How finance maimed America

Jerry Davis
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The corporation as a defining social institution

Synecdoche
“The big enterprise is the true symbol of our social order...In the industrial enterprise the structure which actually underlies all our society can be seen...” (Drucker, 1949)

Surrogate
“Organizations are the key to society because large organizations have absorbed society. They have vacuumed up a good part of what we have always thought of as society, and made organizations, once a part of society, into a surrogate of society” (Perrow, 1991)

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

10 Largest US Corporate Employers, 1960-2009

<table>
<thead>
<tr>
<th>1960</th>
<th>1980</th>
<th>2009</th>
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<tbody>
<tr>
<td>GM</td>
<td>AT&amp;T</td>
<td>WAL-MART</td>
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<td>AT&amp;T</td>
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<td>TARGET</td>
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<td>HOME DEPOT</td>
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<td>KMART</td>
<td>WALGREEN</td>
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<td>BETH. STEEL</td>
<td>MOBIL</td>
<td>VERIZON</td>
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<tr>
<td>ITT</td>
<td>GTE</td>
<td>SUPERVALU</td>
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Manufacturing Oil Services

Wal-Mart now employs roughly as many Americans as the 20 largest manufacturers combined
Retail jobs are not like manufacturing jobs

- Median hourly wage in “Motor Vehicle Manufacturing” for “Production Occupations” (May 2008): $27.14
- Median hourly wage in “General Merchandise Stores” for “Sales and Related Occupations” (May 2008): $9.33
- Median tenure with current employer in “Transportation Equipment Manufacturing” (Jan. 2004 CPS): 8 years
- 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%

Shareholder capitalism and corporate turnover: The Dow Jones 30 Industrials in 1987

<table>
<thead>
<tr>
<th>Company</th>
<th>Median Tenure Current Employer</th>
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<td>Alcoa</td>
<td>8 years</td>
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<td>American Can</td>
<td>3 years</td>
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<td>American Express</td>
<td>3 years</td>
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<tr>
<td>AT&amp;T</td>
<td>3 years</td>
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<tr>
<td>Bethlehem Steel</td>
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<td>Boeing</td>
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<tr>
<td>Chevron</td>
<td>3 years</td>
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<tr>
<td>Coca-Cola</td>
<td>3 years</td>
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<tr>
<td>Du Pont</td>
<td>3 years</td>
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Blue = in index in 1930
Red = gone by 2009

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

The re-configurable supply chain is the new black

A company of 6 people can grow to $2 billion in sales by assembling the right supply and distribution network

“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.

Ties between companies and employees were fraying...

"If there’s one thing you’ll learn—and dot-coms have learned it in the last year—is no one can guarantee lifetime employment... You can give lifetime employability by training people, by making them adaptable, making them mobile to go other places to do other things. But you can’t guarantee lifetime employment."

Jack Welch to Harvard MBAs, 2001

(And some have abandoned their retirees...)

July 2008

Dear Salaried Retiree or Surviving Spouse:

Since the first of this year, U.S. market and economic conditions have become significantly more difficult. These conditions, along with the rapid change in automotive industry sales mix, require us to take further actions that will position GM for sustainable profitability and growth. As a result, GM is announcing a change to the General Motors Salaried Health Care Program.

Effective January 1, 2009, GM is canceling health care coverage for salaried retirees and their dependents age 65 or older. Instead, eligible salaried retirees and surviving spouses over age 65 will receive a monthly pension increase of $300. This pension increase is designed to help offset some of your health care costs in retirement.

MICHIGAN ROSS SCHOOL OF BUSINESS

THE WALL STREET JOURNAL

Slump Prods Firms to Seek New Compact With Workers

By PHRED DVORAK and SCOTT THURM

The deep recession appears to be drawing to a close, but not its effect on the workplace.

Since the downturn began, thousands of employers have cut pay, increased workers’ share of health-care costs or reduced the employer contribution to retirement plans.

Two-thirds of big companies that cut health-care benefits don’t plan to restore them to pre-recession levels, they recently told consulting firms Watson Wyatt. When the first salaried companies that have trimmed retirement benefits when they expect to restore them, fewer than half said they would do so within a year, and 8% said they didn’t expect to ever.

Changes like these are reshaping employment in America, injecting uncertainty and delivering the jolting news that pay cuts are here to stay. The changes are eroding two pillars of the late 20th-century employment relationship: employer-subsidized retirement benefits and employer-paid health care.

Even as Congress wrestles with how to extend health insurance to more Americans, and considers putting pressure on employers to offer coverage, some companies feel they have no choice but to pull back — dropping health plans or weighing such a move.

One reason: Although employers pay a smaller percentage of health costs, their dollar outlays continue to rise rapidly, as medical costs do. Employees that offer health insurance spend an average of $6,700 per employee on it this year, nearly twice as much as in 2001, according to consulting firm Hewitt Associates.

MICHIGAN ROSS SCHOOL OF BUSINESS
Q: If large corporate employers don’t provide for health care or retirement security, who will?

A: Financial markets will

“To give every American a stake in the promise and future of our country, we will build an ownership society. We will widen the ownership of homes and businesses, retirement savings and health insurance - preparing our people for the challenges of life in a free society. By making every citizen an agent of his or her own destiny, we will give our fellow Americans greater freedom from want and fear, and make our society more prosperous and just and equal.”

George W. Bush second inaugural address, January 2005

Households had already turned into banks

- Lower transaction costs for participating in financial markets encouraged households to become both “investors” and “issuers”
- Households as investors
  - Increased use of individual pension plans
  - Savings moved from bank accounts to retail mutual funds
  - By 2001, most American families were invested in the stock market
- Households as issuers
  - Securitized home mortgages => homeowners have dispersed bondholders
  - Securitized auto loans, student loans, credit card debt, insurance settlements => homeowners are CFOs

A super-subtle agenda behind the ownership society?

WASHINGTON -- President Bush's campaign to revamp Social Security is just the boldest stroke in a much broader effort: To rewrite the government's social contract with citizens that was born of Franklin Roosevelt's New Deal and expanded by Lyndon Johnson's Great Society.

Though the president says he sees a continued role for Social Security, Democrats insist his goal is complete privatization and fear a partisan motive as well. Conservative activist and White House ally Grover Norquist, for example, says more stock owners would mean more Republicans, making the party "a true and permanent national majority." He adds: "Obviously Social Security is the key to getting this done."
Expanding home ownership

“The President believes that homeownership is the cornerstone of America’s vibrant communities and benefits individual families by building stability and long-term financial security. In June 2002, President Bush issued America’s Homeownership Challenge to the real estate and mortgage finance industries to encourage them to join the effort to close the gap that exists between the homeownership rates of minorities and non-minorities. The President also announced the goal of increasing the number of minority homeowners by at least 5.5 million families before the end of the decade.”

Ownership Society Fact Sheet

The mortgage finance industry responds

• “The company put ‘bounties’ on minority borrowers. By this I mean that loan officers received cash incentives to aggressively market subprime loans in minority communities”
  Former Baltimore-based Wells Fargo loan officer

• “Wells Fargo mortgage had an emerging-markets unit that specifically targeted black churches, because it figured church leaders had a lot of influence and could convince congregants to take out subprime loans.”
  Another Wells Fargo loan officer

Cultural effects of household participation in financial markets

• The optimist’s account: the “democratization of ownership” will turn people into sophisticated, economically literate Ayn Rand fans who knew what LIBOR is and what the Fed does

• The pessimist’s account: finance will turn people into “Trump Juniors” who view everything through the prism of investment

• And the winner is…the pessimists
  – Over ¼ of houses sold in 2005 were purchased as “investments”
  – “There’s been a change in social attitudes toward default...We’re seeing people who are current on their credit cards but are defaulting on their mortgages.” They are “homeowners in name only. Because these people never put up much of their own money, they don’t act like owners.” (Ken Lewis, Bank of America CEO)
A Copernican shift in American society

From a... to a market-centered 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 conference?

The proportion of U.S. homeowners who owe more on their mortgages than the properties are worth has swelled to about 45%, decreasing prospects for a sustained housing recovery.

Nearly 10.7 million households had negative equity in their homes in the third quarter, according to First American CoreLogic, a real estate information company based in Santa Ana, Calif.

These so-called underwater mortgagors now a roadblock to a housing recovery because the foreclosures are more likely to fall into bank foreclosure and get dumped into an already saturated market. Economists from J.P. Morgan Chase & Co. said Monday they didn’t expect U.S. home prices to hit bottom until early 2011, citing the prospect of oversupply.

Home prices have fallen so far that 5.5 million U.S. households are tied to mortgages that are at least 20% higher than their home’s value, the First American report said. More than 320,000 of these borrowers have received a notice of default, according to First American.

Most U.S. homeowners still have some equity, and nearly 24 million owner-occupied homes don’t have any mortgage, according to the Census Bureau.

But negative equity “is an outstanding risk hanging over the mortgage market,” said Mark Fleming, chief economist of First American CoreLogic. “It hinders homeowners’ mobility because they can’t sell, even if they want to move to get a new job.” Borrowers who owe more than 120% of their home’s value, he said, were more likely to default.

Mortgage troubles are not limited to the unemployed. About 260,000 borrowers defaulted on mortgages last year even though they could afford to pay — more than double the number in 2005, according to a study by Perigon and consulting firm Oliver Wyman. “The American consumer has held a long-held taboo against walking away from the home, and this crisis seems to be eroding that,” the study said.