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## NEWS

### **Let nature take its course KURT HESS**

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DISCLOSURE is good for capital markets and makes them more efficient. That is the mainstream view.

But has anybody seriously studied the cost and benefits of producing the large volume of required investor information for an average listed company these days?

Take as an example the evolution in the past 25 years of reporting by Australian and New Zealand banks. In the first few years, their reporting lacked detail; it has steadily improved since, in line with more stringent accounting and disclosure rules.

However, the major Australian banks must now publish volumes of often very technical disclosure details and, in particular, extra information on corporate governance.

There is research to suggest that most investors do not have a good understanding of this material and that few are willing to spend the time needed to understand it.

Some might argue that this disclosure allows technical experts such as analysts and commentators to extract the information required for an informed market view.

However, the real beneficiaries of such "over-disclosure" material are the accounting and financial services firms that produce it.

Each time a calamity happens in the financial markets, the policy-makers call on "experts" in the field to recommend remedies for the apparent weaknesses of the system.

These "experts" are, in turn, the accounting and financial services firms which propose new rules (and not just related to disclosure). Further rules then guarantee a continuous flow of fee revenues for years.

More recently, three New Zealand finance companies have collapsed.

This sector has enjoyed unprecedented growth in the past few years, as investors attracted by higher yields than bank deposits invested their savings with these non-bank financial institutions. The economy was doing well and so these firms found plenty of opportunity to lend to property developers and consumers.

The demise of these companies came perhaps as a sign of tougher economic times but, let's face it, some failures were statistically long overdue.

A pattern of events is now clear. People say: "We need to find mechanisms 'to prevent' this from happening again."

Interventionist measures may no longer be fashionable in economics but improved disclosure is always seen as a "good thing."

And so people demand continuous disclosure rules for the finance sector, to the same standard as applies to the listed firms. Would such rules really be commensurate?

The non-banking finance sector consists of more than 100 firms, mostly privately owned, some micro-sized.

Continuous disclosure would impose even greater compliance costs on medium-sized business. Yet politicians

of all colours are calling for reducing red tape for business.

Provincial Finance, which defaulted on more than \$300 million of debentures, is an example of why better disclosure would not have helped greatly.

Lending against overvalued cars would not have been picked up in even the best of disclosure regimes. This was simply a consequence of bad management, perhaps a lack of systems to recognise the problem within the company.

The value of great volumes of disclosure, in particular for financial institutions, has to be questioned.

This sector is inherently more opaque than firms in general, a view supported by research of Donald P Morgan in the respected American Economic Review 2002. He found risks in this sector hard to observe and also easy to change. Rating agencies, with their privileged access to company information, were the least likely to agree on credit ratings for this particular segment of firms.

Let us thus not overreact to the default of a few finance companies. They are healthy for the discipline in the New Zealand capital market.

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A full disclosure regime for finance companies would impose large costs out of proportion with its benefits.  
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