Responses to Published Articles

Guy Major's Counter-response to Shann Turnbull. Journal 31.2 & 31.3

I would like to thank Shann Turnbull, and others for their comments, criticisms and suggestions about NOVARS or Non-Voting Value Added sharing Renewable Shares.

Berle and Means suggested many years ago that de facto separation of ownership and control in large public corporations had left management largely autonomous and unaccountable to their shareholders. This viewpoint is controversial, and I agree that it is an over-simplification, and does not apply to most firms. However, my "reference point" is an attempt to diagnose what is "wrong" with many worker-controlled or employee-owned companies. My aim is to promote work-place democracy, not merely to find alternatives to capitalism. I did define "democratic": one worker one vote, maybe weighted for weekly hours worked. Most ESOPs are not democratic.

I agree that the John Lewis Partnership (JLP) has much to teach us. However, it is not a democratic worker-controlled firm, and it is not a worker co-op - it has a more paternalistic structure. In 1950 JLP's owner Spedan Lewis gave the firm to a trust which is required to run the firm for the benefit of the workers. The chairman of the trust (and company) controls the company and appoints his/her own successor and the management. JLP's "parliament" or "Central Council" is 4/5ths elected by the workers. The Central Council can fire the chairman if s/he is incompetent or acts out of line with the principles of the business. There is also a developed system of management accountability through elected "Committees for Communication" and "Branch Councils" (4/5ths elected), and various in-house journals.

Unfortunately there are very few other cases where an owner has given his/her firm away to its workers or to trustees looking after the workers' interests. JLP is not therefore a general "model" that can be "cloned".

Checks and balances: NOVARS provide them in abundance - shareholders have emergency voting rights, voice and consultation rights, the right to stand for election as a director, veto rights over rises in minimum wages and excess advances, the right to demand revaluation of any asset, and so on. Many decisions need the consent of all 3 overlapping "primary interest groups" in the firm (the workers, outside NOVARS holders, and workers and their close relatives who own NOVARS), eg the "fair price" at which additional NOVARS are to be issued. Disputes about accounts, share prices, expenses or asset values are to be resolved by independent experts.

I doubt workers would elect the most socially popular person to be their "leader" unless they also believed it was in their long-term interests.

Discounted Cash Flow ("DCF"), or Present Discounted Value (PDV) of future earnings is an accepted standard method for valuation. It is not unrealistic. Shann Turnbull is forgetting about depreciation allowances when he says that no productive investment provides perpetual earnings streams. Depreciation is deducted from earnings, to pay for repair and replacement of equipment as it wears out. In this way, an investment can in principle yield perpetual earnings, at the price of slightly lower earnings every year, without anyone being exploited. In any case, the PDV calculation takes into account how many years the earnings go on for. As I make clear, even with a limited duration earnings stream, the horizon clash problem doesn't go away if different workers expect to stay in the firm different numbers of years. Under-investment relative to a capitalist firm is still likely to occur if the mean expected stay is less than the duration of the earnings.

Shann Turnbull is missing the crux of the problem with capitalism: inequalities in power allow poorly accountable elites to exploit the majority and destroy the world ecosystem.

One reason banks are reluctant to lend to many worker co-ops is their lack of equity collateral. NOVARS attempt to fix that problem, by encouraging such firms to build up their equity base by reinvestment, as well as by attracting in outside investors.

Secondary markets: much of my article was arguing the case for these, to allow individual investors to "exit" from the company while "locking in" the equity capital. In the US, the share buyback requirement of ESOP companies limits their rise in value if they are successful. Their equity is not properly locked in. This in turn can lead to less entrepreneurial behaviour.

Introducing an active secondary market for their shares fixes this problem.

A high degree of separation of ownership and control is a pre-requisite for any combination of work-place democracy with significant outside equity capital. If shareholders have no normal voting rights, they must be protected in other ways, eg by splitting a firm's value added in pre-defined fractions between workers and shareholders, to stop workers voting to rip off investors by raising wages.

NOVARS have been criticised in a number of ways by other people since my original article appeared. The thrust of these criticisms is that the scheme is too complex, and that it still doesn't fully solve the problems of common ownership, because the potentially large future bonus stream is still commonly owned by the workers. Also, NOVARS rely on backward-looking rather than forward-looking performance criteria, and do not take enough account of "intangible assets".

To answer these criticisms, I and a colleague (Gavin Boby) are in the process of designing a "next generation" of NOVARS, called "Profit-Sharing Shares" or PSS. PSSs are freely tradable and work as follows:

1. Pay all workers a fixed minimum wage. Don't raise total minimum wage by more than 10 per cent a year without permission of investors.

2. Split the profit "cake" into a bonus and a dividend. The bonus and dividend "slices" are pre-arranged fractions of the profit (adding to 1). The total bonus equals profit x bonus slice, and the dividend is what remains in the profit and loss account after corporation tax.

3. Loan monthly advances on bonuses to workers to supplement minimum wages, and pay them the balance at the end of the year.

4. If investors and workers agree, change the dividend and bonus slices, either to attract more/better workers or more capital, to optimise the growth rate of the profit "cake". This should make all stakeholders better off even if their relative slice gets smaller,

because their absolute amount of cake will get bigger.

5. Dividends can be reinvested by issuing more shares to investors in lieu of cash (maybe increasing dividend slice a little, if workers agree). The share price is set by negotiation between investors and workers, or by an independent valuer.

6. Bonuses can be reinvested by issuing more shares to workers in lieu of cash (again, maybe increasing dividend slice a little, if everyone agrees). This has huge tax advantages. Also an Inland Revenue Approved Profit Sharing Scheme can act as a mini secondary market for shares.

7. Part of the "commonly owned" future bonus stream can be "individualised" (capitalised), ie be made "individually owned", to stop future workers free-riding on the prodigious efforts, risk-taking and sweat equity of current workers. Free bonus shares can be issued to workers reflecting their relative contributions to the firm. The dividend slice must be increased proportionately, so the change does not affect the share price. The bonus slice is decreased accordingly. This process allows current workers permanently to "capture" part of future bonuses that would otherwise go to future workers. Part of future bonuses would have to be left uncapitalised, in order to preserve incentives and to attract talented workers, essential for generating good profits in the first place. The option of capitalising part of the future bonus stream will improve current workers' incentives to behave in an entrepreneurial fashion, and to "build the firm up" via hard work.

We hope to prepare model rules for PSSs over the next few months. They will be available via the following web-sites: www.physiol.ox.ac.uk/~gm/coops.html or members.home.net/gmajor/coops.html