Failure of the antitrust policy is the key to what happened
I believe the markets even now are higher than they should be
Increasing punishment will induce crooks to spend more money on evasion

Shyam Sunder

The Yale professor in a candid discussion with Managing Editor Prem Panicker

An accounting authority, a perceptive analyst, and an excellent teacher. And one who manages much deeper. To Shyam S. Sune, we need to go back a quarter century. Until the mid-1970s, it was not US policy to enforce antitrust laws against professionals. The antitrust laws existed, but were not enforced against doctors, engineers, accountants, or attorneys. The argument was that if you force professionals to compete through advertising and other means, you induce them to cut corners on quality of service. Their customers find it difficult to distinguish good from bad when they buy the service.

In a mid-1970s decision, the Supreme Court ruled that attorneys could not be prohibited from advertising their services. In the late 1970s, the government forced the professions to change their codes of ethics, and remove barriers to competition. It was argued that any potential anticompetitive effects were minor. The antitrust laws were designed to ensure competition, to prevent them from lowering the quality and level of service provided. The public’s best guarantee of quality.

Extension of this argument to auditors, you want to make them yourself. Evaluate mean by investor confidence. At its peak, unfettered competition in a profession is a guarantee of quality, not excusing anyone, living from doctors and lawyers for insurance. However, proved to be problematic. With auditors and lawyers, it is not observable - and it is not observable in the auditing industry - encouraging unscrupulous competition in a profession is a recipe for disaster. Relieve auditors from some of the antitrust provisions to let them audit decently, not extravagantly, living from their profession.

President Bush said he would ensure that existing laws are implemented - which is nice. Do consider though why were those not implemented thus far, in the first place? Failure of the antitrust policy is the real key to what has happened, and the solution lies in looking at the policy itself. It may be difficult though for lawmakers and regulators to admit the responsibility for bad policy. So I don’t see such a review happening, at least until after the Fall elections - right now, what we see it media play, meant for electoral consumption.

Another point is that increasing punishment for fraud will in most cases merely induce crooks to spend more money and resources on evasion. Rather than punishment after the event, I would like to see the laws written so most people do not find it in their own best interest to commit fraud, in the first instance.

On the subject of stricter implementation of laws, wasn’t that the substance of President Bush’s speech? A large part of that speech consisted of moral exhortations to the heads of public corporations to be less greedy.

Moral persuasion may have a half chance of succeeding, depending on the credibility of the person. If you believe the preacher, you may listen - but will you listen if the preacher has questions hanging over his own head?

For Instance, President Bush made his speech a day after he refused to make public the record of his own transactions at Harken Energy Corp and its investigation by the Securities and Exchange Commission. If you are a CEO sitting in that audience, listening to that speech, I could not blame you for wondering why someone who is not willing to practice it is preaching you transparency.

What other factors would you say are necessary for the market to regain investor confidence?

We need to be precise about what we mean by investor confidence. At its peak, for example, Enron was selling at around $85 - and people were buying. Is that investor confidence? In order to support that price, Enron would have needed to add its earnings every year for six years, followed by a sustained average rate of growth - a highly unlikely event for such a large corporation.

So when investors bought into Enron at that price, to cite one example, was that confidence, or overconfidence? We can think of investor realism, overconfidence, and pessimism. With neo-classical kinds, what we saw earlier was overconfidence, what you see now may be pessimism - neither may be justified. I believe that the markets even now are higher than they should be.

With investors suffering huge losses, will we now see a tightening of consumer belts, which may have a long-lasting impact on the economy? Fortunately, when deciding how much to spend, most people do not count their stock portfolios as if it were money in the bank. It is not money in the bank until it has been converted into cold cash. Thus, even during the boom, while spending did go up with the portfolio values, it did not go up proportionately with the values of their portfolios - and now, the same applies, the fact that portfolios are down is not likely to decrease spending to the sort of levels that could impact on the economy.

Finally, you mentioned that even today the market is higher than it should be. So where should it be?

There is no single magic figure where the market as a whole should be. I prefer a more pragmatic approach towards each individual firm. As an investor, ask yourself some hard questions - don’t go by the company’s own valuations and projections. Ask yourself, what are the actual earnings, without all the shenanigans, the forward projections.

Ask yourself what is the rate of return you would expect from the investment, and calculate the maximum amount the stock is worth to you on that basis. Use this evaluation of the firm to guide your investment decisions, if you want to make them yourself. Evaluate your company or industry from that perspective. If such a pragmatic approach is applied, then the market will automatically find its ideal level.