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investment bankers



# The Regulation and Decline of the Public Corporation

A Presentation to the Law and Economics Association of NZ

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# Presentation Agenda

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Regulating the Corporation

A Framework for Choices and Challenges Faced by Organisations

The Challenges for the Open Corporation

The issues for Governance Regulation

Private Equity – The threat to the Open Corporation

# Regulating the Corporation

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## ♣ Presumptions

- ♣ Corporate collapse and investors losses are market failures caused by 'agency costs' and 'gate keeper failure'.
- ♣ The failures can be rectified by regulating for compliance with 'good practice'.

## ♣ Flaws

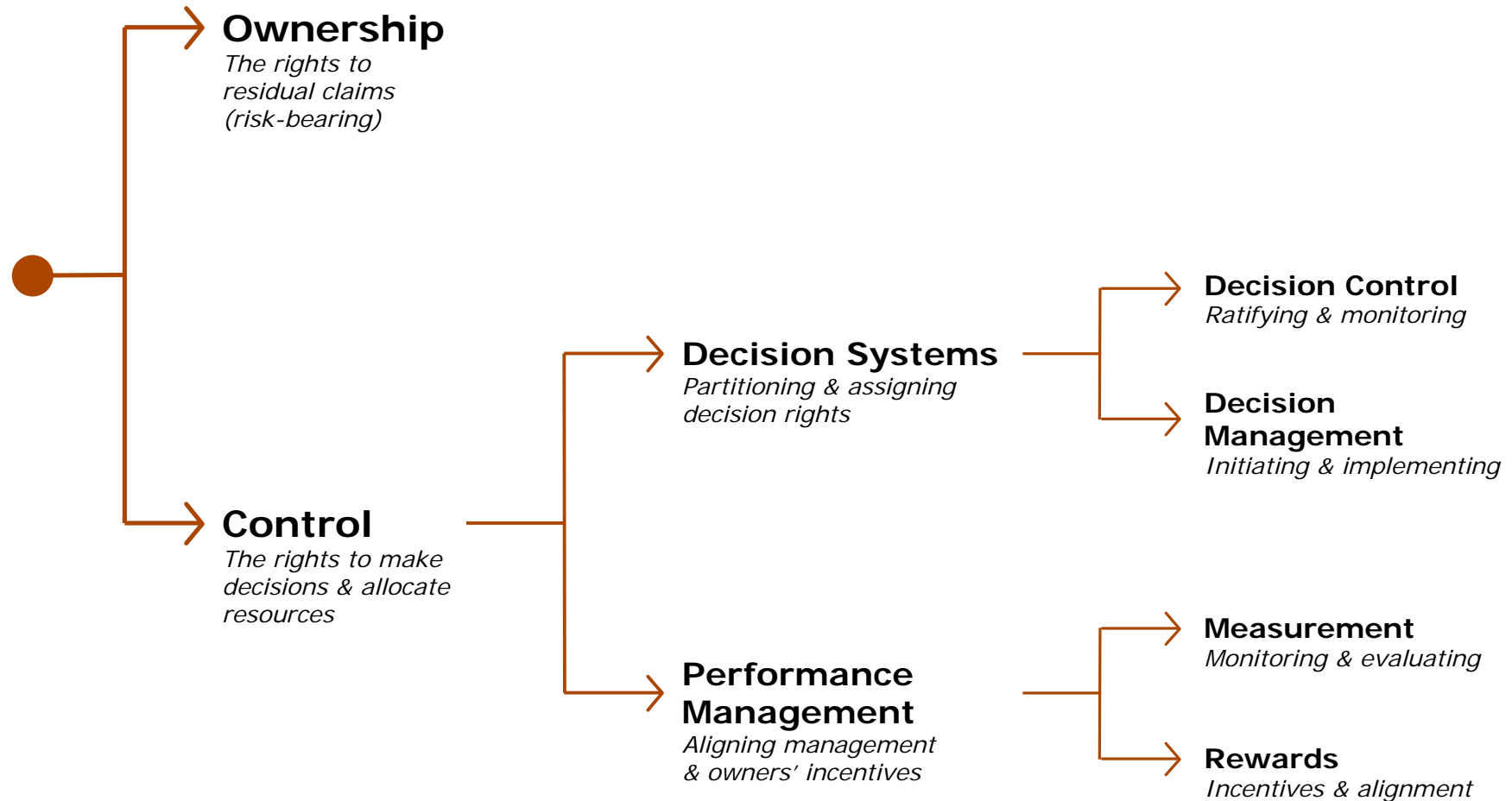
- ♣ Collapses don't constitute market failure.
- ♣ Focus of arguments are too narrow.
- ♣ Solutions don't address real challenges boards and management face in fulfilling their role.
- ♣ Don't consider how regulation will affect choice of organisational form.

## Organisational Architecture – Challenges & Issues

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- ❖ **Primary Challenge** - Allocation of decision rights to those with specific information and capability.
  
- ❖ **Collateral Issue** - Designing control arrangements to align decisions with owner/stakeholder interests using:
  - ❖ Decision Systems.
  - ❖ Performance Measurement.
  - ❖ Compensation and Reward Structures.
  - ❖ Values and Culture.

# Organisational Architecture – The Big Choices

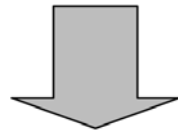


# Organisational Forms

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## Closed Corporate

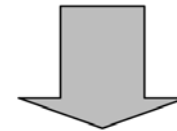
Overlap of Ownership and Control



- ♣ Sole proprietorships.
- ♣ Partnerships.
- ♣ Private companies.
- ♣ Co-operatives.
- ♣ Private equity firms.

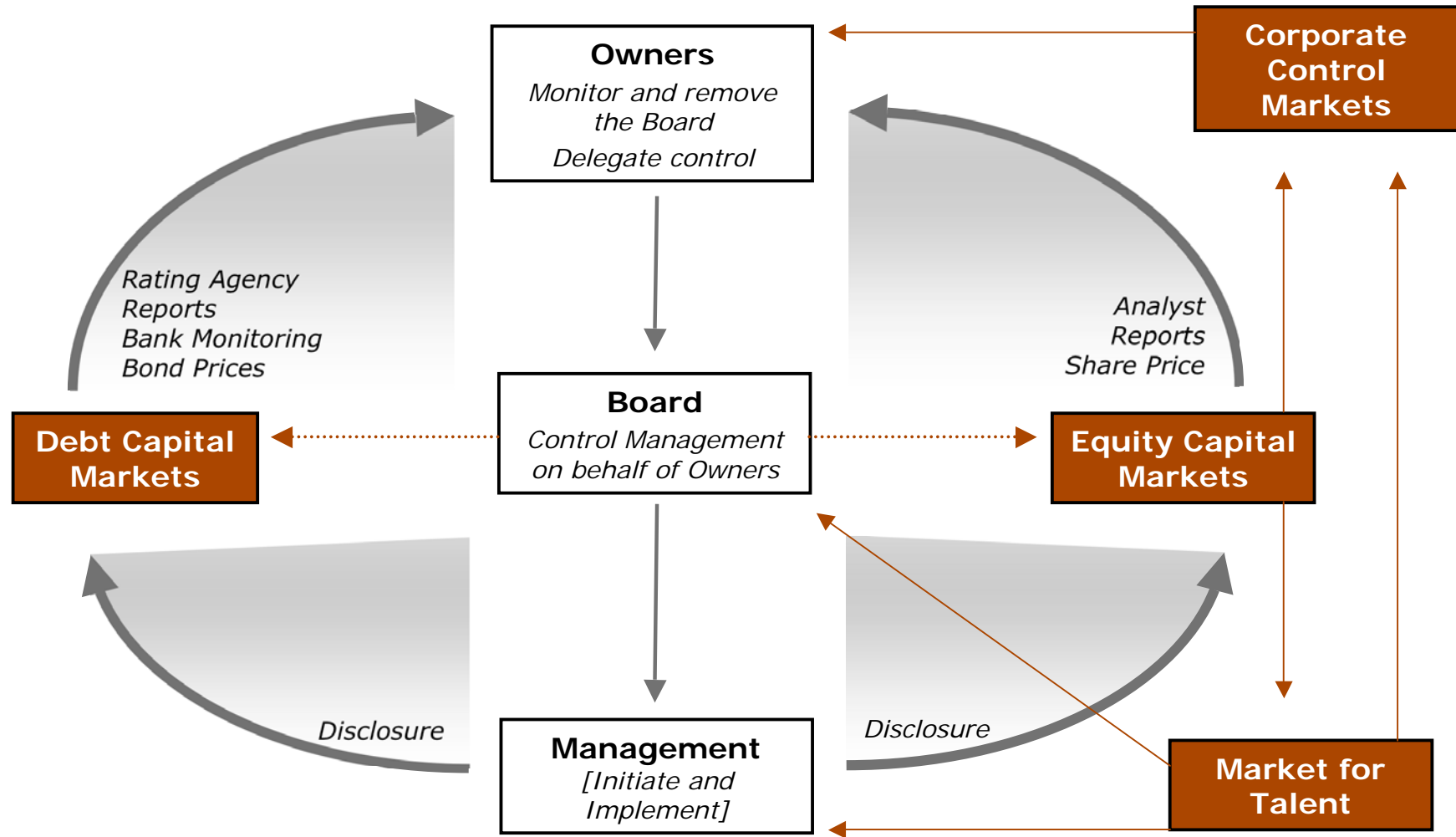
## Open Corporate

Separation of Ownership and Control

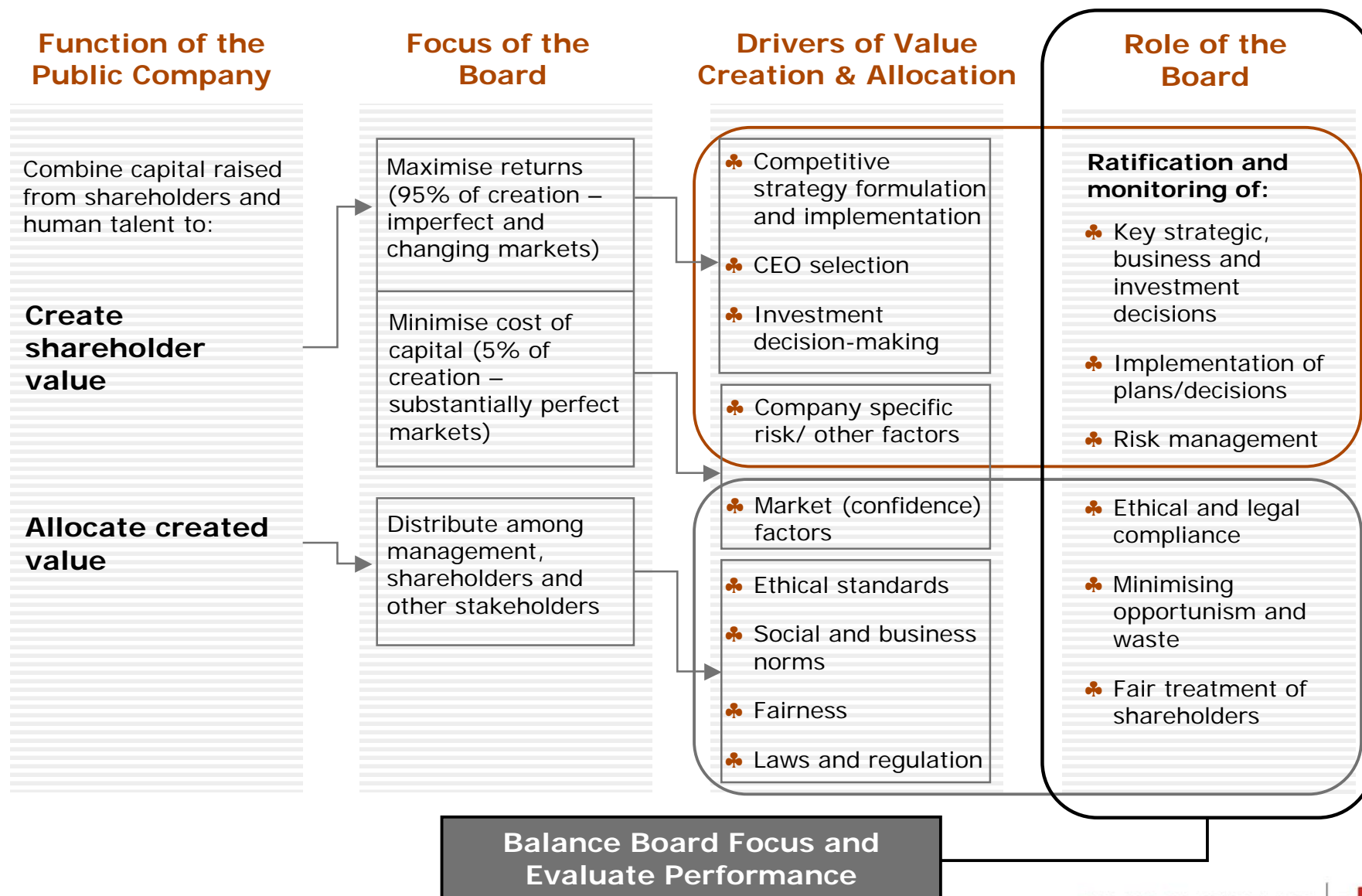


- ♣ Publicly listed corporation.
  - ♣ Dispersed ownership.
  - ♣ Specialist managers and boards.
  - ♣ Decision hierarchies.
  - ♣ Performance management systems and compensation structures.

# The Open Corporate Model – Interaction with Markets



# Governance and Shareholder Value – The Links



## “Best Practice” Boards

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### Requirements

- ❖ Understand and choose level of engagement with management.
- ❖ Determine priorities and tasks.
- ❖ Determine required competencies, composition and size.
- ❖ Select right people and board leader.
- ❖ Establish board culture and interaction with each other and CEO.
- ❖ Align directors' interests with shareholders through “wealth at risk”.
- ❖ Establish board agenda.
- ❖ Ensure board receives necessary information.
- ❖ Regularly evaluate performance.

*“Patently, this is not the stuff of legislation”*

## Issues for Governance Regulation

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- ♣ Regulation can only provide a “compliance floor” but will not produce “best practice” boards.
  
- ♣ Global “one size fits all” regulation is not appropriate due to differences among:
  - ♣ Legal and economic environments.
  - ♣ Robustness of markets for talent, equity capital and corporate control.
  - ♣ Local governance practices.
  
- ♣ In NZ governance regulation has risks:
  - ♣ Diversion of board focus from value creation.
  - ♣ Reduction of supply of talent to public corporations.
  - ♣ Large compliance costs for most companies due to our economic structure.
  - ♣ Firms turning to other sources of capital and organisational solutions.

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## Issues for Governance Regulation

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- ❖ Equity capital and corporate control markets are likely to deliver better governance outcomes for companies.
- ❖ Role for Codes of Conduct.

## Private Equity – The Public Company Threat

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- ♣ Private equity:
  - ♣ Has evolved over 50 years.
  - ♣ Works on “best practice”.
  - ♣ Solves information problems faced by boards.
  
- ♣ Private equity firms are moving to the “centre” of capitalist action and attracting the best business talent.
  
- ♣ In 2004 private equity firms invested \$302 billion and will continue to grow.
  
- ♣ Private equity is the “natural” alternative to the publicly listed corporation.

## An Extract from the Australia Financial Review ...

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### *Directors Cut: why the boardroom is going private*

*Andrew Cornell and Bill Pheasant, 11 April 2005*

"It's called "going dark". As new regulation and governance regimes unfold in the wake of corporate collapses and increased consumer activism, turning the spotlight on companies, their management and directors, some are just turning off.

Would-be directors, wary of collateral damage to their reputations, are choosing not to join public company boards. Companies are choosing either not to go public at all or to structure their operations strategically to avoid regulation. Or, indeed, they are choosing to go private.

Capital, often through private equity funds, is flowing to companies less burdened by the safeguards and the cost of regulation and scrutiny."