CONTROLLING WORLD CORPORATIONS

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One method for overcoming many of the problems associated with the operation of world corporations would be to introduce fade-out arrangements. The arrangement proposed by the writer could be introduced on an entirely voluntary basis within those countries which unilaterally provided the necessary tax incentive to induce the multinational companies already established to adopt the scheme.

The arrangement proposed would provide increased profits for those investors who elected to give up 2-4% of their equity each year to, say, their employee superannuation fund and/or the host country's superannuation fund. Many companies, mainly domestic ones, already do this to some extent without tax incentives and elements of this proposal are already operating in countries like Sweden, Denmark and France.

One important difference of the proposal from those operating in Europe to provide worker participation in corporate ownership is that the legal entity of the corporation has limited life. There is not, however, any requirement for terminating the physical operations of the company. The life of the legal entity is determined by the fade-out rate. A 2% fade-out rate would result in a 50 year life company and a 3.625% fade-out rate a 27 year company. The significance of the figures in the latter example is that they represent 0.01% fade-out per day. In practice, this might be more convenient and the shorter period more desirable.

For companies with a 50% tax rate, the attached table illustrates that it would be more profitable for its investors to give up 2% p.a. of their equity in return for a 5% tax rate reduction, or to trade-off 3.65% equity p.a. for a 10% reduction in the tax rate. The example in the table assumes that an investment of $100 will produce a profit before tax of $40 p.a. over 10 years. For conventional corporations with a perpetual life, a 50% tax rate is assumed, so that the investment would produce $20 each year after tax over the 10 years, providing a total profit of $200. The original investment is thus paid back twice over. On a compound (discounted cash flow) basis this becomes a 15% rate of return over the 10 year period. With the 45% tax rate of the 50 year company the investment produces 10% greater profit of $22 a year to provide total profits of $220. The investors' share of the 10% greater profit, however, reduces by 2% p.a. to 80%. Over the 10 year period the investors' share (equity) of the profits has been reduced on average by 10%, so that using simple averages the 10% increase in profit from the tax reduction makes up for the 10% average loss in equity. Because of the affects of compounding as illustrated in the table, the 50 year company obtains greater value out of the investment than it loses as is indicated by the total Present Value of its earnings being greater than those of the conventional corporation. The 20% tax reduction (50% to 40%) of the 27 year company increases the profit each year by 20%, more than enough to offset the 18% average equity reduction. On a Present Value basis, the table shows that the 27 year company is more profitable than either the 50 year or conventional corporation. The table also indicates how the risk over time of the investment is reduced from the accelerated cash flow pay back.

The most effective method for increasing the attractiveness of the fade-out arrangement would not be by any further tax reductions, but by a fade-out holiday for 3 to 5 years to allow a build up of a pay back cash flow.

If a foreign investor did not voluntarily adopt the corporate arrangements which maximise his profits, then the host country might well have concern over the operations of the corporation. If a business entity is not interested in profit what is its interest? A host country might well be justified in introducing a tax penalty on those companies which did not elect to change to the limited life corporate form proposed. This could also provide some compensation for any understatement of profit - it would be quite rational for world corporations to arrange their affairs so as not to pay tax in a host country. Resources in the host country would not then be allocated according to the values (prices) of its own citizens but by foreign interests. The attenuating corporate concept would discipline the resource allocation role of World Corporations to the priorities of its host countries.

In the past, time limited investment structures nominated a specific time at which the structure and its operations were to terminate. The key to the modern adoption of time limited corporations is to separate the life of the corporate structure from corporate operations, so that the latter may continue if desired. By allowing the business operations to continue in a new legal entity, any problems over operations which involve long term contracts, like life insurance, can be avoided. The method suggested by the writer provides for the attenuation of the corporate equity claims at a constant, predictable rate over the life of the corporate structure, but requires no changes in the business operations, value of total assets, or value of the total liabilities. This is obtained by nominating the original minimum number of subscriber shares required to create the company at its inception with different rights to all other ordinary shares issued. The attenuation over time of shareholders' equity in the ordinary shares would be balanced by an accretion of equity rights in the subscriber shares, which would be held by a public Trustee, or superannuation fund. This would mean that the ordinary shareholders' rights to earnings, dividends, capital, reserves and votes would diminish at a rate of 2% p.a. for a 50 year life company.

The calculation of the ordinary shareholders' equity would be quite simply determined by assessing their entitlements in the normal way as may be prescribed by the company, then discounting this value by multiplying it by the percentage life left in the corporation. Conversely, the rights of the subscribers' shares would be the total rights of all ordinary shares multiplied by the percentage age of the corporation. Under the attenuating plan, a company with a nominated life of 50 years would provide the public Trustee with 50% of the votes and all other ownership rights of the ordinary capital when the corporation was 25 years old, 75% of rights after $37\frac{1}{2}$ years and 100% after 50 years. When the Trustee obtained a 75% interest it could initiate a reconstruction scheme to transfer all assets and liabilities of the company to a new time limited corporate structure with its clock starting afresh, and all non-subscriber common stock of the new corporate shell would be put up for tender. The old stock holders would be entitled to receive their proportional interest, being 25% of the funds so tendered. Bidders for tendered stock might be limited to nationals and/or specified saving institutions, and by this means foreign-owned corporations could be passed back to nationals.

The wholly owned subsidiary of General Motors in Australia was established 47 years ago with only $2 million cash subscribed for all its ordinary shares. Since that time no further cash has been subscribed. The subsidiary has, on the other hand, remitted to its parent over $250 million in dividends and, in addition, increased its net worth to over $200 million. Even after allowing for changes in real value of money, it is quite clear that the original investment has paid itself off over 100 times. Even if General Motors' Australian subsidiary was on a 2% p.a. fade-out arrangement without any tax compensation, GM would have received an annual dividend greater than its original investment in most years up until 1970. GM's equity in the dividend after 44 years in 1970 would have faded out by 88%, leaving only a 12% interest. With only a 12% interest in the 1970 dividend of $27 million, GM would still receive $2.84 million, equivalent to a 142% return on its initial cash investment 44 years earlier.

While it was suggested that the Trustee would initiate a scheme for executing complete reversion when it had obtained a 75% interest, it might be in the foreigner's interest to initiate an earlier reversionary restructuring of the operation, or the Trustee a later one. The Australian subsidiary of GM would have lived 75% of a 50 year life in 1964, when it reported profits after tax of $37 million. If these profits were capitalised in a new corporate structure listed on Australian stock exchanges, $370 million would have been raised using a price earnings ratio of 10. 25% of the proceeds of the public offering, of $92½ million, would be remitted to the parent company in recognition of its residual equity interest. The Trustee/superannuation fund would receive the remaining $277½ million from the offering if the proposal made above was followed.

The examples cited in the table had no residual value after 10 years such as might be found in a 10 year lease arrangement purchased for $100 premium. If we assume the earning streams continued after 10 years and the limited life companies sold their residual interest in year 10 at a price earnings ratio of 10, then the fade-out arrangement would still be more profitable than having a 100% ownership of a perpetual earnings stream in a conventional company. In actual practice, businessmen cannot usually project or forecast with any confidence future cash flows after 10-15 years. Investment decisions are thus justified without expectations of earnings after this period. So, if a foreigner will provide his capital and technology with his earning stream expectation limited to 15 years, say, then it is simply bad business for a host country to provide him with profits for a longer period. Foreign investment which is accepted by a host country on a basis which provides profits for a longer period than is required by an investor for him to commit his capital and technology can thus be unequivocably classified as undesirable from the host country's point of view.

The United Nations 1973 report on "Multinational Corporations in World Development" identified twelve contentious issues in their operations. The attenuating time limited corporate concept would provide a basis for dealing simultaneously to some degree with most of these issues and is consistent with the Report's suggestions for a proposed course of action where it referred to "... novel forms of ownership arrangements will come into being (p.38); "... fade-out arrangements (p.38,78);

"... innovations might be introduced with respect to company structure (p.94); "... ownership for limited time is not necessarily against their (multinational) interests (p.38)."

The attenuating corporate concept would provide a practical basis for a World Corporate Code as it is compatible with diverse political doctrines and offers considerable flexibility in its adoption and operation. No change in corporate law would be required for companies to voluntarily adopt the attenuation plan. Conventional corporations and attenuating corporations could co-exist both within countries and between countries. The proposal is compatible for wholly owned, partly owned or listed subsidiary corporations or affiliates. Minor legislative amendments would be required to preserve the attenuating process only for non subsidiary companies, subject to commercial acquisition or merger. As shown in the table the adoption of the attentuating corporate form could be very persuasively encouraged on a purely voluntary basis by the use of a tax preference for companies complying with the limited life corporate code. Developing countries might well make the adoption of such a code mandatory for direct foreign investment and other prescribed enterprises while the developed countries might entertain only voluntary adoption with such tax preferences and facilitating legislation that they considered appropriate.

In developed countries the concept offers the opportunity to establish a new socio-economic order from the new options created for distributing a nation's wealth held or created in corporate form. This would arise from the arrangement being just as attractive for domestic corporations as for foreign owned companies. Thus, not only does the scheme provide a means to eliminate foreign ownership while still attracting new foreign investment, but it provides a basis for corporate wealth to be distributed free of cost to the workers who contributed to its creation. The scheme would also increase the efficiency of resource allocation in national economies where this is carried out mainly by the pricing mechanism operating between corporations. In the long run it is these advantages which could make the attenuating limited life corporate concept so valuable as a basis for a World Corporate Code.

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