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Has the FSI missed the elephant in the room?

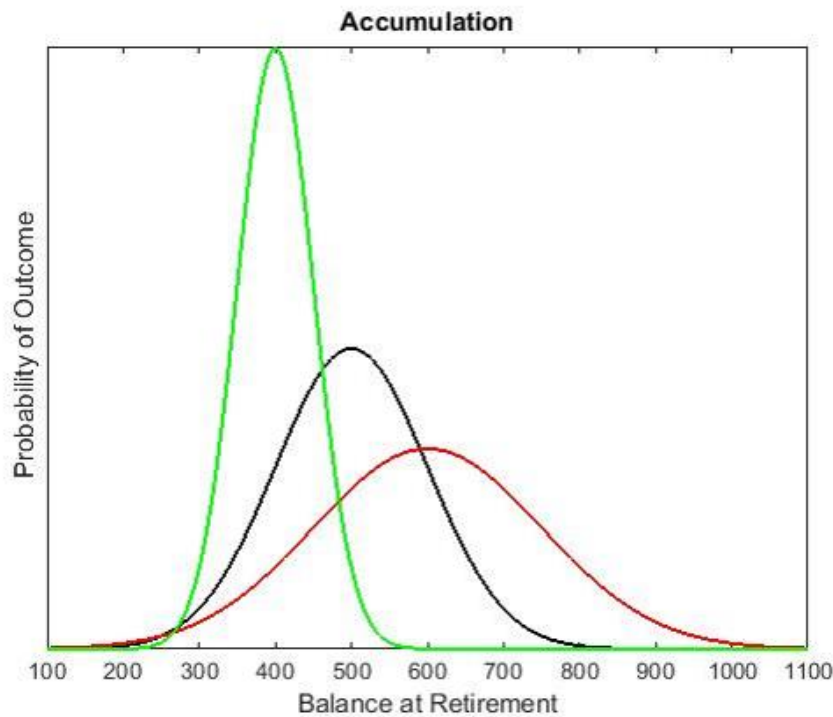
David Bell

The Financial System Inquiry (FSI) makes some important recommendations which would improve the industry if implemented. I agree with the recommendation to clearly define the objectives of superannuation, against which government policy and super fund activities would be assessed. Some of the language used such as "consumption smoothing" (the acknowledgment that the intention of super is to force us to save out of current earnings to provide for consumption when we are no longer earning wages) deserves credit for the way it can re-focus an industry. However the elephant in the room, the trade-off between return and risk, is largely left untouched. This lack of guidance was an important opportunity missed in the FSI.

The trade-off between return and risk is an age long topic. My reflections first address the accumulation focus of the industry and then I consider a retirement outcomes focus.

Risk versus return in accumulation phase

Until recent years much of the industry focus has been on superannuation balances at retirement. "*How big will your nest egg be?*" was a common phrase between industry and consumers. Trustees of super funds had to define the appropriate trade off between return and risk for the default members in their funds. The decision facing the trustee is illustrated in the diagram below.

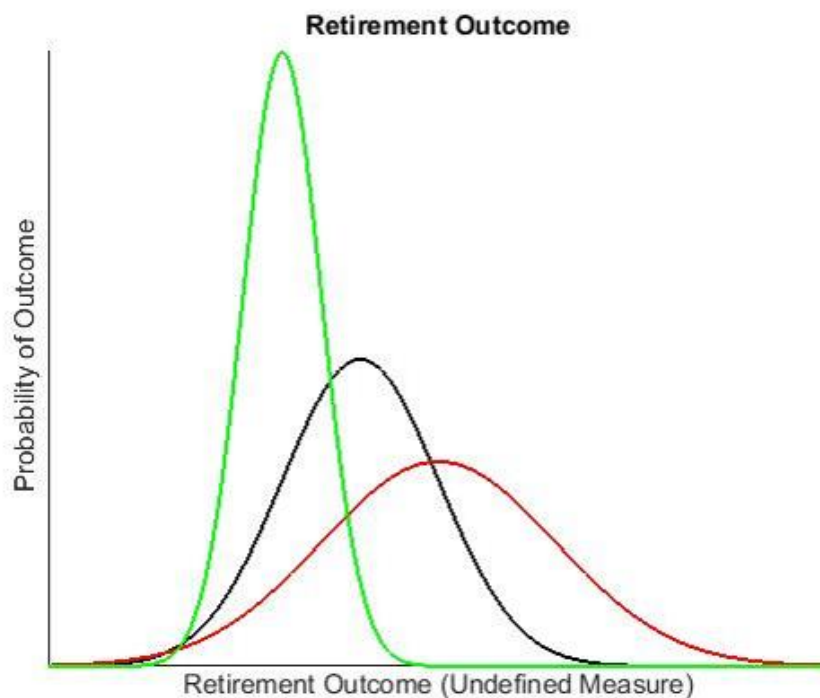


The above diagram is an illustration of the distribution of outcomes of a member's balance at retirement once we account for expected contributions and performance. The black line represents the base case. A trustee could take more risk on the member's behalf. Represented by the red line we expect the accumulation at retirement to be higher (assuming that a higher risk portfolio is expected to deliver higher returns). But the range of potential outcomes is wider, and some of the potential outcomes may be unpalatable. Conversely a trustee could reduce risk, as represented by the green line. The range of potential outcomes is narrower, representing more certainty, but (assuming that lower risk equates to lower expected returns) the expected size of the nest egg at retirement is reduced. Certainty and level of expected outcome pull against each other – yet both are desirable. Note the above analysis could be presented in real or nominal dollars, with real dollars the more appropriate approach.

This is broadly how the '70/30' default portfolio evolved (70% growth assets such as shares and 30% defensive assets such as bonds), however I haven't seen much compelling historical research that explains the origins of '70/30'. Indeed there is a possibility that '70/30' was just back of the envelope analysis that took on an inertia-driven life of its own via peer group risk!

Risk versus return in retirement phase

Let's now switch to the more recent focus on retirement outcomes. The same problem remains but it is more complex and detailed. And again the same ambiguity about the correct trade-off between expected outcome and variability of outcome exists. The diagram below looks similar but the subtle differences are important.



Notice the emphasis on the words 'retirement outcome'. This is a complex topic: how do we define retirement outcome? I suggest it should include the following (but weighting these factors would be complex):

- the level of retirement income
- whether it is achieved through the entire retirement period (does it drop off or run out?)
- the liquidity that is available to meet possible life events (such as a retirement home bond)
- any bequest motive (though this is debateable and likely a secondary issue).

Given the definition of outcome is more complex it is not hard to imagine that measuring the variability of the outcome is also a more intricate exercise. Nonetheless the same framework is relevant: a trustee can make decisions which exchange the level of expected outcome for the opposite move in the variability of the outcome. Both are desirable, and indeed certainty of outcome should be valued and some people view certainty as a luxury. The projected outcome should be considered in terms of the expected outcome against the variability of the projected outcome.

FSI recommendations made without guidance on this trade-off

Alas what remains undefined and unguided by policymakers is the appropriate trade-off between expected outcome and variability of outcome. Every regulatory review, including the FSI, represents an opportunity to address the elephant in the room.

Without such guidance some of the recommendations made in the FSI appear somewhat less formed. Consider two important recommendations made: improving cost efficiency and developing a comprehensive income product for members' retirement (CIPR) which addresses longevity risk. Let's consider these in the outcome framework just outlined.

Cost reductions could increase net investment returns (if achieved through efficiency gains and the deletion of non-beneficial functions and services), or reduce net returns if it means more passive management for a fund that can add value through active management. Cost reductions may increase return volatility because less diversification opportunities into areas such as alternative investments will be available. So all up, a cost reduction focus may increase or may decrease net returns but will likely increase the volatility of returns. So at best this recommendation appears to be pulling the outcome in opposite directions – higher expected outcomes (assuming the FSI believes lower costs translate to higher returns and that active returns don't exist) but greater variability of outcomes. In the absence of

direction as to the appropriate trade-off between expected outcomes and variability of outcomes it is unclear whether such a recommendation will actually improve member outcomes or not.

What about all those other types of risk?

The FSI also recommends the creation of a CIPR to address longevity risk. On the surface, this is a worthwhile recommendation. However longevity risk is just one of many risks to retirement outcomes – investment returns, return volatility, inflation rates, wage growth, house prices, savings rates, mortality outcomes, age pension and taxes, just to name a few. There would be different costs (a negative impact on returns) in hedging these different risks. Perhaps it is cheaper to hedge a unit of investment risk than a unit of mortality risk. If so, then from an outcomes perspective it could be better to hedge a unit of investment risk before we hedge the mortality risk. It is also unclear which risk is most significant to retirement outcomes. What the FSI has done is paternally recommended that we prioritise the hedging of one risk over another, with little assessment of the cost of hedging the different forms of risk or the size of those risks. All this is in the absence of guidance as to the appropriate trade-off between expected outcome and variability of outcomes!

While product solutions such as the CIPR often appear the solution and can really define a regulatory review, it may have been more beneficial to recommend that funds develop more detailed processes and capabilities for modelling what retirement outcomes will look like. It would have been wonderful if a review addressed the elephant in the room, the appropriate trade-off between return and risk, including different types of risk.

David Bell is Chief Investment Officer at AUSCOAL Super. He is working towards a PhD at University of New South Wales. The views contained in this article are those of the author and not AUSCOAL Super.

What will super look like in 40 years?

Graham Hand

This article paraphrases presentations at the Thought Leadership Breakfast, SMSF Association (formerly SPAA) Conference, 18 February 2015 by:

- David Murray, Chairman of the Financial System Inquiry
- Don Russell, Senior Public Servant and one of the architects of compulsory superannuation.

The subject of the breakfast was: "The future of Australia's Retirement Income System: What we want the system to look like in 40 years."

(Presentations by Warwick McKibbin, Andrea Slattery and Sir Anthony Mason will appear in subsequent editions of Cuffelinks).

David Murray

The FSI was specifically asked to consider the financial system in the context of its users and how the system could serve the economy better. The focus was on improving resilience, mainly through strongly capitalised banks; enhancing economic growth through more innovation; building confidence and trust especially in context of financial advice and education; making the regulatory system more accountable and efficient; and extracting more value from superannuation.

It is hard to do a good job on anything unless there are clear objectives, and the FSI saw three objectives of superannuation:

- To provide super for those not previously in the system especially low income workers, and it's certainly done that.
- To augment national savings, and it's not clear if this has occurred because we don't know what would have happened otherwise.
- To improve the government budget position by reducing reliance on the age pension, but this has not happened.

We did not want the financial system to be politicised, but if you have a mandatory system which produces inequities, then it remains politicised.

We also focussed on the costs and they appear to be very high. The compounding effect of this trashes income in retirement. The system is not benefitting from any pooling of risk as might happen with a Defined Benefit system. With better information to superannuants on what income they might earn from their superannuation savings, and some requirement to offer income products, people on average earnings could increase their income in retirement by 25% to 40%.

Australia has a dependency on the rest of the world which can work for or against us. This means Australia has to demonstrate to the world a high quality of management of our system. Australia is a prolific borrower and it is a style of borrower that wants to repay its debt. But Australia has reached the point where we don't manage the budget responsibly, so the imperative with a downturn in the commodity cycle and slowing China is that we must have a more resilient financial system. And in superannuation, we must make the most of those savings.

How do we figure what the system will be like in 40 years' time? Don't try. Don Sanders, my predecessor at CBA, had been Deputy Governor at the Reserve Bank and he told me once, "Before the Campbell Inquiry, the Reserve Bank used to set the exchange rate, we could fix interest rates on deposits and lending, we had qualitative controls on lending, we could control the lot. And we couldn't forecast anything." Nothing has changed. What matters is that the investments made for superannuants meet their needs well and are the most productive outcomes we can achieve.

We can't change the demographics such as the ageing of the population, and we need to make sure the objectives are achieved and we make improvements. If we do not, then we have to ask if we would have been better off without it (the current superannuation system). Would people have saved just as much anyway, invested wisely themselves? I hope we don't get to that point. We must keep the system depoliticised and as simple as we can.

The only priority of the superannuation system should be to provide income in retirement. There are very generous tax concessions in the system and very generous voluntary contribution arrangements, and there is no cap, which drives the inequities. It's not a sustainable system. These are matters for the Tax White Paper.

Don Russell

(Don Russell worked with Paul Keating when compulsory super was introduced in 1992).

It's fair to say a lot of damage has been done to the superannuation industry in the last decade. There is a notion that superannuation is a tax rort for the well-off, and that the industry itself is run largely for the benefit of providers has become almost the conventional wisdom. It has got worse with the focus on budget priorities. Why has it come to this, having started with high hopes and a large amount of public support? Treasury has always disliked tax preferences in superannuation, but the notion that the tax advantages bought the compulsion has been lost. We are asking people to lock their money away, that's why there was an incentive.

People have realised that by locking money away for 35 years, it will run the gauntlet of a minimum of five Treasurers and perhaps 10 Superannuation Ministers and all the bright ideas of hundreds of public administrators for the rest of their lives. With no particular guarantee of whether it will come back to them, people have to believe it's a good deal for a compulsory system to operate. If they don't, someone along the way will say, let's just make the SG voluntary. Most people won't save unless it's a very good deal to lock it up for that time.

It's what makes the Australian system so remarkable. Very few other countries have had the capacity to make people give up such a large part of their current income and get it back in many decades' time.

Why are we in the current predicament? A major reason is the industry has been unable to speak with one voice. The industry has used the political process to try to improve particular competitive positions. This has discredited the industry and strengthened the critics who want to change super. It has enabled the Treasury in particular to hone in on those aspects which are being emphasised within the industry itself, and to remove the tax preferences. The problem for the industry is that people are not listening any more.

Participation in workforce depends on age and the ageing of the population will change the way we view things. The debate about superannuation will change as the population changes. There will be a major collision between the income needs as people age and budget outcomes, and we're seeing it already.

Do we need to create a two-tier system? This notion of income support from the mid-60s may be replaced by support for a fixed time, perhaps private provision helps people from 60s to 80s and then the government picks up the cost after that. If we embrace superannuation filling this 20 years after people leave active employment, then we provide scope for two-tier pension. Or perhaps a lower tier from 65 to 85, and higher when superannuation has run out. We cannot cover longevity risk for most with any type of clever financial planning if people are still alive at 103.

There is scope to cover this first 20 years with significant savings to the budget. I'm sure as an industry we have focussed too much on accumulation, and we need to become active in the debate about ageing. For example, South Australia is dealing with having an older population than the rest of Australia, and is seeing an opportunity to develop a capacity to deal with this which will stand South Australia in good stead as an industry leader, as a creator of technology, where the big picture issues such as prevention and lifestyles are managed. There is a wide range of things people can do to change the costs and the dynamics of living longer.

The system was originally set up to encourage self provision of funding by the majority of people, it was not to channel more income to low income earners. You can only compel people to do things if it's a good deal, and it does need to have tax preference to help savings. It will always benefit high income people because they are the only ones who can save.

But the debate has become, why don't we use the tax preference to channel more income to low income earners? It is a universal system, we were trying to change the behaviour of the entire population to put aside income they probably would have consumed. The equity issue is tricky because aspects of the current arrangements are excessively generous, which go beyond what is necessary, and that's what we should focus on.

Graham Hand attended the Conference as a guest of the SMSF Association.

ETF liquidity: will it be there when I need it?

Louis Crous

One of the benefits of Exchange Traded Funds (ETFs) for investors is their tradability. Unlike traditional funds, ETFs can be bought and sold at any time through the Australian Securities Exchange (ASX) just like an ordinary share.

But since ETFs trade like shares, investors may mistakenly attempt to evaluate their liquidity in the same way they might for shares. This gives rise to one of the most common misunderstandings about ETFs, namely, that an ETF's 'on-screen' volume equates to ETF liquidity.

This misperception reflects the fact that, by comparing them to shares, many investors assume that ETF liquidity is driven by the same factors, namely:

- the ETF's size (funds under management)
- average daily volume traded
- the volume of units quoted 'on screen' at any given time.

For ETFs, however, these measures often vastly understate their effective liquidity. The best measure of an ETF's liquidity is the liquidity of the underlying portfolio of securities (such as company shares) it holds.

ETF open-ended structure facilitates liquidity

The open-ended structure of ETFs effectively means their supply on offer can adjust to demand through the trading day.

In the case of shares, for example, the number of outstanding shares available for trading on any given day is fixed by the level of supply, irrespective of the level of investor demand. As a result, the ability of the market to accommodate swings in demand without affecting prices too much is quite rightly related to the average daily trading volume of these shares.

ETFs, on the other hand, are open-ended funds, meaning supply can adjust to swings in demand *throughout* the trading day. How so? Each ETF trading on the ASX has one or more dedicated market makers. Uniquely to ETFs, these market makers have an ability to add to or withdraw from the supply of ETF units by trading directly with the ETF issuer (such as with BetaShares).

Indeed, unlike the typical company that lists its shares on the market (including listed investment companies, or LICs), ETF issuers stand ready to buy back or sell ETF units to ETF market makers at the net asset value or NAV of the underlying portfolio of securities the ETF holds. Should investor ETF demand exceed what is currently available 'on screen', the market makers can simply create more units (issued by the ETF issuer) to meet the demand. Similarly they can also redeem their units should supply exceed demand. The ETF units issued or redeemed are exchanged for the underlying holdings that comprise the ETF and therefore the liquidity of these underlying holdings is the key determinant of the real liquidity. The volume displayed for sale or purchase at any given moment is only a glimpse of what is available.

Why prices stay close to the NAV

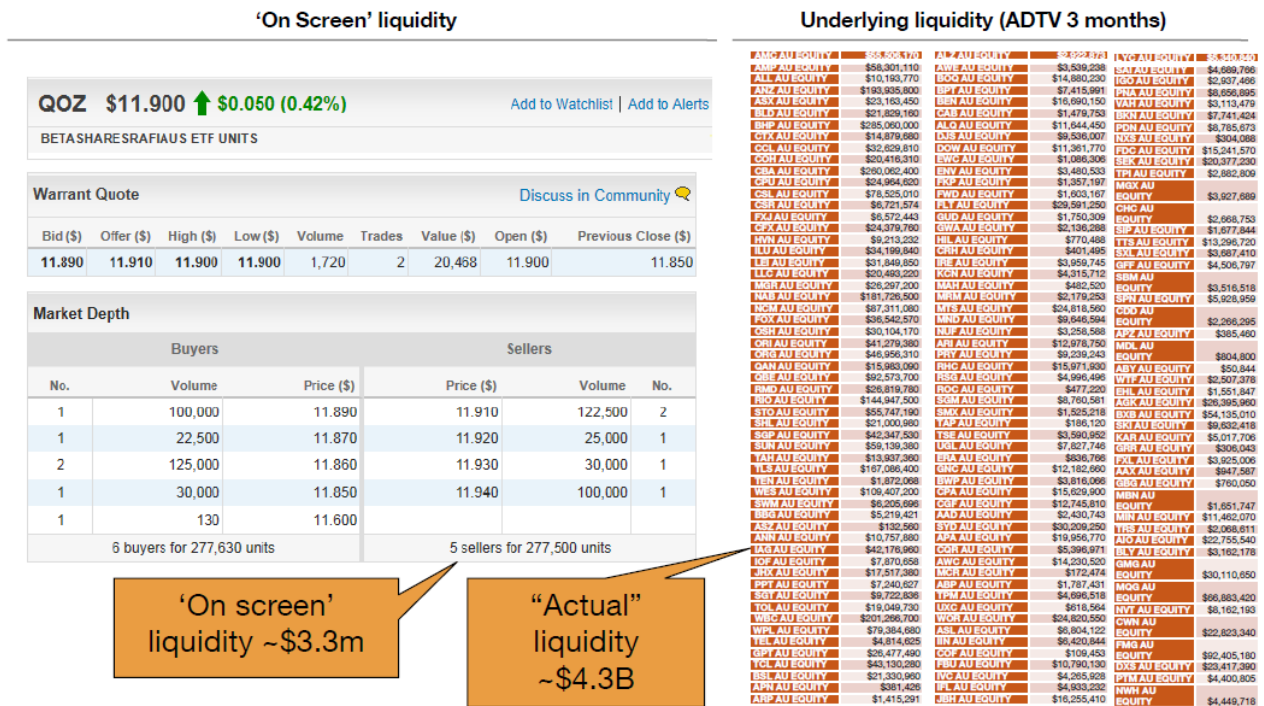
What's more, due to competition between ETF market makers – and their potential to make 'arbitrage profits' in trading ETFs - the best bid and offer prices quoted for an ETF will typically be close to its NAV.

To see why, consider what would happen if an ETF's current offer price (i.e. the price at which you could buy it on the exchange) was well above the NAV of its underlying portfolio of securities. In this case, an ETF market maker could buy up parcels of the underlying securities and exchange them for ETF units with the ETF provider, and the ETF units could then be sold on market at a profit. This process would continue until the ETF's prices were bid down (and the price of the underlying securities bid up) until this arbitrage profit opportunity was eliminated.

Similarly, if the ETF's offer price was well below the NAV of its underlying securities, the ETF market maker could then buy ETF units on the market and exchange them with the ETF provider for parcels of the underlying securities, which could then be sold on market at a profit. Again this process would continue until the price of the ETF was better aligned with the NAV of the underlying securities.

ETFs are as liquid as their underlying holdings

Given the way ETFs work, their 'true' daily liquidity is best reflected by the average daily volume of their underlying holdings. As seen in the example below - using the BetaShares FTSE RAFI Australia 200 ETF - while there was only around \$3.3 million worth of the ETFs available for sale or purchase at the time of this snapshot, the 'true' daily liquidity of its underlying constituents was actually around \$4.3 billion.



At present, most ETFs available in Australia have underlying portfolios that are highly liquid, which contributes to robust liquidity levels and generally ensures that the price of the ETF closely reflects the value of the underlying portfolio.

With this depth of underlying liquidity, it's also possible for trading in an ETF to spike on a particular day with virtually no impact on spreads.

As seen in the example below, trading in the BetaShares U.S. Dollar ETF on a particular day in December 2014 spiked to 2.5 million units (\$31 million) which was 12.5 times the average daily volume traded over the prior 90 days. The bulk of this trading (\$26 million) occurred in just nine minutes between 11.35am and 11.44am without impacting the overall spread of the ETF. Here is an actual example of how the market maker was able to tap the liquid foreign currency market to source US dollars and then provide them to the ETF provider in exchange for newly created ETF units.

Time of trading	Action	Price	Volume
17/12/2014 11:00:07 AM	TRADE	11.96	10,000
17/12/2014 11:00:07 AM	TRADE	11.97	6,277
17/12/2014 11:00:07 AM	TRADE	11.97	5,000
17/12/2014 11:00:07 AM	TRADE	11.97	28,723
17/12/2014 11:13:52 AM	TRADE	11.97	645
17/12/2014 11:17:05 AM	TRADE	11.97	1,250
17/12/2014 11:21:55 AM	TRADE	11.97	12,532
17/12/2014 11:22:56 AM	TRADE	11.97	2,000
17/12/2014 11:22:56 AM	TRADE	11.97	8,445
17/12/2014 11:23:14 AM	TRADE	11.97	5,000
17/12/2014 11:29:01 AM	TRADE	11.97	5,500
17/12/2014 11:35:55 AM	TRADE	11.97	150,000
17/12/2014 11:36:11 AM	TRADE	11.97	3,340
17/12/2014 11:36:29 AM	TRADE	11.97	146,660
17/12/2014 11:36:31 AM	TRADE	11.97	3,340
17/12/2014 11:37:09 AM	TRADE	11.96	150,000
17/12/2014 11:37:36 AM	TRADE	11.97	150,000
17/12/2014 11:38:14 AM	TRADE	11.97	150,000
17/12/2014 11:38:40 AM	TRADE	11.96	150,000
17/12/2014 11:39:04 AM	TRADE	11.97	150,000
17/12/2014 11:39:25 AM	TRADE	11.97	150,000
17/12/2014 11:39:47 AM	TRADE	11.96	150,000
17/12/2014 11:40:28 AM	TRADE	11.97	150,000
17/12/2014 11:40:31 AM	TRADE	11.97	523
17/12/2014 11:40:55 AM	TRADE	11.97	150,000
17/12/2014 11:41:27 AM	TRADE	11.96	150,000
17/12/2014 11:41:45 AM	TRADE	11.97	120,000
17/12/2014 11:42:57 AM	TRADE	11.97	120,000
17/12/2014 11:43:43 AM	TRADE	11.96	130,000
17/12/2014 11:52:21 AM	TRADE	11.97	668
17/12/2014 11:54:57 AM	TRADE	11.97	1,500
17/12/2014 11:58:05 AM	TRADE	11.97	1,670
17/12/2014 12:31:03 PM	TRADE	11.96	13,100
17/12/2014 12:31:04 PM	TRADE	11.96	21,900
17/12/2014 12:31:04 PM	TRADE	11.96	1,000

Source: Bloomberg

Tips on trading ETFs

Despite their unique advantages, some care is still required in trading ETFs, especially if the intended volumes are relatively large. As seen in the example above, limited quantities of an ETF might be shown for sale or purchase at the best bid and offer prices at any particular moment. As with any normal quote screen, other traders or investors may also have stock available for sale or purchase at less favourable prices.

As a result, as with trading company shares, investors should refrain from simply placing large 'at market' orders, as there is the risk of having one's order cascade down and being filled at less than the best prices possible. In these cases, it's better to stagger trades by placing smaller market or limit orders that do not exceed the volumes currently available at the best prices on offer.

Unlike trading in company shares, however, once an ETF trade is completed, the market makers will typically quickly replenish the volumes available at these same best prices, unless the ETF's NAV has suddenly changed.

And if in doubt about an ETF's underlying NAV, most ETF providers have real-time estimations (indicative net asset values or 'iNAVs') available through the trading day on their websites or via an ASX iNAV ticker.

Louis Crous is Senior Portfolio Manager, BetaShares, a leading manager of exchange traded funds. This article is for general information purposes and does not constitute personal financial advice.

Searching for yield to pay the bills

Hugh Dive

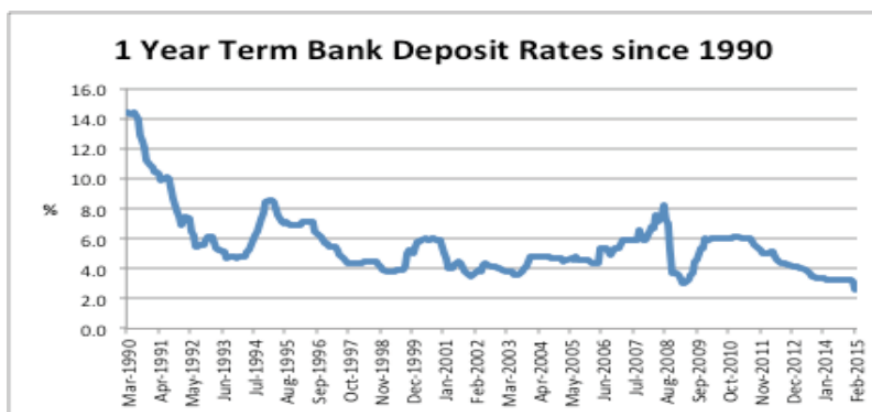
The RBA cut the target cash rate to 2.25% in an effort to boost consumer and business confidence and arrest growth in the unemployment rate. Whilst this move was positive for equity investors and saw the ASX hit multi year highs, it was a negative for savers, especially retirees living off the income generated by their term deposits. ANZ cut its one year TD rate to 2.6% and with the inflation rate for 2014 running at 2.5%, savers are receiving close to a zero percent real return (after inflation) on their term deposits.

The result of this rate cut will be that investors who rely on the income produced by their portfolio will be forced to move up into riskier investments just to maintain their standard of living.

Millionaires eating baked beans on toast!

Earlier this week I met with a well-respected fund manager who raised an interesting point. He said that historically a retiree would feel secure in funding their retirement if they had, through a lifetime of careful saving and judicious investing, amassed \$1 million dollars in their superannuation account. Indeed in 2008 this investor would have received a risk free income of over \$80,000 from investing their portfolio in term deposits, enough to cover a comfortable existence without risking their nest egg.

Currently that same strategy would deliver just \$26,000 for the retiree with \$1 million dollars, effectively the 'poverty line' in 2014 of \$25,896 calculated by the *Melbourne Institute* for a couple with no dependants that own their own home. I found this observation interesting as in the funds management world, the vast majority of our focus is on growing the capital, rather than thinking about the ongoing income that this capital is often required to deliver.



Source: RBA

The Australian banks have been significant beneficiaries of falling term deposit rates, not only through the declining cost of capital, but also due to the increase in retail appetite for bank hybrids. This retail interest has allowed the banks to build their capital bases in the lead up to Basel III, without issuing equity that would dilute earnings (and compromise bank CEO's earnings per share growth targets). In the last three years Australian banks have raised \$20.4 billion in hybrids and subordinated debt from mostly retail investors at attractive margins for the banks. These issues have been sold to yield-hungry investors primarily based on the headline rate and the name recognition of the big bank issuing them, often with little regard to the actual terms and conditions of the issue.

For example in January, ANZ's Capital Notes 3 raised over \$750 million at a margin of +3.6% or a current coupon rate of 5.85%. Not only was this margin too low given the ten-year term of the issue, but also in a 'worst case scenario' investors are no better off than ordinary shareholders, despite owning these 'preference shares'. ANZPF holders will receive a pre-tax distribution of 5.85%, whereas ANZ common stock holders are looking at a grossed up dividend of 8.3% (which can grow) for facing similar risks.

A more extreme variation on this theme of investors not getting compensated for the risks they are taking is the continuing success of finance companies raising money from investors. Companies like Fincorp and Westpoint offered investors interest rates of 9.25% and 12% respectively, which sounded very attractive and almost double the prevailing interest rate. Unfortunately these funds were used to make mezzanine finance loans to property developers, so investors really should have been demanding double this interest rate!

Look behind the yield on high-yielding equities

Over the last few years among the most common questions that I have received from investors are around the theme of 'juicing up' distributions by picking higher yielding stocks. Typically this comes in the form of a list of the highest yielding ASX200 that the investor has obtained from a website and questions as to why these stocks are not in the portfolio.

Top 10 ASX 200 Companies by Dividend Yield				
Company Name	Market Cap \$M	Industry	Payout Ratio	Dividend Yield
ARRIUM	616	Steel	50.0%	10.6%
METCASH LTD	1,318	Consumer Staples	57.0%	8.4%
BRADKEN	422	Mining Services	65.0%	7.7%
WORLEYPARSONS	2,518	Professional Services	76.0%	7.4%
MONADELPHOUS	750	Mining Services	82.0%	7.1%
CROMWELL PROPERTY	2,000	Listed Property Trust	66.0%	6.8%
DUET GROUP	3,439	Utilities	112.0%	6.7%
SCA PROPERTY	1,388	Listed Property Trust	91.0%	6.3%
CABCHARGE	577	Commercial Services	46.0%	6.2%
DOWNER EDI LTD	1,798	Engineering Services	52.0%	6.0%

Source: Bloomberg, Philo Capital

Basic high yield strategies tend to underperform and have done so on the ASX over the past 20 years. We see that this is due to the characteristics of companies that tend to pay high dividends:

- a) mature companies in decline
- b) companies in industries with low growth
- c) companies where there is material risk that the dividend will be maintained.

Looking at the above table of the large listed companies ranked by dividend yield, a number of them have all three dividend risk characteristics. Arrium's steel and Metcash's supermarket businesses could be characterised as being in decline and the market has concerns about both companies' ability to pay dividends in the future. Duet's energy utility business is low growth and faces upcoming regulatory risk, which could impact distributions especially in light of the very high payout ratio (Duet pays out more in distributions than it currently receives in profit). The future of Cabcharge's payments business is opaque with their monopoly on taxicab payments processing being undermined by technological developments such as Uber.

Whilst investors may be able to temporarily generate a high yield from owning a basket of these stocks, there is not a great chance that these companies can maintain their dividends, let alone grow them ahead of inflation.

Hugh Dive is Head of Listed Securities at Philo Capital Advisers. This article is for general investment education purposes. It does not take into account individual objectives, financial situation or needs.

The simple 'hot-desk' equation

Donald Hellyer

Hot-desking is a classic economic phenomenon. For all the hype and discussion it comes down to a very simple equation. A company can reduce its rental expense, but to do this it needs to get its employees to take a pay cut. The pay cut is not in money but rather a reduction in the quality of an employee's working environment. Economists call this an 'externality'. My research could discover no facts on the benefits of hot-desking other than rental cost savings.

Hot-desking is sold as a way to break down work cultural barriers, increase collaboration while creating the 'Office of the Future – Today'. It is a cost saving exercise. Because a very senior executive endorsed the idea, employees are labelled as not having the right cultural values if they show even a hint of disapproval. A totalitarian propaganda machine is in full swing by the time the last photo of the family is removed from the old decommissioned 'cold' desk. [Centre worker, Cori Girondoudas](#) was docked \$3,000 from her pay each year for two years because she repeatedly refused to remove a photograph from her work station. The photograph took her tally of personal items on the desk to four — one above the prescribed limit.

Hot-desking saves material office space and the company can reduce its rental overhead costs. Many companies have reported a reduction in rental costs of up to 30% from adopting hot-desking. These enticing savings have to sell it to the employees who suffer an increase in stress and insecurity. Few employees enjoy hot-desking and those who do are often the same people you regret having near you in a cinema, sports game, bus, plane, or marrying into the family.

Hot-desking conveniently ignores the human condition. Humans are territorial, we enjoy a sense of belonging and like a routine. We are also hierarchical. We work hard to get more pay but we also want the corner office. If some spotty graduate comes in early after his gym class and gets the corner desk, we older guys feel pissed off. We will have to seek revenge, in a team building way of course.

Some of you are thinking that I am just an old guy and I need to get with the times. It is true that I sleep better in the same bed each night and the same goes for my desk. It is hard to get 30 minutes sleep if you wake up in a different part of the office having no idea where you are.

But in [Ross Gittins's article on hot-desking](#), he quotes research that demonstrates that the most important contribution to work place productivity is not collaboration, but individual focus work. In fact, those who can focus on their work in a nesting environment are also better at collaborating.

One of the fundamentals of business is to drive down costs. Businesses are psychopaths and if they can transfer a cost (externality) to the staff then they will. Businesses also suffer from Aspergers. They don't really understand the human condition, nor do they read body language.

I am now implementing hot-desking in my home office to improve collaboration, break old work habits and enhance productivity. My favourite hot desk is the queen sized one on the top floor. I go there for an hour after lunch to do my best thinking.

Some comments from Donald's blog:

Geoff

Unfortunately no one is measuring the cost of the reduction in productivity that's achieved via 'discretionary effort'. Discretionary effort is that extra bang for the buck that an organisation gets from an employee because they feel good about their job and where they work, importantly employers don't have to pay money for this, they just have to demonstrate they value their staff. I have spoken with friends, colleagues and customers on this subject and the common factor is that employers are great at measuring the cost savings from hot-desking but don't attempt to measure at all the loss of discretionary productivity that goes along with it. I wonder if there is a higher turnover rate of staff where hot-desking has been deployed?

Jayne

I would like to add that during flu and cold epidemics, the wonderful world of hot-desking is also introducing us to plagues that seem to move inexorably around the office. If we were truly interested in efficiency we would return to single offices which allow focus, concentration and peace and quiet a la

"Quiet: the power of introverts in a world that can't stop talking". Awesome read if you want to change your thinking on the value of noisy collaboration.

Christine

I'm a working mum who does school drop-offs in the mornings. By the time I get to the office it's impossible to get a desk; not even a spot along the anti-social benches against the windows. When I do find a spot, often practically in the toilet, I spend good third of my day pacing up and down the corridor locating my team for face-to-face discussions. Cost cutting? For sure. Murderer of productivity? I'll say.

Donald Hellyer is the former Global Head of Funds and Insurance at National Australia Bank and is Co-Founder of BigFuture.

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