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The Modern Corporation

Statement on Economics

1. The changing economic conceptualisation of the corporation.

From the early decades of the twentieth century, a dominant characteristic of the modern “capitalist” corporation, especially in the United States, was the separation of asset ownership in the form of publicly traded shares from allocative control over the corporation’s resources by salaried managers (Berle and Means 1932). By the 1950s some depicted managerial-controlled large enterprise as the “soulful” corporation in which the allocation of resources resulted in enhanced social welfare (Kaysen 1957; Mason 1959). In the 1960s, however, some conservative academics looked to market forces, dubbed the ‘market for corporate control’, to ensure that managers as employees would give primacy to shareholders in the allocation of corporate resources (Manne 1962). This market for corporate control could enable hostile takeovers in which shareholders who accumulated large public equity stakes in a company could discipline managers to allocate resources in ways that “the market” deemed to be efficient. The notion that market allocation could control managerial organization was then developed theoretically based on the conceptualisation that the corporation (and indeed any firm) could be conceptualised as a ‘nexus of contracts’ or a ‘collection of assets’ (Cheung 1983; Grossman and Hart 1986; Jensen and Meckling 1976). Rather than view the corporation as a social organization with its unique history and competitive capabilities in which public shareholders had come to play a peripheral role (Chandler 1962 and 1977), neoclassical economists conceptualised the corporation as a set of voluntary contracts among owners of resources and as a portfolio of assets with different market-determined rates of returns (Bratton 1989; Ireland 1999).

2. Maximising Shareholder Value (MSV) as the sole objective of corporate governance.

This conceptualisation of the corporation to fit with the dominant neoclassical theory of the market economy had two core implications. First, it made market-based financial metrics central to corporate strategy and to relations within the corporation (Daily et al. 2003; Davis 2009; Ireland 2009; Lazonick 1992). Second, shareholders could be portrayed as the only risk-bearers since they were the only participants in the corporation who did not get a guaranteed market-determined return for their productive contributions (Blair, 1995). On the assumption that risk results in superior overall economic performance, the central problem became how to align the interests of managers as agents with those of shareholders as principals. The ‘stick’ was the hostile takeover exercised through the market for corporate control (Jensen 1986). But these economists also argued that the ‘carrot’ of stock-based pay could induce executives to allocate corporate resources to maximize shareholder value (Jensen and Murphy 1990). By the 1990s the triumph of MSV as an ideology of corporate governance was virtually complete, with senior executive pay tied to stock-price performance, legitimized by MSV ideology (Davis 2009; Lazonick and O’Sullivan 2000).

3. Short-termism prevails and investments in productive capability diminish.

A view of corporate governance focused on immediate market metrics and MSV reduces the overall time horizon of strategic decision making (Hellman 2005; Useem 1999; Stout 2012), encourages an increased emphasis on cost management and financial engineering (Krippner 2005; Froud et al. 2002), and invites increasing asset churn (mergers, acquisitions, buyouts and demergers) (Davis, 2009). MSV legitimates the replacement of a ‘retain and reinvest’ allocation regime that invests in productive capabilities with a ‘downsize and distribute’ regime that downsizes the labour force and distributes the resultant ‘free’ cash flow to shareholders (Lazonick and O’Sullivan 2000). MSV thus diverts the use of corporate cash flows away from productive investment and supports a decline in innovativeness (Dobbin and Jung 2010).

4. Redistribution of income to public shareholders and corporate executives.

In the United States, under MSV, for the 251 companies in the S&P 500 Index in January 2013 that were publicly listed back to 1981, the buyback payout ratio – that is, repurchases as a proportion of net income – was less than 5% in 1981-1983 but 39% in 2010-2012, with a three-year peak of 70% in 2006-2008. From

the 1980s to the 1990s to the 2000s, the dividend payout ratio declined from 50% to 44% to 41%, while the buyback payout ratio rose from 22% to 35% to 50% (Lazonick 2014b). The top executives who made those allocation decisions were the prime beneficiaries through their stock options and stock awards; in 2012 the remuneration of the 500 highest paid executives averaged \$30.3 million of which 82% came from stock-based pay.

5. Increased within-country income inequalities...

Soaring executive pay has been the main driver of concentration of income among the top 0.1% of households in the United States (Piketty 2014). Beyond the direct redistribution of income in favour of shareholders and corporate executives, a wider macroeconomic consequence of the way in which company profits are divided is a steep increase in income inequalities between labour and capital within economies. From the early 1980s, productivity growth has been outstripping real wage growth, leading to a strongly declining factor share of labour in national income in almost all Western countries over the past thirty years (Davis, 2009; Dobbin and Zorn 2005; Froud et al. 2002; Froud and Williams 2007; Ireland 2005; Ireland 2009; Lazonick and O'Sullivan 2000; Lazonick 2014b; Stout 2012).

6. ...through a race to the bottom in employment conditions and taxation powers.

This trend towards growing structural income inequalities is closely related to shareholder primacy. MSV leads to a decline in stable, well-paid employment opportunities (Widmer 2011; Thompson 2013). Of particular importance has been the end of the employment norm of a career with one company that prevailed at most corporations throughout the 1980s (Lazonick 2013). In addition, corporate governance models based on MSV legitimize the use of international tax structures through tax havens as a strategic imperative, shaping global value chains (Froud et al 2002; Milberg 2008). This pursuit of MSV erodes the tax bases of the jurisdictions that provide for high-quality physical and technological infrastructure, education, health and welfare and educated workers that corporations rely on for their continued operations (Ireland 2005 and 2009; Martin 2010; Stout 2012; OECD 2013). The strategic imperatives of MSV at the firm level thus impact directly on the political and economic framework in which firms, states and trade blocs operate.

7. Marginalisation of investments by other stakeholders in the economy.

MSV runs on the assumption that shareholders are the only participants in the economy who bear risk, that is, they are the only investors without a guaranteed return (Blair 1995). However, taxpayers, workers and governments make risky investments in productive capabilities on a regular basis to create value-creating capabilities that enable the business enterprise to generate competitive products. These stakeholders, therefore, hold a legitimate economic claim to profits, if and when they occur. But MSV ignores these risky investments by stakeholders, while according primacy to public shareholders who typically merely buy and sell outstanding shares (Aglietta and Rebérioux 2005; Lazonick 2014a).

8. Economic instability rather than economic efficiency.

There is no doubt that MSV has triumphed as a theory of resource allocation in favour of specific interest groups. It has contributed to a concentration of income at the top. Far from promoting economic efficiency, MSV is a core factor in growing macroeconomic imbalances, instability and the erosion of innovative capability (Lapavistas 2013; Stockhammer 2004 and 2012). It is destructive of the long-term relations with constituencies upon which corporations ultimately rely and does not even benefit the mass of public shareholders over the long run as the massive distributions to shareholders and the explosion of executive pay have undermined the innovative capability of the corporate economy (Lazonick 2013 and 2014b).

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