

Developing Countries Small Business Manual

1st EDITION

Sam Vaknin, Ph.D.

Editing and Design:
Lidija Rangelovska

Lidija Rangelovska

A Narcissus Publications Imprint, Skopje 2003

First published by United Press International – UPI

Not for Sale! Non-commercial edition.

© 2002 Copyright Lidija Rangelovska.

All rights reserved. This book, or any part thereof, may not be used or reproduced in any manner without written permission from:

Lidija Rangelovska – write to:

palma@unet.com.mk or to

vaknin@link.com.mk

Visit the Author Archive of Dr. Sam Vaknin in "Central Europe Review":

http://www.ce-review.org/authorarchives/vaknin_archive/vaknin_main.html

Visit Sam Vaknin's United Press International (UPI) Article Archive –[Click HERE!](#)

ISBN: 9989-929-38-6

<http://samvak.tripod.com/guide.html>

<http://economics.cjb.net>

<http://samvak.tripod.com/after.html>

Created by: LIDIJA RANGELOVSKA
 REPUBLIC MACEDONIA

C O N T E N T S

- I. [Small Business – Big Obstacles](#)
- II. [Making Your Workers Your Partners](#)
- III. [Going Bankrupt in the World](#)
- IV. [The Inferno of the Financial Director](#)
- V. [Decision Support Systems](#)
- VI. [Valuing Stocks](#)
- VII. [The Process of Due Diligence](#)
- VIII. [Financial Investor, Strategic Investor](#)
- IX. [Mortgage Backed Construction](#)
- X. [Bully at Work – Interview with Tim Field](#)
- XI. [Is My Money Safe?](#)
- XII. [Alice in Credit Card Land](#)
- XIII. [Workaholism, Leisure and Pleasure](#)
- XIV. [Revolt of the Poor – Intellectual Property Rights](#)
- XV. [The Author](#)
- XVI. [About "After the Rain"](#)

Download additional free e-books here:

<http://samvak.tripod.com/freebooks.html>

Small Businesses - Big Obstacles

By: [Dr. Sam Vaknin](#)

Everyone is talking about small businesses. In 1993, when it was allowed in Developing countries, more than 90,000 new firms were registered by individuals. Now, less than three years later, official figures show that only 40,000 of them still pay their dues and present annual financial statements. These firms are called "active" - but this is a misrepresentation. Only a very small fraction really does business and produces income.

Why this reversal? Why were people so enthusiastic to register companies - and then became too desperate to operate them?

Small business is more than a fashion or a buzzword. In the USA, only small businesses create new jobs. The big dinosaur firms (the "blue-chips") create negative employment - they fire people. This trend has a glitzy name: downsizing.

In Israel many small businesses became world class exporters and big companies in world terms. The same goes, to a lesser extent, in Britain and in Germany.

Virtually every Western country has a "Small Business Administration" (SBA).

These agencies provide many valuable services to small businesses:

They help them organize funding for all their needs: infrastructure, capital goods (machinery and equipment), land, working capital, licence and patent fees and charges,

etc.

The SBAs have access to government funds, to local venture capital funds, to international and multilateral investment sources, to the local banking community and to private investors. They act as capital brokers at a fraction of the costs that private brokers and organized markets charge.

They assist the entrepreneur in the preparation of business plans, feasibility studies, application forms, questionnaires - and any other thing which the new start-up venture might need to raise funds to finance its operations.

This saves the new business a lot of money. The costs of preparing such documents in the private sector amount to thousands of DM per document.

They reduce bureaucracy. They mediate between the small business and the various tentacles of the government. They become the ONLY address which the new business should approach, a "One Stop Shop".

But why do new (usually small) businesses need special treatment and encouragement at all? And if they do need it - what are the best ways to provide them with this help?

A new business goes through phases in the business cycle (very similar to the stages of human life).

The first phase - is the formation of an idea. A person - or a group of people join forces, centred around one exciting invention, process or service.

These crystallizing ideas have a few hallmarks:

They are oriented to fill the needs of a market niche (a small group of select consumers or customers), or to

provide an innovative solution to a problem which bothers many, or to create a market for a totally new product or service, or to provide a better solution to a problem which is solved in a less efficient manner.

At this stage what the entrepreneurs need most is expertise. They need a marketing expert to tell them if their idea is marketable and viable. They need a financial expert to tell them if they can get funds in each phase of the business cycle - and wherefrom and also if the product or service can produce enough income to support the business, pay back debts and yield a profit to the investors. They need technical experts to tell them if the idea can or cannot be realized and what it requires by way of technology transfers, engineering skills, know-how, etc.

Once the idea has been shaped to its final form by the team of entrepreneurs and experts - the proper legal entity should be formed. A bewildering array of possibilities arises:

A partnership? A corporation - and if so, a stock or a non-stock company? A research and development (RND) entity? A foreign company or a local entity? And so on.

This decision is of cardinal importance. It has enormous tax implications and in the near future of the firm it greatly influences the firm's ability to raise funds in foreign capital markets. Thus, a lawyer must be consulted who knows both the local applicable laws and the foreign legislation in markets which could be relevant to the firm.

This costs a lot of money, one thing that entrepreneurs are in short supply of. Free legal advice is likely to be highly appreciated by them.

When the firm is properly legally established, registered with all the relevant authorities and has appointed an

accounting firm - it can go on to tackle its main business: developing new products and services. At this stage the firm should adopt Western accounting standards and methodology. Accounting systems in many countries leave too much room for creative playing with reserves and with amortization. No one in the West will give the firm credits or invest in it based on domestic financial statements.

A whole host of problems faces the new firm immediately upon its formation.

Good entrepreneurs do not necessarily make good managers. Management techniques are not a genetic heritage.

They must be learnt and assimilated. Today's modern management includes many elements: manpower, finances, marketing, investing in the firm's future through the development of new products, services, or even whole new business lines. That is quite a lot and very few people are properly trained to do the job successfully.

On top of that, markets do not always react the way entrepreneurs expect them to react. Markets are evolving creatures: they change, they develop, disappear and re-appear. They are exceedingly hard to predict. The sales projections of the firm could prove to be unfounded. Its contingency funds can evaporate.

Sometimes it is better to create a product mix: well-recognized brands which sell well - side by side with innovative products.

I gave you a brief - and by no way comprehensive - taste of what awaits the new business and its initiator, the entrepreneur. You see that a lot of money and effort are needed even in the first phases of creating a business.

How can the Government help?

It could set up an "Entrepreneur's One Stop Shop".

A person wishing to establish a new business will go to a government agency.

In one office, he will find the representatives of all the relevant government offices, authorities, agencies and municipalities.

He will present his case and the business that he wishes to develop. In a matter of few weeks he will receive all the necessary permits and licences without having to go to each office separately.

Having obtained the requisite licences and permits and having registered with all the appropriate authorities - the entrepreneur will move on to the next room in the same building. Here he will receive a list of all the sources of capital available to him both locally and from foreign sources. The terms and conditions of the financing will be specified for each and every source. Example: EBRD - loans of up to 10 years - interest between 6.5% to 8% - grace period of up to 3 years - finances mainly industry, financial services, environmental projects, infrastructure and public services.

The entrepreneur will select the sources of funds most suitable for his needs - and proceed to the next room.

The next room will contain all the experts necessary to establish the business, get it going - and, most important, raise funds from both local and international institutions. For a symbolic sum they will prepare all the documents required by the financing institutions as per their instructions.

But entrepreneurs in many developing countries are still fearful and uninformed. They are intimidated by the complexity of the task facing them.

The solution is simple: a tutor or a mentor will be attached to each and every entrepreneur. This tutor will escort the entrepreneur from the first phase to the last.

He will be employed by the "One Stop Shop" and his role will be to ease life for the novice businessman. He will

transform the person to a businessman.

And then they will wish the entrepreneur: "Bon Voyage" -
and may the best ones win.

Making your Workers Your Partners

By: ***[Dr. Sam Vaknin](#)***

Also read these:

[The Principal-Agent Conundrum](#)

[The Labour Divide - V. Employee Benefits and Ownership](#)

There is an inherent conflict between owners and managers of companies. The former want, for instance, to minimize costs - the latter to draw huge salaries as long as they are in power.

In publicly traded companies, the former wish to maximize the value of the stocks (short term), the latter might have a longer term view of things. In the USA, shareholders place emphasis on the appreciation of the stocks (the result of quarterly and annual profit figures). This leaves little room for technological innovation, investment in research and development and in infrastructure. The theory is that workers who also own stocks avoid these cancerous conflicts which, at times, bring companies to ruin and, in many cases, dilapidate them financially and technologically. Whether reality lives up to theory, is an altogether different question.

A stock option is the right to purchase (or sell - but this is not applicable in our case) a stock at a specified price (=strike price) on or before a given date. Stock options are either not traded (in the case of private firms) or traded in a stock exchange (in the case of public firms whose shares are also traded in a stock exchange).

Stock options have many uses: they are popular investments and speculative vehicles in many markets in the West, they are a way to hedge (to insure) stock positions (in the case of put options which allow you to sell your stocks at a pre-fixed price). With very minor investment and very little risk (one can lose only the money invested in buying the option) - huge profits can be realized.

Creative owners and shareholders began to use stock options to provide their workers with an incentive to work for the company and only for the company. Normally such perks were reserved to senior management, thought indispensable. Later, as companies realized that their main asset was their employees, all employees began to enjoy similar opportunities. Under an incentive stock option scheme, an employee is given by the company (as part of his compensation package) an option to purchase its shares at a certain price (at or below market price at the time that the option was granted) for a given number of years. Profits derived from such options now constitute the main part of the compensation of the top managers of the Fortune 500 in the USA and the habit is catching on even with more conservative Europe.

A Stock Option Plan is an organized program for employees of a corporation allowing them to buy its shares. Sometimes the employer gives the employees subsidized loans to enable them to invest in the shares or even matches their purchases: for every share bought by an employee, the employer awards him with another one, free of charge. In many companies, employees are offered the opportunity to buy the shares of the company at a discount (which translates to an immediate paper profit).

Dividends that the workers receive on the shares that they hold can be reinvested by them in additional shares of the firm (some firms do it for them automatically and without or with reduced brokerage commissions). Many companies have wage "set-aside" programs: employees regularly use a part of their wages to purchase the shares of the company at the market prices at the time of purchase. Another well known structure is the Employee Stock Ownership Plan (ESOP) whereby employees regularly accumulate shares and may ultimately assume control of the company.

Let us study in depth a few of these schemes:

It all began with Ronald Reagan. His administration passed in Congress the Economic Recovery Tax Act (ERTA - 1981) under which certain kinds of stock options ("qualifying options") were declared tax-free at the date that they were granted and at the date that they were exercised. Profits on shares sold after being held for at least two years from the date that they were granted or one year from the date that they were transferred to an employee were subjected to preferential (lower rate) capital gains tax. A new class of stock options was thus invented: the "Qualifying Stock Option". Such an option was legally regarded as a privilege granted to an employee of the company that allowed him to purchase, for a special price, shares of its capital stock (subject to conditions of the Internal Revenue - the American income tax - code). To qualify, the option plan must be approved by the shareholders, the options must not be transferable (i.e., cannot be sold in the stock exchange or privately - at least for a certain period of time).

Additional conditions: the exercise price must not be less than the market price of the shares at the time that the options were issued and that the employee who receives the stock options (the grantee) may not own stock representing more than 10% of the company's voting power unless the option price equals 110% of the market price and the option is not exercisable for more than five years following its grant. No income tax is payable by the employee either at the time of the grant or at the time that he converts the option to shares (which he can sell at the stock exchange at a profit) - the exercise period. If the market price falls below the option price, another option, with a lower exercise price can be issued. There is a 100,000 USD per employee limit on the value of the stock covered by options that can be exercised in any one calendar year.

This law - designed to encourage closer bondage between workers and their workplaces and to boost stock ownership - led to the creation of Employee Stock Ownership Plans (ESOPs). These are programs which encourage employees to purchase stock in their company. Employees may participate in the management of the company. In certain cases - for instance, when the company needs rescuing - they can even take control (without losing their rights). Employees may offer wage concessions or other work rules related concessions in return for ownership privileges - but only if the company is otherwise liable to close down ("marginal facility").

How much of its stock should a company offer to its workers and in which manner?

There are no rules (except that ownership and control need not be transferred). A few of the methods:

1. The company offers packages of different sizes,

comprising shares and options and the employees bid for them in open tender

1. The company sells its shares to the employees on an equal basis (all the members of the senior management, for instance, have the right to buy the same number of shares) - and the workers are then allowed to trade the shares between them
1. The company could give one or more of the current shareholders the right to offer his shares to the employees or to a specific group of them.

The money generated by the conversion of the stock options (when an employee exercises his right and buys shares) usually goes to the company. The company sets aside in its books a number of shares sufficient to meet the demand which may be generated by the conversion of all outstanding stock options. If necessary, the company issues new shares to meet such a demand. Rarely, the stock options are converted into shares already held by other shareholders.

Going Bankrupt in the World

By: [Dr. Sam Vaknin](#)

It all starts by defaulting on an obligation. Money owed to creditors or to suppliers is not paid on time, interest payments due on bank loans or on corporate bonds issued to the public are withheld. It may be a temporary problem - or a permanent one.

As time goes by, the creditors gear up and litigate in a court of law or in a court of arbitration. This leads to a “***technical or equity insolvency***” status.

But this is not the only way a company can be rendered insolvent. It could also run liabilities which outweigh its assets. This is called “***bankruptcy insolvency***”. True, there is a debate raging as to what is the best method to appraise the firm’s assets and the liabilities. Should these appraisals be based on market prices - or on book value?

There is no one decisive answer. In most cases, there is strong reliance on the figures in the balance sheet.

If the negotiations with the creditors of the company (as to how to settle the dispute arising from the company’s default) fails, the company itself can file (=ask the court) for bankruptcy in a “***voluntary bankruptcy filing***”.

Enter the court. It is only one player (albeit, the most important one) in this unfolding, complex drama. The court does not participate directly in the script.

Court officials are appointed. They work hand in hand with the representatives of the creditors (mostly lawyers) and with the management and the owners of the defunct company.

They face a tough decision: should they liquidate the company? In other words, should they terminate its business life by (among other acts) selling its assets?

The proceeds of the sale of the assets are divided (as "bankruptcy dividend") among the creditors. It makes sense to choose this route only if the (money) value yielded by liquidation exceeds the money the company, as a going concern, as a living, functioning, entity, can generate.

The company can, thus, go into "***straight bankruptcy***". The secured creditors then receive the value of the property which was used to secure their debt (the "collateral", or the "mortgage, lien"). Sometimes, they receive the property itself - if it not easy to liquidate (=sell) it.

Once the assets of the company are sold, the first to be fully paid off are the secured creditors. Only then are the priority creditors paid (wholly or partially).

The priority creditors include administrative debts, unpaid wages (up to a given limit per worker), uninsured pension claims, taxes, rents, etc.

And only if any money left after all these payments is it proportionally doled out to the unsecured creditors.

The USA had many versions of bankruptcy laws. There was the 1938 Bankruptcy Act, which was followed by amended versions in 1978, 1984 and, lately, in 1994.

Each state has modified the Federal Law to fit its special, local conditions.

Still, a few things - the spirit of the law and its philosophy are common to all the versions. Arguably, the most famous procedure is named after the chapter in the law in which it is described, Chapter 11. Following is a brief discussion of chapter 11 intended to demonstrate this spirit and this philosophy.

This chapter allows for a mechanism called "reorganization". It must be approved by two thirds of all classes of creditors and then, again, it could be voluntary (initiated by the company) or involuntary (initiated by one to three of its creditors).

The American legislator set the following goals in the bankruptcy laws:

0. To provide a fair and equitable treatment to the holders of various classes of securities of the firm (shares of different kinds and bonds of different types)
 - a. To eliminate burdensome debt obligations, which obstruct the proper functioning of the firm and hinder its chances to recover and ever repay its debts to its creditors.

b. To make sure that the new claims received by the creditors (instead of the old, discredited, ones) equal, at least, what they would have received in liquidation.

Examples of such new claims: owners of debentures of the firm can receive, instead, new, long term bonds (known as reorganization bonds, whose interest is payable only from profits).

Owners of subordinated debentures will, probably, become shareholders and shareholders in the insolvent firm usually receive no new claims.

The chapter dealing with reorganization (the famous "Chapter 11") allows for "**arrangements**" to be made between debtor and creditors: an extension or reduction of the debts.

If the company is traded in a stock exchange, the Securities and Exchange Commission (SEC) of the USA advises the court as to the best procedure to adopt in case of reorganization.

What chapter 11 teaches us is that:

American Law leans in favour of maintaining the company as an ongoing concern. A whole is larger than the sum of its parts - and a living business is sometimes worth more than the sum of its assets, sold separately.

A more in-depth study of the bankruptcy laws shows that they prescribe three ways to tackle a state of malignant insolvency which threatens the well being and the continued functioning of the firm:

Chapter 7 (1978 Act) - liquidation

A District court appoints an "interim trustee" with broad

powers. Such a trustee can also be appointed at the request of the creditors and by them.

The Interim Trustee is empowered to do the following:

- liquidate property and make distribution of liquidating dividends to creditors
- make management changes
- arrange unsecured financing for the firm
- operate the debtor business to prevent further losses

By filing a bond, the debtor (really, the owners of the debtor) is able to regain possession of the business from the trustee.

Chapter 11 - reorganization

Unless the court rules otherwise, the debtor remains in possession and in control of the business and the debtor and the creditors are allowed to work together flexibly. They are encouraged to reach a settlement by compromise and agreement rather than by court adjudication.

Maybe the biggest legal revolution embedded in chapter 11 is the relaxation of the age old ***ABSOLUTE PRIORITY*** rule, that says that the claims of creditors have categorical precedence over ownership claims. Rather, the interests of the creditors have to be balanced with the interests of the owners and even with the larger good of the community and society at large.

And so, chapter 11 allows the debtor and creditors to be in direct touch, to negotiate payment schedules, the restructuring of old debts, even the granting of new loans by the same disaffected creditors to the same irresponsible

debtor.

Chapter 10

Is sort of a legal hybrid, the offspring of chapters 7 and 11:

It allows for reorganization under a court appointed independent manager (trustee) who is responsible mainly for the filing of reorganization plans with the court - and for verifying strict adherence to them by both debtor and creditors.

Despite its clarity and business orientation, many countries found it difficult to adapt to the pragmatic, non sentimental approach which led to the virtual elimination of the absolute priority rule.

In England, for instance, the court appoints an official "receiver" to manage the business and to realize the debtor's assets on behalf of the creditors (and also of the owners). His main task is to maximize the proceeds of the liquidation and he continues to function until a court settlement is decreed (or a creditor settlement is reached, prior to adjudication). When this happens, the receivership ends and the receiver loses his status.

The receiver takes possession (but not title) of the assets and the affairs of a business in a receivership. He collects rents and other income on behalf of the firm.

So, British Law is much more in favour of the creditors. It recognizes the supremacy of their claims over the property claims of the owners. Honouring obligations - in the eyes of the British legislator and their courts - is the cornerstone of efficient, thriving markets. The courts are entrusted with the protection of this moral pillar of the economy.

Economies in transition are in transition not only economically - but also legally. Thus, each one adopted its own version of the bankruptcy laws.

In Hungary - Bankruptcy is automatically triggered. Debt for equity swaps are disallowed. Moreover, the law provides for a very short time to reach agreement with creditors about reorganization of the debtor. These features led to 4000 bankruptcies in the wake of the new law - a number which mushroomed to 30,000 by 5/97.

In the Czech Republic- the insolvency law comprises special cases (over-indebtedness, for instance). It delineates two rescue programs:

0. A debt to equity swap (an alternative to bankruptcy) supervised by the Ministry of Privatization.
- a. The Consolidation Bank (founded by the State) can buy a firm's obligations, if it went bankrupt, at 60% of par.

But the law itself is toothless and lackadaisically applied by the incestuous web of institutions in the country. Between 3/93 - 9/93 there were 1000 filings for insolvency, which resulted in only 30 commenced bankruptcy procedures. There hasn't been a single major bankruptcy in the Czech Republic since then - and not for lack of candidates.

Poland is a special case. The **pre-war (1934) law** declares bankruptcy in a state of lasting illiquidity and excessive indebtedness. Each creditor can apply to declare a company bankrupt. An insolvent company is obliged to file a maximum of 2 weeks following cessation of debt payments. There is a separate liquidation law which allows for voluntary procedures.

Bad debts are transferred to base portfolios and have one of three fates:

1. Reorganization, debt-consolidation (a reduction of the debts, new terms, debt for equity swaps) and a program of rehabilitation.
1. Sale of the corporate liabilities in auctions
1. Classic bankruptcy (happens in 23% of the cases of insolvency).

No one is certain what is the best model. The reason is that no one knows the answers to the questions: are the rights of the creditors superior to the rights of the owners? Is it better to rehabilitate than to liquidate?

Until such time as these questions are answered and as long as the corporate debt crisis deepens -we will witness a flowering of versions of bankruptcy laws all over the world.

The Inferno of the Finance Director

By: [Dr. Sam Vaknin](#)

Sometimes, I harbour a suspicion that Dante was a Financial Director. His famous work, "The Inferno", is an accurate description of the job.

The CFO (Chief Financial Officer) is fervently hated by the workers. He is thoroughly despised by other managers, mostly for scrutinizing their expense accounts. He is dreaded by the owners of the firm because his powers that often outweigh theirs. Shareholders hold him responsible in annual meetings. When the financial results are good – they are attributed to the talented Chief Executive Officer (CEO). When they are bad – the Financial Director gets blamed for not enforcing budgetary discipline. It is a no-win, thankless job. Very few make it to the top. Others retire, eroded and embittered.

The job of the Financial Director is composed of 10 elements. Here is a universal job description which is common throughout the West.

Organizational Affiliation

The Chief Financial Officer is subordinated to the Chief Executive Officer, answers to him and regularly reports to him.

The CFO is in charge of:

1. The Finance Director
2. The Financing Department
3. The Accounting Department which answers to him and regularly reports to him.

Despite the above said, the CFO can report directly to the Board of Directors through the person of the Chairman of the Board of Directors or by direct summons from the Board of Directors.

In many developing countries this would be considered treason – but, in the West every function holder in the company can – and regularly is – summoned by the (active) Board. A grilling session then ensues: debriefing the officer and trying to spot contradictions between his testimony and others'. The structure of business firms in the USA reflects its political structure. The Board of Directors resembles Congress, the Management is the Executive (President and Administration), the shareholders are the people. The usual checks and balances are applied: the authorities are supposedly separated and the Board criticizes the Management.

The same procedures are applied: the Board can summon a worker to testify – the same way that the Senate holds hearings and cross-questions workers in the administration. Lately, however, the delineation became fuzzier with managers serving on the Board or, worse, colluding with it. Ironically, Europe, where such incestuous practices were common hitherto – is reforming itself with zeal (especially Britain and Germany).

Developing countries are still after the cosy, outdated European model. Boards of Directors are rubber stamps,

devoid of any will to exercise their powers. They are staffed with cronies and friends and family members of the senior management and they do and decide what the General Managers tell them to do and to decide. General Managers – unchecked – get involved in colossal blunders (not to mention worse). The concept of corporate governance is alien to most firms in developing countries and companies are regarded by most general managers as milking cows – fast paths to personal enrichment.

Functions of the Chief Financial Officer (CFO):

(1) To regulate, supervise and implement a timely, full and accurate set of accounting books of the firm reflecting all its activities in a manner commensurate with the relevant legislation and regulation in the territories of operation of the firm and subject to internal guidelines set from time to time by the Board of Directors of the firm.

This is somewhat difficult in developing countries. The books do not reflect reality because they are "tax driven" (i.e., intended to cheat the tax authorities out of tax revenues). Two sets of books are maintained: the real one which incorporates all the income – and another one which is presented to the tax authorities. This gives the CFO an inordinate power. He is in a position to blackmail the management and the shareholders of the firm. He becomes the information junction of the firm, the only one who has access to the whole picture. If he is dishonest, he can easily enrich himself. But he cannot be honest: he has to constantly lie and he does so as a life long habit.

He (or she) develops a cognitive dissonance: I am honest with my superiors – I only lie to the state.

(2) To implement continuous financial audit and control systems to monitor the performance of the firm, its flow of funds, the adherence to the budget, the expenditures, the income, the cost of sales and other budgetary items.

In developing countries, this is often confused with central planning. Financial control does not mean the waste of precious management resources on verifying petty expenses. Nor does it mean a budget which goes to such details as how many tea bags will be consumed by whom and where. Managers in developing countries still feel that they are being supervised and followed, that they have quotas to complete, that they have to act as though they are busy (even if they are, in reality, most of the time, idle). So, they engage in the old time central planning and they do it through the budget. This is wrong.

A budget in a firm is no different than the budget of the state. It has exactly the same functions. It is a statement of policy, a beacon showing the way to a more profitable future. It sets the strategic (and not the tactical) goals of the firm: new products to develop, new markets to penetrate, new management techniques to implement, possible collaborations, identification of the competition, of the relative competitive advantages. Above all, a budget must allocate the scarce resources of the firm in order to obtain a maximum impact (=efficiently). All this, unfortunately, is missing from budgets of firms in developing countries.

No less important are the control and audit mechanisms which go with the budget. Audit can be external but must be complemented internally. It is the job of the CFO to provide the management with a real time tool which informs them what is happening in the firm and where are the problematic, potential problem areas of activity and performance.

Additional functions of the CFO include:

(3) To timely, regularly and duly prepare and present to the Board of Directors financial statements and reports as required by all pertinent laws and regulations in the territories of the operations of the firm and as deemed necessary and demanded from time to time by the Board of Directors of the Firm.

The warning signs and barbed wire which separate the various organs of the Western firm (management from Board of Directors and both from the shareholders) – have yet to reach developing countries. As I said: the Board in these countries is full with the cronies of the management. In many companies, the General Manager uses the Board as a way to secure the loyalty of his cronies, friends and family members by paying them hefty fees for their participation (and presumed contribution) in the meetings of the Board. The poor CFO is loyal to the management – not to the firm. The firm is nothing but a vehicle for self enrichment and does not exist in the Western sense, as a separate functional entity which demands the undivided loyalty of its officers. A weak CFO is rendered a pawn in these get-rich-quick schemes – a stronger one becomes a partner. In both cases, he is forced to collaborate, from time to time, with stratagems which conflict with his conscience.

It is important to emphasize that not all the businesses in

developing countries are like that. In some places the situation is much better and closer to the West. But geopolitical insecurity (what will be the future of developing countries in general and my country in particular), political insecurity (will my party remain in power), corporate insecurity (will my company continue to exist in this horrible economic situation) and personal insecurity (will I continue to be the General Manager) combine to breed short-sightedness, speculative streaks, a drive to get rich while the going is good (and thus rob the company) – and up to criminal tendencies.

(4) To comply with all reporting, accounting and audit requirements imposed by the capital markets or regulatory bodies of capital markets in which the securities of the firm are traded or are about to be traded or otherwise listed.

The absence of a functioning capital market in many developing countries and the inability of developing countries firms to access foreign capital markets – make the life of the CFO harder and easier at the same time. Harder – because there is nothing like a stock exchange listing to impose discipline, transparency and long-term, management-independent strategic thinking on a firm. Discipline and transparency require an enormous amount of investment by the financial structures of the firm: quarterly reports, audited annual financial statements, disclosure of important business developments, interaction with regulators (a tedious affair) – all fall within the remit of the CFO. Why, therefore, should he welcome it?

Because discipline and transparency make the life of a CFO easier in the long run. Just think how much easier it is to maintain one set of books instead of two or to avoid conflicts with tax authorities on the one hand and your management on the other.

(5) To prepare and present for the approval of the Board of Directors an annual budget, other budgets, financial plans, business plans, feasibility studies, investment memoranda and all other financial and business documents as may be required from time to time by the Board of Directors of the firm.

The primal sin in developing countries was so called “privatization”. The laws were flawed. To mix the functions of management, workers and ownership is detrimental to a firm, yet this is exactly the path that was chosen in numerous developing countries. Management takeovers and employee takeovers forced the new, impoverished, owners to rob the firm in order to pay for their shares. Thus, they were unable to infuse the firm with new capital, new expertise, or new management. Privatized companies are dying slowly.

One of the problems thus wrought was the total confusion regarding the organic structure of the firm. Boards were composed of friends and cronies of the management because the managers also owned the firm – but they could be easily fired by their own workers, who were also owners and so on. These incestuous relationships introduced an incredible amount of insecurity into management ranks (see previous point).

(6) To alert the Board of Directors and to warn it regarding any irregularity, lack of compliance, lack of adherence, lacunas and problems whether actual or potential concerning the financial systems, the financial operations, the financing plans, the accounting, the audits, the budgets and any other matter of a financial nature or which could or does have a financial implication.

The CFO is absolutely aligned and identified with the management. The Board is meaningless. The concept of ownership is meaningless because everyone owns everything and there are no identifiable owners (except in a few companies). Absurdly, Communism (the common ownership of means of production) has returned in full vengeance, though in disguise, precisely because of the ostensibly most capitalist act of all, privatization.

(7) To collaborate and coordinate the activities of outside suppliers of financial services hired or contracted by the firm, including accountants, auditors, financial consultants, underwriters and brokers, the banking system and other financial venues.

Many firms in developing countries (again, not all) are interested in collusion – not in consultancy. Having hired a consultant or the accountant – they believe that they own him. They are bitterly disappointed and enraged when they discover that an accountant has to comply with the rules of his trade or that a financial consultant protects his reputation by refusing to collaborate with shenanigans of the management.

(8) To maintain a working relationship and to develop additional relationships with banks, financial institutions and capital markets with the aim of securing the funds necessary for the operations of the firm, the attainment of its development plans and its investments.

One of the main functions of the CFO is to establish a personal relationship with the firm's bankers. The financial institutions which pass for banks in developing countries lend money on the basis of personal acquaintance more than on the basis of analysis or rational decision making. This "old boy network" substitutes for the orderly collection of data and credit rating of borrowers. This also allows for favouritism and corruption in the banking sector. A CFO who is unable to participate in these games is deemed by the management to be "weak", "ineffective" or "no-good". The lack of non-bank financing options and the general squeeze on liquidity make matters even worse for the finance manager. He must collaborate with the skewed practices and decision making processes of the banks – or perish.

(9) To fully computerize all the above activities in a combined hardware-software and communications system which integrates with the systems of other members of the group of companies.

(10) Otherwise, to initiate and engage in all manner of activities, whether financial or other, conducive to the financial health, the growth prospects and the fulfillment of investment plans of the firm to the best of his ability and with the appropriate dedication of the time and efforts required.

It is this, point 10, that occupies the working time of Western CFOs. It is their brain that is valued – not their connections or cunning.

Decision Support Systems

By: [Dr. Sam Vaknin](#)

Many companies in developing countries have a very detailed reporting system going down to the level of a single product, a single supplier, a single day. However, these reports – which are normally provided to the General Manager - should not, in my view, be used by them at all. They are too detailed and, thus, tend to obscure the true picture. A General Manager must have a bird's eye view of his company. He must be alerted to unusual happenings, disturbing financial data and other irregularities.

As things stand now, the following phenomena could happen:

0. That the management will highly leverage the company by assuming excessive debts burdening the cash flow of the company and / or
 - a. That a false Profit and Loss (PNL) picture will emerge - both on the single product level - and generally. This could lead to wrong decision making, based on wrong data.
 - b. That the company will pay excessive taxes on its earnings and / or
 - c. That the inventory will not be fully controlled and appraised centrally and / or
 - d. That the wrong cash flow picture will distort the decisions of the management and lead to wrong (even to dangerous) decisions.

To assist in overcoming the above, there are four levels of

reporting and flows of data which every company should institute:

The first level is the annual budget of the company which is really a business plan. The budget allocates amounts of money to every activity and / or department of the firm.

As time passes, the actual expenditures are compared to the budget in a feedback loop. During the year, or at the end of the fiscal year, the firm generates its financial statements: the income statement, the balance sheet, the cash flow statement.

Put together, these four documents are the formal edifice of the firm's finances. However, they can not serve as day to day guides to the General Manager.

The second tier of financial audit and control is when the finance department (equipped with proper software – Solomon IV is the most widely used in the West) is able to produce pro forma financial statements monthly.

These financial statements, however inaccurate, provide a better sense of the dynamics of the operation and should be constructed on the basis of Western accounting principles (GAAP and FASBs, or IAS).

But the Manager should be able to open this computer daily and receive two kinds of data, fully updated and fully integrated:

1. Daily financial statements
2. Daily ratios report.

The daily financial statements

The Manager should have access to continuously updated statements of income, cash flow, and a balance sheet. The

most important statement is that of the cash flow. The manager should be able to know, at each and every stage, what his real cash situation is - as opposed to the theoretical cash situation which includes accounts payable and account receivable in the form of expenses and income.

These pro forma financial statements should include all the future flows of money - whether invoiced or not. This way, the Manager will be able to type a future date into his computer and get the financial reports and statements relating to that date.

In other words, the Manager will not be able to see only a present situation of his company, but its future situation, fully analysed and fully updated.

Using today's technology - a wireless-connected laptop – managers are able to access all these data from anywhere in the world, from home, while traveling, and so on.

The daily ratios report

This is the most important part of the decision support system.

It enables the Manager to instantly analyse dozens of important aspects of the functioning of his company. It allows him to compare the behaviour of these parameters to historical data and to simulate the future functioning of his company under different scenarios.

It also allows him to compare the performance of his company to the performance of his competitors, other firms in his branch and to the overall performance of the industry that he is operating in.

The Manager can review these financial and production ratios. Where there is a strong deviation from historical patterns, or where the ratios warn about problems in the future – management intervention may be required..

Instead of sifting through mountains of documents, the Manager will only have to look at four computer screens in the morning, spot the alerts, read the explanations offered by the software, check what is happening and better prepare himself for the future.

Examples of the ratios to be included in the decision system

- a. ***SUE measure*** - deviation of actual profits from expected profits
- b. ***ROE*** - the return on the adjusted equity capital
- c. ***Debt to equity*** ratios
- d. ***ROA*** - the return on the assets
- e. The ***financial average***
- f. ***ROS*** - the profit margin on the sales
- g. ***ATO*** - asset turnover, how efficiently assets are used
- h. ***Tax burden and interest burden*** ratios
- i. ***Compounded leverage***
- j. ***Sales to fixed assets*** ratios
- k. ***Inventory turnover*** ratios
- l. ***Days receivable and days payable***
- m. ***Current ratio, quick ratio, interest coverage ratio*** and other liquidity and coverage ratios
- n. ***Valuation price*** ratios and many others.

The effects of using a decision system

A decision system has great impact on the profits of the company. It forces the management to rationalize the depreciation, inventory and inflation policies. It warns the

management against impending crises and problems in the company. It specially helps in following areas:

0. The management knows exactly how much credit it could take, for how long (for which maturities) and in which interest rate. It has been proven that without proper feedback, managers tend to take too much credit and burden the cash flow of their companies.

- b. A decision system allows for careful financial planning and tax planning. Profits go up, non cash outlays are controlled, tax liabilities are minimized and cash flows are maintained positive throughout.
 - c. As a result of all the above effects the value of the company grows and its shares appreciate.
1. The decision system is an integral part of financial management in the West. It is completely compatible with western accounting methods and derives all the data that it needs from information extant in the company.

So, the establishment of a decision system does not hinder the functioning of the company in any way and does not interfere with the authority and functioning of the financial department.

Decision Support Systems cost as little as 20,000 USD (all included: software, hardware, and training). They are one of the best investments that a firm can make.

Valuing Stocks

By: *[Dr. Sam Vaknin](#)*

Also Read

[The Myth of the Earnings Yield](#)

[The Friendly Trend - Technical vs. Fundamental Analysis](#)

[The Roller Coaster Market - On Volatility and Risk](#)

The debate rages all over Eastern and Central Europe, in countries in transition as well as in Western Europe. It raged in Britain during the 80s.

Is privatization really the robbery in disguise of state assets by a select few, cronies of the political regime? Margaret Thatcher was accused of it - and so were privatizers in developing countries. What price should state-owned companies have fetched? This question is not as simple and straightforward as it sounds.

There is a stock pricing mechanism known as the Stock Exchange. Willing buyers and willing sellers meet there to freely negotiate deals of stock purchases and sales. New information, macro-economic and micro-economic, determines the value of companies.

Greenspan testifies in the Senate, economic figures are released - and the rumour mill starts working: interest rates might go up. The stock market reacts with frenzily - it crashes. Why?

A top executive is asked how profitable will his firm be this quarter. He winks, he grins - this is interpreted by Wall Street to mean that profits will go up. The share price surges: no one wants to sell it, everyone want to buy it.

The result: a sharp rise in its price. Why?

Moreover: the share price of a company of an identical size, similar financial ratios (and in the same industry) barely budges. Why not?

We say that the stocks of the two companies have different elasticity (their prices move up and down differently), probably the result of different sensitivities to changes in interest rates and in earnings estimates. But this is just to rename the problem. The question remains: Why do the shares of similar companies react differently?

Economy is a branch of psychology and wherever and whenever humans are involved, answers don't come easy. A few models have been developed and are in wide use but it is difficult to say that any of them has real predictive or even explanatory powers. Some of these models are "technical" in nature: they ignore the fundamentals of the company. Such models assume that all the relevant information is already incorporated in the price of the stock and that changes in expectations, hopes, fears and attitudes will be reflected in the prices immediately. Others are fundamental: these models rely on the company's performance and assets. The former models are applicable mostly to companies whose shares are traded publicly, in stock exchanges. They are not very useful in trying to attach a value to the stock of a private firm. The latter type (fundamental) models can be applied more broadly.

The value of a stock (a bond, a firm, real estate, or any asset) is the sum of the income (cash flow) that a reasonable investor would expect to get in the future, discounted at the appropriate rate. The discounting reflects the fact that money received in the future has lower (discounted) purchasing power than money received now. Moreover, we can invest money received now and get interest on it (which should normally equal the discount). Put differently: the discount reflects the loss in purchasing power of money deferred or the interest lost by not being able to invest the money right away. This is the time value of money.

Another problem is the uncertainty of future payments, or the risk that we will never receive them. The longer the payment period, the higher the risk, of course. A model exists which links time, the value of the stock, the cash flows expected in the future and the discount (interest) rates.

The rate that we use to discount future cash flows is the prevailing interest rate. This is partly true in stable, predictable and certain economies. But the discount rate depends on the inflation rate in the country where the firm is located (or, if a multinational, in all the countries where it operates), on the projected supply of and demand for its shares and on the aforementioned risk of non-payment. In certain places, additional factors must be taken into account (for example: country risk or foreign exchange risks).

The supply of a stock and, to a lesser extent, the demand for it determine its distribution (how many shareowners are there) and, as a result, its liquidity. Liquidity means how freely can one buy and sell it and at which quantities sought or sold do prices become rigid.

Example: if a controlling stake is sold - the buyer normally pays a "control premium". Another example: in thin markets it is easier to manipulate the price of a stock by artificially increasing the demand or decreasing the supply ("cornering" the market).

In a liquid market (no problems to buy and to sell), the discount rate is comprised of two elements: one is the risk-free rate (normally, the interest payable on government bonds), the other being the risk-related rate (the rate which reflects the risk related to the specific stock).

But what is this risk-related rate?

The most widely used model to evaluate specific risks is the Capital Asset Pricing Model (CAPM).

According to it, the discount rate is the risk-free rate plus a coefficient (called beta) multiplied by a risk premium general to all stocks (in the USA it was calculated to be 5.5%). Beta is a measure of the volatility of the return of the stock relative to that of the return of the market. A stock's Beta can be obtained by calculating the coefficient of the regression line between the weekly returns of the stock and those of the stock market during a selected period of time.

Unfortunately, different betas can be calculated by selecting different parameters (for instance, the length of the period on which the calculation is performed). Another problem is that betas change with every new datum. Professionals resort to sensitivity tests which neutralize the changes that betas undergo with time.

Still, with all its shortcomings and disputed assumptions, the CAPM should be used to determine the discount rate. But to use the discount rate we must have future cash flows to discount.

The only relatively certain cash flows are dividends paid to the shareholders. So, Dividend Discount Models (DDM) were developed.

Other models relate to the projected growth of the company (which is supposed to increase the payable dividends and to cause the stock to appreciate in value).

Still, DDM's require, as input, the ultimate value of the stock and growth models are only suitable for mature firms with a stable, low dividend growth. Two-stage models are more powerful because they combine both emphases, on dividends and on growth. This is because of the life-cycle of firms. At first, they tend to have a high and unstable dividend growth rate (the DDM tackles this adequately). As the firm matures, it is expected to have a lower and stable growth rate, suitable for the treatment of Growth Models.

But how many years of future income (from dividends) should we use in our calculations? If a firm is profitable now, is there any guarantee that it will continue to be so in the next year, or the next decade? If it does continue to be profitable - who can guarantee that its dividend policy will not change and that the same rate of dividends will continue to be distributed?

The number of periods (normally, years) selected for the calculation is called the "price to earnings (P/E) multiple". The multiple denotes by how much we multiply the (after tax) earnings of the firm to obtain its value. It depends on the industry (growth or dying), the country (stable or geopolitically perilous), on the ownership structure (family or public), on the management in place (committed or mobile), on the product (new or old technology) and a myriad of other factors. It is almost impossible to objectively quantify or formulate this process of analysis and decision making. In telecommunications, the range of numbers used for valuing stocks of a private firm is between 7 and 10, for instance. If the company is in the public domain, the number can shoot up to 20 times net earnings.

While some companies pay dividends (some even borrow to do so), others do not. So in stock valuation, dividends are not the only future incomes you would expect to get. Capital gains (profits which are the result of the appreciation in the value of the stock) also count. This is the result of expectations regarding the firm's free cash flow, in particular the free cash flow that goes to the shareholders.

There is no agreement as to what constitutes free cash flow. In general, it is the cash which a firm has after sufficiently investing in its development, research and (predetermined) growth. Cash Flow Statements have become a standard accounting requirement in the 80s (starting with the USA). Because "free" cash flow can be easily extracted from these reports, stock valuation based on free cash flow became increasingly popular and feasible. Cash flow statements are considered independent of the idiosyncratic parameters of different international environments and therefore applicable to multinationals or to national, export-orientated firms.

The free cash flow of a firm that is debt-financed solely by its shareholders belongs solely to them. Free cash flow to equity (FCFE) is:

***FCFE* = Operating Cash Flow MINUS Cash needed for meeting growth targets**

Where

***Operating Cash Flow* = Net Income (NI) PLUS Depreciation and Amortization**

***Cash needed for meeting growth targets* = Capital Expenditures + Change in Working Capital**

***Working Capital* = Total Current Assets - Total Current Liabilities**

***Change in Working Capital* = One Year's Working Capital MINUS Previous Year's Working Capital**

The complete formula is:

**FCFE = Net Income PLUS
Depreciation and Amortization MINUS
Capital Expenditures PLUS
Change in Working Capital.**

A leveraged firm that borrowed money from other sources (even from preferred stock holders) exhibits a different free cash flow to equity. Its CFCE must be adjusted to reflect the preferred dividends and principal repayments of debt (MINUS sign) and the proceeds from new debt and preferred stocks (PLUS sign). If its borrowings are sufficient to pay the dividends to the holders of preference shares and to service its debt - its debt to capital ratio is sound.

The FCFE of a leveraged firm is:

**FCFE = Net Income PLUS
Depreciation and Amortization MINUS
Principal Repayment of Debt MINUS
Preferred Dividends PLUS
Proceeds from New Debt and Preferred MINUS
Capital Expenditures MINUS
Changes in Working Capital.**

A sound debt ratio means:

**FCFE = Net Income MINUS
(1 - Debt Ratio)*(Capital Expenditures MINUS
Depreciation and Amortization PLUS
Change in Working Capital).**

The Process of Due Diligence

By: [*Dr. Sam Vaknin*](#)

A business which wants to attract foreign investments must present a business plan. But a business plan is the equivalent of a visit card. The introduction is very important - but, once the foreign investor has expressed interest, a second, more serious, more onerous and more tedious process commences: Due Diligence.

"Due Diligence" is a legal term (borrowed from the securities industry). It means, essentially, to make sure that all the facts regarding the firm are available and have been independently verified. In some respects, it is very similar to an audit. All the documents of the firm are assembled and reviewed, the management is interviewed and a team of financial experts, lawyers and accountants descends on the firm to analyze it.

First Rule:

The firm must appoint ONE due diligence coordinator. This person interfaces with all outside due diligence teams. He collects all the materials requested and oversees all the activities which make up the due diligence process.

The firm must have ONE VOICE. Only one person represents the company, answers questions, makes presentations and serves as a coordinator when the DD teams wish to interview people connected to the firm.

Second Rule:

Brief your workers. Give them the big picture. Why is the company raising funds, who are the investors, how will the future of the firm (and their personal future) look if the investor comes in. Both employees and management must realize that this is a top priority. They must be instructed not to lie. They must know the DD coordinator and the company's spokesman in the DD process.

The DD is a process which is more structured than the preparation of a Business Plan. It is confined both in time and in subjects: Legal, Financial, Technical, Marketing, Controls.

The Marketing Plan

Must include the following elements:

- A brief history of the business (to show its track performance and growth)
- Points regarding the political, legal (licences) and competitive environment
- A vision of the business in the future
- Products and services and their uses
- Comparison of the firm's products and services to those of the competitors
- Warranties, guarantees and after-sales service
- Development of new products or services
- A general overview of the market and market segmentation

- Is the market rising or falling (the trend: past and future)
- What customer needs do the products / services satisfy
- Which markets segments do we concentrate on and why
- What factors are important in the customer's decision to buy (or not to buy)
- A list of the direct competitors and a short description of each
- The strengths and weaknesses of the competitors relative to the firm
- Missing information regarding the markets, the clients and the competitors
- Planned market research
- A sales forecast by product group
- The pricing strategy (how is pricing decided)
- Promotion of the sales of the products (including a description of the sales force, sales-related incentives, sales targets, training of the sales personnel, special offers, dealerships, telemarketing and sales support). Attach a flow chart of the purchasing process from the moment that the client is approached by the sales force until he buys the product.
- Marketing and advertising campaigns (including cost estimates) - broken by market and by media

- Distribution of the products
- A flow chart describing the receipt of orders, invoicing, shipping.
- Customer after-sales service (hotline, support, maintenance, complaints, upgrades, etc.)
- Customer loyalty (example: churn rate and how is it monitored and controlled).

Legal Details

- Full name of the firm
- Ownership of the firm
- Court registration documents
- Copies of all protocols of the Board of Directors and the General Assembly of Shareholders
- Signatory rights backed by the appropriate decisions
- The charter (statute) of the firm and other incorporation documents
- Copies of licences granted to the firm
- A legal opinion regarding the above licences
- A list of lawsuits that were filed against the firm and that the firm filed against third parties (litigation) plus a list of disputes which are likely to reach the courts
- Legal opinions regarding the possible outcomes of all the lawsuits and disputes including their potential influence on the firm

Financial Due Diligence

- Last 3 years income statements of the firm or of constituents of the firm, if the firm is the result of a merger. The statements have to include:
- Balance Sheets
- Income Statements

- Cash Flow statements
- Audit reports (preferably done according to the International Accounting Standards, or, if the firm is looking to raise money in the USA, in accordance with FASB)
- Cash Flow Projections and the assumptions underlying them

Controls

- Accounting systems used
- Methods to price products and services
- Payment terms, collections of debts and ageing of receivables
- Introduction of international accounting standards
- Monitoring of sales
- Monitoring of orders and shipments
- Keeping of records, filing, archives
- Cost accounting system
- Budgeting and budget monitoring and controls
- Internal audits (frequency and procedures)
- External audits (frequency and procedures)
- The banks that the firm is working with: history, references, balances

Technical Plan

- Description of manufacturing processes (hardware, software, communications, other)
- Need for know-how, technological transfer and licensing required
- Suppliers of equipment, software, services (including offers)
- Manpower (skilled and unskilled)
- Infrastructure (power, water, etc.)
- Transport and communications (example: satellites, lines, receivers, transmitters)
- Raw materials: sources, cost and quality
- Relations with suppliers and support industries
- Import restrictions or licensing (where applicable)
- Sites, technical specification
- Environmental issues and how they are addressed
- Leases, special arrangements
- Integration of new operations into existing ones (protocols, etc.)

A successful due diligence is the key to an eventual investment. This is a process much more serious and important than the preparation of the Business Plan.

Financial Investor, Strategic Investor

By: [*Dr. Sam Vaknin*](#)

In the not so distant past, there was little difference between financial and strategic investors. Investors of all colors sought to safeguard their investment by taking over as many management functions as they could.

Additionally, investments were small and shareholders few. A firm resembled a household and the number of people involved – in ownership and in management – was correspondingly limited. People invested in industries they were acquainted with first hand.

As markets grew, the scales of industrial production (and of service provision) expanded. A single investor (or a small group of investors) could no longer accommodate the needs even of a single firm. As knowledge increased and specialization ensued – it was no longer feasible or possible to micro-manage a firm one invested in. Actually, separate businesses of money making and business management emerged. An investor was expected to excel in obtaining high yields on his capital – not in industrial management or in marketing. A manager was expected to manage, not to be capable of personally tackling the various and varying tasks of the business that he managed.

Thus, two classes of investors emerged. One type supplied firms with capital. The other type supplied them with know-how, technology, management skills, marketing techniques, intellectual property, clientele and a vision, a sense of direction.

In many cases, the strategic investor also provided the necessary funding. But, more and more, a separation was maintained. Venture capital and risk capital funds, for instance, are purely financial investors. So are, to a growing extent, investment banks and other financial institutions.

The financial investor represents the past. Its money is the result of past - right and wrong - decisions. Its orientation is short term: an "exit strategy" is sought as soon as feasible. For "exit strategy" read quick profits. The financial investor is always on the lookout, searching for willing buyers for his stake. The stock exchange is a popular exit strategy. The financial investor has little interest in the company's management. Optimally, his money buys for him not only a good product and a good market, but also a good management. But his interpretation of the rolls and functions of "good management" are very different to that offered by the strategic investor. The financial investor is satisfied with a management team which maximizes value. The price of his shares is the most important indication of success. This is "bottom line" short termism which also characterizes operators in the capital markets. Invested in so many ventures and companies, the financial investor has no interest, nor the resources to get seriously involved in any one of them. Micro-management is left to others - but, in many cases, so is macro-management. The financial investor participates in quarterly or annual general shareholders meetings. This is the extent of its involvement.

The strategic investor, on the other hand, represents the real long term accumulator of value. Paradoxically, it is the strategic investor that has the greater influence on the value of the company's shares. The quality of management, the rate of the introduction of new products, the success or failure of marketing strategies, the level of customer satisfaction, the education of the workforce - all depend on the strategic investor. That there is a strong relationship between the quality and decisions of the strategic investor and the share price is small wonder. The strategic investor represents a discounted future in the same manner that shares do. Indeed, gradually, the balance between financial investors and strategic investors is shifting in favour of the latter. People understand that money is abundant and what is in short supply is good management. Given the ability to create a brand, to generate profits, to issue new products and to acquire new clients - money is abundant.

These are the functions normally reserved to financial investors:

Financial Management

The financial investor is expected to take over the financial management of the firm and to directly appoint the senior management and, especially, the management echelons, which directly deal with the finances of the firm.

1. To regulate, supervise and implement a timely, full and accurate set of accounting books of the firm reflecting all its activities in a manner commensurate with the relevant legislation and regulation in the territories of operations of the firm and with internal guidelines set from time to time by the Board of Directors of the firm. This is usually achieved both during a Due Diligence process and later, as financial management is implemented.
1. To implement continuous financial audit and control systems to monitor the performance of the firm, its flow of funds, the adherence to the budget, the expenditures, the income, the cost of sales and other budgetary items.
1. To timely, regularly and duly prepare and present to the Board of Directors financial statements and reports as required by all pertinent laws and regulations in the territories of the operations of the firm and as deemed necessary and demanded from time to time by the Board of Directors of the Firm.
1. To comply with all reporting, accounting and audit requirements imposed by the capital markets or regulatory bodies of capital markets in which the securities of the firm are traded or are about to be traded or otherwise listed.

1. To prepare and present for the approval of the Board of Directors an annual budget, other budgets, financial plans, business plans, feasibility studies, investment memoranda and all other financial and business documents as may be required from time to time by the Board of Directors of the Firm.
1. To alert the Board of Directors and to warn it regarding any irregularity, lack of compliance, lack of adherence, lacunas and problems whether actual or potential concerning the financial systems, the financial operations, the financing plans, the accounting, the audits, the budgets and any other matter of a financial nature or which could or does have a financial implication.
1. To collaborate and coordinate the activities of outside suppliers of financial services hired or contracted by the firm, including accountants, auditors, financial consultants, underwriters and brokers, the banking system and other financial venues.
1. To maintain a working relationship and to develop additional relationships with banks, financial institutions and capital markets with the aim of securing the funds necessary for the operations of the firm, the attainment of its development plans and its investments.
1. To fully computerize all the above activities in a combined hardware-software and communications system which will integrate into the systems of other members of the group of companies.
1. Otherwise, to initiate and engage in all manner of

activities, whether financial or of other nature, conducive to the financial health, the growth prospects and the fulfillment of investment plans of the firm to the best of his ability and with the appropriate dedication of the time and efforts required.

Collection and Credit Assessment

1. To construct and implement credit risk assessment tools, questionnaires, quantitative methods, data gathering methods and venues in order to properly evaluate and predict the credit risk rating of a client, distributor, or supplier.
1. To constantly monitor and analyse the payment morale, regularity, non-payment and non-performance events, etc. – in order to determine the changes in the credit risk rating of said factors.
1. To analyse receivables and collectibles on a regular and timely basis.
4. To improve the collection methods in order to reduce the amounts of arrears and overdue payments, or the average period of such arrears and overdue payments.
5. To collaborate with legal institutions, law enforcement agencies and private collection firms in assuring the timely flow and payment of all due payments, arrears and overdue payments and other collectibles.
6. To coordinate an educational campaign to ensure the voluntary collaboration of the clients, distributors and other debtors in the timely and orderly payment of their dues.

The strategic investor is, usually, put in charge of the following:

Project Planning and Project Management

The strategic investor is uniquely positioned to plan the technical side of the project and to implement it. He is, therefore, put in charge of:

The selection of infrastructure, equipment, raw materials, industrial processes, etc.

Negotiations and agreements with providers and suppliers

Minimizing the costs of infrastructure by deploying proprietary components and planning

The provision of corporate guarantees and letters of comfort to suppliers

The planning and erecting of the various sites, structures, buildings, premises, factories, etc.

The planning and implementation of line connections, computer network connections, protocols, solving issues of compatibility (hardware and software, etc.)

Project planning, implementation and supervision

Marketing and Sales

1. The presentation to the Board an annual plan of sales and marketing including: market penetration targets, profiles of potential social and economic categories of clients, sales promotion methods, advertising campaigns, image, public relations and other media campaigns. The strategic investor also implements these plans or supervises their implementation.
2. The strategic investor is usually possessed of a brandname recognized in many countries. It is the market leaders in certain territories. It has been providing goods and services to users for a long period of time, reliably. This is an important asset, which, if properly used, can attract users. The enhancement of the brandname, its recognition and market awareness, market penetration, co-branding, collaboration with other suppliers – are all the responsibilities of the strategic investor.
3. The dissemination of the product as a preferred choice among vendors, distributors, individual users and businesses in the territory.
4. Special events, sponsorships, collaboration with businesses.
5. The planning and implementation of incentive systems (e.g., points, vouchers).

6. The strategic investor usually organizes a distribution and dealership network, a franchising network, or a sales network (retail chains) including: training, pricing, pecuniary and quality supervision, network control, inventory and accounting controls, advertising, local marketing and sales promotion and other network management functions.
7. The strategic investor is also in charge of "vision thinking": new methods of operation, new marketing ploys, new market niches, predicting the future trends and market needs, market analyses and research, etc.

The strategic investor typically brings to the firm valuable experience in marketing and sales. It has numerous off the shelf marketing plans and drawer sales promotion campaigns. It developed software and personnel capable of analysing any market into effective niches and of creating the right media (image and PR), advertising and sales promotion drives best suited for it. It has built large databases with multi-year profiles of the purchasing patterns and demographic data related to thousands of clients in many countries. It owns libraries of material, images, sounds, paper clippings, articles, PR and image materials, and proprietary trademarks and brand names. Above all, it accumulated years of marketing and sales promotion ideas which crystallized into a new conception of the business.

Technology

1. The planning and implementation of new technological systems up to their fully operational phase. The strategic partner's engineers are available to plan, implement and supervise all the stages of the technological side of the business.
2. The planning and implementation of a fully operative computer system (hardware, software, communication, intranet) to deal with all the aspects of the structure and the operation of the firm. The strategic investor puts at the disposal of the firm proprietary software developed by it and specifically tailored to the needs of companies operating in the firm's market.
3. The encouragement of the development of in-house, proprietary, technological solutions to the needs of the firm, its clients and suppliers.
4. The planning and the execution of an integration program with new technologies in the field, in collaboration with other suppliers or market technological leaders.

Education and Training

The strategic investor is responsible to train all the personnel in the firm: operators, customer services, distributors, vendors, sales personnel. The training is conducted at its sole expense and includes tours of its facilities abroad.

The entrepreneurs – who sought to introduce the two types of investors, in the first place – are usually left with the following functions:

Administration and Control

1. To structure the firm in an optimal manner, most conducive to the conduct of its business and to present the new structure for the Board's approval within 30 days from the date of the GM's appointment.
2. To run the day to day business of the firm.
3. To oversee the personnel of the firm and to resolve all the personnel issues.
4. To secure the unobstructed flow of relevant information and the protection of confidential organization.
5. To represent the firm in its contacts, representations and negotiations with other firms, authorities, or persons.

This is why entrepreneurs find it very hard to cohabitate with investors of any kind. Entrepreneurs are excellent at identifying the needs of the market and at introducing technological or service solutions to satisfy such needs. But the very personality traits which qualify them to become entrepreneurs – also hinder the future development of their firms. Only the introduction of outside investors can resolve the dilemma. Outside investors are not emotionally involved. They may be less visionary – but also more experienced.

They are more interested in business results than in dreams. And – being well acquainted with entrepreneurs – they insist on having unmitigated control of the business, for fear of losing all their money. These things antagonize the entrepreneurs. They feel that they are losing their creation to cold-hearted, mean spirited, corporate predators. They rebel and prefer to remain small or even to close shop than to give up their cherished freedoms. This is where nine out of ten entrepreneurs fail - in knowing when to let go.

Mortgage Backed Construction

By: [Dr. Sam Vaknin](#)

THE BUYERS

1. The Buyers of residential property form an Association.
2. The Buyers' Association signs a contract with a construction company chosen by open and public tender.
3. The contract with the construction company is for the construction of residential property to be owned by the Buyers.
4. The Buyers secure financing from the Bank (see below).
5. The Buyers then pay the construction company 25% of the final value of the property to be constructed in advance (=Buyer's Equity). This money is the Buyers' own funds, out of pocket – NOT received from the Banks.
6. The Buyers Association together with the Banks appoints supervisors to oversee the work done by the construction company: its quality and adherence to schedule.

THE BANKS

1. The government provides a last resort guarantee to the commercial banks. This guarantee can be used **ONLY AFTER** the banks have exhausted all other legal means of materializing a collateral or seizing the assets of a delinquent debtor in default.
2. Against this guarantee, the commercial banks issue 10 years mortgages (=lend money with a repayment period of 120 months) to the private Buyers of residential property.
3. The money lent to the Buyers (=the mortgages) **REMAINS** in the bank. It is **NOT** be given to the Buyers.
4. The mortgage loan covers a maximum of 75% of the final value of the property to be constructed according to appraisals by experts.
5. A lien in favour of the bank is placed on the land and property on it – to be built using the Bank's money and the Buyers' equity. Each Buyer pledges only **HIS** part of the property (for instance, **ONLY** the apartment being constructed for HIM). This lien is an inseparable part of the mortgage (loan) contract each and every buyer signs. It is registered in the Registrar of Mortgages and the Courts.

THE CONSTRUCTION COMPANY

1. The construction companies use the advance of 25% to start the construction of the residential property – to buy the land, lay the foundations and start the skeleton. All the property belongs to the BUYERS and is registered solely to their names. The Banks have a lien of the property, as per above.
2. When the advance-money is finished, the construction company notifies the BUYERS.
3. The Buyers then approach the Bank for additional money to be taken from the mortgage loans deposited at the Bank (=the money that the Bank lent the Buyers).
4. The Bank verifies that the construction is progressing according to schedule and according to quality standards set in the construction contract.
5. If everything is according to contract, the Bank releases the next tranche (lot) of financing to the Buyers, who then forward it to the construction firm.
6. The funds that the Buyers borrowed from the Banks are released in a few tranches according to the progress of the construction work. When the construction is finished – the funds should be completely exhausted (=used).

WHEN THE CONSTRUCTION IS FINISHED

1. The construction company will have received 100% of the price agreed in the contract.
2. The Buyers can move into the apartments.
3. The Buyers go on repaying the mortgage loans to the Banks.
4. As long as the mortgage loan is not fully paid – the lien on the property in favour of the Bank remains. It is lifted (=cancelled) once the mortgage loan and the interest and charges thereof has been fully repaid by the Buyers.

WHILE THE MORTGAGE LOAN IS BEING REPAID...

1. The Buyers can rent the apartment.
2. The Buyers can live in the apartment.
3. The Buyers can sell the apartment only with the agreement of the Bank – or if they pre-pay the remaining balance of the mortgage loan to the Bank.

4. The Banks can securitize the mortgage pool and sell units or mortgage backed bonds to the public. This means that the Banks can sell to the public passthrough certificates - securities backed by an underlying pool of mortgages of various maturities and interest rates. This way the Banks can replenish their capital stock and re-enter the mortgage market.

Bully at Work

Interview with Tim Field

By: [Dr. Sam Vaknin](#)

Also published by [United Press International \(UPI\)](#)

In 1994 Tim Field was bullied out of his job as a Customer Services Manager which resulted in a stress breakdown. Turning his experience to good use he set up the UK National Workplace Bullying Advice Line in 1996 and his web site Bully Online in 1997 since which time he has worked on over 5000 cases worldwide. He now lectures widely as well as writing and publishing books on bullying and psychiatric injury. He holds two honorary doctorates for his work on identifying and dealing with bullying. He is the Webmaster of [Bully Online](#).

Q: What is workplace bullying?

A: Workplace bullying is persistent, unwelcome, intrusive behaviour of one or more individuals whose actions prevent others from fulfilling their duties.

Q: How is it different to adopting disciplinarian measures, maintaining strict supervision, or oversight?

A: The purpose of bullying is to hide the inadequacy of the bully and has nothing to do with "management" or the achievement of tasks. Bullies project their inadequacies onto others to distract and divert attention away from the inadequacies. In most cases of workplace bullying reported to the UK National Workplace Bullying Advice Line, the bully is a serial bully who has a history of conflict with staff. The bullying that one sees is often also the tip of an iceberg of wrongdoing which may include misappropriation of budgets, harassment, discrimination, as well as breaches of rules, regulations, professional codes of conduct and health and safety practices.

Q: Should it be distinguished from harassment (including sexual harassment), or stalking?

A: Bullying is, I believe, the underlying behavior and thus the common denominator of harassment, discrimination, stalking and abuse. What varies is the focus for expression of the behavior. For instance, a harasser or discriminator focuses on race or gender or disability.

Bullies focus on competence and popularity which at present are not covered by employment legislation.

Bullies seethe with resentment and anger and the conduits for release of this inner anger are jealousy and envy which explains why bullies pick on employees who are good at their job and popular with people. Being emotionally immature, bullies crave attention and become resentful when others get more attention for their competence and achievements than themselves.

Q: What is the profile of the typical bully?

A: Over 90% of the cases reported to the UK National Workplace Bullying Advice Line involve a serial bully who can be recognised by their behaviour profile which includes compulsive lying, a Jekyll and Hyde nature, an unusually high verbal facility, charm and a considerable capacity to deceive, an arrested level of emotional development, and a compulsive need to control. The serial bully rarely commits a physical assault or an arrestable offence, preferring instead to remain within the realms of psychological violence and non-arrestable offences.

Q: What are bullying's typical outcomes?

A: In the majority of cases, the target of bullying is eliminated through forced resignation, unfair dismissal, or early or ill- health retirement whilst the bully is promoted. After a short interval of between 2-14 days, the bully selects another target and the cycle restarts. Sometimes another target is selected before the current target is eliminated.

Q: Can you provide us with some statistics? How often does bullying occur? How many people are affected?

A: Surveys of bullying in the UK indicate that between 12-50% of the workforce experience bullying. Statistics from the UK National Workplace Bullying Advice Line reveal that around 20% of cases are from the education sector, 12% are from healthcare, 10% are from social services, and around 6% from the voluntary / charity / not-for-profit sector.

After that, calls come from all sectors both public and private, with finance, media, police, postal workers and other government employees featuring prominently.

Enquiries from outside the UK (notably USA, Canada, Australia and Ireland) show similar patterns with the caring professions topping the list of bullied workers.

Q: Could you estimate the economic effects of workplace bullying - costs to employers (firms), employees, law enforcement agencies, the courts, the government, etc.?

A: Bullying is one of the major causes of stress, and the cost of stress to UK plc is thought to be between £5-12 billion (US\$7-17 billion). When all the direct, indirect and consequential costs of bullying are taken into account, the cost to UK plc (taxpayers and shareholders) could be in excess of £30 billion (US\$44 billion), equivalent to around £1,000 hidden tax per working adult per year. Employers do not account for the cost of bullying and its consequences, therefore the figures never appear on balance sheets.

Employees have to work twice as hard to overcome the serial bully's inefficiency and dysfunction which can spread through an organisation like a cancer.

Because of its subtle nature, bullying can be difficult to recognise, but the consequences are easy to spot: excessive workloads, lack of support, a climate of fear, and high levels of insecurity.

The effects on health include, amongst other things, chronic fatigue, damage to the immune system, reactive depression, and suicide.

The indirect costs of bullying include higher-than average staff turnover and sickness absence. Each of these incur consequential costs of staff cover, administration, loss of production and reduced productivity which are rarely recognised and even more rarely attributed to their cause. Absenteeism alone costs UK plc over £10 billion a year

and stress is now officially the number one cause of sickness absence having taken over from the common cold. However, surveys suggest that at least 20% of employers still do not regard stress as a health and safety issue, instead preferring to see it as skiving and malingering.

The Bristol Stress and Health at Work Study published by the HSE in June

2000 revealed that 1 in 5 UK workers (around 5.5m) reported feeling extremely stressed at work. The main stress factors were having too much work and not being supported by managers. In November 2001 a study by Proudfoot Consulting revealed the cost of bad management, low employee morale and poorly-trained staff to British business at 117 lost working days a year. At 65%, bad management (often a euphemism for bullying) accounted for the biggest slice of unproductive days with low morale accounting for 17%. The study also suggested that in the UK 52% of all working time is spent unproductively compared to the European average of 43%.

The results of a three-year survey of British workers by the Gallup Organization published in October 2001 revealed that many employers are not getting the best from their employees. The most common response to questions such as "how engaged are your employees?" and "how effective is your leadership and management style?" and "how well are you capitalising on the talents, skills and knowledge of your people?" was an overwhelming "not very much". The survey also found that the longer an employee stayed, the less engaged they became. The cost to UK plc of lost work days due to lack of engagement was estimated to be between £39-48 billion a year.

Q: What can be done to reduce workplace bullying? Are firms, the government, law enforcement agencies, the courts - aware of the problem and its magnitude? Are educational campaigns effective? Did anti-bullying laws prove effective?

A: Most bullying is hierarchical and can be traced to the top or near the top. As bullying is often the visible tip of an iceberg of wrongdoing, denial is the most common strategy employed by toxic managements. Only Sweden has a law which specifically addresses bullying. Where no law exists, bullies feel free to bully. Whilst the law is not a solution, the presence of a law is an indication that society has made a judgement that the behaviour is no longer acceptable.

Awareness of bullying, and especially its seriousness, is still low throughout society. Bullying is not just "something children do in the playground", it's a lifetime behaviour on the same level as domestic violence, sexual harassment, and rape.

Bullying is a form of psychological and emotional rape

because of its intrusive and violational nature.

Is my Money Safe? On the Soundness of Our Banks

By: [*Dr. Sam Vaknin*](#)

Banks are institutions where miracles happen regularly. We rarely entrust our money to anyone but ourselves – and our banks. Despite a very chequered history of mismanagement, corruption, false promises and representations, delusions and behavioural inconsistency – banks still succeed to motivate us to give them our money. Partly it is the feeling that there is safety in numbers. The fashionable term today is "moral hazard". The implicit guarantees of the state and of other financial institutions move us to take risks which we would, otherwise, have avoided. Partly it is the sophistication of the banks in marketing and promoting themselves and their products. Glossy brochures, professional computer and video presentations and vast, shrine-like, real estate complexes all serve to enhance the image of the banks as the temples of the new religion of money.

But what is behind all this? How can we judge the soundness of our banks? In other words, how can we tell if our money is safely tucked away in a safe haven?

The reflex is to go to the bank's balance sheets. Banks and balance sheets have been both invented in their modern form in the 15th century. A balance sheet, coupled with other financial statements is supposed to provide us with a true and full picture of the health of the bank, its past and its long-term prospects. The surprising thing is that – despite common opinion – it does.

But it is rather useless unless you know how to read it.

Financial statements (Income – or Profit and Loss - Statement, Cash Flow Statement and Balance Sheet) come in many forms. Sometimes they conform to Western accounting standards (the Generally Accepted Accounting Principles, GAAP, or the less rigorous and more fuzzily worded International Accounting Standards, IAS).

Otherwise, they conform to local accounting standards, which often leave a lot to be desired. Still, you should look for banks, which make their updated financial reports available to you. The best choice would be a bank that is audited by one of the Big Four Western accounting firms and makes its audit reports publicly available. Such audited financial statements should consolidate the financial results of the bank with the financial results of its subsidiaries or associated companies. A lot often hides in those corners of corporate holdings.

Banks are rated by independent agencies. The most famous and most reliable of the lot is Fitch Ratings. Another one is Moody's. These agencies assign letter and number combinations to the banks that reflect their stability. Most agencies differentiate the short term from the long term prospects of the banking institution rated. Some of them even study (and rate) issues, such as the legality of the operations of the bank (legal rating). Ostensibly, all a concerned person has to do, therefore, is to step up to the bank manager, muster courage and ask for the bank's rating. Unfortunately, life is more complicated than rating agencies would have us believe.

They base themselves mostly on the financial results of the bank rated as a reliable gauge of its financial strength or financial profile. Nothing is further from the truth.

Admittedly, the financial results do contain a few important facts. But one has to look beyond the naked figures to get the real – often much less encouraging – picture.

Consider the thorny issue of exchange rates. Financial statements are calculated (sometimes stated in USD in addition to the local currency) using the exchange rate prevailing on the 31st of December of the fiscal year (to which the statements refer). In a country with a volatile domestic currency this would tend to completely distort the true picture. This is especially true if a big chunk of the activity preceded this arbitrary date. The same applies to financial statements, which were not inflation-adjusted in high inflation countries. The statements will look inflated and even reflect profits where heavy losses were incurred. "Average amounts" accounting (which makes use of average exchange rates throughout the year) is even more misleading. The only way to truly reflect reality is if the bank were to keep two sets of accounts: one in the local currency and one in USD (or in some other currency of reference). Otherwise, fictitious growth in the asset base (due to inflation or currency fluctuations) could result.

Another example: in many countries, changes in regulations can greatly effect the financial statements of a bank. In 1996, in Russia, for example, the Bank of Russia changed the algorithm for calculating an important banking ratio (the capital to risk weighted assets ratio).

Unless a Russian bank restated its previous financial statements accordingly, a sharp change in profitability appeared from nowhere.

The net assets themselves are always misstated: the figure refers to the situation on 31/12. A 48-hour loan given to a collaborating client can inflate the asset base on the crucial date. This misrepresentation is only mildly ameliorated by the introduction of an "average assets" calculus. Moreover, some of the assets can be interest earning and performing – others, non-performing. The maturity distribution of the assets is also of prime importance. If most of the bank's assets can be withdrawn by its clients on a very short notice (on demand) – it can swiftly find itself in trouble with a run on its assets leading to insolvency.

Another oft-used figure is the net income of the bank. It is important to distinguish interest income from non-interest income. In an open, sophisticated credit market, the income from interest differentials should be minimal and reflect the risk plus a reasonable component of income to the bank. But in many countries (Japan, Russia) the government subsidizes banks by lending to them money cheaply (through the Central Bank or through bonds). The banks then proceed to lend the cheap funds at exorbitant rates to their customers, thus reaping enormous interest income. In many countries the income from government securities is tax free, which represents another form of subsidy. A high income from interest is a sign of weakness, not of health, here today, gone tomorrow. The preferred indicator should be income from operations (fees, commissions and other charges).

There are a few key ratios to observe. A relevant question is whether the bank is accredited with international banking agencies. These issue regulatory capital

requirements and other mandatory ratios. Compliance with these demands is a minimum in the absence of which, the bank should be regarded as positively dangerous.

The return on the bank's equity (ROE) is the net income divided by its average equity. The return on the bank's assets (ROA) is its net income divided by its average assets. The (tier 1 or total) capital divided by the bank's risk weighted assets – a measure of the bank's capital adequacy. Most banks follow the provisions of the Basel Accord as set by the Basel Committee of Bank Supervision (also known as the G10). This could be misleading because the Accord is ill equipped to deal with risks associated with emerging markets, where default rates of 33% and more are the norm. Finally, there is the common stock to total assets ratio. But ratios are not cure-alls. Inasmuch as the quantities that comprise them can be toyed with – they can be subject to manipulation and distortion. It is true that it is better to have high ratios than low ones. High ratios are indicative of a bank's underlying strength, reserves, and provisions and, therefore, of its ability to expand its business. A strong bank can also participate in various programs, offerings and auctions of the Central Bank or of the Ministry of Finance. The larger the share of the bank's earnings that is retained in the bank and not distributed as profits to its shareholders – the better these ratios and the bank's resilience to credit risks.

Still, these ratios should be taken with more than a grain of salt. Not even the bank's profit margin (the ratio of net income to total income) or its asset utilization coefficient (the ratio of income to average assets) should be relied upon. They could be the result of hidden subsidies by the government and management misjudgement or understatement of credit risks.

To elaborate on the last two points:

A bank can borrow cheap money from the Central Bank (or pay low interest to its depositors and savers) and invest it in secure government bonds, earning a much higher interest income from the bonds' coupon payments. The end result: a rise in the bank's income and profitability due to a non-productive, non-lasting arbitrage operation. Otherwise, the bank's management can understate the amounts of bad loans carried on the bank's books, thus decreasing the necessary set-asides and increasing profitability. The financial statements of banks largely reflect the management's appraisal of the business. This has proven to be a poor guide.

In the main financial results page of a bank's books, special attention should be paid to provisions for the devaluation of securities and to the unrealized difference in the currency position. This is especially true if the bank is holding a major part of the assets (in the form of financial investments or of loans) and the equity is invested in securities or in foreign exchange denominated instruments.

Separately, a bank can be trading for its own position (the Nostro), either as a market maker or as a trader. The profit (or loss) on securities trading has to be discounted because it is conjectural and incidental to the bank's main activities: deposit taking and loan making.

Most banks deposit some of their assets with other banks. This is normally considered to be a way of spreading the risk. But in highly volatile economies with sickly, underdeveloped financial sectors, all the institutions in the sector are likely to move in tandem (a highly correlated market). Cross deposits among banks only serve to increase the risk of the depositing bank (as the recent affair with Toko Bank in Russia and the banking crisis in South Korea have demonstrated).

Further closer to the bottom line are the bank's operating expenses: salaries, depreciation, fixed or capital assets (real estate and equipment) and administrative expenses. The rule of thumb is: the higher these expenses, the weaker the bank. The great historian Toynbee once said that great civilizations collapse immediately after they bequeath to us the most impressive buildings. This is doubly true with banks. If you see a bank fervently engaged in the construction of palatial branches – stay away from it.

Banks are risk arbitrageurs. They live off the mismatch between assets and liabilities. To the best of their ability, they try to second guess the markets and reduce such a mismatch by assuming part of the risks and by engaging in portfolio management. For this they charge fees and commissions, interest and profits – which constitute their sources of income.

If any expertise is imputed to the banking system, it is risk management. Banks are supposed to adequately assess, control and minimize credit risks. They are required to implement credit rating mechanisms (credit analysis and value at risk – VAR - models), efficient and exclusive information-gathering systems, and to put in place the right lending policies and procedures.

Just in case they misread the market risks and these turned into credit risks (which happens only too often), banks are supposed to put aside amounts of money which could realistically offset loans gone sour or future non-performing assets. These are the loan loss reserves and provisions. Loans are supposed to be constantly monitored, reclassified and charges made against them as applicable. If you see a bank with zero reclassifications, charge offs and recoveries – either the bank is lying through its teeth, or it is not taking the business of banking too seriously, or its management is no less than divine in its prescience. What is important to look at is the rate of provision for loan losses as a percentage of the loans outstanding. Then it should be compared to the percentage of non-performing loans out of the loans outstanding. If the two figures are out of kilter, either someone is pulling your leg – or the management is incompetent or lying to you. The first thing new owners of a bank do is, usually, improve the placed asset quality (a polite way of saying that they get rid of bad, non-performing loans, whether declared as such or not). They do this by classifying the loans. Most central banks in the world have in place regulations for loan classification and if acted upon, these yield rather more reliable results than any management's "appraisal", no matter how well intentioned.

In some countries the Central Bank (or the Supervision of the Banks) forces banks to set aside provisions against loans at the highest risk categories, even if they are performing. This, by far, should be the preferable method.

Of the two sides of the balance sheet, the assets side is the more critical. Within it, the interest earning assets deserve the greatest attention. What percentage of the loans is commercial and what percentage given to individuals? How many borrowers are there (risk diversification is inversely proportional to exposure to single or large borrowers)? How many of the transactions are with "related parties"? How much is in local currency and how much in foreign currencies (and in which)? A large exposure to foreign currency lending is not necessarily healthy. A sharp, unexpected devaluation could move a lot of the borrowers into non-performance and default and, thus, adversely affect the quality of the asset base. In which financial vehicles and instruments is the bank invested? How risky are they? And so on.

No less important is the maturity structure of the assets. It is an integral part of the liquidity (risk) management of the bank. The crucial question is: what are the cash flows projected from the maturity dates of the different assets and liabilities – and how likely are they to materialize. A rough matching has to exist between the various maturities of the assets and the liabilities. The cash flows generated by the assets of the bank must be used to finance the cash flows resulting from the banks' liabilities. A distinction has to be made between stable and hot funds (the latter in constant pursuit of higher yields). Liquidity indicators and alerts have to be set in place and calculated a few times daily.

Gaps (especially in the short term category) between the bank's assets and its liabilities are a very worrisome sign. But the bank's macroeconomic environment is as important to the determination of its financial health and of its creditworthiness as any ratio or micro-analysis. The state of the financial markets sometimes has a larger bearing on the bank's soundness than other factors. A fine example is the effect that interest rates or a devaluation have on a bank's profitability and capitalization. The implied (not to mention the explicit) support of the authorities, of other banks and of investors (domestic as well as international) sets the psychological background to any future developments. This is only too logical. In an unstable financial environment, knock-on effects are more likely. Banks deposit money with other banks on a security basis. Still, the value of securities and collaterals is as good as their liquidity and as the market itself. The very ability to do business (for instance, in the syndicated loan market) is influenced by the larger picture. Falling equity markets herald trading losses and loss of income from trading operations and so on.

Perhaps the single most important factor is the general level of interest rates in the economy. It determines the present value of foreign exchange and local currency denominated government debt. It influences the balance between realized and unrealized losses on longer-term (commercial or other) paper. One of the most important liquidity generation instruments is the repurchase agreement (repo). Banks sell their portfolios of government debt with an obligation to buy it back at a later date. If interest rates shoot up – the losses on these repos can trigger margin calls (demands to immediately pay the losses or else materialize them by buying the securities back).

Margin calls are a drain on liquidity. Thus, in an environment of rising interest rates, repos could absorb liquidity from the banks, deflate rather than inflate. The same principle applies to leverage investment vehicles used by the bank to improve the returns of its securities trading operations. High interest rates here can have an even more painful outcome. As liquidity is crunched, the banks are forced to materialize their trading losses. This is bound to put added pressure on the prices of financial assets, trigger more margin calls and squeeze liquidity further. It is a vicious circle of a monstrous momentum once commenced.

But high interest rates, as we mentioned, also strain the asset side of the balance sheet by applying pressure to borrowers. The same goes for a devaluation. Liabilities connected to foreign exchange grow with a devaluation with no (immediate) corresponding increase in local prices to compensate the borrower. Market risk is thus rapidly transformed to credit risk. Borrowers default on their obligations. Loan loss provisions need to be increased, eating into the bank's liquidity (and profitability) even further. Banks are then tempted to play with their reserve coverage levels in order to increase their reported profits and this, in turn, raises a real concern regarding the adequacy of the levels of loan loss reserves. Only an increase in the equity base can then assuage the (justified) fears of the market but such an increase can come only through foreign investment, in most cases. And foreign investment is usually a last resort, pariah, solution (see Southeast Asia and the Czech Republic for fresh examples in an endless supply of them. Japan and China are, probably, next).

In the past, the thinking was that some of the risk could be ameliorated by hedging in forward markets (=by selling it

to willing risk buyers). But a hedge is only as good as the counterparty that provides it and in a market besieged by knock-on insolvencies, the comfort is dubious. In most emerging markets, for instance, there are no natural sellers of foreign exchange (companies prefer to hoard the stuff). So forwards are considered to be a variety of gambling with a default in case of substantial losses a very plausible way out.

Banks depend on lending for their survival. The lending base, in turn, depends on the quality of lending opportunities. In high-risk markets, this depends on the possibility of connected lending and on the quality of the collaterals offered by the borrowers. Whether the borrowers have qualitative collaterals to offer is a direct outcome of the liquidity of the market and on how they use the proceeds of the lending. These two elements are intimately linked with the banking system. Hence the penultimate vicious circle: where no functioning and professional banking system exists – no good borrowers will emerge.

Alice in Credit-Card Land

On Chargebacks

By: [Dr. Sam Vaknin](#)

Your credit card is stolen. You place a phone call to the number provided in your tourist guide or in the local daily press. You provide your details and you cancel your card. You block it. In a few minutes, it should be transferred to the stop-list available to the authorization centres worldwide. From that moment on, no thief will be able to fraudulently use your card. You can sigh in relief. The danger is over.

But is it?

It is definitely not. To understand why, we should first review the intricate procedure involved.

In principle, the best and safest thing to do is call the authorization centre of the bank that issued your card (the issuer bank). Calling the number published in the media is second best because it connects the cardholder to a "volunteer" bank, which caters for the needs of all the issuers of a given card. Some service organizations (such as IAPA – the International Air Passengers Association) provide a similar service.

The "catering bank" accepts the call, notes down the details of the cardholder and prepares a fax containing the instruction to cancel the card. The cancellation fax is then sent on to the issuing bank.

The details of all the issuing banks are found in special manuals published by the clearing and payments associations of all the banks that issue a specific card. All the financial institutions that issue Mastercards, Eurocards and a few other more minor cards in Europe are members of Europay International (EPI). Here lies the first snag: the catering bank often mistakes the identity of the issuer. Many banks share the same name or are branches of a network. Banks with identical names can exist in Prague, Budapest and Frankfurt, or Vienna, for instance. Should a fax cancelling the card be sent to the wrong bank – the card will simply not be cancelled until it is too late. By the time the mistake is discovered, the card is usually thoroughly abused and the financial means of the cardholder are exhausted.

Additionally, going the indirect route (calling an intermediary bank instead of the issuing bank) translates into a delay which could prove monetarily crucial. By the time the fax is sent, it might be no longer necessary.

If the card has been abused and fraudulent purchases or money withdrawals have been debited to the unfortunate cardholders' bank or credit card account – the cardholder can reclaim these charges. He has to clearly identify them and state in writing that they were not effected by him. A process called "chargeback" thus is set in motion.

A chargeback is a transaction disputed within the payment system. A dispute can be initiated by the cardholder when he receives his statement and rejects one or more items on it or when an issuing financial institution disputes a transaction for a technical reason (usually at the behest of the cardholder or if his account is overdrawn).

A technical reason could be the wrong or no signature, wrong or no date, important details missing in the sales vouchers and so on. Despite the warnings carried on many a sales voucher ("No Refund – No Cancellation") both refunds and cancellations are daily occurrences.

To be considered a chargeback, the card issuer must initiate a well-defined dispute procedure. This it can do only after it has determined the reasons invalidating the transaction. A chargeback can only be initiated by the issuing financial institution. The cardholder himself has no standing in this matter and the chargeback rules and regulations are not accessible to him. He is confined to lodging a complaint with the issuer. This is an abnormal situation whereby rules affecting the balances and mandating operations resulting in debits and credits in the bank account are not available to the account name (owner). The issuer, at its discretion, may decide that issuing a chargeback is the best way to rectify the complaint.

The following sequence of events is, thus, fairly common:

1. The cardholder presents his card to a merchant (aka: an acceptor of payment system cards).
2. The merchant may request an authorization for the transaction, either by electronic means (a Point of Sale / Electronic Fund Transfer apparatus) or by phone (voice authorization). A merchant is obliged to do so if the value of the transaction exceeds predefined thresholds. But there are other cases in which this might be either a required or a recommended policy.
3. If the transaction is authorized, the merchant notes down the authorization reference number and

gives the goods and services to the cardholder. In a face-to-face transaction (as opposed to a phone or internet/electronic transaction), the merchant must request the cardholder to sign the sale slip. He must then compare the signature provided by the cardholder to the signature specimen at the back of the card. A mismatch of the signatures (or their absence either on the card or on the slip) invalidate the transaction. The merchant will then provide the cardholder with a receipt, normally with a copy of the signed voucher.

4. Periodically, the merchant collects all the transaction vouchers and sends them to his bank (the "acquiring" bank).
5. The acquiring bank pays the merchant on foot of the transaction vouchers minus the commission payable to the credit card company. Some banks pre-finance or re-finance credit card sales vouchers in the form of credit lines (cash flow or receivables financing).
6. The acquiring bank sends the transaction to the payments system (VISA International or Europay International) through its connection to the relevant network (VisaNet, in the case of Visa, for instance).
7. The credit card company (Visa, Mastercard, Diners Club) credits the acquirer bank.
8. The credit card company sends the transaction to the issuing bank and automatically debits the issuer.
9. The issuing bank debits the cardholder's account. It issues monthly or transaction related statements

to the cardholder.

10. The cardholder pays the issuing bank on foot of the statement (this is automatic, involuntary debiting of the cardholders account with the bank).

Some credit card companies in some territories prefer to work directly with the cardholders. In such a case, they issue a monthly statement, which the cardholder has to pay directly to them by money order or by bank transfer. The cardholder will be required to provide a security to the credit card company and his spending limits will be tightly related to the level and quality of the security provided by him. The very issuance of the card is almost always subject to credit history and to an approval process.

My credit card was stolen in 1998, in a crowded film festival. I placed a phone call to the number provided by my bank. The same number was also published in my tourist guide and in the local daily press. I gave my details and asked to have my card cancelled, or at least blocked. I felt safe because I knew that, in a few minutes, my card number will pop up in a stop-list available to authorization centres worldwide. From that moment on, no thief will be able to fraudulently abuse my card, I thought as I reverted to my delicious lunch, sighing in relief.

But the danger was far from over.

Though rarely advised to do so, the best and safest thing is to call the authorization centre of the bank that issued the card - i.e., the issuing bank. That being a weekend, the number I called instead was a poor second. It belonged to a "volunteer" bank, which catered to the needs of all the issuers of a given type of card - "MasterCard", "Visa", or "American Express" in this case. Some travel service

organizations (e.g., IAPA – the International Air Passengers Association) provide a similar service.

Updating the stop-list is a low priority with the overworked weekend staff of the "catering bank". Sometimes it takes hours before the list is updated. The "catering bank" sends a fax to the issuing bank, asking it to cancel the card. The details of all the issuing banks are available in special manuals. These are published by the clearing and payments associations of all the banks that issue a specific type of card. All the financial institutions that issue MasterCard, Eurocards and a few other minor cards in Europe are members of Europay International (EPI), for example.

Here lies the first snag: the catering bank often mistakes the identity of the issuer. Many issuers - especially branches of the same bank - are eponymous. Banks with identical names exist in Prague, Budapest, Frankfurt, London, Zagreb, or Vienna, for instance. In my case, they alerted the wrong bank in the wrong country. My card was never blocked. The thieves simply abused it to the limit.

Thus, going the indirect route (calling an intermediary bank instead of the issuing bank) translates into a delay which could prove monetarily crucial. By the time the fax is sent, it might be no longer necessary. To be on the safe side, standard credit card contracts in some countries apply coverage only one hour after the theft - when most of the damage has already been done. In the USA credit card liability in case of fraudulent transactions is limited to the first \$50.

The cardholder can reclaim, in writing, fraudulent charges and money withdrawals. This ritualistic dispute procedure is called "chargeback". A chargeback is a transaction disputed within the payment system by the cardholder through the card issuer. It can also be initiated by the card-issuer on technical grounds, usually at the behest of the cardholder or if his account is overdrawn: wrong or no signature, wrong or no date, important details missing in the sales vouchers and so on. Despite the warnings carried on many a sales voucher ("No Refund – No Cancellation") both refunds and cancellations occur daily.

The cardholder himself has no standing in the process and is confined to lodging a complaint with the issuer. The rules and regulations governing chargebacks are internal and inaccessible to him though they often result in debits and credits to his bank account. The issuer, at its discretion, may decide that issuing a chargeback is the best way to rectify the complaint.

The typical credit card transaction involves these steps:

1. The cardholder presents his card to a merchant, the acceptor.
2. The merchant may request an authorization for the transaction, either by electronic means (a Point of

Sale / Electronic Fund Transfer apparatus) or by phone (voice authorization). A merchant is obliged to do so if the value of the transaction exceeds predefined thresholds. But there are other cases in which this might be a policy either required or recommended by issuers, card companies, or clearinghouses.

3. If authorized, the merchant notes down the transaction authorization code and gives, or ships, the goods, or services to the cardholder. If the cardholder is present, he must sign the sale slip (voucher) and the merchant validates the signature by comparing it to the specimen at the back of the card. The transaction goes through only if the signatures match. The merchant then provides the cardholder with a receipt, normally with a copy of the signed voucher.
4. The merchant collects all the transaction vouchers periodically and gives them to his bank (the "acquiring" bank).
5. The acquiring bank credits the merchant's bank account with the difference between the total amount of the transactions and the commissions and fees payable to the credit card company. Some banks pre-finance or re-finance credit card sales vouchers (receivables financing) - i.e., they lend against future credit card revenues.

6. The acquiring bank forwards the slips or an electronic ledger to the payments system (VISA International, or Europay International) through its connection to the relevant network (VisaNet, in the case of Visa, for instance).
7. The credit card company (Visa, MasterCard, Diners Club) credits the acquiring bank.
8. The credit card company sends the transactions to the issuing bank and automatically debits it.
9. The issuing bank automatically debits the cardholder's account. It issues monthly or transaction related statements to the cardholder.

In some countries - mainly in Central and Eastern Europe, the Middle East, Africa, and Asia - credit card companies sometimes work directly with their cardholders who pay the companies via money order or bank transfer. The cardholder is often required to provide a security to the credit card company and his spending limits are tightly supervised. Credit history, collateral, and background checks are rigorous. Even then, the majority of the cards issued are debit - rather than credit - cards.

Andrew Greenstein's Internet business - sold last year - did a great volume of credit card transactions and experienced chargebacks of between 0.5 to 3 percent. Despite its positive cashflow and good standing with the bank, it was fined by Visa, placed in its "Merchant Watch" list and forced to set aside \$125,000 in a reserve account. Its fee per chargeback shot from nil to \$25 on local cards and \$50 per foreign chargeback.

Greenstein says:

"Over the years, I experienced bank re-negotiations, bank

switches, used various online credit card processing software. I successfully negotiated our way out of additional reserve accounts, set up alternate merchant accounts with lower - sometimes virtually no - fees, and helped the company scale down its chargeback picture considerably. It was always frustrating though that even when we'd show Merchant Services & Visa dramatically reduced chargebacks, increased revenue, a large positive cashflow, years of success, letters from accountants, etc. - they'd continue to fine us over and over again, insisting that even 1.75% was 'too high for an Internet business.'

"It always seemed as though they were doing it to profit - knowing full well that the company I ran had one of the rosier chargeback pictures of all and one of the cleanest reputations around. Still, for years the company continued to suffer nicks and jabs at the whim of either Merchant Services or Visa. My years of experiences getting new accounts, changing accounts, offsetting reserves, and more - led me to create ChargebackPrevention.Com to help less knowledgeable merchants benefit from my years of 'education' in the field."

Q. How bad is the problem of Internet credit card fraud?

A. Having no medium-wide statistics, I'd say that the amount of chargebacks/fraudulent orders is only increasing as more people take to the Internet and as more pranksters realize that the odds of "getting busted" are pretty low.

Though frustrating to businesses, I believe that most reasonably-accomplished outfits can survive with a certain number of chargebacks even if it amounts to 3 or 4%. The problem arises when the "powers-that-be" add insult to injury by demanding a reserve account, or by arbitrarily "fining" merchants for being "bad boys." That's when Internet credit card fraud becomes a the seed that spawns a whole garden of trouble.

Q. Chargebacks allow consumers to protect themselves against fraud, faulty products, and breach of sales contracts. Would you say that consumers are abusing this protection? If so, how would you restructure the chargeback process to balance the rights and obligations of all parties?

A. Abuse exists in any scenario. If you ask most merchants, those few cases of torment when they knew they were being taken advantage of probably stuck in their memory and their response would be "yes, consumers are abusing this protection!".

Indeed, I can't help but recall those individual cases of obvious abuse. Still, I'd have to say that the number of people intentionally doing chargebacks to get money back is quite low. I also believe that the ONE thing Visa/MasterCard does right is to limit people in quality dispute chargebacks. When they see someone doing it excessively, they flag their account. I don't think there's a big problem of people doing it regularly, but there is a problem when consumers read articles like this one and realize, in the back of their minds, that they can chargeback. Then every slight problem with a merchant gets blown out of proportion and they try to get the product/service for free.

In my experience, however, quality dispute chargebacks

are generally very easy to reverse or beat and ChargebackPrevention.Com spends a great deal of time on this - and offers many pages of information and even examples of successful rebuttal letters - teaching merchants how to diffuse this sort of chargeback.

In sum, I would say that while there are some abuses - this is the one area MC/VISA has "down pat" reasonably well. There are ways they could improve the tackling of fraud but I can't see many ways they can improve the treatment of quality disputes. Everything is well-mediated. Every once in a while you come across a grumpy anti-merchant sort of chargeback handler burnt out and tired of his or her job reviewing chargebacks all day. But such cases are few and far between. Take it from someone who has successfully reversed - or been involved in the reversal of -hundreds of these!

Q. What percentage of sales goes towards paying credit card-related expenditures: processing fees, chargebacks, fines, and reserve accounts (please explain each of these terms)?

Processing discount rates right now for phone/mail orders seem to have bottomed out around 2.2-2.3 percent depending on the variables involved. Many newer merchants pay as much as 2.57 and even 4 percent, though they can definitely negotiate a lower rate. Most merchants pay \$10-\$15 per chargeback but some pay as high as \$25. A few merchants even pay a bogus \$10-\$15 fee per ticket retrieval request.

Thus, if you have a \$50 sale and the customer has a gripe, you may be slapped with a \$15 fee for the slip request, another \$25 for the chargeback.. and then even if you reverse the chargeback - some banks charge another \$25 to do it. If the customer does a second chargeback, that's another \$25. So you can lose your \$50 plus pay another \$90 by the time you're done - in the worst case scenario with the worst merchant account conceivable!

Merchants can negotiate deals with no chargeback fees - though, generally, this increases the processing discount rate a bit - so merchants need to crunch numbers to figure out where they save the most money - with lower discount fees or with lower or no chargeback fees.

In sum, figure an average of 2.5% paid for processing discount rates, 15-40 cents per transaction (unless you negotiate a no fee per transaction deal), and \$0-\$25 per chargeback. Chargeback and reserve accounts happen only to "select" merchants, of course! But additional fees sometimes seen are:

- *Extra charges if the merchant's batch isn't settled every 24 hours

- *Additional fees and/or augmented rates for international transactions

- *Specific per transaction fees for the type of software being used or to have "the privilege" of checking AVS or CVV2

- *Monthly statement fees - unless otherwise negotiated.

Q. Processing agents seem to benefit greatly from chargeback fees, reserve accounts, and related fines. Do they contribute to the proliferation of chargebacks? Wouldn't you say that the relationship between financial intermediaries (banks, processing agents, credit card companies) are incestuous and that the problem is structural?

In my opinion, though generally viewed as being noble and legitimate - it's one of the most corrupt businesses out there. I could never fully understand how a corporate entity is allowed to "fine" its customers. It's no wonder it's so difficult to get out of the "Merchant Watch Program". Visa certainly has no incentive to release the merchants on the list when they can get away with fining them \$10,000 or more - almost at whim.

Reserve accounts at least make a little bit of sense for banks to protect themselves. But grabbing \$100k or more from so many merchants and holding it for 6 months or longer - can only be increasing bank profits ever so much. Some merchant representatives seem motivated to set reserve accounts and are probably paid based on some sort of incentive program. There appear to be employees at FirstData (which now has a virtual monopoly) who do nothing else but answer calls from merchants griping about reserve accounts - and it's very difficult (but, from our experience, not impossible) to get them to act in the merchant's favor.

In the case of the e-business I developed and owned for so many years, I found the "loss prevention" people to be vindictive and senseless with little concern for anything other than their own agenda.

When one loss prevention agent was shown in detail by a team of accountants that the company only makes money, turns profits, has never failed to pay a chargeback, has a positive cash flow and so on - her response was simply: "We don't care about making money, we only care about loss prevention." And that was a management-level employee.

An even better example comes to mind. FirstData has the "right" to use the letterhead of any bank they represent and to act "on their behalf", so newer merchants tend to think they're dealing w/ their own merchant bank directly. But really the two interests couldn't be more contrary!

In one case, our corporate checking account had an open \$100,000 line of credit. Yet FirstData - acting in the name of the bank's merchant services - declared after 2 years that a \$100,000ish reserve was necessary to offset chargebacks. FirstData didn't know or realize that our bank gave us \$100,000 worth of open credit even as FirstData's "mid-level risk loss prevention" department was telling us that we're a "risky business" and need to post \$100,000 immediately to offset potential losses to the bank from chargebacks!

We had the President of our bank call FirstData directly and tell them not to hold any of the company's money; informing them what a great client we were and what a great banking relationship we had. FirstData uses that bank's letterhead and claims to represent it - but it refused to release our funds despite the explicit request of the bank whose merchant services they're contracted to represent!

Q. Give us one tip or technique on how to avoid chargebacks and describe the most widespread frauds

A. Even though it adds a bit of time and expense, the one technique that works best - better than CVV2 verification or any other generic technique touted by MC/Visa - is to verbally verify each order. Just pick up the phone and call each customer. Internet frauds enjoy their anonymity and are scared senseless about actually playing their act out over the telephone. Most of them aren't "real" thieves in the sense that they would shoplift from retail stores or perpetrate fraud in a non-electronic scenario. You'll find out who is real and who is fraudulent if you pick up the phone and start calling the phone numbers on your incoming order forms. At ChargebackPrevention.Com, we teach users precisely what to look for, what to say, what questions to ask over the telephone, etc.

Q. Can you comment on the current antitrust investigation against Visa and MasterCard and its potential implications? Additionally, do you believe that the aggressive marketing drives of credit card issuers, involving little or no background checks, contribute to an increase in credit card fraud?

A. Sorry, no comment on this aspect!

Q. Can you compare the advantages and disadvantages of "card not present" and "card present" sales? Is e-commerce hobbled by some of the procedures and safeguards required by credit card companies and clearinghouses?

A. Obviously, "card present" transactions are safer for merchants.

If only every computer terminal could have its own magnetic swiping device! I can't help but wonder if clearinghouses are just seeing e-commerce as a "whipping boy" - constantly crying wolf - telling merchants that they have too many chargebacks and hitting them with profitable fines.

Retailers usually don't have the same chargeback problems as E-tailers when it comes to fraud. But E-tailers generally don't have the same overhead that retailers do - so we're able to comfortably survive with 3, 4, 5 percent chargebacks. But clearing houses are too gung-ho in their search for "red flags." They simply need to stop applying the same flags to every business in every case.

A company that delivers information electronically is going to have more chargebacks than one who ships to a home address. But a company with a negative cashflow is going to be more of a risk than a company with a positive one. They should really evaluate companies more deeply before charging them with so many fines and fees. Most of the advice given by clearinghouses is generic and empty and that's one of the main reasons chargebackprevention.com came to be.

Telling everyone: ship to the billing address only, use AVS, and use CVV2 may be fine and dandy but billing addresses don't apply to information-only merchants, AVS can cause problems of its own and CVV2 still confounds customers and loses legitimate sales when they fail to recite their credit card number by heart.

ChargebackPrevention.Com tries to create more of a 'happy third way' between reducing chargebacks and maintaining sales volume - something that the powers-that-be seem to care very little about. When they get chargebacks down, they reward themselves, they pat themselves on the back, they attribute it to their fines and strong-armed reserve accounts - without delving deeper. We try to teach the merchant to proactively avoid fraud, reserve accounts, and fines and to reactively deal with these issues effectively when they do occur.

Q. How will smart wallets, e-cash, PayPal and other debit/credit money substitutes affect the credit card industry?

I haven't seen much worth experimenting with. They require the customer to go through extra steps. So many online buyers are still "new to it". Some are making impulse purchases and some are just barely convinced to buy. Requiring them to go sign up for an account with PayPal and so forth is asking for extra steps, instructions, and can pull them out of "the ether", or make them back away from sales.

Only the net-savvy really know about companies like PayPal and trust them. The typical occasional user about to make a purchase at your site is trusting enough to give you their information. Going over to PayPal adds another party, one they haven't even always heard of as often as you or I. I would never risk clientele by asking them to sign up.

Workaholism, Leisure and Pleasure

By: [Dr. Sam Vaknin](#)

Also Read:

[***Entrepreneurship and Workaholism***](#)

The official working week has been reduced to 35 hours a week in France. In most countries in the world, it is limited to 45 hours a week. The trend during the last century seems to be unequivocal: less work, more play.

Yet, what may be true for blue collar workers or state employees – is not necessarily so for white collar members of the liberal professions. It is not rare for these people – lawyers, accountants, consultants, managers, academics – to put in 80 hour weeks.

The phenomenon is so widespread and its social consequences so damaging that it has acquired the unflattering nickname workaholism, a combination of the words "work" and "alcoholism". Family life is disrupted, intellectual horizons narrow, the consequences to the workaholic's health are severe: fat, lack of exercise, stress - all take their lethal toll. Classified as "alpha" types, workaholics suffer three times as many heart attacks as their peers.

But what are the social and economic roots of this phenomenon?

Put succinctly, it is the outcome of the blurring of boundaries between work and leisure. This distinction between time dedicated to labour and time spent in the pursuit of one's hobbies – was so clear for thousands of

years that its gradual disappearance is one of the most important and profound social changes in human history.

A host of other shifts in the character of work and domestic environments of humans converged to produce this momentous change. Arguably the most important was the increase in labour mobility and the fluid nature of the very concept of work and the workplace.

The transitions from agriculture to industry, then to services, and now to the knowledge society, increased the mobility of the workforce. A farmer is the least mobile. His means of production are fixed, his produce mostly consumed locally - especially in places which lack proper refrigeration, food preservation, and transportation.

A marginal group of people became nomad-traders. This group exploded in size with the advent of the industrial revolution. True, the bulk of the workforce was still immobile and affixed to the production floor. But raw materials and finished products travelled long distances to faraway markets. Professional services were needed and the professional manager, the lawyer, the accountant, the consultant, the trader, the broker – all emerged as both parasites feeding off the production processes and the indispensable oil on its cogs.

The protagonists of the services society were no longer geographically dependent. They rendered their services to a host of geographically distributed "employers" in a variety of ways. This trend accelerated today, with the advent of the information and knowledge revolution.

Knowledge is not geography-dependent. It is easily transferable across boundaries. It is cheaply reproduced. Its ephemeral quality gives it non-temporal and non-spatial qualities. The locations of the participants in the economic interactions of this new age are transparent and immaterial.

These trends converged with increased mobility of people, goods and data (voice, visual, textual and other). The twin revolutions of transportation and telecommunications really reduced the world to a global village. Phenomena like commuting to work and multinationals were first made possible.

Facsimile messages, electronic mail, other forms of digital data, the Internet - broke not only physical barriers but also temporal ones. Today, virtual offices are not only spatially virtual – but also temporally so. This means that workers can collaborate not only across continents but also across time zones. They can leave their work for someone else to continue in an electronic mailbox, for instance.

These technological advances precipitated the transmutation of the very concepts of "work" and "workplace". The three Aristotelian dramatic unities no longer applied. Work could be performed in different places, not simultaneously, by workers who worked part time whenever it suited them best.

Flextime and work from home replaced commuting (much

more so in the Anglo-Saxon countries, but they have always been the harbingers of change). This fitted squarely into the social fragmentation which characterizes today's world: the disintegration of previously cohesive social structures, such as the nuclear (not to mention the extended) family.

All this was neatly wrapped in the ideology of individualism, presented as a private case of capitalism and liberalism. People were encouraged to feel and behave as distinct, autonomous units. The perception of individuals as islands replaced the former perception of humans as cells in an organism.

This trend was coupled with – and enhanced by – unprecedented successive multi-annual rises in productivity and increases in world trade. New management techniques, improved production technologies, innovative inventory control methods, automatization, robotization, plant modernization, telecommunications (which facilitates more efficient transfers of information), even new design concepts - all helped bring this about.

But productivity gains made humans redundant. No amount of retraining could cope with the incredible rate of technological change. The more technologically advanced the country – the higher its structural unemployment (i.e., the level of unemployment attributable to changes in the very structure of the market).

In Western Europe, it shot up from 5-6% of the workforce to 9% in one decade. One way to manage this flood of ejected humans was to cut the workweek. Another was to support a large population of unemployed. The third, more tacit, way was to legitimize leisure time. Whereas the Jewish and Protestant work ethics condemned idleness in the past – the current ethos encouraged people to contribute to the economy through "self realization", to pursue their hobbies and non-work related interests, and to express the entire range of their personality and potential.

This served to blur the historical differences between work and leisure. They are both commended now. Work, like leisure, became less and less structured and rigid. It is often pursued from home. The territorial separation between "work-place" and "home turf" was essentially eliminated.

The emotional leap was only a question of time. Historically, people went to work because they had to. What they did after work was designated as "pleasure". Now, both work and leisure were pleasurable – or torturous – or both. Some people began to enjoy their work so much that it fulfilled the functions normally reserved to leisure time. They are the workaholics. Others continued to hate work – but felt disorientated in the new, leisure-like environment. They were not taught to deal with too much free time, a lack of framework, no clear instructions what to do, when, with whom and to what end.

Socialization processes and socialization agents (the State, parents, educators, employers) were not geared – nor did they regard it as their responsibility – to train the population to cope with free time and with the baffling and dazzling variety of options on offer.

We can classify economies and markets using the work-leisure axis. Those that maintain the old distinction between (hated) work and (liberating) leisure – are doomed to perish or, at best, radically lag behind. This is because they will not have developed a class of workaholics big enough to move the economy ahead.

It takes workaholics to create, maintain and expand capitalism. As opposed to common opinion, people, mostly, do not do business because they are interested in money (the classic profit motive). They do what they do because they like the Game of Business, its twists and turns, the brainstorming, the battle of brains, subjugating markets, the ups and downs, the excitement. All this has nothing to do with money. It has everything to do with psychology. True, money serves to measure success – but it is an abstract meter, akin to monopoly money. It is proof shrewdness, wit, foresight, stamina, and insight.

Workaholics identify business with pleasure. They are hedonistic and narcissistic. They are entrepreneurial. They are the managers and the businessmen and the scientists and the journalists. They are the movers, the shakers, the pushers, the energy.

Without workaholics, we would have ended up with "social" economies, with strong disincentives to work. In these economies of "collective ownership" people go to work because they have to.

Their main preoccupation is how to avoid it and to sabotage the workplace. They harbour negative feelings. Slowly, they wither and die (professionally) – because no one can live long in hatred and deceit. Joy is an essential ingredient of survival.

And this is the true meaning of capitalism: the abolition of the artificial distinction between work and leisure and the pursuit of both with the same zeal and satisfaction. Above all, the (increasing) liberty to do it whenever, wherever, with whomever you choose.

Unless and until Homo East Europeansis changes his state of mind – there will be no real transition. Because transition happens in the human mind much before it takes form in reality. It is no use to dictate, to legislate, to finance, to cajole, or to bribe. It was Marx (a devout non-capitalist) who said: it is consciousness that determines reality. How right was he. Witness the prosperous USA and compare it to the miserable failure that was communism.

FROM AN INTERVIEW I GRANTED

Q. In your article, *Workaholism, Leisure and Pleasure*, you describe how the line between leisure and work has blurred over time. What has allowed this to happen? What effect does this blurring have on the struggle to achieve a work-life balance?

A. The distinction between work and leisure times is a novelty. Even 70 years ago, people still worked 16 hours a day and, many of them, put in 7 days a week.

More than 80% of the world's population still live this way. To the majority of people in the developing countries, work was and is life. They would perceive the contrast between "work" and "life" to be both artificial and perplexing. Sure, they dedicate time to their families and communities. But there is little leisure left to read, nurture one's hobbies, introspect, or attend classes.

Leisure time emerged as a social phenomenon in the twentieth century and mainly in the industrialized, rich, countries.

Workaholism - the blurring of boundaries between leisure time and time dedicated to work - is, therefore, simply harking back to the recent past. It is the inevitable outcome of a confluence of a few developments:

I. **Labour mobility** increased. A farmer is attached to his land. His means of production are fixed. His markets are largely local. An industrial worker is attached to his factory. His means of production are fixed. Workers in the services or, more so, in the knowledge industries are attached only to their laptops. They are much more itinerant. They render their services to a host of geographically distributed "employers" in a variety of ways.

II. The advent of the **information and knowledge revolutions** lessened the worker's dependence on a "brick and mortar" workplace and a "flesh and blood" employer. Cyberspace replaces real space and temporary or contractual work are preferred to tenure and corporate "loyalty".

Knowledge is not geography-dependent. It is portable and cheaply reproduced. The geographical locations of the

participants in the economic interactions of this new age are transparent and immaterial.

III. The **mobility of goods and data** (voice, visual, textual and other) increased exponentially. The twin revolutions of transportation and telecommunications reduced the world to a global village. Phenomena like commuting to work and globe-straddling multinationals were first made possible. The car, the airplane, facsimile messages, electronic mail, other forms of digital data, the Internet - demolished many physical and temporal barriers. Workers today often collaborate in virtual offices across continents and time zones. Flextime and work from home replaced commuting. The very concepts of "workplace" and "work" were rendered fluid, if not obsolete.

IV. The **dissolution of the classic workplace** is part of a larger and all-pervasive disintegration of other social structures, such as the nuclear family. Thus, while the choice of work-related venues and pursuits increased - the number of social alternatives to work declined.

The extended and nuclear family was denuded of most of its traditional functions. Most communities are tenuous and in constant flux. Work is the only refuge from an incoherent, fractious, and dysfunctional world. Society is anomic and work has become a route of escapism.

V. The **ideology of individualism** is increasingly presented as a private case of capitalism and liberalism. People are encouraged to feel and behave as distinct, autonomous units. The metaphor of individuals as islands substituted for the perception of humans as cells in an organism. Malignant individualism replaced communitarianism. [Pathological narcissism](#) replaced self-love and empathy.

VI. The last few decades witnessed unprecedented successive **rises in productivity and an expansion of world trade**. New management techniques, improved production technologies, innovative inventory control methods, automatization, robotization, plant modernization, telecommunications (which facilitates more efficient transfers of information), even new design concepts - all helped bring workaholism about by placing economic values in the forefront. The Protestant work ethic ran amok. Instead of working in order to live - people began living in order to work.

Workaholics are rewarded with faster promotion and higher income. Workaholism is often - mistakenly - identified with entrepreneurship, ambition, and efficiency. Yet, really it is merely an addiction.

The absurd is that workaholism is a direct result of the culture of leisure.

As workers are made redundant by technology-driven productivity gains - they are encouraged to engage in leisure activities. Leisure substitutes for work. The historical demarcation between work and leisure is lost. Both are commended for their contribution to the economy.

Work, like leisure, is less and less structured and rigid. Both work and leisure are often pursued from home and are often experienced as pleasurable.

The territorial separation between "work-place" and "home turf" is essentially eliminated.

Some people enjoy their work so much that it fulfils the functions normally reserved to leisure time. They are the workaholics. Others continue to hate work - but feel disorientated in the new leisure-rich environment. They are not taught to deal with too much free and unstructured time, with a lack of clearly delineated framework, without clear instructions as to what to do, when, with whom, and to what end.

The state, parents, educators, employers - all failed to train the population to cope with free time and with choice. Both types - the workaholic and the "normal" person baffled by too much leisure - end up sacrificing their leisure time to their work-related activities.

Alas, it takes workaholics to create, maintain and expand capitalism. People don't work or conduct business only because they are after the money. They enjoy their work or their business. They find pleasure in it. And this is the true meaning of capitalism: the abolition of the artificial distinction between work and leisure and the pursuit of both with the same zeal and satisfaction. Above all, the (increasing) liberty to do so whenever, wherever, with whomever you choose.

The Revolt of the Poor The Demise of Intellectual Property?

By: [Dr. Sam Vaknin](#)

Also Read

[*Contracting for Transition*](#)

[*The Case of the Compressed Image*](#)

[*The Disruptive Engine - Innovation and the Capitalist Dream*](#)

Three years ago I published a book of short stories in Israel. The publishing house belongs to Israel's leading (and exceedingly wealthy) newspaper. I signed a contract which stated that I am entitled to receive 8% of the income from the sales of the book after commissions payable to distributors, shops, etc. A few months later (1997), I won the coveted Prize of the Ministry of Education (for short prose). The prize money (a few thousand DMs) was snatched by the publishing house on the legal grounds that all the money generated by the book belongs to them because they own the copyright.

In the mythology generated by capitalism to pacify the masses, the myth of intellectual property stands out. It goes like this : if the rights to intellectual property were not defined and enforced, commercial entrepreneurs would not have taken on the risks associated with publishing books, recording records, and preparing multimedia products. As a result, creative people will have suffered because they will have found no way to make their works accessible to the public. Ultimately, it is the public which pays the price of piracy, goes the refrain.

But this is factually untrue. In the USA there is a very limited group of authors who actually live by their pen. Only select musicians eke out a living from their noisy vocation (most of them rock stars who own their labels - George Michael had to fight Sony to do just that) and very few actors come close to deriving subsistence level income from their profession. All these can no longer be thought of as mostly creative people. Forced to defend their intellectual property rights and the interests of Big Money, Madonna, Michael Jackson, Schwarzenegger and Grisham are businessmen at least as much as they are artists.

Economically and rationally, we should expect that the costlier a work of art is to produce and the narrower its market - the more emphasized its intellectual property rights.

Consider a publishing house.

A book which costs 50,000 DM to produce with a potential audience of 1000 purchasers (certain academic texts are like this) - would have to be priced at a minimum of 100 DM to recoup only the direct costs. If illegally copied (thereby shrinking the potential market as some people will prefer to buy the cheaper illegal copies) - its price would have to go up prohibitively to recoup costs, thus driving out potential buyers. The story is different if a book costs 10,000 DM to produce and is priced at 20 DM a copy with a potential readership of 1,000,000 readers. Piracy (illegal copying) should in this case be more readily tolerated as a marginal phenomenon.

This is the theory. But the facts are tellingly different. The less the cost of production (brought down by digital technologies) - the fiercer the battle against piracy. The bigger the market - the more pressure is applied to clamp down on samizdat entrepreneurs.

Governments, from China to Macedonia, are introducing intellectual property laws (under pressure from rich world countries) and enforcing them belatedly. But where one factory is closed on shore (as has been the case in mainland China) - two sprout off shore (as is the case in Hong Kong and in Bulgaria).

But this defies logic : the market today is global, the costs of production are lower (with the exception of the music and film industries), the marketing channels more numerous (half of the income of movie studios emanates from video cassette sales), the speedy recouping of the investment virtually guaranteed. Moreover, piracy thrives in very poor markets in which the population would anyhow not have paid the legal price. The illegal product is inferior to the legal copy (it comes with no literature, warranties or support). So why should the big manufacturers, publishing houses, record companies, software companies and fashion houses worry?

The answer lurks in history. Intellectual property is a relatively new notion. In the near past, no one considered knowledge or the fruits of creativity (art, design) as 'patentable', or as someone's 'property'. The artist was but a mere channel through which divine grace flowed. Texts, discoveries, inventions, works of art and music, designs - all belonged to the community and could be replicated freely. True, the chosen ones, the conduits, were honoured but were rarely financially rewarded.

They were commissioned to produce their works of art and were salaried, in most cases. Only with the advent of the Industrial Revolution were the embryonic precursors of intellectual property introduced but they were still limited to industrial designs and processes, mainly as embedded in machinery. The patent was born. The more massive the market, the more sophisticated the sales and marketing techniques, the bigger the financial stakes - the larger loomed the issue of intellectual property. It spread from machinery to designs, processes, books, newspapers, any printed matter, works of art and music, films (which, at their beginning were not considered art), software, software embedded in hardware, processes, business methods, and even unto genetic material.

Intellectual property rights - despite their noble title - are less about the intellect and more about property. This is Big Money : the markets in intellectual property outweigh the total industrial production in the world. The aim is to secure a monopoly on a specific work. This is an especially grave matter in academic publishing where small- circulation magazines do not allow their content to be quoted or published even for non-commercial purposes. The monopolists of knowledge and intellectual products cannot allow competition anywhere in the world - because theirs is a world market. A pirate in Skopje is in direct competition with Bill Gates. When he sells a pirated Microsoft product - he is depriving Microsoft not only of its income, but of a client (=future income), of its monopolistic status (cheap copies can be smuggled into other markets), and of its competition-detering image (a major monopoly preserving asset). This is a threat which Microsoft cannot tolerate. Hence its efforts to eradicate piracy - successful in China and an utter failure in legally-relaxed Russia.

But what Microsoft fails to understand is that the problem lies with its pricing policy - not with the pirates. When faced with a global marketplace, a company can adopt one of two policies: either to adjust the price of its products to a world average of purchasing power - or to use discretionary differential pricing (as pharmaceutical companies were forced to do in Brazil and South Africa). A Macedonian with an average monthly income of 160 USD clearly cannot afford to buy the Encyclopaedia Encarta Deluxe. In America, 50 USD is the income generated in 4 hours of an average job. In Macedonian terms, therefore, the Encarta is 20 times more expensive. Either the price should be lowered in the Macedonian market - or an average world price should be fixed which will reflect an average global purchasing power.

Something must be done about it not only from the economic point of view. Intellectual products are very price sensitive and highly elastic. Lower prices will be more than compensated for by a much higher sales volume. There is no other way to explain the pirate industries : evidently, at the right price a lot of people are willing to buy these products. High prices are an implicit trade-off favouring small, elite, select, rich world clientele. This raises a moral issue : are the children of Macedonia less worthy of education and access to the latest in human knowledge and creation ?

Two developments threaten the future of intellectual property rights. One is the Internet. Academics, fed up with the monopolistic practices of professional publications - already publish on the web in big numbers. I published a few book on the Internet and they can be freely downloaded by anyone who has a computer or a modem.

The full text of electronic magazines, trade journals, billboards, professional publications, and thousands of books is available online. Hackers even made sites available from which it is possible to download whole software and multimedia products. It is very easy and cheap to publish on the Internet, the barriers to entry are virtually nil. Web pages are hosted free of charge, and authoring and publishing software tools are incorporated in most word processors and browser applications. As the Internet acquires more impressive sound and video capabilities it will proceed to threaten the monopoly of the record companies, the movie studios and so on.

The second development is also technological. The oft-vindicated Moore's law predicts the doubling of computer memory capacity every 18 months. But memory is only one aspect of computing power. Another is the rapid simultaneous advance on all technological fronts. Miniaturization and concurrent empowerment by software tools have made it possible for individuals to emulate much larger scale organizations successfully. A single person, sitting at home with 5000 USD worth of equipment can fully compete with the best products of the best printing houses anywhere. CD-ROMs can be written on, stamped and copied in house. A complete music studio with the latest in digital technology has been condensed to the dimensions of a single chip. This will lead to personal publishing, personal music recording, and the to the digitization of plastic art. But this is only one side of the story.

The relative advantage of the intellectual property corporation does not consist exclusively in its technological prowess. Rather it lies in its vast pool of capital, its marketing clout, market positioning, sales organization, and distribution network.

Nowadays, anyone can print a visually impressive book, using the above-mentioned cheap equipment. But in an age of information glut, it is the marketing, the media campaign, the distribution, and the sales that determine the economic outcome.

This advantage, however, is also being eroded.

First, there is a psychological shift, a reaction to the commercialization of intellect and spirit. Creative people are repelled by what they regard as an oligarchic establishment of institutionalized, lowest common denominator art and they are fighting back.

Secondly, the Internet is a huge (200 million people), truly cosmopolitan market, with its own marketing channels freely available to all. Even by default, with a minimum investment, the likelihood of being seen by surprisingly large numbers of consumers is high.

I published [one book](#) the traditional way - and [another on the Internet](#). In 50 months, I have received 6500 written responses regarding [my electronic book](#). Well over 500,000 people read it (my Link Exchange meter registered c. 2,000,000 impressions since November 1998).

It is a [textbook \(in psychopathology\)](#) - and 500,000 readers is a lot for this kind of publication. I am so satisfied that I am not sure that I will ever consider a traditional publisher again. Indeed, [my last book](#) was published in the very same way.

The demise of intellectual property has lately become abundantly clear. The old intellectual property industries are fighting tooth and nail to preserve their monopolies (patents, trademarks, copyright) and their cost advantages in manufacturing and marketing.

But they are faced with three inexorable processes which are likely to render their efforts vain:

The Newspaper Packaging

Print newspapers offer package deals of cheap content subsidized by advertising. In other words, the advertisers pay for content formation and generation and the reader has no choice but be exposed to commercial messages as he or she studies the content.

This model - adopted earlier by radio and television - rules the internet now and will rule the wireless internet in the future. Content will be made available free of all pecuniary charges. The consumer will pay by providing his personal data (demographic data, consumption patterns and preferences and so on) and by being exposed to advertising. Subscription based models are bound to fail.

Thus, content creators will benefit only by sharing in the advertising cake. They will find it increasingly difficult to implement the old models of royalties paid for access or of ownership of intellectual property.

Disintermediation

A lot of ink has been spilt regarding this important trend. The removal of layers of brokering and intermediation - mainly on the manufacturing and marketing levels - is a historic development (though the continuation of a long term trend).

Consider music for instance. Streaming audio on the internet or downloadable MP3 files will render the CD obsolete. The internet also provides a venue for the marketing of niche products and reduces the barriers to entry previously imposed by the need to engage in costly marketing ("branding") campaigns and manufacturing activities.

This trend is also likely to restore the balance between artist and the commercial exploiters of his product. The very definition of "artist" will expand to include all creative people. One will seek to distinguish oneself, to "brand" oneself and to auction off one's services, ideas, products, designs, experience, etc. This is a return to pre-industrial times when artisans ruled the economic scene. Work stability will vanish and work mobility will increase in a landscape of shifting allegiances, head hunting, remote collaboration and similar labour market trends.

Market Fragmentation

In a fragmented market with a myriad of mutually exclusive market niches, consumer preferences and marketing and sales channels - economies of scale in manufacturing and distribution are meaningless.

Narrowcasting replaces broadcasting, mass customization replaces mass production, a network of shifting affiliations replaces the rigid owned-branch system. The decentralized, intrapreneurship-based corporation is a late response to these trends. The mega-corporation of the future is more likely to act as a collective of start-ups than as a homogeneous, uniform (and, to conspiracy theorists, sinister) juggernaut it once was.

T H E A U T H O R

SHMUEL (SAM) VAKNIN

Curriculum Vitae

Click on [blue text](#) to access relevant web sites – thank you.

Born in 1961 in Qiryat-Yam, Israel.

Served in the Israeli Defence Force (1979-1982) in training and education units.

Education

Graduated a few semesters in the Technion - Israel Institute of Technology, Haifa.

Ph.D. in Philosophy (major : Philosophy of Physics) - Pacific Western University, California.

Graduate of numerous courses in Finance Theory and International Trading.

Certified [E-Commerce Concepts Analyst](#).

Certified in [Psychological Counselling Techniques](#).

Full proficiency in Hebrew and in English.

Business Experience

1980 to 1983

Founder and co-owner of a chain of computerized information kiosks in Tel-Aviv, Israel.

1982 to 1985

Senior positions with the Nessim D. Gaon Group of Companies in Geneva, Paris and New-York (NOGA and APROFIM SA):

- Chief Analyst of Edible Commodities in the Group's Headquarters in Switzerland.
- Manager of the Research and Analysis Division
- Manager of the Data Processing Division
- Project Manager of The Nigerian Computerized Census
- Vice President in charge of RND and Advanced Technologies
- Vice President in charge of Sovereign Debt Financing

1985 to 1986

Represented Canadian Venture Capital Funds in Israel.

1986 to 1987

General Manager of IPE Ltd. in London. The firm financed international multi-lateral countertrade and leasing transactions.

1988 to 1990

Co-founder and Director of "Mikbats - Tesuah", a portfolio management firm based in Tel-Aviv. Activities included large-scale portfolio management, underwriting, forex trading and general financial advisory services.

1990 to Present

Free-lance consultant to many of Israel's Blue-Chip firms, mainly on issues related to the capital markets in Israel, Canada, the UK and the USA.

Consultant to foreign RND ventures and to Governments on macro-economic matters.

President of the Israel chapter of the Professors World Peace Academy (PWPA) and (briefly) Israel representative of the "Washington Times".

1993 to 1994

Co-owner and Director of many business enterprises:

- The Omega and Energy Air-Conditioning Concern
 - AVP Financial Consultants
 - Handiman Legal Services
- Total annual turnover of the group: 10 million USD.

Co-owner, Director and Finance Manager of COSTI Ltd.
- Israel's largest computerized information vendor and developer. Raised funds through a series of private placements locally, in the USA, Canada and London.

1993 to 1996

Publisher and Editor of a Capital Markets Newsletter distributed by subscription only to dozens of subscribers countrywide.

In a legal precedent in 1995 - studied in business schools and law faculties across Israel - was tried for his role in an attempted takeover of Israel's Agriculture Bank.

Was interned in the State School of Prison Wardens.

Managed the Central School Library, wrote, published and lectured on various occasions.

Managed the Internet and International News Department of an Israeli mass media group, "Ha-Tikshoret and Namer".

Assistant in the Law Faculty in Tel-Aviv University (to Prof. S.G. Shoham).

1996 to 1999

Financial consultant to leading businesses in Developing countries, Russia and the Czech Republic.

Collaborated with the Agency of Transformation of Business with Social Capital.

Economic commentator in "[Nova Makedonija](#)", "[Dnevnik](#)", "Izvestia", "Argumenti i Fakti", "The Middle

East Times", "Makedonija Denes", "[The New Presence](#)", "[Central Europe Review](#)", and other periodicals and in the economic programs on various channels of Developing countries Television.

Chief Lecturer in courses organized by the Agency of Transformation, by the Developing countries Stock Exchange and by the Ministry of Trade.

1999 to 2002

Economic Advisor to the Government of the Republic of Developing countries and to the Ministry of Finance.

2001 to present

Senior Business Correspondent for [United Press International \(UPI\)](#)

Web and Journalistic Activities

Author of extensive Websites in Psychology ("[Malignant Self Love](#)") - An [Open Directory Cool Site](#)

Philosophy ("[Philosophical Musings](#)")

Economics and Geopolitics ("[World in Conflict and Transition](#)")

Owner of the [Narcissistic Abuse Announcement and Study List](#) and the Narcissism Revisited mailing list (more than 3900 members)

Owner of the [Economies in Conflict and Transition Study list](#).

Editor of mental health disorders and Central and Eastern Europe categories in web directories ([Open Directory](#), [Suite 101](#), [Search Europe](#)).

Columnist and commentator in "[The New Presence](#)", [United Press International \(UPI\)](#), [InternetContent](#), [eBookWeb](#) and "[Central Europe Review](#)".

Publications and Awards

"Managing Investment Portfolios in states of Uncertainty", Limon Publishers, Tel-Aviv, 1988

"The Gambling Industry", Limon Publishers., Tel-Aviv, 1990

["Requesting my Loved One - Short Stories"](#), Yedioth Aharonot, Tel-Aviv, 1997

"The Developing countries Economy at a Crossroads - On the way to a Healthier Economy" (with [Nikola Gruevski](#)), Skopje, 1998

["Malignant Self Love - Narcissism Revisited"](#), Narcissus Publications, Prague and Skopje, 1999, 2001, 2002

[The Narcissism Series](#) - e-books regarding relationships with abusive narcissists (Skopje, 1999-2002)

["The Exporters' Pocketbook"](#), Ministry of Trade, Republic of Developing countries, Skopje, 1999

["The Suffering of Being Kafka"](#) (electronic book of Hebrew Short Fiction, Prague, 1998)

["After the Rain - How the West Lost the East"](#), Narcissus Publications in association with [Central Europe Review/CEENMI](#), Prague and Skopje, 2000

Winner of numerous awards, among them the Israeli Education Ministry Prize (Literature) 1997, The Rotary Club Award for Social Studies (1976) and the Bilateral

Relations Studies Award of the American Embassy in Israel (1978).

Hundreds of professional articles in all fields of finances and the economy and numerous articles dealing with geopolitical and political economic issues published in both print and web periodicals in many countries.

Many appearances in the electronic media on subjects in philosophy and the Sciences and concerning economic matters.

Contact Details:

palma@unet.com.mk

vakin@link.com.mk

My Web Sites:

Economy / Politics:

<http://ceeandbalkan.tripod.com/>

Psychology:

<http://samvak.tripod.com/index.html>

Philosophy:

<http://philosophos.tripod.com/>

Poetry:

<http://samvak.tripod.com/contents.html>

[Return](#)

After the Rain

*How the West
Lost the East*

The Book

This is a series of articles written and published in 1996-2000 in Developing countries, in Russia, in Egypt and in the Czech Republic.

How the West lost the East. The economics, the politics, the geopolitics, the conspiracies, the corruption, the old and the new, the plough and the internet – it is all here, in colourful and provocative prose.

From "The Mind of Darkness":

"The Balkans' – I say – 'is the unconscious of the world'. People stop to digest this metaphor and then they nod enthusiastically. It is here that the repressed memories of history, its traumas and fears and images reside. It is here that the psychodynamics of humanity – the tectonic clash between Rome and Byzantium, West and East, Judeo-Christianity and Islam – is still easily discernible. We are seated at a New Year's dining table, loaded with a roasted pig and exotic salads. I, the Jew, only half foreign to this cradle of Slavonics. Four Serbs, five Developing countries. It is in the Balkans that all ethnic distinctions fail and it is here that they prevail anachronistically and atavistically. Contradiction and change the only two fixtures of this tormented region.

The women of the Balkan - buried under provocative mask-like make up, retro hairstyles and too narrow dresses. The men, clad in sepia colours, old fashioned suits and turn of the century moustaches. In the background there is the crying game that is Balkanian music: liturgy and folk and elegy combined. The smells are heavy with muskular perfumes. It is like time travel. It is like revisiting one's childhood."

The Author

[Sam Vaknin](#) is the author of [Malignant Self Love - Narcissism Revisited](#) and [After the Rain - How the West Lost the East](#). He is a columnist for [Central Europe Review](#) and [eBookWeb](#), a [United Press International \(UPI\)](#) Senior Business Correspondent, and the editor of mental health and Central East Europe categories in [The Open Directory](#) and [Suite101](#).

Until recently, he served as the Economic Advisor to the Government of Developing countries.

Visit Sam's Web site at <http://samvak.tripod.com>