There is now no incentive for the Australian to participate in
exploration and foreign companies are being encouraged to stay out.

Furthermore Australian mining companies seem to have been singled
out for discriminatory action whether large or small, foreign owned or
Australian.

As one result there is little real dialogue between industry and the
Federal government.

No one is advocating a return to the "good old days" but surely both
sides should be getting together and freely exchanging views in a
co-operative spirit. In this way the government may eventually be
persuaded that some of its policies need modification and will make changes
that will benefit the industry and the country.

THE PRICES JUSTIFICATION TRIBUNAL:
WHAT'S IN STORE FOR INVESTORS?
By N.E. Renton, Melbourne

(This address was given by Mr. Renton, the
Federal President of the Society, on 17 May,
73 to a meeting of the Victorian Branch of
the Australian Shareholders' Association.)

Last week the Federal Government introduced a Bill to
establish its promised Prices Justification Tribunal. Investors
are now wondering how they will be affected by this new legis­
lation.

We are all consumers, and as such we are keen to see
goods and services as cheap as possible. But domestic prices
which are set too low as a result of official measures can
rebound on consumers. Such prices may lead manufacturers to
cease production of certain goods if a profit cannot be made.

In the long run, prices which are unrealistically low
will result in the cessation of further capital investment.

These factors will eventually lead to shortages of
goods locally, and to imports at higher prices than would
have applied in the absence of official pressures. In
addition, employment opportunities within Australia will be
reduced.

Naturally, these adverse features - all of which have
multiplier effects - take some time to become obvious. The
time span between a decision not to expand plant capacity and
the development of shortages may be a matter of some years.

In addition, the expectation that a Prices Justification
Tribunal is about to be appointed can in itself be a factor causing price rises, as companies may be tempted to take steps to protect their profit base in anticipation of a "freeze" or in the expectation that future profits will be related to past profits.

It appears that the machinery for investigating prices and the criteria for justifying them will be left to the Tribunal, and it may thus be instructive to look at the only Australian case so far held in this area - Mr. Justice Moore's inquiry into proposed steel price increases last January.

The Broken Hill Proprietary Company Limited submitted that price rises could be justified by "the low level of profitability in relation to funds employed in the steel industry" and "the need for adequate profit margins on steel products to make possible further investment in this industry". The company stated that "it is evident that the return from the steel industry section would be less than 2% on funds employed", but did not set out what size return it thought appropriate.

B.H.P. had 182,733 shareholders as at 31st May, 1972. (This may be compared with the number of employees, which was only 54,920.) These shareholders were the suppliers of the risk capital and without their money Australia would not have had a steel industry, with all its benefits to employees, consumers and the nation as a whole. It follows that these shareholders are entitled to a reasonable rate of return on their investment.

The assessment of what actually is a "reasonable rate of return" is complex. Two suggested guidelines are the rate of return on gross assets employed and the rate of return on shareholders' funds representing net assets. The more appropriate method would appear to be the return on net assets, but if this principle is accepted it is necessary to stipulate a desired rate of return and to calculate a correct value for the assets involved.

The Reserve Bank of Australia, in its Statistical Bulletin Company Supplement of December, 1972, shows that the average rate of profit after tax on shareholders' funds of listed companies is of the order of 8 1/2 per cent. This corresponds to a before-tax rate of about 16 per cent.

This is an average rate for companies as a whole, and clearly a higher rate would apply in the case of companies of above-average efficiency. If a company is in this category, it would seem that a before-tax return of about 20 per cent per annum on shareholders' funds would not be inappropriate.

Assets are frequently shown in companies' balance sheets at directors' valuation, or at cost, less depreciation. However, for the purpose of a prices justification exercise, it would appear preferable to make an estimate of the current replacement value of the assets concerned when arriving at true shareholders' funds. Reasons for this include the following:

- Distortions would arise in allocation of the nation's resources if assets were to be valued at anything but a current day basis.
companies should cease to put any further money into acquiring similar assets, and that they should sell their existing assets. (If the value of income-producing assets is fixed at a figure below their replacement value they would obviously prove an attractive purchase to any organisation wishing to enter the industry.)

- Companies should not be put in a worse position just because they are well established than they would be if they were starting afresh.

- Any other basis of valuation would not ensure that shareholders were protected against the ravages of inflation. The shareholders are just as entitled to this protection as the employees, who have the benefit of periodical wage reviews.

Having established the value of the assets employed in any particular operation, suitable prices for the goods concerned can then be arrived at mathematically using discounted cash flow techniques. The assets concerned must produce the desired return after allowing for the expenses of the operations and for an appropriate share of administrative expenses.

The above brief description of suggested principles of necessity understates the complexity of the problem in any actual case. In particular, the question of whether a particular company is efficient is obviously always going to be a difficult one. But to disregard equitable criteria because of problems of implementation does not seem reasonable either.

In the B.H.P. case, both the company and the judge had regard to cost increases, and it would appear that this factor, rather than the "adequate return on funds" concept, influenced the award of an average 3% steel price increase. Yet such an approach seems highly dangerous.

If it is to be adopted by the new Tribunal, there will be no incentive to companies to reduce their costs. In fact, they may even be encouraged to grant every wage increase sought by their employees, knowing that this will make life easier for them without cutting into their profits. But the rest of the community will suffer from increased inflationary pressures.

Such an approach was, of course, particularly inappropriate in the case of B.H.P., which has always, as a matter of declared policy, shown considerable restraint in its steel pricing. Thus, merely to perpetuate an inadequate return on funds seems hardly equitable. There is no reason why shareholders generally, or of one company in particular, should be singled out to subsidise the community as a whole. As mentioned previously, B.H.P. has over 182,000 shareholders, all of whom are dependent to some extent on the dividends they receive on their investment. The latest B.H.P. Annual Report shows that 139,000 of these shareholders hold 20 million shares between them; this represents an average holding of less than
150 shares each. Furthermore, many shares are owned by institutions on behalf of large numbers of individuals, some of whom would undoubtedly be in low-income groups.

Mr. Justice Moore's report contains the following very significant sentence: "In my view if there is any doubt the interests of the public would have to prevail over the interests of B.H.P. and its shareholders." For the reasons set out above, it is to be hoped that such a view will not be regarded as a precedent by the Tribunal. With the greatest respect to the learned judge, his finding here is as illogical as one requiring taxpayers called "Smith" to pay twice the normal rate of tax because this would be in the interests of other members of the public.

In conclusion, let us consider the question of the procedure to be adopted before the new Tribunal. Who will have the right to put arguments? Will there be a right of cross-examination? And, most important of all, where will the onus of proof lie?

It is to be hoped that early applications to the Tribunal can be developed as test cases, so that the community will learn where it stands.

Quite clearly, parties effected in any application could include customers, employees, shareholders, as well as the companies concerned and the Federal Government. Possibly other parties, such as suppliers (who would be affected if manufacture ceases) might also be involved.

Mr. Justice Moore received 29 submissions. Their composition is of some interest:

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<td>B.H.P.</td>
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<tr>
<td>Individuals: Shareholders</td>
<td>4</td>
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<td>Mr. Albert Shepherd</td>
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<td>Other (including 5 academics)</td>
<td>10</td>
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<td>Customers</td>
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<td>Organisations:</td>
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<td>Association</td>
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<td>Consumer bodies (including</td>
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<td>Total</td>
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Investors will no doubt be left in the dark until actual practice reveals the general principles to be adopted by the new body.

However, one thing does appear obvious. Any sort of price squeeze may merely serve to encourage companies to find non-traditional ways of using their cash flows - whether retained profits, released depreciation provisions or fresh capital raisings. If this happens, earnings per share may well turn out to be higher than would have been the case if the legislation had not been introduced!