What is the fundamental cause of the "credit crisis"?

I feel that the ANSWER IS SIMPLE and hinges around some essential differences between SMALL BUSINESS and BIG BUSINESS, throughout the world…

There are a number of fundamental reasons why business collapses are taking place around the world at the moment, which involve imbalances within business structures. Within the organizations, inequities in leadership and remuneration structures have existed for a long time and in this short paper, some fundamental imbalances that have led to the credit crisis are shown.

These notes were originally written in May 2008 (before the main crisis occured) and are essentially unchanged, although relevant updates have been added.

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What are the essential differences between "BIG BUSINESS" and "SMALL BUSINESS"?
A simple definition for the purpose of this discussion:

- BIG-BUSINESS = ALL STOCK EXCHANGE LISTED COMPANIES
- SMALL BUSINESS = NON STOCK EXCHANGE COMPANIES

- Small business owners are generally PERSONALLY FINANCIALLY INVESTED in their enterprise; if they are not, then somehow they get found out and quickly their business fails. This is part of the natural process of seasonal changes, blossoming, hibernation, and survival of the fittest.
- BIG business operates through large organizations, listed on stock exchanges with substantial control and influence by CEO and management teams. BIG organizations are generally run by people who are essentially PERSONALLY FINANCIALLY DIS-INVESTED from that organization; except that the CEO, and his management team are mostly on massive BONUS structures (this is the first problem)

How do SMALL and BIG companies get funding?
(Enter the banks!)
There is a subtle but important difference between them:

- When a SMALL company needs funding, the primary source is hard work to ensure profits are made to ensure organic growth; the small business owner could also go to his local banker who always requires collateral backing, in the form of the business owners FIXED ASSETS, usually his/her HOME. Bankers are not interested in (and generally don't understand) business plans; they only understand PROPERTY as a collateral asset. So if SMALL BUSINESS OWNERS need money, then they have to bet their own house on their own ideas… this is GOOD, and is a useful NATURAL REGULATOR!
- When a BIG company wants further funding, the CEO and management team motivates to the shareholders, banks, etc. by drawing up fancy business plans to get funding. CEOs and company managers are not allowed to invest too much of their own cash because (the presently held view is that) this constitutes insider trading... Bankers often DO NOT UNDERSTAND THESE BUSINESS PLANS, but out of SENTIMENT FOR THE COMPANY LOGO ON WHICH THE PLAN IS DRAWN the Bankers are more easily convinced by BIG-business plans to release funding… this is the massive PROBLEM we are all now facing, as there is NO NATURAL REGULATOR in the system

What's at stake for SMALL company owners and BIG Company CEOs & team? (Enter the home!)

- It is standard practice that small business owners MUST BE prepared to LOSE THEIR HOME if their business is not successful, and bankers have little hesitation in recovering their losses by liquidating the small business owners HOME. This is OK, and is pretty close to the way things are ***NATURALLY REGULATED*** in the wild. It feels the natural and normal way of living to me (I'm from Africa... it gets us closer to Mother Earth!) Farmers and other professions who are close to the earth know this is nature's way of dealing with failure; i.e. the shriveling and falling by the wayside, being eaten, or dying. Often, nature offers another chance to the fallen, who could learn from his/her previous mistake, to blossom again in future.
- On the other hand, with BIG BUSINESS: At the beginning of their contract, the CEO and management team creates and plans (for themselves) a NICE BIG salary with NICE BIG bonus structures, which either pay out handsomely, or it doesn't pay out. IT GENERALLY DOES NOT REQUIRE PENALTY ***PAY-BACK*** FOR PERFORMANCE FAILURES. HEREIN LIES THE REAL PROBLEM. There are ***NO NEGATIVE BUSINESS CONSEQUENCES*** that the CEO and management team will lose nothing more than their job. They are not required to BET THEIR HOME on them EARNING their big bonus. There is no balance in them either EARNING the big bonus, and LOSING their home; there is NO NATURAL REGULATOR built into the system. Herein lies the intrinsic ***INEQUALITY OF BUSINESS CONSEQUENCES***, in our present day financial system.

How should the inequality of business consequences be addressed?

- If a CEO or management team member wants to receive a sizeable bonus, then he/she should be ***PREPARED TO LOSE AN EQUAL AMOUNT***, if his company objectives are not met i.e. they should have to ***BET THEIR OWN PROPERTY*** on them earning their BIG bonus.
- BIG-business CEOs and management teams should be required to accept a bonus NO HIGHER THAN THEY ARE WILLING TO LOSE, and they MUST BE PREPARED TO LOSE their home(s)
- New legislation needs to be written to rectify this balance of business expectations. Everyone knows that there should be improvements in the way things are REGULATED… but the ***NATURAL REGULATION*** option (rather than some new government connived set of regulations) must be chosen
- With NATURAL REGULATION in place, bankers will never be required to evaluate a business plan again… they will be able to do a better job of lending money against KNOWN, IDENTIFIED AND QUANTIFIED assets. This will make banks slimmer and more efficient
- CEOs and management teams will automatically work more diligently for their company; they will become more focused on their job at hand to ensure that they don't lose their home, and through this process they will meet their company objectives in a more just way

In conclusion:

- Credit crisis cause is SIMPLE and identifiable and hinges around some essential differences between SMALL BUSINESS and BIG BUSINESS, throughout the world.
- Fixing the crisis could also be SIMPLE (not necessarily EASY), by legislating for ***NATURAL REGULATION*** around a ***SYMMETRICAL*** bonus reward structure for BIG BUSINESS
- No need to change SMALL BUSINESS structures, as it already has natural regulation in place
- There has been a transfer of wealth process ongoing for many decades (centuries?) from poor to the rich, much of it due to the deficient financial system described above
- Until these intrinsic business inequalities are addressed, our present day financial system WILL have further systematic failures in future
- Bonuses are not bad in themselves; rather they can be very motivational and they should only be used as incentives for clearly identifiable and achievable goals
- It is not the ***SIZE OF BONUS*** that is a problem in our system, but rather our bonus problem stems from the lack of ***SYMMETRY in the RISK / REWARD*** structure
- No bonus should be offered unless the recipient is prepared to LOSE an equivalent amount of his FIXED ASSETS which he must put up as collateral
- Bankers should not need to adjudicate business plans to make decision whether to lend money, they should stick to ensuring that they lend only on the basis of using "clearly identifiable fixed assets" as collateral; then their "promise to pay the bearer" could be met with more certainty

RECENT RELEVANT ISSUES

British Politician misdemeanors (added July 2009):

- In Britain recently, politicians have (wisely, although late) between themselves put a finger on their own indiscriminate spending.
- Sadly, Mr. Gordon Brown has referred to this form of ***"NATURAL REGULATION NOT WORKING"***; and so they will be getting a more appropriate regulatory framework in place.
- The politicians' original framework was in no way ***"NATURALLY REGULATED"***; but rather he should have called it ***"SELF REGULATION"***, which of course has been found wanting!
- Incorrect use of the term ***"NATURAL REGULATION"*** has been made by Mr. Brown, which has only served to cause further confusion and put people off "doing the right thing" (he likes using this phrase!)
- This author believes things are never "right" nor "wrong", or "good" nor "bad"… things simply ARE the way they ARE… but we should rather ask ourselves whether it is BENEFICIAL to ALL concerned, which requires us all to really look hard at the outcome of our decisions and actions

Bankers bonuses being curtailed (added December 2009):

- On many occasions lately when some top bankers bonuses are vigorously questioned, a remarkable response is observed from both the bonus recipient AND society
- Bonus grabbing banker's response is that they will leave town and go to where they will better command their required bonus!
- Even more remarkable is the response to this statement by all else throughout the western world; the standard naive response (even the financial media!!) is "ooohh.. we can't afford to loose our top bankers!!!"
- Amazing!!! I believe that everyone would be better off without them, because they contributed greatly to getting us into this mess in the first place.
- The bankers response is actually extortion, as they hold society to ransom over their bonuses
- These bonus grabbing bankers are actually thieves, and take an aggressive stance as they DEMAND their bonuses
- Please remember, this author believes that bonuses are GOOD, but only if the recipient is prepared to LOSE an equal amount of their own capital assets for bad performance