



Ach'd

**WARWICK
BUSINESS SCHOOL**

BRIAN T. HOULDEN
BSc PhD DIC ARSM FInst D

INSTITUTE OF DIRECTORS
PROFESSOR OF BUSINESS STUDIES

14th July 1992

Mr Nigel Peace
P.O Box 433
Moorgate Place
London EC2P 2BJ

Dear Mr Peace,

Thank you for sending me the draft report of the Committee on the Financial Aspects of Corporate Governance. As this is a topic of considerable interest to both my staff colleagues and many of our MBA students, if possible I would appreciate two additional copies of the draft, one of which I would place in our library.

Since the issue of the draft I have seen some of the comments in the national press. My overall views are:

- . improvement in the quality of corporate governance is overdue
- . the balance of the recommendation is about right
- . understandably comments from company chairman have varied - some may well see the proposals as a threat to their power. The attached photocopy of a statement from the Reed plc annual report is supportive of the proposals.
- . I do not support comments by lawyers that much more needs to be covered by new laws rather than self-regulation. Companies and people vary too widely even if the focus is limited to the plcs. The article by Professor Kenneth Andrews of Harvard Business School under the title 'Rigid rules will not make good boards' which appeared in the Harvard Business Review, November/December 1982 pages 34 to 46 is still relevant.
- . although the Committee's brief was somewhat limited, I think the report could do with strengthening in one area.

On this latter point I attach a recent and related copy of a cutting from the Financial Times. My view is that the financial environment has played a major part in bringing to the fore the concerns which led to the Committee's deliberations. Yes, accounting standards have been too loose as have certain aspects of corporate governance. But Big Bang and the excesses of borrowers have played a part.



I would focus on the problem associated with the 'shooting stars' of the 1980s - not only those like Poly Peck and MCC which have led to court proceedings but also the rise and fall of companies like Coloroll, Blue Arrow etc. My belief is that the core of that problem is the ability of stockbroking analysts to allow for the quality of earnings (i.e. their sustainability over a longer period) as well as short term forecasts or yesterday's actual figures. Because some analysts paid too much attention to figures and too little to other signals, these companies found that they were highly regarded and could raise the funds they needed for even more headlong growth. The investing institutions and the banks have too little independent advice and therefore put in the funds needed.

Typically the top management of such companies are high risk takers for what they hope to be high rewards. When faced with difficulty, sometimes such people will then look for accounting dodges to keep the company growing; they are growth oriented and if the market turns down will be slow to accept that it has. In some cases their risk taking or egos encourage them to break the law in an attempt to recover a losing position.

So the environment has encouraged the advance of business leaders of this type. If this part of the behaviour is to be corrected a number of changes are needed

- 1) Learning from the excesses of the 1980s must occur. Most of those who have been through it are learning but what about 10 years from now when a new generation of top executives (in companies and financial institutions) is developing?
- 2) Financial institutions need to strengthen their own position - I understand for example that with this in mind one of the top institutions has decided to concentrate on a few sectors for their future investment.
- 3) The development of stockbroking analysts needs to be improved, so that they give due weight to factors such as quality of management, quality of product etc and uncertainty about the future, in their assessment of companies.
- 4) Consideration should also be given to whether the combination of analysts, salesmen and market ~~makers~~^{makers}, often in the same organisation, is in the best interests of the banks and institutions who are giving so much weight to analysts' advice.

I appreciate that the area I have been sketching is probably outside the Committee's brief but I do think that more should have been said at least to expose this problem.

Yours sincerely,



Brian Houlden.

BH/PEACE/D3.2