a direct result of the turbulence caused by a series of regulatory measures mandated by Sarbanes-Oxley Act, new rules of NYSE and Nasdaq Stock Market.

Directors are becoming increasingly afraid of being hauled up in legal actions for letting fraudulent conduct go unchecked. The record increase in the sacking of CEOs despite the fact CEOs are reported to be spending nearly 40% time more in the office than a year ago is the result of the increasing public pressure on the credibility of CEOs. A recent survey stated as many as 73% of CEOs have thought of quitting.

Another reason for the increasing pressure is also the settlement of last January whereby Enron and WorldCom directors agreed to shell out \$31 million to recoup shareholder losses.

The bad news is that at least in some cases these sackings are not because of fraud but an irrational exercise by the board of their new found authority. Carly Fiorina whose stellar performance brought Hewlett Packard to such heights was one of those to face the brunt simply because her merger of HP with the Compaq failed to deliver results. Similarly Stonecipher's exit from Boeing had nothing to do with his performance or even his integrity. This was simply an over reaction to reports of his romance with an unmarried female executive.

The fact is that a fear psychosis has set in motion by a variety of new laws. There are several regulators working overtime in competing with each other on who goes the farthest. This excessive focus on regulation is hurting the investors. In this the work done by Eliot Spitzer, the New York Attorney General, is worthy of commendation. He has shown how the system can be reformed applying the existing laws instead of bringing new ones. The issue, therefore, is not of having more laws but enforcing the ones we have more effectively.

The proposition that the corporate world and specially the capital markets need to be regulated to improve transparency, accountability and integrity is uncontestable. Self governance has really not helped. The opacity with which the market is run has excluded most of the world population from the stock market. Corporate governance is not only an issue of compliance and disclosures but a powerful instrument for national economic and social transformation. Only by encouraging the participation of disfranchised masses in the stock markets can any nation hope to achieve a measure of sustainable prosperity and remove inequalities.

In his article in this issue Rene Banez talks about restoring trust at the workplace. A recent study of the World Economic Forum shows a dramatic lack of trust in key institutions. In fact the public trust in institutions is increasingly going downhill. The worst in this are corporates. 67% of those surveyed distrusted executives of multinational companies.

The real issue in corporate governance is the handling of individual greed as opposed to self-interest. Self interest can be enlightened and long term. Greed is self centered and short term. The current business culture is not driven by “do what is right” but “do whatever you want to do but don’t get caught”. The issue is not that there are a few rotten apples, as some tend to think. Both pre-Enron and post-Enron eras have shown us that greed is widely spread. Post Enron years have seen mighty falls of corporate icons from their pedestals. Almost all the business icons have fallen from grace. It was not only Tyco’s chairman who gave huge gifts to his wife and had lavish parties on her birthdays. Maurice “Hank” Greenberg, a celebrated star in the American corporate firmament until last month gave his wife more than 2 billion dollars of AIG shares 3 days before he stepped down. He was forced to resign after New York Attorney General Elliot Spitzer started investigating AIG’s business practices. Even Warren Buffet the great sage of Omaha is being grilled by Spitzer’s office about his role in a questionable deal between Berkshire Hathaway and AIG.

Like in the sustainability debate where the defenders of the old regime have tried to pooh pooh the idea of the sustainable development and the reduction of the green house gases, there is a strong lobby spawned by Chief Executives, Board Directors and Chairmen, threatened by the new regulations requiring induction of independent directors. This lobby is working overtime and sponsoring reports showing companies would be better off without outside directors. Independence is an attitude of mind. You can be independent as an Executive Director and not independent even as a Non-Executive Independent Director. The fact is that there are a lot of us who like to be led rather than lead, who cannot handle conflict and avoid stress situations, who never take any risks and will never ask an awkward question. Leadership skills and communication skills have to be cultivated. So the endemic problem of the conflict of interest cannot be solved simply by having more independent directors. Furthermore, if these independent directors, most of whom are usually retired people, are paid remunerations in the region of £100,000 a year by the company, would you really expect them to be independent? The key issue in the debate about independent directors is the selection and training of directors. We have to train directors to develop leadership skills and an independent mind because independent minded directors are the only hope of good governance. Excessive regulation on the other hand simply means throwing good money of the investors down the drain.

These are some of the issues being addressed in the 6th International Conference on Corporate Governance in London on 12-13 May 2005 where the theme is “making corporate governance decisions that work”.