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The Coefficient of Greed
by Steven Abernathy
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The past couple of months we have all watched the markets get pummeled because of concerns about sloppy accounting practices and possibly even fraud by some of our country's leading companies.

The series of accounting nightmares by companies that have included **Enron Corp.**, **Conseco**, **Sunbeam Corp.** and **Cendant Corp.**, combined with Argentina's default and the painful memory of defaults in Mexico and Russia, has caused reflection about the stability and condition of the capital markets.

Our financial system is largely based on faith — faith in the capital markets, faith in the U.S. companies that lead the world's most important industries and faith in the entities that govern them. Our faith has been shaken and challenged. We must brace ourselves for a potential exodus from the capital markets.

The quest for quick returns and instant payback has created a lust or greed coefficient of easy money that has been magnified over the past 10 years. When you have such deep underpinnings of greed, a system based on trust and faith is much more vulnerable than a market that is orderly, trustworthy and driven by accounting standards that are enforced.

The capital markets certainly have changed over the past 30 years. Experts have debated whether the general market place is looking at absolute valuations, or is it more important to look at relative valuations in order to determine the drivers of the market. Many have agreed that a shift toward relative valuations has taken place already. If these folks are correct, the most important determinant of value becomes the flow of assets into or out of the market, and not the absolute or intrinsic value of the assets.

Accompanying this assumption is the desire to determine the underlying reasons for massive inflow/outflow in the markets. Overvaluation is undeniably a key part of this puzzle, and it is clear that this imbalance will continue to evolve.

Where did these overvaluations come from? They came from a lack of attractive alternatives, and then greed. Greed ensures that those investing would never be satisfied with a 4% bond even though it may be the right thing to do.

The lack of attractive alternatives, coupled with greed, creates a demand for public securities that outweighs the supply. The number of those purchasing overvalued securities is higher than those selling these securities.

This is why you seldom see a public-company acquisition take place with cash as the currency. It is much less expensive to use the acquiring company's overvalued stock as currency.
The ease of making money over the last four years allowed the proliferation of greedy companies using shoddy accounting practices and in some cases outright fraud.

Factors such as these will continue to heavily affect the marketplace over the near future, with recurring setbacks each time a new company is discovered to be fraudulent. These reactions will be short term and, most often, unpredictable.
Two possible paths could emerge.