STC

Improving capitalism for the public good – what do we have in mind? – and can it be done?

by Martin White

By way of introduction, our STC-related articles this month will inevitably cover at least some ground that we have covered in previous issues. However, with new readers in mind, including people completely new to UKSA, the idea is that, taken together, they are sufficient to give a good idea what it's all about.

Back to the title of this article, ultimately, "improving capitalism" is what we are trying to do our bit towards.

What do we want to influence, exactly? Company behaviour is one thing.

We'll start with expectations of, and within, companies. The corporate world is currently getting a lot of criticism. The **headline problems** are well understood throughout the country, with discussions in the media and in political debate frequently covering them at some length:

- Corporate short-termism; leading to a focus on today's profit and today's share price;
- Executive pay, especially bonuses and "performance" pay, out of control, with an upward trend still, in spite of decades of regulatory attempts to get a grip;
- Increasing concern at the growing disparity between top incomes and the bottom;
- Increasing concern about productivity – and thus employability of people in our competitive world. There is a suggestion that this is in part a consequence of under-investment.

Andrew Smithers is an economist with a long career in the world of finance. He is perhaps best known for the book he co-wrote with Andrew Wright "valuing wall street", which came out in March 2000. This argued, using a couple of measures which had proved to be good long-term indicators of whether general stock market levels were relatively expensive or cheap, that the market at the time was particularly expensive. Nine years later, a follow-up book emerged entitled "Wall Street Revalued: Imperfect Markets and Inept Central Bankers". More recently, in 2019, his book "Productivity and the Bonus Culture" was published.

If you look up the 2019 book on Amazon, you will find the following description:

> "Living standards in the UK and US are in danger of falling. A decline in growth due to poor productivity and an unfavourable change in demography has weakened the stand of liberal democracy, and voter dissatisfaction is encouraging populist policies that threaten even worse outcomes. Whilst living standards once grew faster than productivity, they now grow more slowly, and the working population is no longer growing faster than the population as a whole. To avoid falling living standards the productivity problem must be addressed.
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> Andrew Smithers argues that faster productivity does not depend, as many suggest, on technology; it also relies on investment. Current growth theory is based on a faulty model which has induced pessimism about our ability to encourage more growth. Productivity and the Bonus Culture sets out a revised model which demonstrates that weakness in productivity is the result of the bonus culture, and suggests ways to change this flawed system so that investment is encouraged and growth returns."

At the root of corporate culture is what is perceived to get the "well done". The biggest "well done" for senior executives is often something tied in some way to measures which are, at least in the short term, capable of targeting. Smithers suggests that today's profits will come at the expense of under-investment, with a long-term price for workers and society generally.

We could use many column inches on this. Much work has been done on the problem of short-termism, including on behalf of Government. In TPI issue 204, we quoted John Kay on remuneration as follows:-

> "No one company can easily shift from current norms in terms of remuneration quantum and norms. Initiative in changing the bonus culture must come from investors acting collectively with the strong support of government.
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> Such government support should be expressed in general, not over-prescriptive terms. Regulation of pay is likely (as with much regulation of the financial sector) to lead to avoidance activity and a tendency for the limits of what is permissible to become the norm."

In the quote above, "investors acting collectively" is more about managers of collective investments than it is about individuals. And they will not act collectively unless there is a public demand for them to do so. Which links us to our next change.

The other change we want to see is to do with individuals and their relationship with long-term savings

Put simply, individuals are in a weak position when it comes to long-term savings. A small number of people have enough knowledge to manage their long-term savings with confidence, understanding the importance of minimising expenses, and knowing how to achieve this. The essential knowledge you need starts with compound interest. Not only do investment returns compound over time, but so do expenses. And the same applies to inflation. Einstein is reputed to have said: "Compound interest is the eighth wonder of the world. He who understands it, earns it." Achieving a better understanding of essential investment principles within the general population will be hard grind; the education system certainly hasn't achieved it. For one thing, understanding the principles should help protect people from marketing spin. These principles include a number of investment facts of life, especially facing up to uncertainties, and the importance of diversification.

UKSA played our part some years ago in lobbying the regulators to attack commission bias in the financial advice world – and the result was the Retail Distribution Review (RDR). We did at least some good there, though there are always voices arguing to weaken the rules. But the financial sector is still unique in terms of information asymmetry between the industry and the customer. Look at almost all other goods and services you can buy – you can quite easily compare costs between alternatives. You can compare the price of a pound of sugar between Sainsburys, Tesco, Asda, Aldi and Lidl easily enough. It gets more difficult as the "deal" gets more complicated – a good example is mobile phones, another is home electricity and gas tariffs. For both mobile phones and home utility tariffs, most people, if they put the effort in, especially with the internet to help, could find themselves a reasonably good deal and avoid the worst. But businesses make more money when their customers don't put in the effort they could.

These more complicated consumer pricing and shopping-around challenges tend to have one thing in common; to analyse the situation you have to look at the problem over time. Such as asking "if a mobile phone will last five years, what will be the total cost over time using different combinations of phone and tariff?" – for me, buying the phone myself and then separately paying £7 per month as a relatively low user turned out best.

But for long-term savings, there are hidden costs as well as the explicit costs. And, as we explained in the front page editorial of TPI 204, it is easy to demonstrate how the impact of expenses can reduce your ultimate outcome, but we'll give another illustration here too. Let's say you can reduce the expenses on your savings by 2% per annum – how many years before your fund is double what it would have been? The answer is just over 34 years. For those interested in the maths, this works out as 0.98*0.98*0.98… (multiplied together 34.3 times) = 0.5. Put this into a retirement context – the fund you would have from the amount you saved 34 years before retirement would have been twice as big if you had managed to avoid annual charges to the extent of 2% per annum. That means double the retirement income from that bit of saving. You then have to consider the impact of expenses post retirement, of course – yet more complications!

Now understanding this sort of stuff is completely essential if you are to work things out for yourself. But what if you aren't in a position to do this – who can you trust to help you?

Which brings us to the nub of the problem. If you can only navigate the financial future with the aid of an adviser, that adviser is going to have to put in a fair amount of time with you. Which is expensive. And if you really know how much you are paying the adviser – transparency – you may well be put off seeking the advice at all. This is one reason the financial sector didn't like the Retail Distribution Review – with transparency, it was harder to levy the sort of charges that make the business viable, so you hear the spin in this form: "now only the rich can afford advice". Never take any industry's lobbying at face value!

Can it be done? Start with diagnosis.

So the battle lines are beginning to become clear. The first step in determining your strategy, if you want to change a situation from where it is today, is to ask "what is really going on here?" And you have to do this very thoroughly; we live in a very complex world where if you change one thing, it is hard to be sure what the ultimate consequences will be. Even identifying the questions to ask is not easy. But getting to a diagnosis of "the problem" is not so hard now, as a number of good analysts have thought deeply and written about it. One of the most accessible writers is John Kay, and we are always recommending people to read his books "The Long and the Short of It" and "Other People's Money". The point is that the intellectual heavy lifting in terms of diagnosing the problem has been done. Readers can look at the various presentations and articles relating to our "Savers Take Control" project that are now in the public domain via our UKSA website.

So what is really going on today, in terms of the corporate world on the one hand, and the retail savings business on the other?

It is important to stress the general point that things can evolve in an unfortunate direction without any particular evil design on the part of any individual. To a great extent, our behaviour is governed by the system of relationships, beliefs and expectations that we find ourselves in. As regards corporate behaviour, there is really no "owner" power at work. Paul Myners has argued that corporations are essentially "ownerless". What he means by this is that those with the power are not looking after their own money – we are miles away from a Victorian time in which some important businesses were owned and directly controlled by Quaker families with a strong social conscience. And stock market investment has become depersonalised – with what used to be individual shareholders on the company register, with a vote and ability to attend and speak up in company AGMs now disenfranchised behind nominee accounts. And most people don't even think of buying individual shares. They aren't encouraged to do so by the financial sector, which makes much more money marketing "funds".

There is a huge "corporate governance" industry, largely created by regulatory "improvements". But step back a moment and ask what this has achieved. For example, executive pay transparency didn't have the desired effect; instead it had a ratcheting effect.

Parliament pays huge attention to scandals in business and major failings of all sorts. We had the Banking Standards Commission. We have had the PPI mis-selling scandal. Every now and then we have another corporate governance review. The Kay Review of Equity Markets and Long-Term Decision Making was published in 2012. But does anything ever really change? No. And the most vital reason? That's quite simple. And because it's so important and so fundamental, we have decided to put it first in small print: vested interests.

Why are the vested interests so powerful? The simple answer is that there is no effective countervailing people power. There are lots of reasons why this is, but it's where we are today. Politicians definitely can act to change things – in theory at least – but look what happens when some technical reform is contemplated. Vast numbers of paid lobbyists and senior industry people will dominate the representations made to any consultation put out by

Government. Whilst there are indeed a number of very good charitable foundations working to make a difference, true people power is largely lacking.

Savers Take Control is all about a radical, ambitious, but very simple idea for altering the balance of power and influence, which we don't believe has been tried before. We believe that we can bring about a gentle revolution in the way people think about finance and relate to the world of business. We explain this magic ingredient in the next article.

STC

The magic ingredient: Savers and Investors helping each other for free – would you like to help?

What we most need in new volunteers is specialist knowledge and, vitally, independence.

Ultimately, once you have met the essential needs of food, shelter etc., a really strong motivating force for most of us it to feel useful and appreciated. As well as working with people we like.

Savers Take Control (STC) is all about a few highly knowledgeable volunteers putting in their knowledge, time and effort for free. We need all sorts of skills and energies to make things happen, of course, especially organisational and people skills, but it's the people with the critical investment knowledge that will be the key to making the greatest impact.

Knowledge is the first requirement of the magic ingredient. The second requirement, independence, is even more important.

It is vital that people in our STC core team are completely independent of both the financial and corporate world.

For this reason, many of our most active volunteers are retired. Typically, they have worked in the financial sector, and want to "give something back". It is vital that you are not squeamish about, indeed that you fully buy into, the two key themes of STC:

- Empowered savers and investors sharing information and working together to ensure that the amount taken by the financial advice and investment chain is much reduced. This means becoming recognised as a trusted voice, completely independent of any part of the financial sector. At present the financial world exists first to make money and second to serve the interests of the customers. This needs to reversed, with the customers taking control, in the way in which the customer is king in the high street. It is a pity that the mutual model is so rare these days. The shining exception, as a financial mutual which is growing in influence, is Vanguard.
- A change to the culture of all business, bringing top pay, especially bonus pay, down to a level that is more generally regarded as fair. And with the removal of the damaging incentives that focus on share price performance. Only when the conflicts between senior management of companies and the rest of society can be brought under control will business stand a chance of being appreciated as it should be. See the articles in TPI 204 quoting John Kay, and the Institute of Business Ethics to get an idea of the principles we support.

These are not going to be simple aims to achieve. For example, how do we get to a situation on executive pay which is sufficiently widely understood that there can be an informed consensus on what is "fair"? We have to find ways to trigger and energise public discussions about business and its place in society. As it happens, there seems to be more appetite for such discussions today than ever before, so we could be pushing on an already opening door.

We intend to build UKSA's Savers Take Control into a well-recognised movement, with a clear brief to share financially empowering knowledge with everyone in society – not just members of UKSA. We want to help people develop the confidence to make good decisions in their personal financial management, but also to be more aware how the world of business works, how it generates good employment, how profits are essential to affording pensions, and to feel they have a voice they can use to influence the world of business. This is not an overthrowing of capitalism – indeed, we believe that to survive and deliver the best it can for society, we need a more intelligent, more patient, less greedy and more long-term focused capitalism.

We would like to appeal to anyone who meets the independence criteria who feels they have special relevant knowledge, especially in the world of investment, to come forward and talk to us. Similarly, please also talk to us if you think you can help in any other way, such as helping organise membership activities.

There is a long road ahead, and all this is going to take time.

In order to succeed, rather than fall flat on our faces, we need to go very carefully. This is what we might call a "system" problem, which needs very deep thought. And we need to encourage as much dialogue as possible with all interested parties, whilst jealously guarding and never compromising on our own independence.

We must also never forget the extent to which the "establishment" will feel threatened by what we are doing. Again, only with complete independence can we hope to make a real difference. And that includes financial independence – our member subscriptions are all we have. That greatly limits our ability to have paid staff. We can accept donations, but never if they come with strings or expectations of influencing us.

Importance of a team player mentality

The mindset we all need within the STC team is one of personal growth. It is more important to work to learn from each other than to rush to persuade others of your personal ideas for solutions. From personal experience of years of voluntary research work with fellow actuaries, this is actually huge fun and very stimulating.

So if you think you might be interested in helping, first explore the STC pages on our website, including the articles reproduced from our magazine, The Private Investor, and also our developing basic education site honestmoneynow. Then please contact us at STC@UKSA.org.uk.

STC

Developing the UKSA experience

With a stronger public profile for UKSA brought about by additional publicity for STC, we need to ensure that we have the logistics in place to support activity. Since the founding of UKSA, we have had many concurrent activities happening. These include member-to-member discussions at different venues around the country, policy representative work carried out by a set of volunteers, and contact with companies that members invest in. The member-to-member discussions vary in character, but a social element is always present and important. Post the coronavirus lockdown, there have been a number of online meetings – and we even had to have our AGM online this year. Once face-to-face meetings are possible again, there is no doubt that online meetings, which have been quite a success, will also continue in the future. For members who are not within easy reach of a number of fellow members, online meetings are the easiest way of achieving contact. Our most active members, in terms of attending meetings, tend to be retired and thus more flexible in terms of meeting times. But online meetings can offer a way for those with jobs to participate as well. And if you want to have a discussion on a particular topic, we can use the UKSA network to see if anyone else would like to join in, and arrange an online discussion.

Existing members have an important role, with many years of investment experience to share. Helping other members by sharing knowledge and experience is of course happening all the time at meetings. It is vital that we never transgress the law in relation to regulated investment "advice". Unless you are a regulated investment or financial adviser, you are not allowed to actually advise any specific investment decision – such as to buy a particular product, or to invest in a particular stock. But "generic" ideas and saying "I'm doing x for this reason" are fine.

To participate in UKSA events, you generally need to be a full member, and pay the annual subscription, which is £50 per annum. We need this money to meet our modest central expenses, which include our secretarial function, website costs, audit, etc. We occasionally have special conferences, which have to be priced to pay for themselves. To help with STC, you need to be a full member.

As set out in TPI 205, we are now also introducing **Associate Membership**, which costs nothing, does not generally permit participation in UKSA events, but does enable us to keep people informed by email.

Extending our reach beyond our membership

The other category of involvement is simply **registering a particular interest**, or interests – again free of charge; you don't have to be a member. This facility will be essential as STC develops and as we generate and test educational material, and look for ways in which people can help each other with financial capability. Once again, communication will be by email whenever we have something to share which people have expressed an interest in. There is no limit to the number of people that can register with us in this way, but it all has to be entirely automatic. As soon as people want to talk to us, we won't have the resources to cope, which is why anyone who actually wants to talk to us will generally have to be a full member.

Over time, we will always be looking for ways in which we can contribute to financial education generally. It would be good, for example, to contribute to and road-test teaching material which could be used as the basis for adult education classes run by local authorities throughout the country. Improving financial education and empowerment is, as mentioned in TPI 205, going to be a hard grind. But we are not totally alone in this of course; there are a number of charitable organisations dedicated to financial education in schools.

But what about shareholding? Yes, fair question. We believe that for many people, investing in individual shares makes sense and can also be enjoyable. And we need individuals to act as shareholders, and take part in the governance of companies. But that supply of individuals has fallen off a cliff following the widespread requirement to hold investments in nominee names, and we have to work to change the rules around nominees so that all owners through nominees have the same rights of communication with companies as shareholders on the company register still have. If you are able to make your own decisions around investment, it can be the very lowest-cost way of investing. You can avoid annual percentage charges altogether through this route. But over-confidence can be disastrous, and having a network of friends to talk to can be very helpful.

Most personal investing these days is carried out through pooled vehicles – "funds". Go to a financial adviser, and you will be put into funds. But the impact of expenses of going this route can be huge, and it is a tough ask for people to work it all out for themselves and decide what is good value. Hence the need for Savers Take Control.

Most people will never think about buying individual shares, and that is completely sensible, though in the US the ownership of individual shares is more widespread than in the UK. But there will be people who could be encouraged to learn more about their personal finances and for most people the place to start will not be experimenting with individual shares. Instead, you need the knowledge to take control of your own finances. Once your finances are under control, you can start thinking more about how you are going to invest, including whether individual shares might be right for you. Our website honestmoneynow can be viewed by anyone and is designed to be accessible, especially to people who are at the beginning of the journey.

Even though most people will never take the decision to select individual shares, it is important to appreciate that most of us are actually shareholders, albeit indirectly. With auto-enrolment, most people will have some pension savings, for example. Much of this money will be invested in companies. Being aware of this is important – if we criticise a particular company, it is very likely that we indirectly own a tiny bit of it! And if we feel that companies should behave in a particular way, it should be possible to speak up and for our voice to be heard. That's a topic for another day, but an important one – are there some core principles that we should be asking for, in relation to corporate behaviour? And how can we encourage a discussion throughout society about what those principles should be?

STC

Being prepared for growth in numbers, being flexible

As UKSA membership grows, and as our STC movement becomes more widely known, we have to be prepared to absorb many more volunteers into the band of people who really make things happen within UKSA. Our public messaging will include some detail about the kinds of tasks and projects we are currently working on, and are considering at the time, and this messaging will have to be kept up to date. If it all sounds too vague, that can be off-putting. But there is an army of potential volunteers out there, especially people who are retired; the older generation helping younger generations is one of the important dynamics of UKSA.

It's all about volunteers – if you join us you can make a real difference

The UKSA culture is very much centred on our members; our legal structure is that the members elect the Board that serves the members, and that we are technically a company limited by guarantee. The Board members are all volunteers, and so are our regional organisers. We have minimal paid administrative support, and to stay financially viable we have to keep our administration budget and any other spending down to what the £50 member subscriptions and any donations will permit. If, as we hope, our current push to expand our activities and our public profile bears fruit, we will need our voluntary organisation to adapt, whilst trying to grow our surplus funds a little in order to give flexibility to undertake risky projects such as the occasional conference.

Organising volunteers is not like running a normal company – a command and control mentality will not work. Instead, we have to respect the particular interests of our new volunteers and help them to organise themselves into new task groups. So precisely what we can do, and the order in which we can do it, will be largely determined by exactly who hears about STC and comes forward to volunteer.

So to any non-member reading these articles in response to hearing about STC and checking out our website, do consider whether joining our ranks is something you would like to try – we would love to hear from you.