THE HISTORICAL CONTEXT OF SHAREHOLDER VALUE CAPITALISM

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INTRODUCTION

Dobbin and Zorn offer a rich and insightful explanation for recent shifts in corporate strategies and incentives that, they argue, left American firms open to the wave of scandals that have filled the nightly news over the past few years. Where once far-sighted corporate leaders trained their eyes on stability and long-term growth, today's CEOs have trouble looking beyond the quarterly profit predictions that constitute the new bottom line in corporate America. Focused as they are on "meeting the quarterlies," institutional investors, takeover artists, and financial analysts have emerged as the new corporate elite, displacing the largest private owners of capital and bureaucratic managers alike.

The argument is made all the more powerful by the authors' deft integration of historical contingency – the "happenstance" of the baby boom generation that empowered institutional investors, and the high tech boom that placed performance forecasts in command of profits – into a powerful and revealing account of the unanticipated consequences of purposive social action in which, according to Dobbin and Zorn, "Takeover specialists convinced themselves that they were ousting inept CEOs. Institutional investors

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convinced themselves that CEOs should be paid for performance. [And] analysts convinced themselves that forecasts were a better metric for judging stock price than profits." The rise of this new corporate elite was thus not entirely coincidental, and certainly not random, but few could have predicted the particular path of its ascendance, much less its harmful consequences for our "shareholder nation."

Although we could raise questions about some aspects of their argument – hostile takeover firms seem more a phenomenon of the 1980s than of the present, for example, and the idea of growth by acquisition remains far from dead (the emphasis has merely shifted to huge within-industry mergers) – we find the general contours of Dobbin and Zorn's story compelling. Our goal in this comment is therefore not to take issue with their argument per se. Instead, we would like to address a question that emerges from their discussion: What were the historical and political conditions that gave rise to and empowered this new class of financial professionals? In particular, we seek to understand the rise of institutional investors and financial analysts in relation to the post-war decline of American labor, the relaxation of government regulation, and the declining influence of finance capital. Our comments are necessarily brief and uneven – brief because of our role as commentators; uneven because of the preliminary and, in some cases, speculative state of our thinking.

POST-WAR MANAGERIAL CAPITALISM

Our story begins in the post-war period marked by the ascendance of the management-controlled, giant, bureaucratic, American corporation. In the now classic formulation of managerialism first elaborated by Berle and Means (1968 [1932]), corporations were seen as having thousands of widely dispersed stockholders, who exerted little if any influence over management. Firms operated in concentrated markets, were highly profitable, and flush with cash. At the same time, the United States had emerged from the war as the preeminent economic power in the world, giving domestic firms a leg up on foreign competitors, most of whom were tied down rebuilding their war ravaged infrastructures. In this favorable environment, the primary goals of American managers were growth and stability – the former because it led to prestige and high salaries, and the latter because it allowed them to maintain their privileged positions.

This system was characterized, and sustained, by a set of institutional conditions that, arguably, were historically unique. First, most large corporations

had come to accept the existence of labor unions. The recent experience of wartime coordination – what some would later term "collaboration" – between big business and big labor revealed a side to unions that had seldom been seen. In the interests of maximizing wartime production, the AFL and the CIO both signed no-strike pledges, disciplined recalcitrant militants, and engaged in limited short-term economic planning. Though their abandonment of the class struggle was only temporary, American labor, especially following the Cold War purge of the Communists, was now sufficiently domesticated to lay a foundation for the post-war "labor–capital accord" which gave organized labor a permanent place at the corporate table – or so it seemed through the early 1970s (Aronowitz, 1973).

Second, unlike the earlier corporatization wave at the turn of the 20th century, the post-war period witnessed the emergence of an expanding and more activist state. Government regulation of business was not necessarily greater during this period than in earlier decades; in fact, the levels of government activism tended to fluctuate depending on which political party occupied the White House. But the state's penetration of civil society, building on the legacy of the New Deal, increased significantly by taking on a wider range of regulatory functions and spearheading a wave of new social legislation during the 1960s. Although many corporate leaders might have preferred a less active state, they also recognized that programs such as Social Security and welfare reduced the potential for social unrest, socialized the costs of reproducing labor, and shored up the legitimacy of the system as part of the ongoing ideological battle between East and West.

A third feature of the post-war world was the changing social organization and growing activism within the corporate elite. New instruments of policy formation, representing the major factions of the business community, appeared at the national level to better coordinate corporate interests both at home (the Committee for Economic Development, and, later, the Business Roundtable) and abroad (the Council on Foreign Relations). The increasing influence of these consensus-making bodies, coupled with the growing participation of financial institutions, whose capital was required by most major firms and whose interests transcended those of particular industries or sectors, created an internal discipline and coherence within the corporate elite, ensuring greater uniformity of action, if not of thought.

This confluence of a strong labor movement, an activist state, and the centrality of finance capital had the consequence, we suggest, of keeping corporations in check. The presence of a strong labor movement generally served as an effective countervailing force to corporate hegemony by partially constraining the enormous power of capital while also providing

another source of accountability for economic decision-making. Similarly, government involvement in the economy, particularly in the regulatory arena, fortified the state with the requisite legislative and enforcement powers, as well as conferring the necessary political legitimacy to more closely monitor internal corporate affairs, such as work safety and environmental practices. And the centrality of finance capital placed banks – with their more risk-averse orientation – at the center of the corporate economy. Although corporate takeovers, particularly those involving diversification, were rampant during the 1960s, they were – unlike the subsequent wave of takeovers in the 1980s – typically encouraged by the leading banks, whose capital they usually required. Individual investors or CEOs who tried to "game the system" or who behaved in ways that the banks viewed as erratic, such as Saul Steinberg and James Ling, were quickly disciplined and brought into line.

This is not to romanticize the post-war corporation as a "soulful" economic citizen, as some have suggested. Illegal and unethical corporate behavior certainly occurred during this period, but any transgression that deviated from a relatively narrow norm was quickly sanctioned, not only by the state and occasionally by labor, but also by the financial community. The result was that corporate malfeasance on the scale of today's Enron scandal was neither imaginable nor, in most cases, possible.

TURMOIL AND REORGANIZATION: LABOR AND THE STATE IN RETREAT

As we moved into the 1970s, however, the system began to unravel. Mounting inflationary pressures, generated by the fiscally impossible "guns and butter" policy of simultaneously placating the domestic population while pursuing an expensive overseas war, took a heavy toll on the American economy, dampening productivity and choking off new investment. The concurrent rise of foreign manufacturing and the increase in the U.S. balance of payments deficit led, in 1973, to the abandonment of the Bretton Woods international monetary agreement, which had fixed foreign exchange rates to the U.S. dollar. American firms, having been insulated from overseas competition, now found themselves unable to compete with the growing power of European and Asian manufacturers whose rebuilt and modernized plants flooded the domestic market with high quality but less-expensive goods – everything from cars to consumer electronics. The

energy crisis of 1974 only exacerbated these problems, with the simultaneous appearance of rising inflation and unemployment, a combination thought to be impossible according to the prevailing Keynesian economic theory. This "stagflation," as it was dubbed, led first to a sharp decline in the stock market, and then to continued economic stagnation throughout the remainder of the decade. A weakened stock market, as Dobbin and Zorn (and many others) note, set the stage for the takeover wave of the 1980s.

With inflation and unemployment both high, and with profits and stock prices both low, the American business community faced a crisis. In the wake of the Watergate scandal, public confidence in the nation's major institutions, including especially business, was at a historical low. The emergence of powerful consumer and environmental movements expanded once again the scope of state regulation with the formation of the Environmental Protection Agency and the Occupational Health and Safety Administration, both of which were signed into law by a reluctant President Nixon.

Having seen enough, the business community mounted a counteroffensive that would dramatically remake the country's political and economic landscape. Their response, bankrolled by wealthy individuals and leading corporations, targeted what many conservatives believed was responsible for the decline of the American economy: a lack of productivity, caused in part by a labor movement whose long-standing work rules purportedly impinged on the flexibility of firms; and government regulation that presumably increased the cost of doing business. Both organized labor and the state were thus seen as obstacles to economic revitalization, making it difficult, if not impossible, for American firms to compete with their foreign adversaries.

The election of Ronald Reagan in 1980 was pivotal in bringing this anti-union, anti-statist ideology from the periphery to the center of American politics. While Reagan certainly deserves much of the credit for mainstreaming the business agenda, the assault on labor and the state had already been launched under the previous Carter administration. Anti-union sentiments, galvanized by the emerging business counteroffensive, were already powerful enough by the late 1970s to defeat or weaken several attempts at labor law reform (Vogel, 1989, Chapter VII), despite Democratic control of the executive and legislative branches of government. Simultaneous attacks on "big government," always a mainstay of Republican politics, also found new life, as business leaders aggressively lobbied President Carter to roll back regulations that were supposedly strangling the economy.

Still, Reagan's election in 1980 was a turning point, particularly insofar as his vision for the country offered a more coherent ideology for the deepening assault on labor and the state. In his view, which has since become a foundation of neo-liberalism, unions, regulations, or anything else that interfered with the workings of an unfettered market constituted unnecessary impediments to economic growth. By freeing up markets and implementing fiscal and tax policies designed to encourage investment, Americans, in this view, would enjoy a level of personal freedom never before experienced under the shadow of big government.

The new president fired his first shot shortly after taking office, when he personally dismissed the nation's striking air traffic controllers. His subsequent decision to hire replacement workers reversed nearly half a century of accepted industrial relations practice, which held that unions should have the right in a democratic society to strike without fear that their members would be subject to permanent replacement. Reagan's action, however, was far less risky than it appeared, since the labor movement, reeling from almost three decades of decline, was in no position to resist. The message was not lost on organized labor, whose members all but abandoned the work stoppage as a weapon of industrial warfare. An emboldened President Reagan then took aim at the legal infrastructure of modern industrial relations, neglecting to enforce legislation that protected worker rights on the job, and stacking the National Labor Relations Board with like-minded appointees, some of whom openly questioned organized labor's right to exist. Following a decade of steadily declining representation elections and union wins, organized labor was no longer capable of exercising much restraint on capital, especially in the private sector heartland of the economy, where unions had been hardest hit (Fantasia & Voss, 2004).

Under the cover of attacking big government, hundreds of loyal foot soldiers in the Reagan revolution waged a relentless campaign against the state's regulatory functions. The Clean Air Act was weakened, although not nearly as much as either the president or business wanted. At the same time, as Dobbin and Zorn note, enforcement of antitrust legislation declined precipitously, and favorable policies, including the ability to deduct the interest on the debt used for acquisitions, created a friendly environment for the wave of takeovers that followed. The growing reliance on markets, rather than governmental oversight, to regulate corporate behavior left the door open for "a wide range of speculative behaviors" that would eventually lead to the scandals of recent years (Prechel, 2003, p. 327).

THE CHANGING NATURE OF BANKS DURING THE 1980s

With labor and the state in full-scale retreat, the banks were the last layer of defense against corporate malfeasance. Although banks never actually controlled corporations on a wide scale, during the 1970s they exercised what Mintz and Schwartz (1985) termed "hegemony" due to their control over scarce investment capital and their leadership role in coordinating complex financing schemes. Given their economic centrality, banks were often able to set limits on the behavior of the non-financial firms that depended on them.

Bank hegemony was undermined during the 1980s by a combination of technological and regulatory changes that enabled firms to reduce their reliance on banks for capital. Increasingly they borrowed directly from other firms through the use of commercial paper. By 1994, the amount of debt in commercial paper equaled that owed to commercial banks, while individual investors turned to mutual, pension, and money market funds, thereby reducing their deposits in commercial banks. The banks responded to these changes in two ways. First, they engaged in a series of high-risk ventures that led to several bank failures and near failures by the late 1980s. Second, they began to shift their focus away from lending, and toward financial services, including, eventually, securities underwriting. In the process, commercial banks came to more closely resemble investment banks. The separation of commercial and investment banking had been legally mandated since the Glass-Steagall Act of 1933, but American banks by the 1990s were challenging Glass-Steagall, claiming that the law unfairly disadvantaged them in the increasingly competitive world of international finance. The law's final blow came with the 1998 merger of Citicorp and Travelers Insurance (which included the investment firm of Salamon Smith Barney). Glass-Steagall was repealed by Congress in 1999.

The upshot of this is that banks lost their formerly privileged place within the social organization of the business community. Davis and Mizruchi (1999) have documented that between 1982 and 1994, the centrality of banks in corporate interlock networks – a virtual constant since 1900 – sharply declined. Because they were no longer corporations' chief (or even a necessary) source of capital, whatever ability the banks had to influence nonfinancial firms – in particular, the ability to provide internal discipline to the business community as a whole – likely declined as well. Even during their heyday, it is true that banks supported mergers and acquisitions, including hostile ones. But one wonders whether the actions of Michael Milken and

others would have been tolerated had the banks been in a commanding position like they were in the 1960s.

CONCLUSION

Dobbin and Zorn suggest that the power structure of the American business world has undergone a significant transformation over the last two decades. After emerging from a period of managerial capitalism through the 1970s, the American business community experienced a massive upheaval, in which one-third of the 500 largest non-financial corporations disappeared. This shakeout left no one in particular in charge. When Michael Useem (1984) wrote eloquently in the early 1980s about the "inner circle" – the group of corporate leaders whose interests transcended those of the individual firms with which they were associated – he could not have known that this circle would be decimated by the events of the next few years. In his subsequent works describing the siege under which managers operated by the 1990s, whose titles, *Executive Defense* (Useem, 1993) and *Investor Capitalism* (Useem, 1996), provide a good synopsis of the situation he believed they now faced, Useem no longer speaks of an inner circle, or any coherent group of central leaders with responsibility for the overall fate of the business community. Instead, he speaks of a Darwinian world, dominated by financial professionals with no coherent organizing principle, much like the environment portrayed by Dobbin and Zorn, in which firm managers are now forced to operate at the seeming mercy of institutional investors and, especially, financial analysts.

We have attempted to situate the ascendance of institutional investors and financial analysts in relation to the changing international political economy. Our analysis suggests three main points: First, the rise of institutional investors and financial analysts has occurred in part because three significant forces – organized labor, the state, and the banks – have either abdicated or been driven from their former roles in helping to keep corporations, and corporate abuse, in check. Without the internal discipline provided by the banks and the external discipline provided by the state and labor, the corporate world has been left to the professionals who have the ability to manipulate the vital information about corporate performance on which investors depend. Second, despite the growing power and activism of institutional investors, and despite the machinations of financial analysts, what is striking about Dobbin and Zorn's account is the continued ability of managers to resist external monitoring. The monitors may change, but the

managers – as they seemingly always have – find a way to deceive them. Finally, let us not forget that however much this situation differs from the satanic mills described by Marx, and however many Americans may now be invested in the stock market, the system remains, in all of its most important features, capitalist – marked, in its current form, by an increasing polarization of wealth and life chances between those with and those without any real control over capital.

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