

Study on the Idea of Maximum Payout

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Abstract In this paper, the Idea of Minimum Cost (IMC) is discriminated and its disadvantages are discussed and concluded. Subsequently, this paper collects the financial annual reports of 1752 listed companies in China in 2009 and analyzes the relationships of among Sales Cost (SC), Total Assets (TA) and Sales Profit (SP), as well as the relationships among Net Asset per share (NAPS), Earning per share (EPS) and Return on Net Assets (RONA). And the Idea of Maximum Payout (IMP) is demonstrated according to the results of the above analysis, with the addition of some other literature materials. Then the concept of IMP is defined and its connotation is also introduced, based on which the concept and connotation of Payout Transferring (PT) are introduced. At the end of this paper, the significance and main application of IMP are described.

Key words Idea of minimum cost (IMC); Idea of maximum payout (IMP); Enterprise payout (EP); Payout transferring (PT);

1 Introduction

IMC is the powerful part of the cost-benefit idea of the enterprises. Concretely speaking, IMC emphasizes the cost's minimizing when the enterprise income stays at the same size, which is beneficial to getting more net income. This idea is widely accepted in theory and practice circle because it is helpful to achieve the enterprise targets "Cost Minimum" and "Profit Maximum". From finance and accounting perspective, IMC seems thoroughly right. That's why there are nearly any scholars and experts who have any different opinions to date.

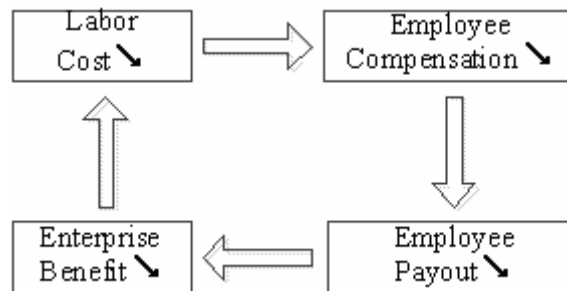


Figure 1 IMC's Vicious Circle

However, we found some disadvantages of IMC. And we believe that IMC may easily lead to a vicious circle, as is shown in Figure 1. From Figure 1 we know that the enterprise owners will try their best to reduce the labor cost according to IMC, which will lower the level of employee compensation. This compensation lowering, plus the IMC's influencing on enterprise employees, will of course make employees reduce their payout consciously or unconsciously. Generally speaking, the reducing of employees' payout is mainly reflected by the less seriousness and less diligence in their jobs and work, which may definitely bring down the enterprise performance and benefit. This result will make the enterprise owners further reduce the labor cost, which will form a vicious circle gradually. Besides the easily forming of this vicious circle, IMC also strengthens the attribute "Economic Man" of all stakeholders of the enterprises, as well as enhancing the material interest relationships of the inner and exterior enterprises, which will not facilitate the constructions of enterprises' and society's culture and atmosphere.

2 Demonstration and Induction of IMP

2.1 Demonstration of IMP

The following analysis will use several financial indexes of 1752 listed companies' financial annual reports of China in 2009, which is taken from the NetEase website (www.163.com) from January 1st to April 28th, 2010. And these financial indexes include the Earning per share (EPS), Net Assets per Share

(NAPS), Return on Net Assets (RONA), Sales Revenue (SR), Sales Profit (SP) and Total Assets (TA). However, for the lack of space, here Table 1 only displays 5 listed companies' financial indexes of their annual reports.

According to the formula “Sales Cost (SC) =Sales Revenue (SR) – Sales Profit (SP)”, we can calculate the SC of each listed company. Subsequently, with the help of SPSS 16.0, we can do the correlation analysis (CA) of SC and SP, and the correlation coefficient is 0.785, as is shown in Table 2. Likewise, we can get the correlation coefficients of TA-SP, NAPS-EPS and NAPS-RONA, and they are 0.680, 0.608 and 0.242 respectively, as is shown in Table 3, 4 and 5.

Table 1 Financial Indexes of China's Listed Companies in 2009^[1]

Company Name	EPS (Yuan)	NAPS (Yuan)	RONA (%)	SR (RMB in 10 Thousand)	SP (RMB in 10 Thousand)	TA (RMB in 10 Thousand)
Eastern Gold Jade Co., Ltd	0.03	1.06	3.25	111542	8964.87	150943.76
Shanghai Prosolar Real Estate Co., Ltd	0.05	1.51	2.36	8964.84	3359.39	72183.57
Beijing Huaye Real Estate Co., Ltd.	0.18	3.21	5.75	121004.15	23461.38	667597.77
Guangxi Wuzhou Zhongheng Group Co., Ltd	0.48	2.18	24.74	71239.59	33850.82	150455.46
Jiugang Iron & Steel Co., Ltd	0.16	4.83	3.05	3594844.16	334375.96	2608558.28

Table 2 SC and SP's CA

		SC	SP
SC	Pearson Correlation	1	.785**
	Sig. (2-tailed)		.000
	N	1750	1750
SP	Pearson Correlation	.785**	1
	Sig. (2-tailed)	.000	
	N	1750	1752

Table 3 TA and SP's CA

		TA	SP
TA	Pearson Correlation	1	.680**
	Sig. (2-tailed)		.000
	N	1751	1751
SP	Pearson Correlation	.680**	1
	Sig. (2-tailed)	.000	
	N	1751	1752

Note: **. Correlation is significant at the 0.01 level (2-tailed).

Table 4 SC and SP's CA

		NAPS	EPS
NAPS	Pearson Correlation	1	.608**
	Sig. (2-tailed)		.000
	N	1750	1748
EPS	Pearson Correlation	.608**	1
	Sig. (2-tailed)	.000	
	N	1748	1750

Table 5 TA and SP's CA

		NAPS	RONA
NA PS	Pearson Correlation	1	.242**
	Sig. (2-tailed)		.000
	N	1750	1723
RO NA	Pearson Correlation	.242**	1
	Sig. (2-tailed)	.000	
	N	1723	1724

Note: **. Correlation is significant at the 0.01 level (2-tailed).

From the above data we can know that, the enterprise profit, revenue and cost, assets have a positive correlativity. In other words, the EP will increase with the increase of the enterprise profit; meanwhile, when the payout direction and the environment are suitable, the enterprise profit will increase with the EP's increase. And the result will be also proved by the following literature data: (a) In accordance with Sun Qianlu, Yang Yufeng, Shen Yuling and Hu xin's papers^{[2]-[3]}, there is a positive relationship between the senior executive compensation and Enterprise performance, as well as between the senior executives' education background and their compensation; (b) according to Ma Guanghui's paper^[4], the learning achievement of foreign languages will become higher and higher if more and more effort is spared.

2.2 Induction of IMP

Through the above demonstration, we believe that there is a positive relationship between the Enterprise profit and payout. Here, Enterprise Payout (EP) refers to all the payout paid for obtaining more profit and much bigger space of living and developing, such as the material cost of production, financial expense of loan, labor cost of employees, profit distribution of shareholders, unpaid donation of enterprises, etc. According to IMP, the corresponding total payout will increase if the enterprises want

to improve their total profit. At the same time, the corresponding payout items will increase, too. At this moment, if the enterprises want to lower one payout item, such as the material cost of production as is shown in Figure 2, the other payout items have to further increase, such as the labor cost of employees. And this will result in the payout transferring (PT), which means the transferring from one payout item to the others.

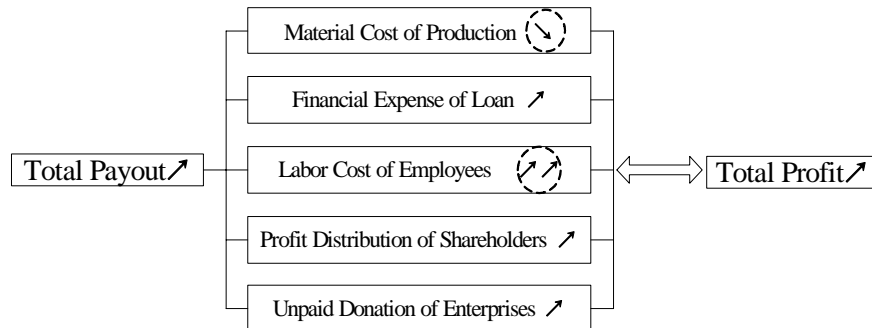


Figure 2 Enterprise Payout and Profit

Based on above analysis, here we put forward the Idea of Maximum Payout (IMP), which means that the enterprises should emphasize the positive relationship between the total payout and total profit in their business operation and administration, and the enterprise total payout should be increased to the maximum, wherever and whenever reasonably practicable; meanwhile, the enterprises should always look for the best payout direction, and after ensuring the other payout items in their best appropriate proportion, all of the residual payout should be transferred into the best payout items with the highest profits, which is helpful to get more profits and bigger space of living and developing.

In order to understand IMP well, it is necessary to elucidate the following points. (a) IMP is not meant to pay out blindly without regard to the principle of cost and benefit. In fact, if the enterprises want to minimize the total cost, it is necessary to figure out which payout items are reducible, as well as working out and carrying out the concrete measures. Obviously, all of these activities need the serious and diligent work of the enterprise employees, and more labor payout is heavily needed to ensure the goal of cost minimum. (b) IMP asks for frequent payout transferring to ensure that the enterprise limited resources are used on the best payout items with the highest profits. We should know that the enterprises are not just the resource repositories but the places of capital investing and increasing. Therefore, the enterprise goal should not just be saving and reducing the resource but ensuring these resources in the highest-profit investments, especially for the employees' labor resources. (c) IMP pays attention to the incremental contribution. The method of IMP's profit increasing is not just reducing cost, but paying more attention to insuring the resources to fully play the role in order to get more profits. (d) IMP emphasizes the effect of labor resources, especially in looking for the most cost-effective payout items and the best investing direction. Meanwhile, enterprises also should attach importance to the payout of labor resources when carrying out the concrete investment programs. (5) IMP changes the idea of enterprise cost management, from the ideas of "Minimum Cost and Maximum Profit" to the ideas of "Most-suitable Cost, Maximum Payout, Optimized Profit and Biggest Space". We know that, it is hard and uneconomical to minimize the cost because of the complicated and changed environment, thus most of time the cost may only be controlled at a most suitable level in practice. Meanwhile, in order to keep the enterprise sustainability, the owners should just enjoy the most appropriate proportion in profit distribution, which can ensure the enterprises and their owners get more profits and bigger space of living and developing in the future.

3 Significance and Application of IMP

3.1 Significance of IMP

The significance and value of IMP mainly are embodied in the following aspects.

1) IMP changes and reconfirms the correct idea of cost control and management. IMC believes that the enterprise profit will be the biggest when the cost is the lowest. However, this idea may be not very true if all the things are considered. On the contrary, IMP definitely demonstrated the positive relationship between the enterprise profit and their payout. Thus, the key point is whether the enterprises put their limited resources into the rightest and optimum places, rather than how much the cost is reduced. In other words, the places, which really need the most payout, should be given to the maximum;

while the places, which really need no investment and payout, shouldn't be spent anything.

2) IMP perfects the new idea of enterprise profit distribution. It is well-known that there are many competitions and conflicts in the enterprises. However, the cooperation and coordination is also badly needed in the enterprises. Therefore, in order to keep enterprises steady and ensure enterprises get more profits and space of living and developing in the long term, the owners and enterprises should just enjoy a appropriate proportion of profit distribution according to IMP.

3) IMP demonstrates the secrets of enterprise successful operation and management. As is well known, the operation and management of the enterprises is very hard. And no matter what level they are at, what environment they are in, what kind workers they have, the enterprise related people have to be careful and work hard all the time. No production technology, idea of operation and management or rules and regulations can make sure the enterprises exist and develop forever. In our opinion, only the greatest seriousness, diligence and payout of all the related people of the enterprises can go better and better, which will be helpful to win a place in the highly competitive environment.

4) IMP voices the ultimate goal of enterprise existing and development. For a long time, the goal of enterprise existing and development is always the goals "Enterprise Profit Maximization" or "Enterprise Value Maximization", etc. However, this idea and goal can't combine all the respects of the enterprises and the whole society very well. Besides, this kind of idea and goal is the one that is extremely only in pursuit of the enterprise material interest maximization, which of course will bring many interior conflicts in the enterprises, as well as lots of related social problems. On the contrary, IMP asks all enterprise stakeholders spare no effort to work hard for the enterprise existing and development, which certainly bring more and more profits. As for the profit distribution, IMP calls for all the stakeholders only enjoy the best appropriate proportion of the whole profits, which may be easier to keep the enterprise in good steadiness, cooperation and coordination. In a word, IMP can not only make all the enterprise stakeholders get more and more profit forever, but also promote the harmoniousness of all the whole society, which embodies the ultimate value and significance of the enterprises.

3.2 Application of IMP

IMP can be used every aspect of the enterprise, especially being shown in the following ones.

1) The choosing of the best capital investing direction. The capital investing activities in enterprises, which are like to arrange forces in certain information in wars, always need lots of hard-working preparation work before making the decisions. The preparation work, as well as the careful analysis in the decision-making may improve the odds of success of the investing activities. Otherwise, the investing activities tend to fail. Obviously, IMP could frequently reminds the senior executives in the decision-making level well, which will let them work more careful and diligent in looking for the right direction of enterprise investment.

2) Timely and suitable payout transferring. We know that, the enterprise environment is always in change, as well as all business activities, employees, etc. So after a brief spell, many things will change and the new situations and environment calls for appropriate readjustments in many aspects of the enterprises. From the perspective of cost control and management, the enterprises should often analyze which payout items are most cost-effective, where is the right investing direction. Subsequently, some concrete measures should be made timely to promote the enterprise resource transferring from the less cost-effective payout items to the most cost-effective ones, which can make sure the limited resource be in the most cost-effective places and directions.

3) Emphasizing labor resources and establishing the virtuous circle of enterprise value. It is well known that nearly all the enterprise resources are limited and non-renewable. However, there is an exception, and it is the enterprise labor resource. The enterprise labor resources are not only renewable but also can recover very fast. So in our opinion, the enterprise labor resources are one of the most important resources in the enterprises, and we should pay enough attention to them. IMP does well in using the enterprise labor resources. And according to it, we can establish the virtuous circle of enterprise value through some measures like the employee stock ownership plan, as is shown in Figure 3. In Figure 3, in order to get more profits, the enterprise owners, senior executives and ordinary staff try their best to look for the most cost-effective investing direction and the direction of diligence and payout. After that they will also spare no effort to carry out the enterprise goals of operation and management. And these cooperation and coordination, plus the maximum payout of all the people related to the enterprise, will bring more and more profits. In accordance with IMP, in order to keep the cooperation and coordination relationships among all the stakeholders, the enterprise owners and the senior executives will be willing to give out profits to the ordinary staff to motivate them for greater diligence and higher performance. Obviously, IMP will be helpful to improve the relationships among all

enterprise stakeholders, let all the stakeholders get more profits and get bigger space of living and developing for the enterprises.

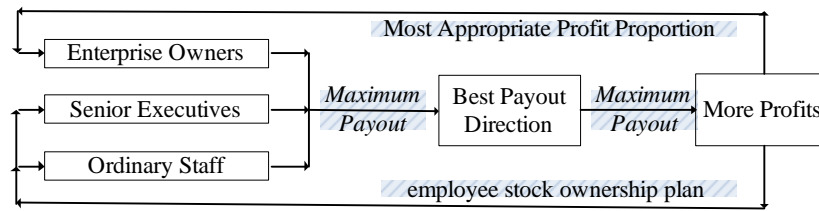


Figure 3 Virtuous Circle of Enterprise Value

4 Conclusion

For a long time, IMC is widely accepted in theory and practice fields. However, according to our thinking and analysis, we believe that IMC is not the best idea for us to learn, which brings this paper. In this paper, through the financial annual reports of 1752 listed companies in China in 2009, the relationship between enterprise payout and profit is analyzed, and the result is positive. On this basis, this paper puts forward IMP and introduces its connotation, significance and application.

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