How finance maimed America

Jerry Davis
Research Frontiers in International Business
Charleston, South Carolina
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Agenda for this talk

- ~~The corporate-centered society, 1930-2000~~
- ~~The ownership society, 2001-2007~~
- The mess we're in right now

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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)

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

10 Largest US Corporate Employers, 1960-2009

1960	1980	2009
GM	AT&T	WAL-MART
AT&T	GM	TARGET
FORD	FORD	UPS
GE	GE	KROGER
US STEEL	SEARS	SEARS HLDGS
SEARS	IBM	"AT&T"
A&P	ITT	HOME DEPOT
EXXON	KMART	WALGREEN
BETH. STEEL	MOBIL	VERIZON
ITT	GTE	SUPERVALU

Wal-Mart now employs roughly as many Americans as the 20 largest manufacturers *combined*

Manufacturing Oil Services

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Retail jobs are not like manufacturing jobs

GM

Walmart
Save money. Live better.

- 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%**

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

~~Allied Signal~~	~~Eastman Kodak~~	~~Navistar International~~
Alcoa	Exxon	~~Philip Morris~~
~~American Can~~	General Electric	Procter & Gamble
American Express	~~General Motors~~	~~Sears Roebuck~~
AT&T	~~Goodyear~~	~~Texaco~~
~~Bethlehem Steel~~	IBM	~~Union Carbide~~
Boeing	~~International Paper~~	United Technologies
Chevron	McDonald's	~~US Steel~~
Coca Cola	Merck	~~Westinghouse Electric~~
Du Pont	3M	~~Woolworth~~

Blue = in index in 1930

= gone by 2009

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

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The re-configurable supply chain is the new black

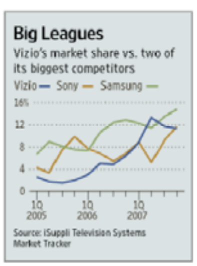
THE WALL STREET JOURNAL.
WSJ.com

LEADER (U.S.) | APRIL 15, 2008
PICTURE SHIFT

U.S. Upstart Takes On TV Giants in Price War

By CHRISTOPHER LAWTON in San Francisco, YUKARI IWATANI KANE in Tokyo and JASON DEAN in Beijing

But one upstart, Irvine, Calif.-based Vizio Inc., has largely surfed past the industry's woes. Its single focus: churning out low-priced flat-panel TVs.



Vizio is a fraction 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 2007. That's just behind Sony's 12.5% share and Samsung's 14.2%, according to research firm iSuppli Corp. Overall, Vizio's sales have multiplied to just under $2 billion last year, up from $700 million in 2006 and $142 million in 2005, 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 huge 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.

But panel technology is becoming ever more commoditized, meaning big brands aren't the only ones controlling the field. The shift has allowed nimble players like Vizio, which handles the design and marketing, to hook up with contract manufacturers and produce their own cheap TVs. At the same time, discount retailers such as Wal-Mart Stores Inc. are increasing their sales in the electronics category, slashing prices in the process.

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

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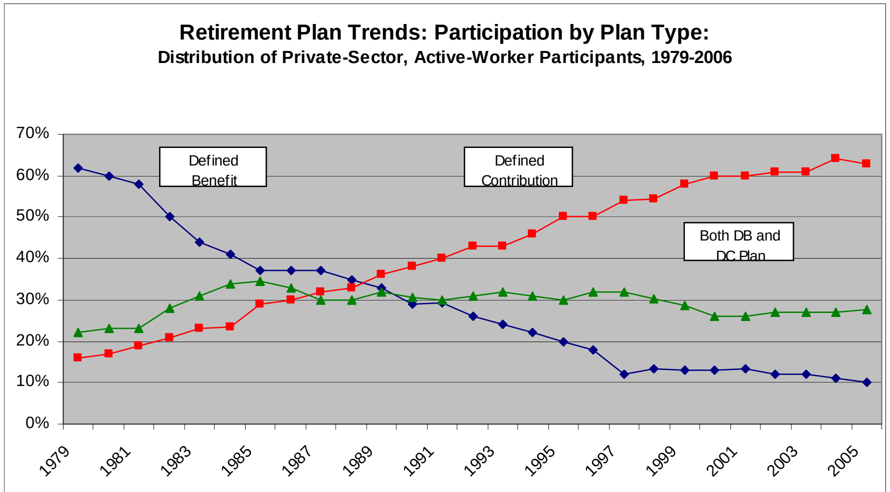
…so most employers have abandoned traditional company pensions in favor of relatively portable 401(k) plans



Source: U.S. Department of Labor, *Form 5500 Survey Report* (Summer 2004); EBRI estimates for 2002-2005

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(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.

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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

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…and the slump is finishing the job

THE WALL STREET JOURNAL.
WSJ.com

OCTOBER 19, 2009

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 firm Watson Wyatt. When the firm asked 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 can go down as well as up. 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. Employers 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.

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?

WSJ.com THE WALL STREET JOURNAL. ONLINE

February 28, 2005

PAGE ONE

New Contract

In Bush's 'Ownership Society,' Citizens Would Take More Risk

**Beyond Social Security Moves,
His Vision Encompasses
Health Care and Housing
Shrinking the Safety Net**

By JACKIE CALMES
Staff Reporter of THE WALL STREET JOURNAL
February 28, 2005; Page A1

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."

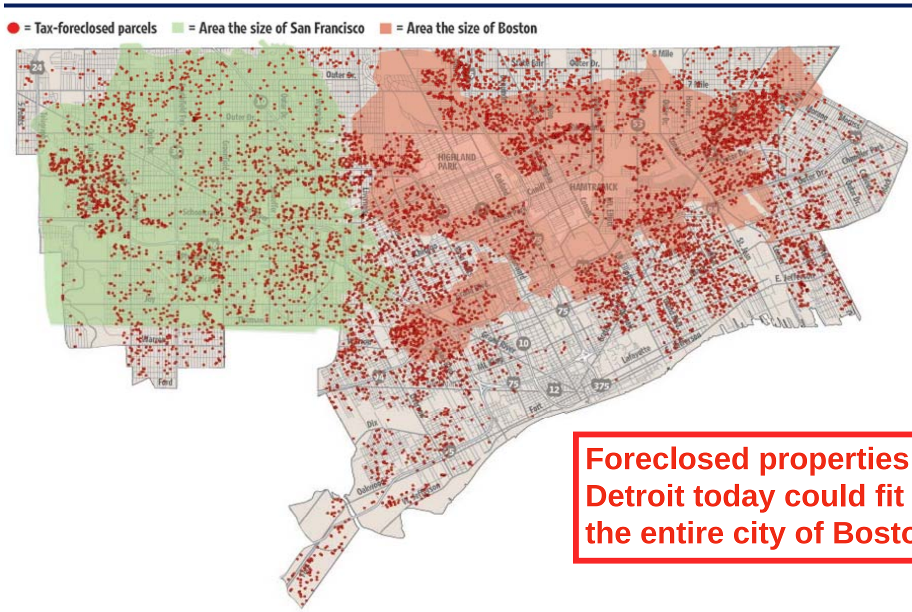
Ownership Society Fact Sheet

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

America's Homeownership Challenge indeed…



Foreclosed properties in Detroit today could fit the entire city of Boston

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)

THE WALL STREET JOURNAL.
WSJ.com

NOVEMBER 24, 2009

1 in 4 Borrowers Under Water

By RUTH SIMON and JAMES R. HAGERTY

The proportion of U.S. homeowners who owe more on their mortgages than the properties are worth has swelled to about 23%, threatening 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 mortgages pose a roadblock to a housing recovery because the properties 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.

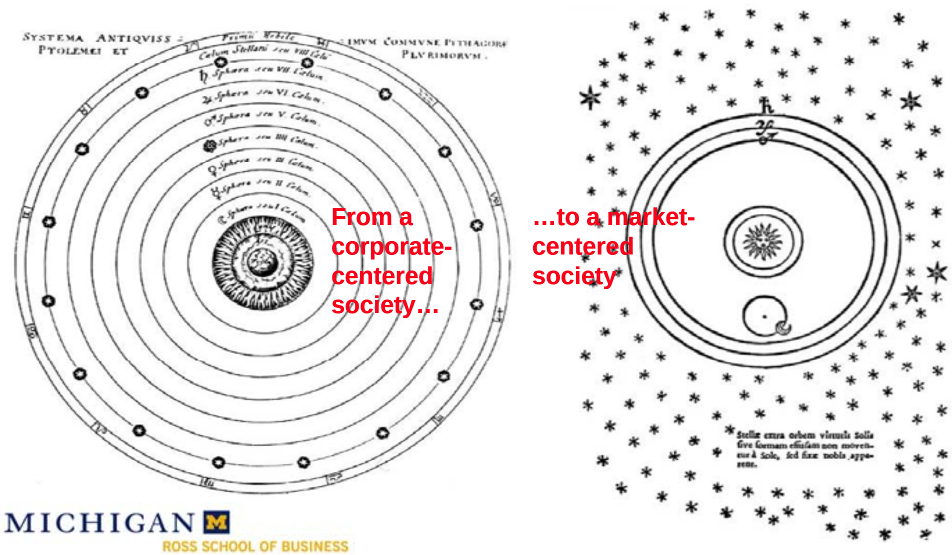
Home prices have fallen so far that 5.3 million U.S. households are tied to mortgages that are at least 20% higher than their home's value, the First American report said. More than 520,000 of these borrowers have received a notice of default, according to First American.

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 Core Logic. "It lowers 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 588,000 borrowers defaulted on mortgages last year even though they could afford to pay -- more than double the number in 2007, according to a study by Experian and consulting firm Oliver Wyman. "The American consumer has had a long-held taboo against walking away from the home, and this crisis seems to be eroding that," the study said.

A Copernican shift in American society



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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?

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