



## **Contemporary Issues in Finance**

*Developments in corporate governance*

### **Martin Upton**

We explore some of the key issues affecting the financial environment and comment on what developments we expect in the coming years. Now, forecasting the future is always a precarious exercise, so I'm pleased to be joined today by two seasoned commentators on financial matters. I'm delighted to welcome Marcus Davidson and Graham

### **Honeybourne.**

The first question I want to talk about relates to corporate governance. There have been some significant developments in corporate governance in recent years. What I want to ask is – is this growth and extension of regulation going to lead to a reduction – or perhaps an elimination of fraud or mis-use of company assets? Perhaps I can turn to you first Marcus.

### **Marcus Davidson**

I think the basic problems of agency, the relationship between shareholders and the managers that they appoint to look after their companies, the basic problems of agency and moral hazard will not go away so easily. Regulators in general are seeking a kind of holy grail, a regime where their reporting and supervision doesn't generate into meaningless box ticking and doesn't encourage an atmosphere of what I call regulatory tourism, where companies go around the world trying to settle in whatever habitat regulates them most lightly.

### **Martin Upton**

Graham, what's your view?

### **Graham Honeybourne**

My view is that the nature of corporate governance has grown significantly over the last hundred years. So, if we look at it going back to the early sort of statutory formed companies there were a lot of impropriety. Today, with transparency and with the clarity of information on public companies far more freely available, I think that has brought that level of impropriety down. But, how we go forward with this is, I think, that there's an inherent rate of moral hazard that we have when we're dealing with enterprise and, it's like Marcus says, the agency theory is there with us and corporates are a structure of contracts and there will be contract failure and there will be misbehaviour. The involvement to try and increase regulation will only reveal the errors – it won't actually change the underlying embedded level.

### **Martin Upton**

And are there any costs associated with the developments in corporate governance?

### **Graham Honeybourne**

The costs are significant and this is the big issue we have at the moment the recent requirements for additional regulation right across the financial services sector and with regard to listed companies is significantly increasing the costs for organizations and there will be a rebellion by corporate management who are under profit pressure.

### **Marcus Davidson**

I think a problem here is that there's an ongoing campaign to try to bring managers' interests into line with those of shareholders; and these efforts have costs. They have direct costs but they also have indirect costs in that they could foster an atmosphere in which the companies begin to be managed not for the maximization of shareholder wealth, but in a kind of satisficing way, the compromise between shareholder interests and management interests

may result in compromising of shareholders' interests. For instance, the widespread use of options to remunerate directors has led to clear abuses. In retrospect it's clear what's happened. Shareholders have a, if you like, a linear pay-off from the movement in the share price – if it goes up they gain, if it goes down they lose. Directors have options which means they have nothing to lose if it does down.