

Responses to Published Articles

Shann Turnbull's response to Guy Major's article 'The need for NOVARS', Journal 31.2

This author has his heart in the right place but seems to accept the traditional paradigm of negotiable capitalism as a reference point for his analysis. I use the word negotiable because he compares co-ops with the classical Berle and Means model of the widely-held publicly-traded investor-owned firm. Such classical firms represent less than 1 per cent of all firms in market economies. Their numbers, size and scope do not provide an appropriate basis for comparing the operation of non-publicly traded interests in "common ownership" or other forms of "democratic firms". Even if we only consider listed firms, many have a controlling investor contrary to the Berle and Means model.

One common ownership firm which has the size and scope of a publicly traded enterprise is the John Lewis Partnership (JLP) which Major ignores. He cannot then go to say that "There is a certain amount of theoretical and anecdotal evidence that one breed of democratic firm, the common ownership workers' co-operative, is particularly prone to this problem" [of under-investment] without showing why the JLP is an exception. There are over 10,000 firms with employee ownership in the USA with only a minority of these being publicly traded. The majority of these firms involve both employed and non-employed shareholders without the need for NOVARS. This is not to say that NOVARS may not be useful in some situations. However, many of the reasons put forward by Major for using NOVARS can be achieved by appropriately designing the control architecture of the firm rather than the control structure of its shares. It is an empirical fact that non trivial worker co-operatives which are sustainable over the longer term have a complex architecture with executive power divided into two, three or more boards or control centres. This provides checks and balances against both excessive executive power and excessive worker interference. Crucially, it also provides a basis for managing executive succession in a constructive manner. Without divided power and indirect appointment, the most popular or political

person may be appointed the CEO rather than the best manager.

Major's DCF model is not realistic. More importantly it accepts the intrinsic flaw of capitalism which allows investors to be overpaid. No productive investment provides perpetual earning streams, as proposed in his model, as they all wear out. However, as Major states, shares last forever. This is the crux of the problem of why the capitalist system is both inefficient and inequitable to create excessive concentration of wealth as it allows investors to be overpaid in perpetuity. NOVARS would simply contribute to this fundamental problem of capitalism unless they were issued so as to have limited life, like all real productive investments. All productive investments must create more value than they cost by definition. By definition all productive investment must therefore pay for itself and become self-financing. The ability of any productive investment to become self-financing is not dependent upon either its total cost or the total number of people/workers who own it as in Major's model. Provided credit can be obtained during the payback period, no salary sacrifice is required to finance a productive investment. In practice, some salary sacrifice may be needed to create an equity or "hurt money" to give a financier confidence to bridge the payback period. Lack of finance by co-operatives arises because financiers have less confidence in managers when they are subject to being fired at the whim of their workers. There are two non NOVARS solutions to this problem as used in Mondragon. One is for the co-ops to own their own financier/bank and the other is for managers to be insulated from being fired at the whim of the workers through a control architecture which introduces decentralised power with checks and balances. The Mondragon bank makes such a corporate architecture a condition of obtaining finance and so a condition of becoming part of the Mondragon system.

The Mondragon system illustrates the ability of enterprises to be self-financing as do the many leveraged buyouts of publicly traded companies in the US. Because viable firms must be self-financing, most companies have their shares publicly traded not to raise money but to provide an exit for their investors!

Major goes on to say "to avoid underinvestment and degeneration, democratic firms need fully tradable investment which like debt is not voting. This statement is not supported by

the many thousands of privately owned ESOP firms in the US which have a mix of capitalists and worker owners. The degree to which they may be democratic in the sense used by Major is open to conjecture. Major needs to define what democratic means. Would it include firms where workers cannot directly fire the CEO as is the case in all non-trivial sustainable non-capitalistic firms that I have heard about?

US ESOPs which utilise tax incentives, are required to both provide votes to their employed owners for key decisions and buyback employee shares when they depart. The buyback price is determined by an independent appraiser. The price may also be used by non-employee investors. There is no need for "Splitting a firm's value added in a pre-defined way between worker and shareholders". Major needs to relate his analysis and solution to the widely practiced US procedures.

To sum up, I suspect there are situations where some sort of NOVARS could be useful. US practice could provide a basis for identifying their strengths and weaknesses and in which situations they may be most attractive. Definitions need to be presented to describe a "democratic firm" and what is an "optimal labour-capital mix". So I think some more work is required.