Finance and Society

Jerry Davis
Laurent Picard Distinguished Lecture
McGill Desautels Faculty of Management
12 April 2011

THE WALL STREET JOURNAL

Document Questions Cloud Recovery

Agents Fear Housing Could Stall as Uncertainties on Foreclosures Unease Buyers, Especially Investors

By N.P.L.

Sales of foreclosed homes have helped lay the groundwork for housing recovery in many of the nation’s boom-to-boom markets. Now, some real-estate agents say that recovery is at risk because of delays in bank foreclosures.

Homes are being pulled from the market, and buyers—especially investors intent on quickly reselling foreclosed properties—are retreating to the sidelines amid growing uncertainty over the extent to which banks filed fraudulent foreclosure documents.

On Tuesday, Wells Fargo & Co. said it had started a review of all pending home foreclosures in states where certain paperwork was required but it did not suspend foreclosures or foreclosure sales, as have other big banks.

Meanwhile, GMAC Mortgage, a unit of Ally Financial Inc. and one of the first to suspend some foreclosures last month, expanded its review to all 50 states. Initially, GMAC’s review was limited to 23 states that require court approval for foreclosures.

Bank of America Corp. last Friday agreed to halt all foreclosures and foreclosure sales, the first bank to do so.

THE WALL STREET JOURNAL

The Great Mortgage Mystery

By BRETT ARENDS

The big question from the mortgage meltdown isn’t why so many distressed homeowners are defaulting on their loans. It’s why any of them are still making payments.

In the worst-hit areas millions have no equity left, and little hope of seeing any anytime soon. The market value of their homes is far below the size of the mortgage.

If they just stop paying, what is going to happen to them? In many cases they may get to live in the home rent-free for months, even years, until the bank gets around to seizing it.

If Frank Abagnale—the con man played by Leonardo DiCaprio in the film “Catch Me If You Can”—were operating today, he’d probably be living rent-free in a one-bedroom high-rise in Miami.

Consider the latest revelations. The big banks are so backed up with foreclosures that some of them resorted to hustling through repossessions without the proper paperwork. Some of them—including Bank of America, J.P. Morgan Chase and Ally Financial’s GMAC Home Mortgage—have announced a temporary freeze in some states on further foreclosures while they sort through the mess.
How did Main Street turn into Wall Street?

- Half of US households are invested in the stock market through mutual funds and 401(k) plans
- Thanks to mortgage securitization and low interest rates, most homeowners with mortgages refinanced them during the first half of this decade
- The personal savings rate (employment income – spending) in the US turned negative in 2005 for the first time since the Great Depression
- But don’t worry:
  “The decline in an often-cited aggregate personal saving rate may not be cause for much alarm for retirement preparedness. Much of this decline can be attributed to spending triggered by wealth increases from capital gains on housing and financial assets.” (Economic Report of the President 2006)

Due to this “wealth effect,” the housing bubble disguised weaknesses in the real economy

- Americans extracted perhaps $800 billion per year in home equity from 2004-2006 – about 9% of US disposable income (Greenspan and Kennedy, 2008)
- Housing price increases fueled economic activity and job creation in retail and housing sectors
  - One-quarter of new jobs created between 2003-2006 were in housing-related industries
  - There were 400,000 mortgage brokers in 2006
  - And 1.2 million real estate agents
  - Roughly $300B/year went for personal consumption, promoting growth in retail employment

Was the housing crash utterly unpredictable?

“The magnitude of the current boom is practically unique in history, making it difficult to predict what comes next based on historical examples…It’s notable that until the recent explosion in home prices, real home prices in the United States were virtually unchanged from 1890 to the late 1990s.”

Robert Shiller, March 2006
The mortgage crisis is a symptom of a broader transition in economic institutions

- The US has shifted from an industrial to a post-industrial economy
- Employees are less tied to particular employers located in particular places
- Households are more tied to financial markets through college and retirement savings invested in mutual funds, credit card payments tied to LIBOR, and mortgages ultimately owned by dozens of different financial institutions

Post-industrialism (def. 1): “the majority of the labor force is no longer engaged in agriculture or manufacturing but in services” (Daniel Bell, 1973)

Manufacturing employment is increasingly rare in the US

Since January 2001, the US has shed 5.5 million jobs in manufacturing—one in three

As of March 2009, more Americans were unemployed than were employed in manufacturing
The US still leads the world in manufacturing value-added:

**Global share, 2008:**
- US: 19.0%
- China: 16.1%
- Japan: 10.5%
- Germany: 8.0%
- Italy: 4.1%
- France: 3.3%
- UK: 3.0%
- Russia: 2.7%

*Source: World Bank World Development Indicators*

The US still leads the world in manufacturing value-added... it just doesn’t require employees to do it (cf. agriculture)

**THE WALL STREET JOURNAL**

**THE WALL STREET JOURNAL**

**CAREERS | MARCH 3, 2005**

**Lean Factories Find It Hard to Cut Jobs Even in a Slump**

By TIMOTHY APEL AND JUSTIN LAHART

SPARTANBURG, S.C. — At a factory here that churns out plastic parts for everything from spray cans to blasting caps, laying off just one worker can be more trouble than it’s worth.

The plant, owned by Cleveland-based Parker Hannifin Corp., has become so lean over the past decade that many assembly lines run with only a handful of highly trained workers.

So while mass layoffs have driven the U.S. unemployment rate to its highest in 26 years, Parker and other companies like it are responding to the slump in more surgical ways, mainly by cutting hours and shedding temporary workers.

Because of productivity gains, every one of my people carries more dollars in sales today," says Donald Washlevic, Parker’s chief executive. In 2000, the average Parker worker represented about $205,000 a year in sales. Today, that figure tops $200,000. "If I need to cut back, I have to cut back fewer people to achieve the same goal."

Similar trim is taking place at each of Parker’s nearly 500 factories. And to varying degrees, this is happening at thousands of other large and small factories across the U.S.

The largest US employers have shifted from manufacturing to retail and other services

**10 Largest US Corporate Employers, 1960-2010**

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<td>TARGET</td>
<td>GE</td>
<td>KROGER</td>
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<td>FORD</td>
<td>FORD</td>
<td>UPS</td>
<td>GE</td>
<td>KROGER</td>
<td>HOME Depot</td>
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<td>GE</td>
<td>KROGER</td>
<td>HOME Depot</td>
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<td>KROGER</td>
<td>KROGER</td>
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<td>US STEEL</td>
<td>SEARS</td>
<td>SEARS HLDGS</td>
<td>SEARS HLDGS</td>
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<td>SEARS</td>
<td>IBM</td>
<td>&quot;AT&amp;T&quot;</td>
<td>A&amp;P</td>
<td>&quot;AT&amp;T&quot;</td>
<td>&quot;AT&amp;T&quot;</td>
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<tr>
<td>A&amp;P</td>
<td>ITT</td>
<td>&quot;AT&amp;T&quot;</td>
<td>EXXON</td>
<td>KMART</td>
<td>WALGREEN</td>
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<td>EXXON</td>
<td>KMART</td>
<td>WALGREEN</td>
<td>BETH. STEEL</td>
<td>MOBIL</td>
<td>VERIZON</td>
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<tr>
<td>BETH. STEEL</td>
<td>MOBIL</td>
<td>VERIZON</td>
<td>ITT</td>
<td>GTE</td>
<td>SAFEWAY</td>
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Wal-Mart now employs roughly as many Americans as the 20 largest manufacturers combined

**Ten industries with most-tenured employees**

<table>
<thead>
<tr>
<th>Industry</th>
<th>Avg tenure</th>
<th>Age</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>14</td>
<td>47</td>
<td>1.6</td>
</tr>
<tr>
<td>Utilities</td>
<td>13</td>
<td>45</td>
<td>0.9</td>
</tr>
<tr>
<td>Petroleum and coal products mfg</td>
<td>11</td>
<td>45</td>
<td>0.1</td>
</tr>
<tr>
<td>Forestry, logging, fishing, hunting</td>
<td>10</td>
<td>44</td>
<td>0.2</td>
</tr>
<tr>
<td>Electrical equipment, appliance mfg</td>
<td>10</td>
<td>46</td>
<td>0.3</td>
</tr>
<tr>
<td>Public administration</td>
<td>9</td>
<td>45</td>
<td>4.9</td>
</tr>
<tr>
<td>Transportation equipment manufacturing</td>
<td>8</td>
<td>44</td>
<td>1.4</td>
</tr>
<tr>
<td>Beverage and tobacco products</td>
<td>8</td>
<td>38.5</td>
<td>0.1</td>
</tr>
<tr>
<td>Paper and printing</td>
<td>8</td>
<td>43</td>
<td>0.9</td>
</tr>
<tr>
<td>Primary metals and fabricated metal prods.</td>
<td>7</td>
<td>43</td>
<td>1.4</td>
</tr>
</tbody>
</table>

*Source: 2004 Current Population Survey*
Ten industries with least-tenured employees

<table>
<thead>
<tr>
<th>Industry</th>
<th>Avg tenure</th>
<th>Age</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internet publishing and broadcasting</td>
<td>0.5</td>
<td>42.5</td>
<td>0.0</td>
</tr>
<tr>
<td>Food services and drinking places</td>
<td>1.5</td>
<td>26.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Private households</td>
<td>2.0</td>
<td>40.0</td>
<td>0.6</td>
</tr>
<tr>
<td>Retail trade</td>
<td>3.0</td>
<td>38.0</td>
<td>11.9</td>
</tr>
<tr>
<td>Motion picture and sound recording</td>
<td>3.0</td>
<td>34.0</td>
<td>0.3</td>
</tr>
<tr>
<td>Rental and leasing services</td>
<td>3.0</td>
<td>36.0</td>
<td>0.4</td>
</tr>
<tr>
<td>Administrative and support services</td>
<td>3.0</td>
<td>40.0</td>
<td>3.3</td>
</tr>
<tr>
<td>Social assistance</td>
<td>3.0</td>
<td>41.0</td>
<td>2.2</td>
</tr>
<tr>
<td>Arts, entertainment, and recreation</td>
<td>3.0</td>
<td>38.0</td>
<td>1.8</td>
</tr>
<tr>
<td>Accommodation</td>
<td>3.5</td>
<td>40.0</td>
<td>1.3</td>
</tr>
</tbody>
</table>


Retail jobs are not like manufacturing jobs

- Median hourly wage in “Motor Vehicle Manufacturing” for “Production Occupations” (May 2008): $27.14
- Median tenure with current employer in “Transportation Equipment Manufacturing” (Jan. 2004 CPS): 8 years
- Median hourly wage in “General Merchandise Stores” for “Sales and Related Occupations” (May 2008): $9.33
- Median tenure with current employer in “Retail Trade”: 3 years
- Mean weekly hours worked at Wal-Mart: 34
- Estimated annual turnover at Wal-Mart: 40%

Long-term attachments to employees can be costly...

“Our legacy costs in pensions and health care are an area of significant competitive disadvantage for us... We're now subject to global competition. We're running against people who do not have these costs, because they are funded by the government.”

Rick Wagoner, CEO of GM, Feb. 2006

…so most employers have abandoned traditional company pensions in favor of relatively portable 401(k) plans

Retirement Plan Trends: Participation by Plan Type:
Distribution of Private-Sector, Active-Worker Participants, 1979-2006

Source: U.S. Department of Labor, Form 5500 Survey Report (Summer 2004); EBRI estimates for 2002-2005
As a result, households became increasingly invested in the stock market during the 1980s and 1990s. Specifically: investors in mutual funds. There are many more US mutual funds now, and they gathered a lot of assets.
But “name brand” funds got most of the benefit

Market share of top 5 fund families

![Market share of top 5 fund families graph]


Leaving US corporate ownership largely “intermediated” by a few mutual funds

Corporate ownership by mutual funds
- 1950: 3%
- 1990: 8%
- 2005: 28%

Mean ownership by institutional investors of 1000 largest corporations

Source: Spectrum 13F database, various years

Fidelity is now the largest shareholder of one in ten US corporations

Number of US-listed firms in which Fidelity is largest shareholder

![Number of US-listed firms in which Fidelity is largest shareholder graph]

Source: Spectrum 13F and 13G databases, various years

Increased ownership by institutions has corresponded to increased devotion to “shareholder value”…

“We exist to create value for our share owners on a long-term basis by building a business that enhances The Coca-Cola Company’s trademarks.”

“Sara Lee Corporation's mission is to build leadership brands in consumer packaged goods markets around the world. Our primary purpose is to create long-term stockholder value.”
…and an orientation to share price induced massive restructuring favoring a “Nike model” of production

“Wall Street can wipe you out. They are the rule-setters. They do have their fads, but to a large extent there is an evolution in how they judge companies, and they have decided to give premiums to companies that harbor the most profits for the least assets.”

John Bryan, CEO, explaining Sara Lee’s "de-verticalization" program

The US economy is at an advanced stage of Nike-fication

Corporation ≠ organization: no fixed nationality

Accenture to Move Base To Ireland From Bermuda

Accenture Ltd. said its board has voted to change the consulting company’s place of incorporation to Ireland from Bermuda.

Accenture incorporated in Bermuda in 2001 after the company did an initial public offering.

Several large companies have recently announced plans to reincorporate from Bermuda, helping them avoid what are expected to be significant changes in how the U.S. taxes multinational corporations. Earlier this month, drug maker Warner Chilcott Ltd. said its board approved a plan to relocate to Ireland from Bermuda.

Accenture shareholders will be asked to vote on the proposed move at meetings in the next three to four months.

“We believe that incorporating in Ireland will provide Accenture with economic benefits and help ensure our continued global competitiveness,” said Chairman and Chief Executive William D. Green, adding that the company will benefit from Ireland’s well-developed corporate, legal and regulatory environment.

Corporation ≠ organization: no fixed boundaries

Vizio now has the largest market share of LCD televisions in the US (22%)—with 180 employees

Vizio is a fraction of the size of Sony and Samsung Electronics Co., both leading brands in the U.S. flat-panel market. Yet Vizio shipped 12.4% of North America’s liquid-crystal display, or LCD, TVs in the last quarter of 2004. That’s just behind Sony’s 15.6% share and Samsung’s 14.4%, according to research firm DisplaySearch. Overall, Vizio’s sales have multiplied more than 2.2 times last year, up from $720 million in 2003 and $322 million in 2002, according to the closely held company.

The California company’s success illustrates the rise of a new business model in the fast-changing TV industry. Big Korean and Japanese consumer-electronics makers spent large sums developing and marketing their own technology, creating a high barrier to entry for newcomers. They also built many key components in-house, including the all-important LCD and plasma display panels.

The technology outsourcing and management consulting company doesn’t expect any material change in its operations, financial results or tax treatment as a result of the change.

The company will continue to be registered with the Securities and Exchange Commission and its shares will continue to trade on the New York Stock Exchange.
Corporation ≠ organization: no fixed identity

The Wall Street Journal
May 9, 2007

ADVERTISING

101 Brand Names, 1 Manufacturer
The Mass Pet-Food Recall Reveals a Widespread Practice: Many Competing Products Come From the Same Factory
By ELLEN BYRON
May 9, 2007

(See Corrections & Amplifications item below.)

Pet owners have been reeling ever since tainted pet food led to the confirmed deaths of more than a dozen dogs and cats and likely sickened many more.

Some owners were also startled to learn that dozens of competing brands, from discount to premium, are all made by the same company, Menu Foods Inc. of Ontario.

Menu has recalled more than 60 million cans of pet food under more than 100 brand names ranging from Procter & Gamble Co.'s Iams and Enkana brands to Hill's Pet Nutrition Science Diet, owned by Colgate-Palmolive Co., to Ol' Roy pet food by Wal-Mart Stores Inc. Each was apparently affected by wheat gluten contaminated with melamine, a chemical substance with no approved use in food.

Corporation ≠ organization: no fixed industry

What is a “bank”?

The Wall Street Journal
May 9, 2007

National Information Center

What is a “bank”?

Corporation ≠ organization: no employees

“Hermit crab organizations” maintain the brand but lose the people (e.g., Circuit City’s 43,000 employees)
Can corporations be used as tools of public policy, e.g., to create jobs?

**String of Suicides Continues at Electronics Supplier in China**

SHANGHAI — A 19-year-old employee was found dead Tuesday morning in what appears to have been the ninth suicide this year at a factory in southern China operated by Foxconn Technology, one of the world’s largest contract electronics manufacturers, according to China’s state-run news media.

Foxconn, which produces electronics and computer components for Apple, Dell, Hewlett-Packard and other global companies, has been struggling this year to explain a string of suicides among young workers at its large complexes in the city of Shenzhen, where the company employs about 400,000 workers.

A spokesman for Foxconn, a unit of Hon Hai Precision Industry of Taiwan, could not be reached for comment Tuesday, and the Shenzhen police did not return phone calls. But Xinhua, China’s official news agency, said the Shenzhen police had reported that a young man identified as Li Ha had apparently jumped to his death at 12:00 a.m. Tuesday at Foxconn. Mr. Sheng said he had seen bodies.

Company executives say Foxconn is planning to hire psychiatrists, counselors and monks, and intends to bring in 2,000 shamans, dancers and guitarists to improve life in its two sprawling campuses in Shenzhen.

China’s state-run news media also reported Tuesday that Foxconn was building tall fences at its dormitories to prevent workers from jumping to their deaths.
America’s most innovative companies employ few people

- Apple: 34,300
- Google: 19,835
- Intel: 79,800 [44,000 US]
- Amazon.com: 24,300
- Cisco: 65,550 [37,050 US]
- Microsoft: 93,000 [56,000 US]

**TOTAL:** 316,785 [215,485 US]

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**Shareholder capitalism and corporate turnover:**

The Dow Jones 30 Industrials in 1987

<table>
<thead>
<tr>
<th>Company</th>
<th>Jobs lost in 1/09: 598,000</th>
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<td>Allied Signal</td>
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<td>Alcoa</td>
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<td>American Can</td>
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<td>American Express</td>
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<tr>
<td>AT&amp;T</td>
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<td>Bethlehem Steel</td>
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<td>Boeing</td>
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<td>Chevron</td>
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<td>Coca Cola</td>
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<td>Du Pont</td>
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**Blue = in index in 1930**

- Recent exits include AIG, Citigroup, and GM (all now wards of the state)

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**Q:** If household savings have moved to mutual funds, what happened to the banks?

**A:** They got acquired by Bank of America or JP Morgan Chase
How North Carolina National Bank became Bank of America

Bank of America holds nearly 10% of all deposits in the US through its 5800 branches

How (almost) every New York-based commercial bank became JP Morgan Chase

Of the 10 biggest US banks in 1989, 5 are now part of JP Morgan Chase

The surprising new geography of banking

Ten largest US-based traditional commercial banks

<table>
<thead>
<tr>
<th>Bank</th>
<th>Location</th>
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<tbody>
<tr>
<td>JP Morgan Chase</td>
<td>New York</td>
</tr>
<tr>
<td>Bank of America</td>
<td>Charlotte, NC</td>
</tr>
<tr>
<td>Citibank</td>
<td>New York</td>
</tr>
<tr>
<td>Wells Fargo</td>
<td>San Francisco</td>
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<tr>
<td>US Bank</td>
<td>Minneapolis</td>
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<tr>
<td>PNC</td>
<td>Pittsburgh</td>
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<tr>
<td>Bank of NY/Mellon</td>
<td>New York</td>
</tr>
<tr>
<td>Suntrust</td>
<td>Atlanta</td>
</tr>
<tr>
<td>BB&amp;T</td>
<td>Winston-Salem, NC</td>
</tr>
<tr>
<td>Regions Bank</td>
<td>Birmingham, AL</td>
</tr>
</tbody>
</table>

7 of the 10 largest US cities no longer have a major local commercial bank

The basic business of banking has changed

“No, but you ... you’re thinking of this place all wrong. As if I had the money back in a safe. The money’s not here. Your money’s in Joe’s house ... right next to yours. And in the Kennedy house, and Mrs. Macklin’s house, and a hundred others. Why, you’re lending them the money to build, and then, they’re going to pay it back to you as best they can. Now what are you going to do? Foreclose on them?”
Banking 2.0: This time, it’s impersonal

“No, but you . . . you . . . you’re thinking of this place all wrong. As if I held your mortgage on my balance sheet. I sold your mortgage to Countrywide 10 minutes after we closed the deal, and they sold it along with 3000 other mortgages to Merrill Lynch, which divided it into bonds that were bought by a Cayman Islands LLC, which bundled them together with other mortgage-backed bonds into a collateralized debt obligation that Citigroup sold to a Norwegian pension fund. Now what are you going to do? Stop making your payments and force those Norwegian retirees to go back to work?”

Securitization:
or, What can be bundled together and sold as bonds?

- Mortgages
- Auto loans
- Student loans
- Corporate loans
- Credit card receivables
- Business receivables (even in distress)
- Settlements of tobacco lawsuits
- David Bowie’s royalties
- Blends of the above (CDOs)
- Your neighbors’ life insurance policies

Thanks to securitization, a US bank today is often a façade—a portal to financial markets.
What’s a government to do?

“The interests of a transnational company are not the same as those of the country from which it originates or of the workers it has historically employed. It has become, to coin a phrase, a ‘rootless cosmopolitan.’”

Martin Wolf, Why Globalization Works

If you can’t beat ‘em, join ‘em: Governments as vendors in a marketplace of laws

The corporate and ship registry for “Liberia” is operated out of an office park near Dulles Airport
Conclusion: a Copernican shift in American society

The frontier: what next?

Stock market app
- What's the market doing?
- Barolo or Boone's Farm with dinner?

FICO app
- Can I skip yet another month's credit card payment?

Zillow app
- What's my house worth right now?
- Still time to refi and move to Canada?

Facebook “Social Capital Asset Pricing Model” (SCAPM) app
- Whom should I be shorting at this talk?