

**“Economics for Everyone:
How to Cut Through the Jargon”**

Later Life Learning, Innis College

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Session 4

**Bosses, Owners,
and Companies**

**Readings:
Chapters 7-8**

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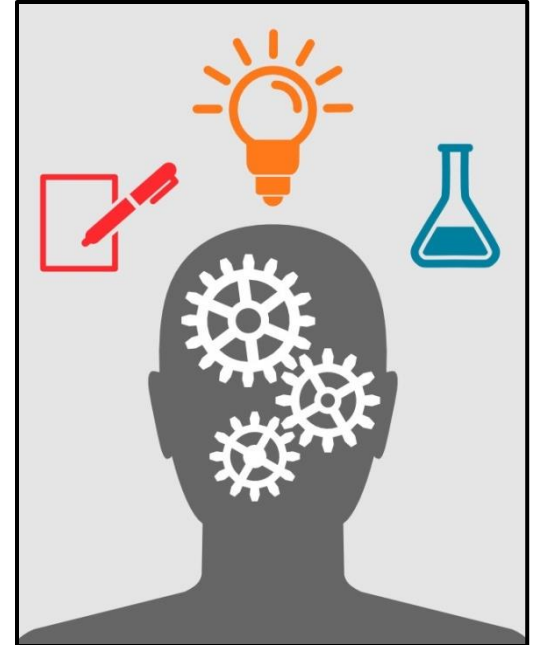
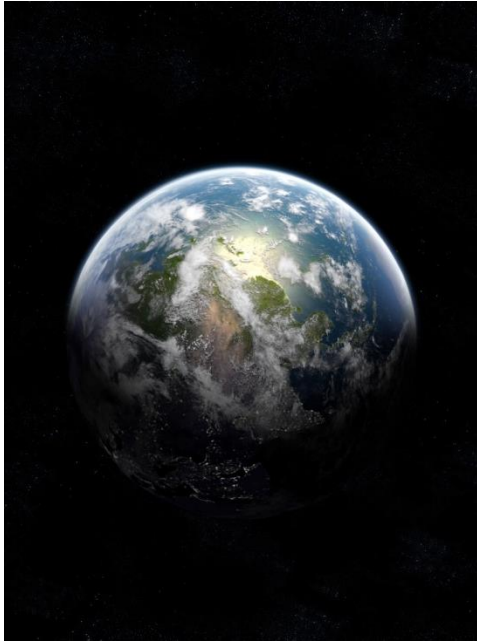
Key Topics Covered

- What is capital
- How companies are organized
- The ownership of companies
- How companies behave
- The logic of profit
- Business investment performance

Key Terms Introduced

- corporation
- capitalist class
- top managers
- major owners
- surplus
- profit
- interest
- investment
- private costs and benefits
- social costs and benefits
- retained earnings
- capital gain
- stock market
- return on equity
- depreciation

The Economy is Work



- We use our capacity to work (brains & brawn) to transform what we harvest from nature (hopefully sustainably!) into useful goods & services.

Working With Tools

- Nobody works only with their bare hands.
- Humans learned very early that working with tools makes us more productive.
 - Even many animals know this!
- Tools allow us to:
 - Produce more output.
 - Produce higher quality output (goods and services that we couldn't produce without the right tools).
- Humans “learn by doing”:
 - The more we work, the more we find better ways to work (including new tools).



Where Do Tools Come From?

- Like any other product, tools are produced by work.
 - “Intermediate good”: Something that is produced to then produce something else (rather than consumed).



Where Do Tools Come From?

- Like any other product, tools are produced by work.
 - “Intermediate good”: Something that is produced to then produce something else (rather than consumed).
- Think of working with tools as a two-stage, “indirect” way of working:
 1. First we work to produce the tool.
 2. Then we use the tool to perform our end task.
- But remember: Humans did all the work.
 - The tools themselves are not productive.
 - Knowing how to make & use tools is productive.
- Merely owning a tool is not a productive act.

This machinery is very productive, and I own it. That's why I'm rich.

But you didn't build this machinery.

And you don't operate it.

In fact, you don't seem to do any work around here at all!



Demystifying “Capital”

- “Capital” is just the economic term for “tools.”
- Physical capital: real, tangible products used to produce other products.
 - Distinct from “financial capital,” which is just money.
- Fixed capital: long-lived, used in a workplace.
 - **Structures**: buildings, offices, stores.
 - **Machinery and equipment**: computers, assembly lines, hand tools, transportation equipment.
 - **Infrastructure**: roads, bridges, utilities.
- Working capital: the value of raw materials, inventories, and other items used up in production.

The Private Company

- One of the defining features of capitalism: most production is undertaken for private profit
- The private company is the entity through which that profit-seeking activity is organized
- Private companies come in all shapes and sizes:
 - Large corporations, with global reach
 - Medium-sized firms (most work done by paid workers)
 - Very small firms (most work done by owner & family)
- All companies have two key features:
 1. Somebody owns them and its profits
 2. The owner directs the firm in their interests

Types of Companies

- Individual proprietorships
 - Individual owner owns & controls it directly
- Partnerships
 - Joint owners share the investment & profit
- Corporations
 - Separate legal entity which limits the liability and potential losses of the owners
 - Large corporations are usually owned through joint-stock (issuing equity shares)
 - The biggest global corporations are economically larger than many countries, and operate through tight central plans

The Biggest of the Big

(p.90)

Category	Large Company	Equivalent Country
Value-Added	<i>ExxonMobil</i> <i>(\$195 billion)</i>	<i>Finland</i> <i>(\$195 billion)</i>
Employment	<i>Wal-Mart</i> <i>(2.3 million)</i>	<i>New Zealand</i> <i>(2.3 million)</i>
Cash	<i>Apple Inc.</i> <i>(\$147 billion)</i> <i>(Cash & securities)</i>	<i>U.S. Fed Govt</i> <i>(\$110 billion)</i> <i>(official reserves)</i>
<i>2013 data, \$US.</i>		

Who Owns Corporations?

- Ownership of joint stock companies is dispersed
 - Shares are bought & sold on the stock market
- Problem: how to ensure company acts in owners' interests
 - Problem solved through major share ownership and executive compensation
 - Top managers of the firms are major owners, with huge personal stake in share price
- Ownership of business wealth as a whole is concentrated among a small elite
 - It's a myth that the stock market, mutual funds, etc., have allowed everyone to become "owners"

Meet The Modern Capitalist



- Less than 2% of advanced capitalist population owns enough wealth to not have to work
 - Many do work anyway, but they are not compelled to work for survival
- This small group owns a controlling interest in the private business sector
- Large overlap between this group and top executives of large and medium companies
- “Major owners and top managers” = the modern capitalist class


The Shocking Concentration of Business Wealth

Distribution of Financial Wealth				
	Top 10%	Top 1%	Billionaires	Bottom 50%
Canada	58%	~30%	5% (54)	3%
U.S.	71%	34%	6% (≈500)	2%
Australia	53%	~25%	7% (37)	6%
U.K.	71%	34%	10% (169)	1%
World	57%	32%	n.a.	4%

- *Most financial wealth is owned by the top 10%.*
- *The bottom 50% own almost no financial wealth.*
- *A handful of billionaires own more than the majority.*

The Logic of Profit

- Competition forces companies to meet the “going rate” of profit or go out of business
 - This imposes a logic & discipline on the system
 - This logic (not the personal views and actions of CEOs) explains why capitalism does so much harm
- Under capitalism (“production for profit”) something is done if it is profitable
 - Not necessarily if it is useful
- We cannot assume that profitability is a measure of an activity’s value
 - “Production for profit” does not guarantee that human needs are being met



Right then, it looks like we've agreed on our corporate mission statement: *"to make money, wads of it, and pay as little income tax as possible."*

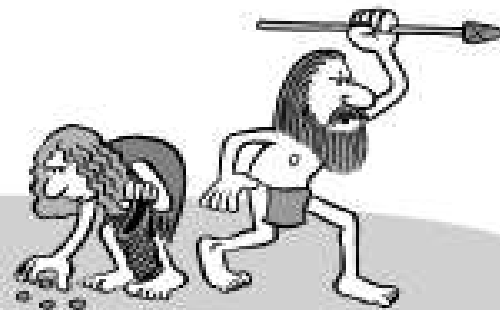
The Logic of Profit

- Think of something that is profitable but not useful.
- Mention it in the Q&A.
- One example:



What is Profit?

- In both economic and accounting terms, it is a “surplus.”
 - Economic: Something left over after the costs of reproduction (human and capital) are paid.
 - Accounting: What remains after production costs are deducted from revenue.



Hunting gathering



Slave ownership



Feudalism



Capitalism

Something else?

Measuring Profit

Operating revenues

– Operating expenses

= Operating profit

– Depreciation (wear & tear on capital)

– Interest costs

– Other overhead

= Income before tax

– Corporate income tax

= Net income

Evaluating Profit

Operating margin =

$$\text{Operating profit} \div \text{Revenue}$$

EBITDA = Earnings before interest tax
depreciation & amortization

Return on capital =

$$\text{Net income} \div \text{All invested capital}$$

Return on equity =

$$\text{Net income} \div \text{Shareholder equity}$$

Total surplus =

$$(\text{Profit} + \text{Interest}) \div \text{Invested capital}$$

Capturing Profit

- There are many ways for owners to access the profits of their businesses.
 - Direct income (proprietorships).
 - Dividends.
 - Interest in various forms.
 - Capital gains.
- Big irony: Tax system offers huge advantages to capital income.



Business Investment Today

- We are told that economic policy must cater to business, so we get “jobs and growth.”
 - Can you list examples? (Use the Q&A!)
- Problem: Under neoliberalism, the economy has become more business-friendly (and profits have improved).
- But business investment spending has slowed down, not picked up.

Less Effort

(p. 156)

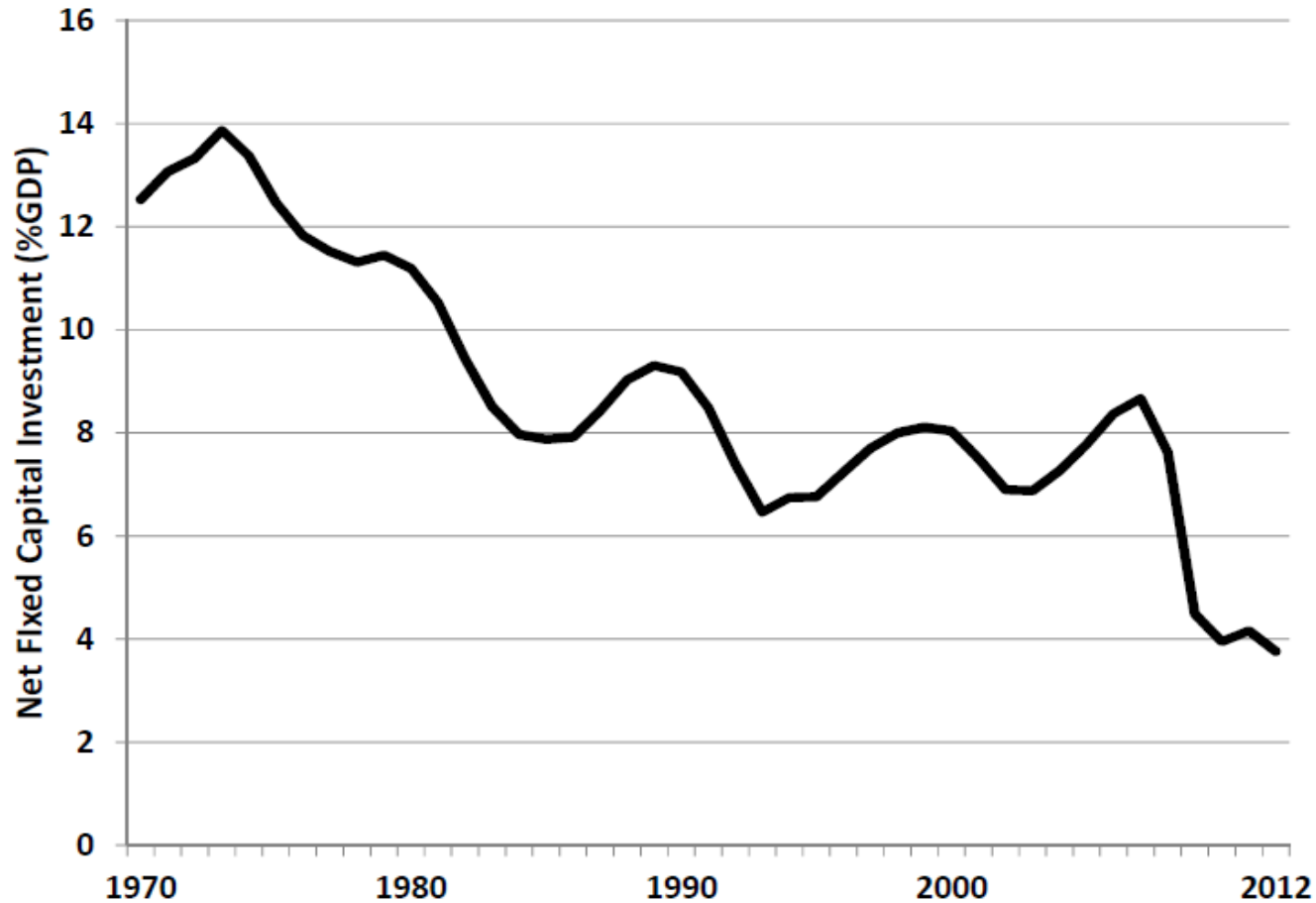
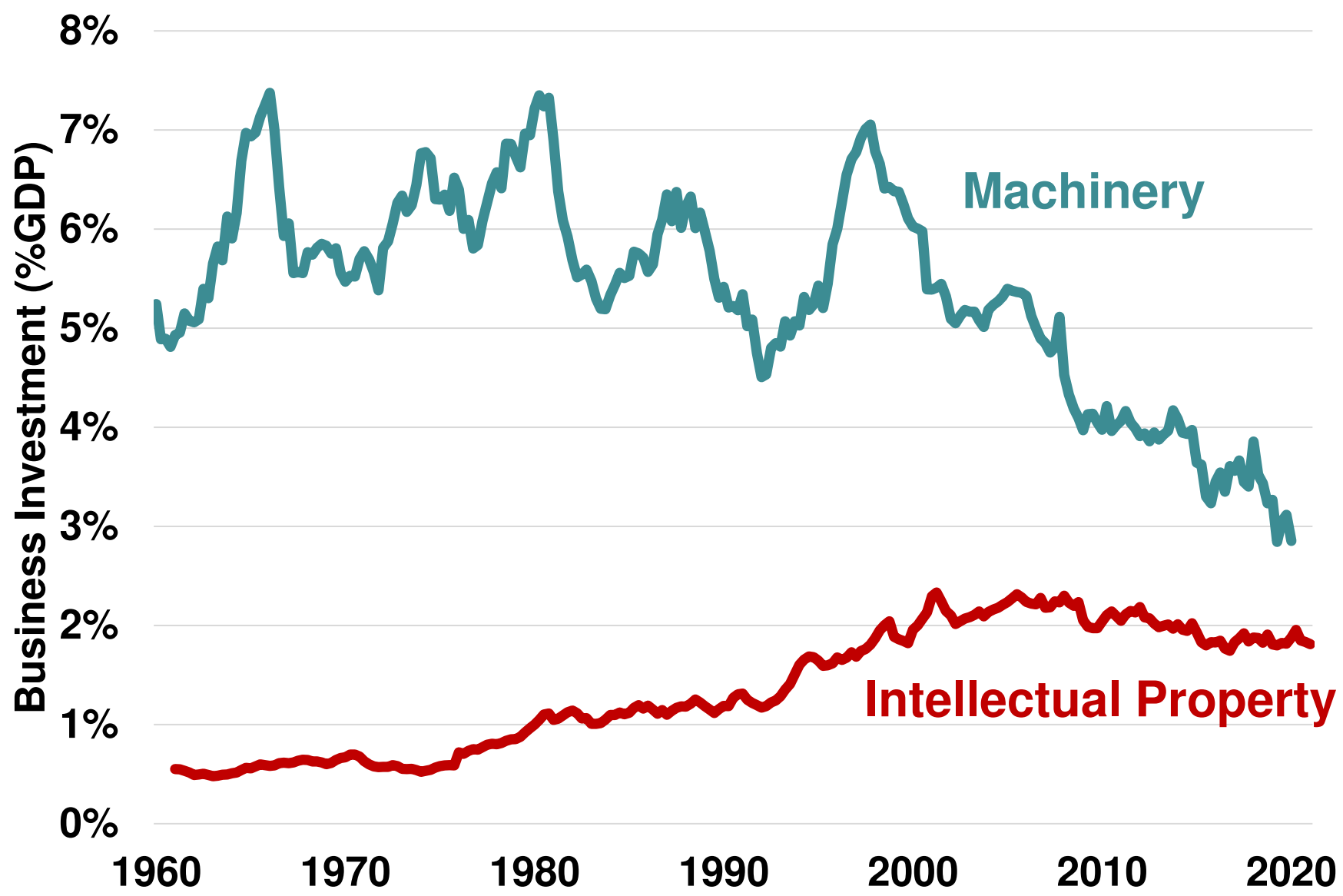


Figure 12.1 Falling Investment Rate, OECD

Lazy Canadian Capitalists



Determinants of Business Investment

- AMOUNT:
 - Profit (current & expected)
 - Capacity utilization
 - Economic growth (current & expected)
 - Interest rates
 - Political / legal environment
- LOCATION:
 - Unit labour costs
 - Infrastructure
 - Taxes
 - Transport costs
 - Supply chain
 - Local market
 - Trade policy
 - Political / legal environment

Have Capitalists Lost the Will to Work???

- Neoliberalism has boosted profitability.
- But investment spending has weakened.
- Uninvested profits are a source of ongoing stagnation:
 - Excess corporate savings.
 - Increased payouts to owners.
 - Financial speculation & other schemes.
- Stock markets remove capital, not raise it.
- Does the economy need a new engine?

Thank You!

Let's take 5 minutes...