Corporate Governance Lessons to learn from Financial Crisis.

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Abstract

In the recent past, there has been a great weakness in the global financial sector. It is attributable to a diverse array of the causes of the global financial crisis. Due to the enormous risk measures taken by corporate bodies, and poor governance by the financial regulatory bodies, it is no doubt a cause for worry (Tricker 2012). Failure by the corporate bodies to stem the down spiral experienced during the financial crisis is a major cause of the spiral itself. The paper tries to get a deep and critical analysis of the corporate governance’s weaknesses which led to failure of the global financial sector. This proposal identifies corporate governance as a critical cause of the financial crisis coupled exorbitant executive remunerations, poor risk management strategies, transparency, and full disclosure. It also brings to light the key issues to be deduced from the crisis that are to be put into practice to avert any future crisis such as transparency in board room matters, management of risks, executive salaries among others. This study is crucial as it gives a clear perspective of the necessary corporate governance reforms that are not only useful to the financial sector, but also to other organizations.

Chapter 1: Overview of the Project

1.1 Introduction

Many financial scholars have been attracted to the critical study of the causes of the failure of the global financial markets. It can be likened to the historical great depression of the 1930’s. Whereas different scholars have put forth different arguments, it still remains evident that the financial crisis was greatly triggered by poor corporate governance strategies. There was an acute shortfall in the corporate governance whereby financial institutions largely failed to adhere to advise given. At a time when their services were the most needed, the existing standards failed to give the necessary check and balances that financial institutions needed in
order to make sound business decisions (Joseph 2008). When put to the balance, corporate governance routines miserably failed to safeguard against the excessive risk taking in quite a number of financial service companies. The risk management apparatus were a let-down in most of the cases due to corporate governance procedures as opposed to the inadequacy of computer models. Risk was taken as an activity rather than an enterprise based one (Joseph 2008). This paper will analyse numerous aspects of corporate governance failures and the constructive lessons that can be learnt from the global financial crisis. The paper uses both qualitative and quantitative research techniques by way of literature review and respondent questionnaires to a variety of financial institutions.

1.2 Topic

My research study is to be done in two parts: the preliminary study and the final research. The preliminary study will include:

I. An investigation into corporate governance, its management systems, risk reduction stems, and general lessons to learn from the financial crisis.

II. An inquiry on better corporate governance for sustainable financial institutions and markets.

1.3 Significance

Before and after the global financial crisis, it is largely felt that the corporate governance issues were not accorded the deserved attention to alleviate the crisis. The global crisis happened after the breaking up of the international financial markets with an accusing finger pointing at the poor management practices in the corporate governance sector. My study will analyse the deficiencies that led to the downfall of financial institutions that consequently led to the financial crisis and this was implicated on the few and fragile risk management techniques that led to
several firms collapsing (Tricker 2012). The Organization for Economic Cooperation and Development (OECD) report indicates that the supreme cause of the financial crunch was the neglect by corporate governance. A brief insight in my research, will seek to highlight corporate governance failures in the wake of the global financial crisis as a core factor of the downfall. It is owing to the large volumes of complex financial matters that were overlooked in the financial policy formulation. Several financial institutions, as shown by Joseph (2008), indicate that several banking institutions and their boards of management failed to understand complex financial products with their attention focused on internal stress rather than the broader looming financial pandemic. The investment boards miserably collapsed in giving strategic guidance and adoption of sound risk control procedures. The risk and investment managers failed miserably to give proper guidance and risk control measures to alleviate the crisis.

The performance rewards that gave executives hefty salaries as incentives are also to blame. My research paper will seek to analyse the data of affected firms by the crunch. As observed by (Tricker 2012), the design to award executives incentives based on their performance is a contributing factor in that managers became risk perverse and ended taking excess risks which were to beneficial in the short term. It was a tool to encourage the managers to make more risky decisions on stock options without being risk averse and mainly this was for their short term gains. Executives were permitted higher risks in stock options and their exit on the other hand granted hefty perks even in the event of failure. Even when there was imminent failure of their strategies, they still could make away with the incentives for trying. The boards again failed to address properly the risk factors before their implementation. Disclosure by financial institutions as regards to the foreseeable aspects of risk and methods of accurately managing and monitoring these risks were out of place. A study on the impact of the financial
crisis indicates that several firms suffered from the crisis owing to the adoption of poor managerial incentives, inadequate risk control measures and risk management systems. These causes coupled with inferior human capital skills, proficiency, and veracity significantly failed to give sensible direction (Tricker 2012). The risk pervasiveness attitude by financial institutions was a big factor in culmination of the financial crunch experienced. Formulation of remuneration incentives that set stage for an increase in the risk appetite of executives led to failure to reach sound agreements in the boardroom. Besides all these factors, accounting standards and some regulatory standards also proved to be insufficient in some areas.

1.4 Research aims and Objectives

My research paper will investigate:

i. The role played by corporate governance in the financial sector.

ii. Principles and regulations that should be adopted as a lesson from the financial crisis.

1.5 Research Questions

1. What factors led to the crumbling of the international financial institutions?

2. What was the total effect of the financial crisis?

3. What lessons can be learnt from the global financial crisis?

Research methodology

The study employs will employ a mixture of both qualitative and quantitative methods to carry out the research. A blend of primary and secondary research methods are used to answer the research questions. The researcher data is gathered from the field through administering self-administered questionnaires. However for purposes of this research, secondary data from sources such as previous research material, company annual reports, and information from working reports as well as economic reports is heavily used. The research employs the panel data
framework which analyses cross sectional data from independent units. Further this study identifies the use of the Black Box Model that explains the corporate governance functions as the best tool for conducting this research.

**Data collection and findings**

Questionnaires were distributed to various financial institutions, and mostly those that were affected by the financial crunch. Few of the institutions received severe global financial crisis impact. Follow-up interviews were conducted on chief financial officers, risk managers and internal auditors to act as supplement to the questionnaires.

The existent findings on the literature review on the shortfall of corporate governance provide several insights to learn from and be able to formulate better and far reaching policies. The literature review findings are that the major sources of the financial crunch as far as corporate governance is concerned are the remuneration systems adopted, the boards room wrangles, transparency and full disclosure and the most importantly the protection of shareholders rights. The European banking sector found that reforms be directed toward better risk management processes to curb uncertainties in the financial market avoiding excessive risk ventures in the short term and a harmonized remuneration system. It is suggested that executive remunerations should be pegged on long term performance coupled with adjustment for risk with a limit to internal control.

The response from the questionnaires indicates that the financial crisis provoked disclosure of inadequacies and shortfalls on management skills for various managers in different firms. For some reasons not in this study, some managers are not able to objectively make independent financial judgments. In overall, it is evident that during financial crisis, respective managers lack the adequate skills to prevent or control such crisis. It comes out as a bad trend in
the management of financial institutions as it is a vital organ in economic matters and the economy at large.
References

