MANAGEMENT ENTRENCHMENT, CORPORATE GOVERNANCE and ACCOUNTING ARBITRAGE

by

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ABSTRACT

This paper examines the short term reaction of entrenched management to external regulation that jointly threatens managerial job security and firm survival. We utilise the 1992 imposition of the Australian Financial Institutions Code (AFIC) and a case study of New South Wales (NSW) credit unions to test "co-operative stakeholder", "regulatory-capital arbitrage", and "job-security" hypotheses. Credit unions have a governance system, operating policies, and an entrenched management structure significantly different from other banking institutions. We predict that these institutional and governance constraints limit the ability of managers to undertake substantial operating efficiencies required to meet target capital ratios, and managers will react by undertaking aggressive accounting manipulations. Consistent with predictions we find limited evidence of increased operating 'efficiency' and find that at-risk credit unions aggressively managed their capital adequacy ratios via a portfolio of accounting techniques and by taking 'asset baths'. Results raise questions about regulatory authorities imposing (possibly) inappropriate template regulation, the ethical reaction of managers and the corporate governance structures of co-operative institutions.

Classification Codes: G21, M40

Key Words: stakeholder corporate governance, credit unions, regulatory-capital arbitrage, accounting manipulations

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