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The IBM dollar

by
Edward de Bono

CENTRE FOR THE STUDY OF FINANCIAL INNOVATION

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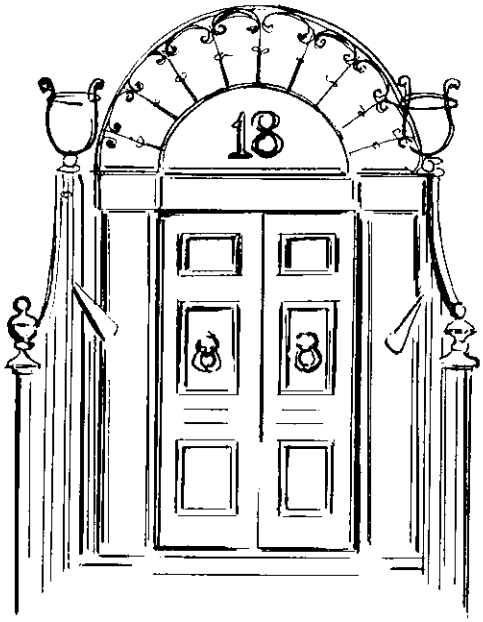

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Executive summary

The financial markets provide us with the means of investing in large companies and buying their products. They do not, however, enable us to invest in *future* production. Such an arrangement would bring advantages both to production companies and their customers, and it should be possible using the notion of "target currencies".

This paper proposes that large manufacturing corporations should create their own special currencies which would be exchangeable for, or "targeted" on, their products. IBM, for example, could sell "IBM dollars" which entitled the purchaser to buy a stated amount of computer equipment at a future date. The currency would be issued at a discount from its face value, the discount being determined by reference to interest rates, the perceived value of IBM products, and the level of market confidence in IBM's ability to remain competitive. At the redemption date the purchaser would exchange the currency, at face value, for equipment.

The advantage for IBM would be improved cash flow and greater sales predictability. For the purchaser, the scheme would provide a means of exploiting interest rate expectations to obtain equipment more cheaply. The risks for both sides would be minimised if a secondary market in IBM dollars were to develop, based on market makers.

The IBM dollar is only one example of the potential for target currencies. These could be developed around a wide range of services and goods such as housing, luxury goods, airline seats and supermarkets. They might also be issued by official agencies for circulation in selected geographical areas, such as development zones. The concept has macro-economic implications insofar as these currencies would enable government to stimulate selected sectors of the economy without fuelling all-round inflation.

Introduction

You are head of the computer department of a large corporation. You are about to buy IBM product. You can get a 20 per cent discount just by asking for it. Would you bother to ask? You would have to. You would be seriously failing in your duty if you did not ask for the discount. What if the discount was only one per cent? Would you have to ask for such a tiny discount? Of course you would. There is no logical reason which would ever justify your paying more than you have to - no matter how small the difference.

We are used to investing in *production capacity,* for example by buying stock in IBM. When we invest in the *product* itself, we call it trade. But there is an in-between position which the usual dichotomy habits of thinking make it somewhat difficult for us to perceive.

Investing in future product

Instead of investing in the company itself or in a finished product, we can come to invest in future product. There may already exist roundabout ways of achieving this aim. However, for convenience, it requires *a new investment instrument.* This new instrument could be of value to four classes of people:

- the corporation issuing the instrument;
- the future buyer of the product;
- the future buyer who changes his or her mind; and
- a potential investor who has no intention of buying the indicated product.

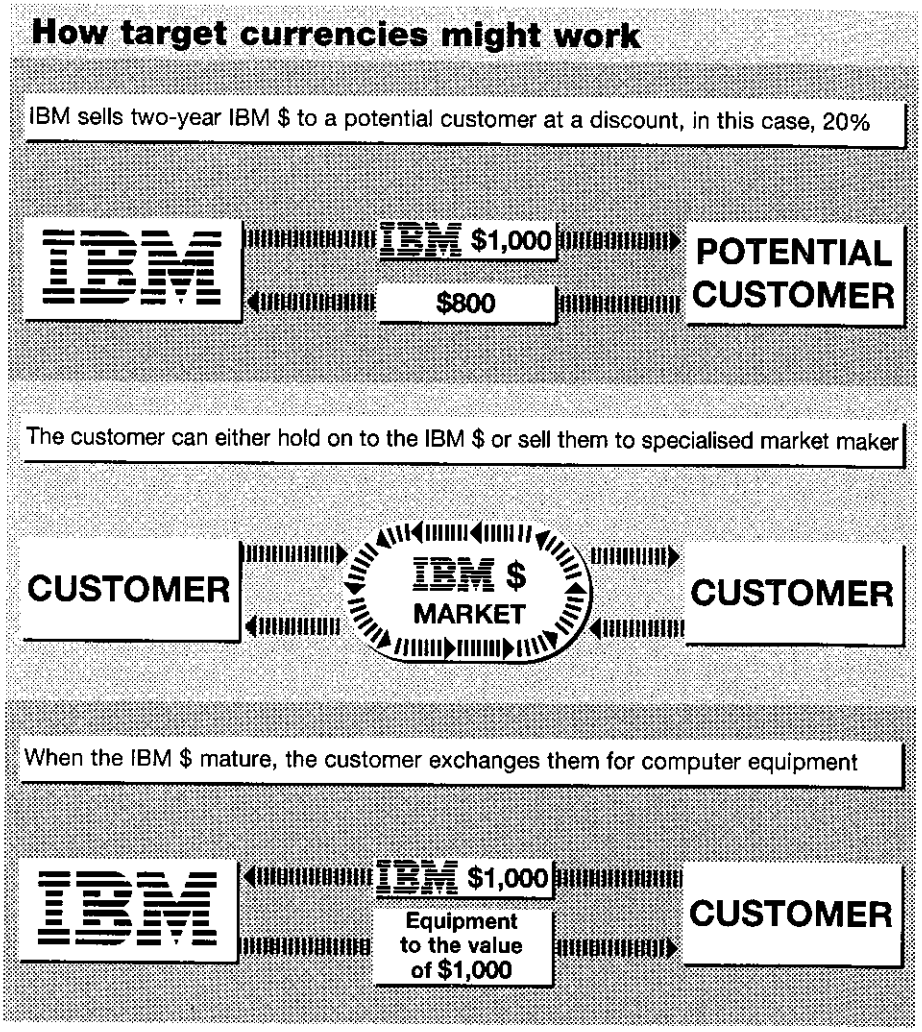
One way of achieving this is shown in the following example.

The concept is that *IBM would issue its own currency.* In practice this would take the form of warrants or vouchers, but not forward purchase contracts. For example an "IBM dollar" would be usable after March 1 1995 at its full face value of IBM $1 when used to purchase IBM product. Such an IBM dollar could be purchased today for, say, 80 cents. This deep discount would, of course, diminish as the full value date approached.

The opposite approach could also be used. The IBM dollar could bear the date of issue or purchase - and could then appreciate in value by, say, ten per cent or 15 per cent a year (perhaps up to a maximum) when used for the purchase of IBM product.

In essence, IBM would be issuing zero-coupon bonds or appreciating assets targeted directly and exclusively at IBM purchases.

Although we use IBM as an example here, such a currency could be issued by any major corporation which sells large volumes of popular



products, like cars, consumer goods, even airline seats. Indeed, "*target currencies*" have a potentially very much broader application, not only for industrial corporations but for economic management.

They could be issued by official bodies or governments, and targeted at particular areas of the economy, geographical or sectoral. They could be exchangeable for designated types of goods, or in chosen parts of the country such as development zones, enabling governments to stimulate the economy more selectively. We will examine these wider possibilities in a moment.

Who would benefit from IBM dollars? And what would be the risks?

Benefits

First, by choosing the discount rate on its currency, IBM would have a cheap and simple way of raising money which did not dilute the company's equity or impose a heavy debt burden.

Second, IBM would attract - and would even lock in - the future purchasers of its products. As computer products become more and more of a commodity, the non-product integrated values become more and more important.

Third, IBM would in effect be making forward sales to suit its own needs and plans.

Purchasers would save money...

Fourth, intending purchasers of IBM product would have a cheaper method of purchase. They might even decide that buying IBM dollars was the best way to invest their money. If they did not buy IBM dollars in advance, they could always buy them from investors just before an IBM purchase. In terms of its own financial planning, it might suit a corporation to buy IBM dollars - though this would depend on the legal and tax positioning of such instruments.

Fifth, investors would have a low-risk investment with a high rate of return and an almost guaranteed selling price (this could also be underwritten by a third party or by an IBM-guaranteed repurchase agreement).

Risks

What would happen if IBM went belly up and ceased to exist? Inevitably, the IBM dollar - unless underwritten by a third party - would become worthless.

...and take only limited risks

But if IBM ceased to exist, then IBM shares would also become worthless, and so would its debts (according to agreed schedules of ranking). When the IBM share price recently fell from a peak of $176 to a low of $46, the shareholders took that full loss. Such a fall in the share price would have no effect at all on the holder of IBM dollars, which would return the full expected appreciation.

It is also possible that if IBM did cease to exist, then IBM dollars would qualify for repayment ahead of other obligations because they are, in reality, a form of advance purchase. Trade creditors normally rank ahead of investors in a liquidation.

A second risk is that *IBM might push its prices up.* If intending IBM purchasers bought the currency at a discount of, say, 20 per cent and IBM then raised its prices relative to the rest of the industry by 20 per cent, they would be no better off - and perhaps worse off because they could have used their money better elsewhere. However this is not a very realistic scenario. Unless all IBM purchases were to be made with IBM currency, normal market pressures would prevent IBM from raising prices out of line with other suppliers.

An intending purchaser might feel that IBM would be unlikely to offer normal trading discounts if a purchase was to be made with IBM dollars.

In practice, the way to get round this problem would be for the purchaser not to declare the final form of payment until a deal had been agreed. In any case it could never be in IBM's longer term interest to discriminate against the users of IBM dollars.

A potential objection might be *the impact on IBM itself.*

Depending on the discount rate chosen, it could hurt IBM's profitability if too many IBM dollars were issued at too cheap a rate. So IBM would have to limit the issue of IBM dollars to some fraction of sales revenue. For example on yearly sales of $60bn, IBM might issue only $6bn in target currency.

The currency issuer benefits too

There might be a risk for third party investors (i.e. those who had no intention of ultimately buying IBM product) that no IBM purchasers would want to buy their IBM currency. However, as stated earlier, even if the discount rate were slight, any IBM purchaser would be logically obliged to take it. It would be up to market forces and third party investors to decide how much of the discount to pass along to real IBM customers.

Any intending IBM purchaser who then changed his or her mind and decided to buy from another supplier would be in exactly the same position as a third party investor: he or she could sell on the IBM currency that had been purchased.

Would the value of the IBM dollar be affected by product risk? Suppose IBM competitors produced models which were perceived to be better than IBM products. Would holders of the IBM currency see a fall in the market value of their currency?

If IBM models were so bad that IBM actually went out of business, then clearly the holders of IBM currency would be in a similar position as (though ranking ahead of) shareholders. But so long as IBM was selling product of whatever quality, then the IBM dollar would be just as valuable for purchasing that product - and purchasers would logically need to acquire the currency even if the discount was low. Suppose IBM dropped prices to attract back customers who had been tempted away by a rival's technically superior products, the IBM dollar would still have the same high value as before. It is only if IBM's total sales fell very sharply, and if too much IBM currency had been issued, that the value of the IBM dollar would actually fall in the market.

Finally, a guarantee by IBM or an independent underwriter to repurchase IBM currency at a set price would remove all remaining downside risks.

Usage

Would it be possible to choose a discount rate which made the IBM dollar attractive to IBM, to intending IBM purchasers and to third party investors?

The answer to this would depend on IBM's need for money, prevailing market conditions (interest rates etc.) and IBM's profit margins. IBM could always control the issue of its currency and also the amount outstanding in the market. IBM would also set the discount rate and could repurchase the currency if necessary.

The discounted price (or the discount rate) would have to match market conditions in terms of both the value for IBM in issuing the currency and the value to potential investors. Because IBM would be locking in future purchasers and because it might be able to raise its prices slightly in order to diminish the effective discount, it should be possible to offer buyers attractive rates. The tax treatment of the target currency would also affect the comparative advantages for investors.

It is easy to envision that broking houses would establish specialised markets in IBM dollars, and that the market price for IBM currency would fluctuate according to supply and demand on a daily basis.

Target currencies

The IBM dollar is only one example of possible target currencies. The scheme could be of value to any large organisation selling quasi-commodity products. Motor cars might fall into this bracket. Indeed the GM credit card, with its cumulative discount feature, is a step in this direction.

Applying the idea to cars, airlines, housing and luxuries

Companies like British Airways or Sainsburys could issue their own currencies, and could benefit from the float until these currencies were used. This could be done in a number of innovative ways. Where an identifiable and easily comparable item is sold, like a first class trans-Atlantic air passage, the currency could be valued against that product. For instance, a hundred units could purchase such a flight at any future date. This would provide a hedge against inflation.

On a much larger scale, it might even be possible to think about a *''housing currency''* which could be used to finance building projects.

Of equal interest is the possibility, albeit less clearly defined at present, of using target currencies in smaller communities to finance the start up of local businesses which would be selling into that community.

A kind of target currency already exists in the form of the US Food Stamp programme which caters very successfully for 26m Americans. There is now even a food stamps credit card.

The Central Provident Fund in Singapore is a further example. The Singapore government takes a percentage of wages, matched by employers, which is put into a fund which will be paid out to the employee at a certain date or upon retirement. Meanwhile the employee can borrow against this fund for certain specific purposes: housing, health, education

and the stock market. (The inclusion of the last item is one explanation for the boom in the Singapore stock market.)

Historically target currencies acquired a bad reputation when they were used to force employees to spend their wages back in the company store. *But that particular experience should not prejudice our willingness to explore the potential of this concept.* After all capital itself is only a time-shift phenomenon whereby predicted sales are used to finance the production of the product with profit as the reward for assessing the risk.

Consumers could trade between target currencies

Computers now make it possible to run a system with multiple target currencies. In such a system, an employee might be rich in "housing currency" but poor in "luxury currency". Wages might be split between different currencies - though the consumer would be able to trade between different types of currency, exercising his or her choice.

The consumer is already able to exercise choice in many ways. For instance, in spite of the recent GATT agreement on agriculture there is a looming trans-Atlantic trade battle because Europe is reluctant to admit US steroid-fed beef. The matter will probably be resolved by eventually allowing in the beef - but insisting that it be labelled as "steroid-fed beef". The consumer, aided by proper health information, may then prefer to avoid buying such beef. Unless governments insist on fooling the consumer, this kind of non-tariff barrier is bound to multiply.

The target currencies that people select would be merely another manifestation of consumer choice. The only difference is that the choice can be time-shifted backwards from the moment of purchase. For example, bulk negotiations may mean that workers are partly paid in a target currency which has a much higher value at Sainsbury's than normal currency. That is a free choice on the part of the consumer. It now becomes possible to distribute the benefits of competitive bulk buying in a personal manner.

The notion of multiple target currencies opens up a new way of thinking in economics. Volatility and fluctuation could be much reduced. It could become considerably easier to stimulate individual sectors of the economy without immediately running into inflation. The present obsession with free markets and deregulation sometimes obscures the inherent dangers in fungible "soup" systems where everything can flow in any direction. Multiple parallel systems, with permeable membranes between them, give very stable systems - as in the human body. This is a whole field which needs, and will get, attention.

Dr. Edward de Bono is widely acknowledged as the leading international authority in creative thinking. He is the inventor of "lateral thinking" and has written 45 books with translations into 27 languages. He is the founder of the International Creative Forum which has as members some of the leading corporations in the world (DuPont, Prudential, Nestlé, Merck, IBM, British Airways etc.). Recent books include: Serious Creativity (Harper 1992); Surpetition (Harper 1992); I am right, you are wrong (Viking 1991); Teach your child to think (Viking 1992); Water Logic (Viking 1993).

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