Institute of Actuaries of Australia

Equity Driven Productivity

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Abstract

Business is generally structured to fit into our capitalistic and adversarial world. This makes it opportunistic, inequitable and driven by short term considerations. It seems that any ideas for improvements are aimed at the symptoms.
The actuarial approach is to address the root causes and this paper outlines the core problems and proposes an actuarial approach to fixing them.
The proposal is to provide a basic return on human and equity capital in priority to bonuses which should be fairly distributed. This leads to issues of equity, reserving and confidence.
The specific proposals set out in this paper would benefit from broader scrutiny, input and support.

Key Words: Equity driven productivity; business structures; estimating and allocating surplus; liquidity management

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"Our deepest fear is not that we are inadequate.
Our deepest fear is that we are powerful beyond measure.
It is our light, not our darkness that most frightens us."

A return to love - Marianne Williamson

1) Introduction

The brilliance of capitalism is the brilliance of humans pursuing self interest. Motivation is the core driver of productivity.
The weakness of capitalism is that individual self interests are often not compatible. A lot of productive time is spent on non productive and even destructive activities. As a result, some individuals may gain excessively at the expense of others and often at the expense of the community as a whole. Motivation itself can become a casualty for many in this 'motivated' environment.

To avoid wanton destruction of wealth by individuals pursuing self interest, structures and rules are put in place to try to eliminate the worst destructive behaviors. By limiting the damage, we hope for fairer outcomes. These structures are costly and create other opportunities for self interest to cause wealth destruction or productivity substitution. However, it is clear that some defensive structure is essential simply to provide a workable environment.

The key to better productivity (and lifestyle) outcomes lies in creating more positive environments. This could be achieved by improving the alignment of self interests without adding to the cost of defensive structures and rules.

In this paper I set out, without too much novelty, how we should be able to redefine and reengineer the common relationship between capital and labor to dramatically improve confidence and belief in the economic structure and our current working relationships. This should lead to greater equity, motivation and productivity. And it should happen with little or no net cost and without any painful transition.

To the extent that I can, I want to focus simply on promoting self interest and productivity at work without spending time on the community's greater objectives and challenges. And for the moment, I want to look at private enterprise even though I believe that many of the ideas can be discussed in the context of public enterprise. So here goes equity driven productivity - improving confidence in business structures and outcomes to increase productivity and create more equity.

2) Purpose

I would like to make the world a better place and I suspect that I have been spectacularly unsuccessful in this aim to date. I am sure that I am not the only person to find myself in this position. But perhaps it is less common to suddenly believe that enough like-minded individuals out there could take a good plan and make it happen. So I seek help to turn some of my ideas into that good plan and help to make it happen.

Please excuse my use of the first person in this paper. This choice was deliberate due to a greater than normal - for an actuarial paper - reliance on opinion.

I want to promote a general corporate philosophy and develop the concept of an investor friendly company with a focus on traditional actuarial topics – solvency, equity, reserving and sustainability. This brings with it the actuarial control cycle, a financial condition report and a greater focus on analyzing and understanding cohorts of business (or the progress of each business over time rather than all of the business during a time frame).

This concept will require strong input from suitable dispassionate and independent observers such as actuaries to create confidence amongst the participants. Creating a broadly accepted approach and standards will assist in building this confidence.

The investor friendly company will create a better risk/return profile for investors by reducing the investment risks significantly. This should encourage investment and employment. I hope that you will also see the potential of far better outcomes for both labor and the community… and the probability that better alignment of interests naturally leads to a more genuine form of self regulation and the appearance of morality.

This all sounds far too sweet! I should be clear that I want bad businesses to fail (the sooner the better) and good executives to get very big bonuses. These PR ‘negatives’ are an important part of making good businesses grow.

I respect the right of government to vary the business environment in order to change the lot of certain types of business but hope that the urge to do so subsides in time. Improving infrastructure, helping the vulnerable and punishing the cheats helps business much more.

3) The structure of business

Most business occurs through corporate structures. These are reasonably flexible arrangements that allow capital and labor to be pooled. The common form that they operate in is subject to fashion and circumstance.

Early companies probably evolved from sole traders and partnerships which were driven by individuals or families. As companies grew, professional managers would have increased their influence but maintained the conservative philosophy of the main sponsors. Growth in commerce and markets probably led to bigger companies, bigger shareholder registers and more independent boards of directors.

In more recent times, professional management has taken the opportunities to be more entrepreneurial and take greater risks within the company. Often this has also allowed them to claim that they are responsible for greater returns and to claim a greater participation in those gains. There is clearly some incentive to increase the risk profile of companies and potentially an incentive to increase it dramatically.

At the same time, shareholders have been distanced by the increasing use of professional money managers who often control the outcomes of shareholder votes. I think that there is a perception that big business management, professional money managers and big company boards of directors are inclined to work together or close ranks when deals are done or problems are encountered at the expense of transparency and perhaps fair outcomes.

I think that over time corporate structural changes reflect the relative power of shareholders, board members, executives and workers. Corporations tend to work on an adversarial basis with labor on the weaker side. During buoyant periods, executives can prosper while the others do well. In these difficult times, it is likely that we will see changes that highlight the importance of finding and rewarding risk capital. These are times when workers are not empowered but when business needs to find ways to foster morality and good working practices. There is a choice between a stick and a carrot approach to motivating labor but in a disillusioned environment both can be very blunt instruments.

3.1) Non-productive and Destructive behaviors

Work time spent being idle, playing games or doing personal tasks is non-productive from the businesses perspective. Some socializing and networking may also be considered non-productive.

The lawyer, consultant or healer (and I am sure there are many more examples) who knows the answer but wants to inflate the size and duration of the response also creates a far less productive environment.

Destructive behavior would naturally include stealing and damaging business property. Often sabotage and power plays will have an even greater negative impact on a business.

Most of these behaviors are the result of some form of conflict of interest.
Can I justify my position and remuneration with an efficient response?
Should I address my personal task list or my business task list as my priority?
Am I more focused on the business or me personally going forward?
Can I gain from a co-worker's or a project's failure?
Will the business notice some lost stationery or assets?
Should I pay for my $5 lunch or get the company to pay for a $100 lunch for 2?
How much daily travel allowance do I earn for an unnecessary trip to Perth?
Are business decisions driven by business objectives or friendships?

We cannot eliminate all of these conflicts and the related behaviors. We would certainly like to remove all of the destructive activity but probably don't want to eliminate all non-productive behaviors. Some social intercourse and interaction is vital in creating a more efficient working environment. Ideally the grey areas could be self-governed by responsible and basically moral individuals because we know that rules cannot properly deal with intentions. Self regulation relies on a sense of participation and responsibility. Of course, the prospect of some auditing is very helpful too.

3.2) Structures and Rules

Communities generally accept the need for some government and governance. Practically, we end up with some combination of;

1) Laws and regulation; and
2) Cultural paradigms.

These are interrelated. But many would have the impression that communities are driven by cultural factors and business was driven by laws and regulation. Therefore politicians try to address community issues by arbitration in the first instance and business issues by regulation. Getting an outcome from arbitration is generally a positive result as interests are likely to be somewhat aligned. Laws and regulations should only be used when no system of natural justice can function adequately.

Unfortunately, the current 'end justifies the means' money culture means many business laws and some regulation are necessary. I suspect that business often suffers from a discomfort with cultural factors. (Perhaps this should refer to business leadership.) So there is an innate preference for clarity about the rules. At the same time, it seems, there is also a preference not to appreciate the intentions of those rules. And with a political environment that is conducive to regulation and referral, it is difficult for good businesses to avoid costs and restrictions.

3.3) Basic Assumptions

The ideas in this paper are based on a belief in self-interest. There is some public discussion of self-interest having failed the markets and many institutions but I believe that it was the institutions that simply failed to align interests. If the major Wall Street investment banks collectively lost $26bn in 2008 while paying bonuses of $27bn, it is hard for me to see that the bonus system has adequately tied self-interest of individuals to the interests of the institution.

I assume that most of the working community has great productive potential and that while they will have other reasons and interests, the motivation to work and their self-interest will be driven by an interest in their remuneration.

Other factors such as status and job satisfaction may also figure in individuals assessments of their self interest. I believe that many of these factors improve if individuals feel more confident that they are treated equitably and are part of a tribe.

3.4) Alignment of interests

Capital and labor normally compete for a greater share of the surplus of any business. The outcomes of this tension will vary over time as either side finds itself in a more or less powerful position. Within these groups there is also competition over distribution of the surplus. If we accept that internal competition is commonplace, then we accept that potential productivity is compromised.

This is not a revelation and many have tried to create bonus systems to better align internal interests. I have seen bonus systems that have worked extremely well for a period but have lost their way. Unfortunately, most bonus systems suffer from features that can cause the beneficiaries to lose confidence. They may come to feel that their interests are not that well aligned. Some of the issues are a lack of transparency, apparently arbitrary allocations of bonus, problems in an unrelated part of the organization, disparity between the before and after speeches, executive control of the process, publishing of huge executive bonus numbers, unnecessary delays in payment, excessive payments to some individuals, etc.

Many of these issues would seem less threatening if there was a clear philosophy that was consistently applied. If this framework was applied by suitably qualified independent parties, an even greater comfort level could be achieved. Conflict of interest must be avoided.

4) Could actuaries help create a better platform?

Actuaries have dealt with the issues of equity, solvency and distribution of surpluses for a long time. They have built processes and methodologies to apply to these issues. In many ways, their work can be applied to the issues of profit or surplus determination and distribution for a corporation. I see no theoretical reason why actuarial techniques and thinking should not be more useful in creating more equitable and productive corporate entities. And I see no reason why these techniques cannot be used by others to achieve the same result.

The following pages set out some thoughts about how business should be structured to provide motivation and equity for employees and productivity for investors. They borrow from an actuarial education and assume some actuarial involvement. However, these ideas could be taken up and applied by accountants or other suitable practitioners outside the profession. The approach is to;

Start with a philosophical position
Establish the principles
Produce some guiding rules
Set out details of standard approach and special cases
Consider transitional arrangements

5) Philosophy

Create a more productive environment by sharing the risks and rewards more equitably. Try to align interests and eliminate conflicts of interest. Use independent parties to avoid conflicts where necessary to create confidence in the process.

Equity demands freedom of choice. These ideas should not be enforced. Investors should be encouraged to think about the reduced risks and potential advantages of a more motivated workforce with aligned interests. Labor should be free to embrace or desert an environment with lower fixed rewards but greater potential for community, responsibility and ultimately financial reward.

5.1) Principles for an equitable company

These thoughts need to be collected into some guiding principles;

1. Capital – it should earn a basic return. Both equity and human capital have a basic servicing cost that should be the priority.
2. Equity - structures should aim to allocate surplus returns fairly between stakeholders.
3. Surplus - the distribution of surplus should not endanger the company's liquidity or the proper allocation of surplus over time.
4. Conflicts of interest – avoid wherever possible
5. Efficiency - must be encouraged by reward
6. Audit – transgression must be judged fairly and independently (on the balance of probabilities) and punished simply.

5.2) Financial Rules for equitable corporate structures

1. Pay human capital a basic return
2. Pay equity capital a basic return
3. Estimate surplus periodically
4. Allocate surplus to capital providers
5. Distribute surplus

5.3) Basic remuneration

Defining a basic return for human capital has proved difficult over the years. In practice we can use measures such as the Minimum Wage and Average Weekly Earnings for the purpose. Minimum wages sound like they fit the theoretical goal more closely but are often set up with the needs of business and young single employees in mind. Something like 60% AWE could provide a basic wage for everyone. Some businesses operate with a greater proportion of lower paid employees and this should be a factor in arriving at a suitable basic return for everyone.

There are genuine arguments for providing some additional basic compensation for experience, education, needs, etc. I would prefer that these factors were taken into account in the process of allocating surplus. However, the business world needs to be pragmatic and, particularly during a transition period, there would be incredible pressure to take current earnings into account. Doing so would likely complicate the surplus distribution process more that the surplus allocation.

In time, it is likely that businesses offering finance against surplus allocations would emerge to relieve some of the pressures for compromise. It may even be possible that one day a lower base pay would be something to boast about in social situations.

5.4) Basic equity returns

A basic return for equity capital could be taken to be a risk free interest rate. The central bank target cash rate could be chosen. I believe that this would be a useful and simple starting point. Higher rates could be argued for on the basis of risk. To some extent this argument is similar to the considerations in arriving at basic compensation levels. Simplicity and ease of understanding need to be weighed against a more complicated but potentially fairer outcome. A risk adjusted basic return could be estimated by applying some measure of the relative volatility of earnings to a risk premium and adding the risk free rate. Again I would prefer to go for a bigger surplus.

5.5) Surplus

Profit is a measure of the surplus generated by a company. However, profit can be a less than satisfactory measure of the value added over the period. The reason for this is that it has become a product of tax and accounting rules. As a result profit is not a universally applicable number. There is often a lot of analysis done on various components of a company's results and the sustainability of these elements. There is nothing wrong with having statistics that try to quantify the same thing but vary as long as they are broadly understood and do not create unnecessary work. Actuaries have lived happily with means, medians and modes for a long time.

I take the word surplus to mean an estimate of the economic value added during a period. This should be a subjective number that requires a consistent approach but may not use all of the taxation rules or valuation codes. The estimation of surplus needs to be discussed fully. Care needs to be taken if large differences emerge between surplus and profit as this could impact on confidence.

5.6) Equity

Equity can be an elusive concept. Arguably it is at its most elusive when it comes to distributing money. Regardless, there is likely to be more acceptance of a process that is simple and transparent.

A company should share its **surplus** between contributors of human and equity capital. A natural starting point is 50:50 and this should be encouraged unless there are strong arguments against it. These arguments might arise where a business needs very little working capital but lots of human capital or the opposite extreme. Over time, both extremes should sort themselves out - valuable human capital sells itself out of the business and so do high yielding assets. Being acutely aware of the ability of structure and restructuring to affect the outcomes of surplus distribution in the short term and the need for transition, I can live with a different split.

Another issue that may influence the split temporarily is the possibility of a negative surplus. The frequency of negative outcomes in established businesses should be far lower than the current frequency of negative profit results due to decreased fixed costs and the benefits of positive motivation. This would affect both liquidity and possibly distribution of prior surpluses but it should not be allowed to unduly affect ongoing surplus allocations to the current workforce.

Getting the surplus distribution package broadly right and engendering confidence is the key to making positive change. Confidence is likely to be more important than demonstrable accuracy in this process. Some thought also needs to go into transitional arrangements. Luckily, actuaries have had a few hundred years to dwell on issues of solvency, surplus and equity!

5.7) Distribution of Surplus

The first aspect to distribution relates to timing. The distribution of surplus should not compromise the company's liquidity or make it too easy to distribute overestimated 'surplus' that needs to be written back in subsequent years. There would be much subjectivity in any assessment of how long surplus should be held back. I think that a maximum distribution of 20% of the previous 5 years of surpluses and a minimum distribution of 10% of each year of outstanding surplus would be reasonable. The minimum target would be subject to liquidity considerations. This should mean that most surpluses are paid out over 5 years but in extreme cases no more than 10. Of course, the payments within each cohort may not be equal from year to year where there are changes made to earlier surplus estimations. Note also that long standing and ex employees should be receiving surplus allocations from their participation over the past 5 to 10 years.

Without becoming equity owners, labor (and the equity providers) has contributed a form of temporary equity to the company for the period until it is finally distributed. This becomes a reserve to cover write downs in earlier years' surpluses and perhaps future negative surplus. I think that this reserve should rank parri passu with the rest of the equity in terms of earnings. This would mean that the undistributed surplus reserve would earn a basic return and share in new surplus distributions. This should create a fair starting point in any decision to defer the surplus distribution.

The management and control of the undistributed surplus raises some issues. It has features of retained earnings and features of a short term superannuation scheme. An annual report on the new surplus, revisions of past estimates and distribution would be required.

After splitting the surplus between human and equity capital, further subdivisions will be required. The sharing amongst capital providers is likely to be straightforward but the distribution amongst the workforce will be more complicated. It could follow a standard set by any present day company with a suitably strong bonus culture and structure. The important point to note is that we have tried to set the base remuneration at a very low and flat level. Therefore, we want a good surplus result to produce very attractive outcomes for all of the staff. Those who would normally take home a modest wage do not need a massive allocation but we want them to participate in more than a token way.

The allocation process and method should be made as transparent as possible. And I ask the profession to help me work on principles and methodologies that can be broadly applied and hopefully accepted. Clearly there are cultural issues involved in disclosing individual allocations. However, I do not see any serious harm in outlining the factors that drive those allocations and the totals allocated. While we tend to keep salaries confidential, most of us have a general appreciation of the relative earnings of our co-workers.

I suggest that the workforce could be given entitlements calculated adjusted according to;
Role;
Experience;
Time off;
Performance;
Mistakes;
Time with company;
Type of work;
Performance of the department;
Etc.
The surplus allocation is then simply split amongst the total of entitlements.

Very interesting equity issues are likely to arise in relation to equity between cohorts of participants and equity between successful and unsuccessful areas of a conglomerate. The question of rewarding past participants with some of the unanticipated surplus generated from their efforts is simply a question of balancing equity and complexity. Clearly, we would try to estimate the value of development work without always having a great feeling of its potential. And we anticipate reducing bonuses if the development work does not live up to expectations.
The question of whether entitlement allocations might be negative needs to be considered in light of the whole framework. Is there a minimum allocation for everyone in positive times? Can individuals be penalized through the bonus system?

I have no problem with open ended bonus allocations. However, I share some of the concerns that are publically expressed about the relative outcomes of the highest and lowest paid individuals. Therefore some simple but reasonable criteria aimed directly at this gap and the perception of fairness would be useful. Perhaps the largest allocation should be no more than 200 times the smallest (full-time) allocation. Companies could promote a history of smaller gaps to create a greater sense of equity and participation.

Would this be too restrictive? Clearly that depends on your point of view. I do not think that it is and as discussed individuals must be free to accept or reject a ‘team plan’.

Superstars who believe that they can add more than $10m in value each year (or whatever the expected bonus maximum might be) should be well placed to sell themselves as medium term contractors with all of the power to make change that they may have had as an employee. Clearly companies are comfortable paying large sums to valuable representatives such as sports stars. Valuable executives would be in a similar position. Such an arrangement should also help to reduce the risk of the departing 'superstar' taking a huge settlement after presiding over some debacle. These incidents may be few but they tend to be well publicized and very damaging to the confidence of motivated labor.

6) Financial Condition Report

This approach has similarities to the actuarial review of a life office. I think that there would be long term benefits for corporate entities that were able to get a regular independent financial condition report discussing structure, equity, solvency, reserving and profitability. Sustainability, projections and analysis of cohorts of business might be included if there were sufficient data and resources. These reports should not be mandatory but should provide better data for analysts and shareholders.

I have done some work on a numerical example of a theoretical company using the suggested approach to remuneration. The next step would be to fully analyze a number of real companies to get a better feel for the way outcomes might vary between actual and expected under these rules. This analysis could also look at the effects of varying profit/surplus.

7) Conflict of Interest

Conflict of interest in business is often dealt with by creating practice codes and processes. These may make everyone involved feel better but I often suspect that avoiding the conflict where possible would produce vastly superior outcomes.

Some conflicts of interest require independent input to be properly dealt with. Clearly this input should occur at the determination time rather than at a time of conflict resolution much later.

Distribution of surplus or profit will create conflicts of interest if controlled by management. These conflicts of interest in turn create great potential for cynicism and doubts about the fairness of the process. I would imagine that only a very small proportion of those involved would be unhappy about an independently conducted process that was broadly prescribed. The bonus motivation could be destroyed without confidence in this process. Of course, there are other elements discussed above – such as deferring payments – that might be generally disliked.

I believe that independent actuaries or maybe some other professionals need to take control of the surplus determination and allocation process for it to be genuinely accepted. Over time much of the calculations could be taken in-house and simply audited.

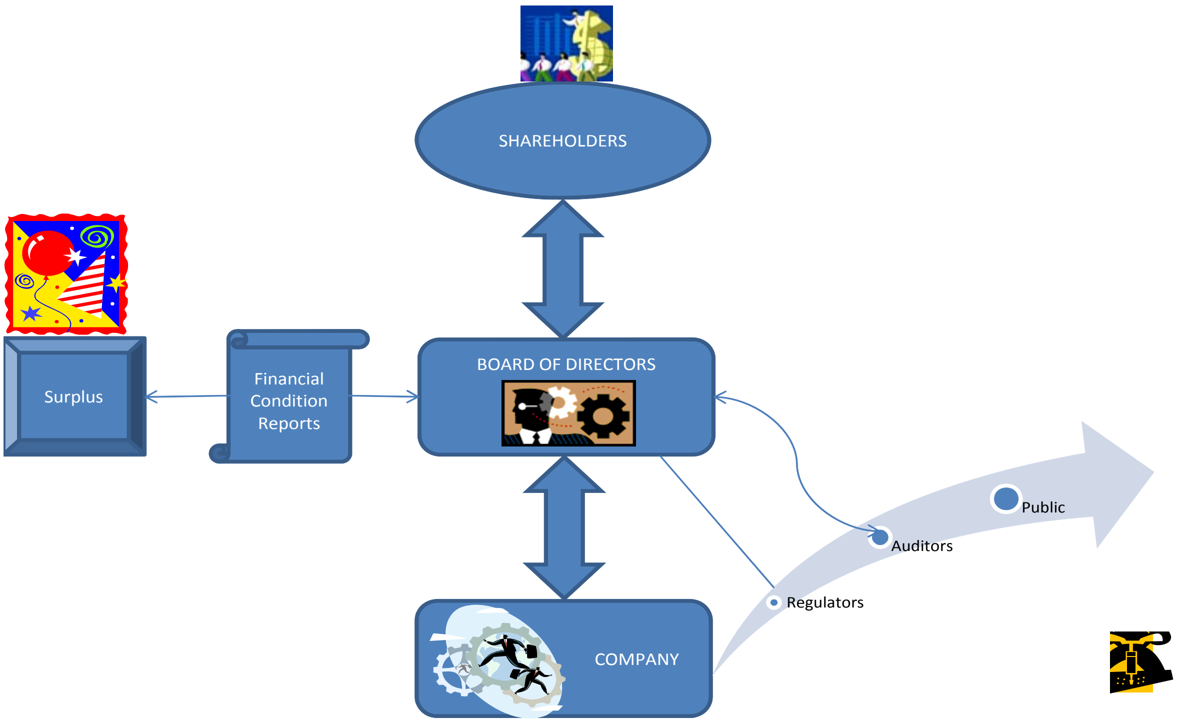
The issue of conflict of interest and confidence goes well beyond remuneration as touched on earlier. There are very important issues such as;

Do we appoint executives to the company board?
Who appoints the auditors – management or the Board?
How do we control the allocation and quantum of non-financial benefits?
Do we allocate external contracts in an unbiased way?

I believe that most people would think that these issues are being properly addressed. My observations suggest that this is probably not always the case. Therefore all conflicts should be reviewed in attempting to create more confidence in a corporate structure.

It seems that business is comfortable with some conflicts and chooses to add compliance processes and costs to deal with it. Perceptions that the same people who ultimately control the decision making are controlling compliance do exist. Wouldn't we be better off if a board that represented the shareholders did not contain the executive team? The executives should clearly be regular presenters and contributors of opinion. I understand that in practice, executive appointments to the Board often arise because the strong executive demands a board position as well as their executive title. This is not an encouraging argument for me.

Proposed Corporate Structure



7.1) Remuneration of the Board

The Board has a very important role in establishing and reviewing strategy and direction. It will also be involved in selecting the CEO, the auditors and possibly other senior executives or contractors. In some ways the board executes a high level specialist consulting role that justifies very high fees. However, I prefer to see the board as the executive arm of the shareholders and therefore in a position that should be primarily rewarded out of shareholder returns.

There is clearly scope to create a similar remuneration arrangement for the board as for the company employees. This would certainly have the effect of aligning financial interests and avoiding situations where privileged groups prosper in difficult periods. At the same time the company must be able to obtain the services of suitable independent individuals who are properly able to look after shareholder interests.

8) Evaluation of Corporate Integrity

I imagine that there is much good work being done on assessing various aspects of a corporate entity. I apologize if I am repeating any of their output. My point is that it is worth focusing on corporate structure and internal equity as a priority when assessing a company. These factors should determine the long term motivations of employees and the risks to shareholders of an inequitable outcome. They should have a strong bearing on the corporate culture. The integrity of corporate structures does not seem to get much discussion as corporate entities are considered to have no personality.

Again actuarial skills and judgment would be useful in assessing corporate integrity. The framework would not be dissimilar to the task of comparing funds management operations. Standards could be established to assist actuaries or others wanting to practice in the area. The main points to address based on the ideas in this paper are;
Management of conflicts of interest;
Discretionary vs. structured and equitable remuneration;
Immediate vs. deferred remuneration approach.

9) Analysis of surplus and projections

Accounting approaches are evolving as different issues are being addressed. It is difficult for most of us to work out exactly what accounts are saying. Historical cost causes problems in inflationary environments but some more recent techniques have led to situations where offsetting transactions may be valued on a different basis. In any case it is not clear that even the professional analysts understand today’s accounts fully.

I believe that actuaries must be able to add value to corporate analysis and understanding. This could be done as part of an ‘actuarial’ surplus (financial condition) report that includes the analysis of solvency and distributions.

We need to look at subdividing conglomerates into business lines and analyzing these businesses in cohorts. I think that some exposed to risk theory techniques might be useful in unbundling and representing cohorts of business. Our claims projecting techniques could be useful in projecting lines of business forward. The main aim would be to treat new and closed lines of business properly in any analysis of profitability and projections.

Going further, I suggest that analysis of surplus techniques might provide management with another tool to look at successful and problem areas. There may need to be some added discipline in projecting expected outcomes but an actual vs. expected table could be illuminating.

10) Small and start-up companies

These companies may have difficulty meeting external overhead costs and standards. Start-up companies in particular are also considered to be high risk since they are unproven.
Both are often driven by one or two individuals and it is not easy to create all of the structure of a larger company. In fact, the circumstances and resources may demand that the same individual is responsible for management, strategy, administration and shareholder representation. Clearly, it is inappropriate to expect independent reviews of surplus if the cost of this could be the difference between satisfactory profits with growth and struggle street.

A practical solution might be to stop the distribution of any surplus to human capital until the invested equity has been returned. This would mean that equity holders were entitled to all of the surplus distributions until their contribution was returned. Labor would then have a catch-up period of allocations. There could be taxation issues but essentially investor exposure to the corporate risk is reduced and a highly motivated environment is created.

The human capital would be earning their share of surplus for some time without being able to take it and management would be encouraged to move to the external review status as soon as the business could reasonably bear the cost. At that point, there could be a reallocation of the equity/surplus and some consideration of the time frame for allocating past and ongoing surpluses. Until the external review, labor would simply see their surplus entitlements deferred as follows;

	Surplus up to equity level	Surplus after equity returned
Equity provider entitlement	50%	50%
Labor entitlement	50%	50%
Equity provider receipts	100%	50%
Labor receipts	0%	50%

Deferring surplus allocation should not be used by equity providers to unfairly delay payment to the human capital.

11) Transitional Arrangements

There is clearly scope for structural changes to occur over time to allow companies and individuals to adapt and assess. As discussed, the suggested approach can be flexible in terms of base returns and allocation of surplus so that it should be reasonably easy to change base salaries and surplus allocation arrangements in stages. There are also good arguments for limiting the number of stages and the time frame.

12) Current Economic Situation

Change is seldom easy to drive. This paper discusses ways to improve equity and productivity within a corporate structure and to create more confidence in equitable outcomes by using independent professionals with a suitably developed approach. These arguments are unlikely to be persuasive by themselves. However, the current circumstances demand that capital being raised and invested in businesses should be properly rewarded. The philosophy and approach suggested should greatly reduce some investor risks and provide genuine businesses with a framework for properly rewarding their employees and the shareholders. It is also an environment where individuals should be more prepared to accept a greater alignment of their income with that of the shareholders.

13) Some consequences of more equitable corporate structures

- Lower risk for investors. This should lead to better risk/return outcomes and in a low interest rate environment significantly improved efficient frontiers
- Perceptions of greater equity
- Productivity improvements
- More satisfying work environments
- Reallocation of capital – especially where capital can more comfortably be provided to conservatively structured small and start-up companies
- Greater employment
- Lower take home remuneration for labor in the short term (I think that markets may quickly find ways around this if these structures bloom.)
- Higher remuneration for labor in the long term.
- The focus of industrial relations could become access to bonus entitlements, safety and working conditions.
- Possibly smaller packages for senior executives, almost certainly less of a golden boot.
- Better analysis of companies
- More transparency
- Business is better protected against rogue employees
- Small investors are better protected against corporate schemes
- Employees are more connected to the business even after they leave
- Corporate analysis might include an assessment of the structural integrity
- Capital (e.g. Preference share) structures may need to be revisited
- Corporate profits will be higher
- There will be less bankruptcies
- Corporate crime will be far easier to identify and prove

13.1) Risks and Obstacles

Although I expect that these changes might deliver better productivity and therefore a bigger cake to distribute, it is clear that some players will feel that they may be worse off or worse off in the immediate future. The same forces of self interest might then be harnessed to try to stop change. Some of those concerned might be shareholders seeing deferred dividends, executives losing control of remuneration and particularly their own remuneration and employees who have little capacity to adjust to lower immediate cash entitlements.

The most likely arguments from the negative are that these arrangements are too costly, unfair and make a business uncompetitive. Without a track record, these arguments can be quite effective.

14) Conclusions and Outcomes

Actuarial expertise in surplus management and distribution might become the vital ingredient in creating and preserving confidence in these types of business structures. There will be pressures for change but transparency, properly constructed standards, a track record and competent oversight should create positive outcomes and a greater sense of participation generally.

First and foremost, I need a reality check. I need independent feedback on the thrust of this paper to understand exactly where to file it.

Then, if I can find some support, we need to discuss and refine the proposed standards. I would be happy to form an IAA committee to develop acceptable approaches with standards. Ideally, there would be some Institute support and external contribution too.

Assuming that we get this far, I would like to see the concepts working in practice. I can think of several new businesses that might prosper with a low fixed wage overhead. However, it is more important to find established businesses that would be willing to work towards a more investor friendly structure with increased analysis so that some evidence of the results of changes can begin to emerge.

Assistance

I am very grateful to Martin Mulcare for his peer review work. He accepted the challenge of working with my approach and helped create a better paper without changing the flavor. My brother David also helped in the review process.

There are no specific references for this paper but it should be evident that I have read and believed at least some of the contents of relevant articles and newspapers over a long period. It may also be apparent that many financial heroes and cheats have all influenced my thinking.