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Financialization and corporate governance[1]

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Corporate governance and financialization

It used to be thought that what we now call "corporate governance" was a rather complex affair, involving a range of difficult issues: productive efficiency, wealth and welfare, equity and justice.[3] Which models of the corporation and corporate governance were productively superior? Which most encouraged research and development and investment in new technologies? Which best contributed to job satisfaction, to social cohesion and to the realisation of some notion of the "good life"? In the 1970s and 1980s, as the developed capitalist world lurched from one economic crisis to another, many commentators came to believe that the more stakeholder-friendly models of the corporation found in Germany and Japan were not only socially more cohesive than their more shareholder-oriented counterparts in the US and the UK, but economically more efficient. Some continued to make this argument well into the 1990s. In 1992, for example, one of America's most influential management writers, Michael Porter, argued that American corporate ownership and governance structures were seriously defective, prioritising short-term shareholder returns over long-term productive investment. By incorporating the interests of employees, suppliers, customers and the local community, he argued, the structures found in places such as Germany and Japan "better capture[d] the social benefits that private investment brings".[4] In the UK in 1996, as the country prepared for the inevitable electoral defeat of the Conservatives and the advent of New Labour, commentators such as the business

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3 The term "corporate governance" emerged in the 1980s to refer to a range of issues concerning the proper management of corporations, rising rapidly to political and academic prominence as the idea that investor protection and the maximisation of shareholder value were important policy objectives gained ground. In this essay, I have taken the liberty of transporting the term back into history to describe earlier debates about the running of large joint stock corporations.

4 M Porter, "Capital disadvantage: America's failing capital investment system" (1992) 65(Sept–Oct) *Harvard Business Review* 65–82. See also M Albert, *Capitalism versus Capitalism* (New York: Four Walls Eight Windows 1993) and R Dore, *Stock Market Capitalism–Welfare Capitalism: Japan and Germany versus the Anglo-Saxons* (Oxford: OUP 2000).

economist John Kay were making very similar cases for the adoption of a conception of the corporation as a social or quasi-social institution.[5]

By this time, however, the issues surrounding corporate governance had been radically redefined and simplified. Beginning in the US in the 1970s and 1980s, with financial economists taking the lead and corporate lawyers following sheepishly in their wake, corporate governance came widely to be seen as involving a relatively simple "agency problem". Far from being a social institution as some claimed, it was argued, the corporation was a pure "fiction", a legal construct which served to facilitate private contracting.[6] It was nothing more than a nexus of contracts, including, crucially, one between managers and shareholders, the suppliers of capital. The key governance question was how could agent-managers be made to act in the interests of their shareholder-principals? The rights-based arguments for shareholder primacy which resulted from these assertions about the contractual nature of corporations were reinforced by consequentialist claims that the exclusive pursuit by managers of the shareholder interest also served to maximise productive efficiency and aggregate social wealth and welfare.[7] The result was that, by the early 1990s, the mainstream corporate governance agenda had been radically stripped down and many of the issues it had previously encompassed dismissed as irrelevant. Recognition of the contractual nature of the corporation, argued two leading American corporate law scholars, Frank Easterbrook and Daniel Fischel, "remove[d] from the field" many of the "interesting questions" that had hitherto attracted the attention of legal scholars, such as: "What is the goal of the corporation? Is it profit and for whom? Social welfare more broadly defined?" Corporate governance was about markets and contracts; about devising ways of ensuring that managers single-mindedly pursued the shareholder interest. The "interesting questions", Easterbrook and Fischel cheerfully informed the world, could therefore be answered with a conversation-stopping "Who cares?"[8]

These ideas about the subject matter of corporate governance paved the way for the emergence, initially in the US and the UK but spreading elsewhere, of the idea of "shareholder value". According to the shareholder value model of the corporation, which rose rapidly to prominence in the 1990s, the object of corporate governance is simply to ensure that managers act so as to maximise shareholder value – meaning, in essence, the dividends and capital gains accruing to shareholders.[9] To achieve this end, various strategies have been deployed. Some of them – accounting regulation and the sorts of things embodied in the UK's Combined Code on Corporate Governance – essentially operate

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5 J Kay and A Silberston, "Corporate governance" (1995) 14 *National Institute Economic Review* 84. See also W Hutton, *The State We're In* (London: Vintage 1996), calling for the establishment of a "stakeholder capitalism". They were encouraged by Tony Blair and New Labour's brief flirtation with the idea of "the stakeholder society". Although occasionally wheeled out, however, e.g. in relation to pensions, stakeholding never really emerged as the Big Idea that many thought it might become.

6 Except in relation to the limited liability of shareholders, in which context the contractualist's "fictional entity" springs suddenly and miraculously to life: see P Ireland, "Property and contract in contemporary corporate theory" (2003) 23 *Legal Studies* 453 at 474–5.

7 For a critical account of the shift from rights-based (ownership) to consequentialist (efficiency) defences of shareholder primacy, see P Ireland, "Defending the rentier: corporate theory and the reprivatization of the public company" in J Parkinson, A Gamble and G Kelly (eds), *The Political Economy of the Company* (Oxford: Hart 2001) 141–73.

8 F Easterbrook and D Fischel, *The Economic Structure of Corporate Law* (Cambridge MA: Harvard UP 1991), pp. 35–6.

9 As Julie Froud et al. point out, the rhetoric of "shareholder value" is actually very "malleable" and has been "appropriated and inflected" by a range of different groups seeking to justify their behaviour: J Froud, S Johal, A Leaver and K Williams, *Financialization and Strategy: Narrative and numbers* (London: Routledge 2006), pp. 4, 8–9, 36.

from *within* the corporation and focus on such things as the use of (allegedly) independent non-executive directors to monitor managers and executive remuneration packages linked to performance as measured by share price. Others, such as the encouragement of an active takeover market – the "market for corporate control" – operate from *without*.

By the mid–late 1990s, when the US and UK economies seemed to be faring better than their main rivals, the Anglo-American, shareholder value model of the corporation and corporate governance was being widely lauded as economically superior, leading two American academics famously to announce "the end of corporate history".[10] Indeed, during this period the establishment of Anglo-American-style corporations around the world became a key element of the neoliberal, "Washington Consensus", policy packages that international agencies, such as the World Bank and the International Monetary Fund, set about imposing on the developing world. When the OECD (Organisation for Economic Co-operation and Development) Principles of Corporate Governance first emerged in 1999 following the East-Asian financial crisis of 1997–98, it was clear that they were firmly rooted in an Anglo-American, stock market-based, shareholder-oriented model of the corporation, notwithstanding nods in the direction of diversity.[11]

Enron and the other corporate scandals that greeted the new millennium made claims about the "end of corporate history" seem a tad premature, but did little to shift the focus of the corporate governance agenda. The protection of investors and the maximisation of shareholder value remained the principle policy goals. They still are. The working assumption of policymakers continues to be that corporate governance is an agency problem and that the standard devices for protecting shareholders would work if only they were better designed and implemented. Thus far, therefore, the goal of reform has been to try to create improved versions of the standard 1990s measures; to do more of the same only better. Thus, in the UK, the Higgs Review on the role and effectiveness of non-executive directors sought more effective board supervision of executives and was used to beef up the Combined Code, while endorsing the existing self-regulatory, non-prescriptive approach. In the US, on the other hand, the response to the scandals was legislative, but the Sarbanes-Oxley Act similarly left the fundamental tenets of the existing shareholder-value-oriented structures of governance firmly intact.[12]

It remains to be seen how far the consensus which has prevailed will be shaken by the economic and financial crisis in which we are now embroiled. This paper argues that it is to be hoped that it will be, for corporate governance, and Anglo-American corporate governance in particular, is in need of radical rather than ameliorative reform. Among the things that the current economic and financial crisis has highlighted is the deeply dysfunctional nature of the highly financialized corporate cultures and systems of governance that have developed in recent decades, particularly in places such as the US and the UK. In order to develop a better understanding of the nature of these financialized forms of governance, this paper briefly sketches the rise, retreat and recent resurgence of

10 H Hansmann R Kraakman, "The end of history for corporate law" (2001) 89 *Georgetown Law Journal* 439.

11 See S Soederberg, *The Politics of the New Financial Architecture* (London: Zed Books 2004), ch. 5. The principles were revised in 2004. Compliance with them is theoretically voluntary, but in practice it is near compulsory for states who wish to retain their credibility with foreign investors.

12 See D Higgs, *Review of the Role and Effectiveness of Non-executive Directors* (London: DTI January 2003); the Public Company Accounting Reform and Investor Protection Act 2002, known as Sarbanes-Oxley (SOX). George W Bush claimed that the Act implemented the "most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt": *New York Times*, 31 July 2002. SOX sought, amongst other things, to establish new or enhanced standards for the boards of US public companies and established a new quasi-public agency, the Public Company Accounting Oversight Board to regulate accounting firms in their capacities as auditors of public companies.

financial power and traces its impact on the way in which corporations have been run. En route, it examines the critiques of financialization and financialized corporate governance developed by writers such as Thorstein Veblen, Adolf Berle, R H Tawney, Harold Laski and John Maynard Keynes in the opening decades of the 20th century. Against this backdrop, the paper suggests that the simplistic conception of corporate governance as an "agency problem", a straightforward question of investor protection, is itself a product of resurgent financial power and needs to be discarded. Corporate governance reform, it argues, is a complex, multi-faceted matter which demands that we rethink the way in which we conceptualise the large public corporation and radically revise our understanding of what corporate governance is about. The crisis in the financial system and the measures that governments around the world are being forced to take to try to rescue it, the paper concludes, may provide us with a historic opportunity to do this. In trying to map ways forward, it advocates a return to these earlier critiques for guidance as to the direction in which we should be heading.

The corporate revolution and the rise of finance capitalism

In recent years, social scientists, reflecting on the dramatic economic and social changes of recent decades, have begun to deploy a new concept, "financialization", to try to grasp what has been happening. As Greta Krippner notes, the term has been used to refer to rather different phenomena. Some have used it to refer to the growing dominance of stock-market-based over bank-based systems of capitalism; others to refer to the massive increase in (and trading of) financial property forms; still others to refer to the changes that have taken place in corporate governance and to the rise of the shareholder value corporation. Krippner herself sees it as the process whereby profits are sought through financial rather than productive channels – through the creation of and trading in financial property.[13] In similar vein, for Gerald Epstein financialization refers to "the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies".[14] A number of other commentators, trying to grasp the same phenomena, have resurrected the older concept of "finance capitalism", which first appeared in the opening decade of the 20th century, arguing that a "new finance capitalism" has emerged.[15] Indeed, in recent months, more and more commentators and policymakers have begun to rummage through history for guidance as they struggle to understand the nature and causes of the financial crisis which has engulfed the global economy. In this context, the depression of the 1930s has attracted particular attention. Can history and the concepts of finance capitalism and financialization help us to grasp the nature and trajectory of contemporary corporate governance, to identify its peculiarities and weaknesses, and critically to assess the current reform agenda?

13 G Krippner, "The financialization of the American economy" (2005) 3 *Socio-Economic Review* 173. In the US, the proportion of profits earned by financial and non-financial corporations has dramatically changed. From 1946–50, the proportion of profits earned by financial corporations averaged a little under 10%, rising with increasing rapidity thereafter, peaking at 45% in 2002 before falling back to 33% in 2006, mainly because of a sharp increase in profits among non-financial firms.

14 G Epstein, "Introduction" in G Epstein (ed.), *Financialization and the World Economy* (Cheltenham: Edward Elgar 2005), p. 3. See also "General introduction" in I Erturk, J Froud, S Johal, A Leaver and K Williams, (eds), *Financialization at Work* (London: Routledge 2008), p. 1.

15 See e.g. G Davis, "A new finance capitalism? Mutual funds and ownership re-concentration in the United States" (2008) 5 *European Management Review* 11.

The term finance capitalism was first coined by the Austrian economist Rudolf Hilferding in 1910.[16] Significantly, Hilferding's invention of the term was sparked by the "rise of the corporate economy", the processes whereby the economies of the most industrialised countries of the West came increasingly to be dominated by a relatively small number of very large incorporated joint stock companies.[17] In developing his analysis of contemporary capitalism, Hilferding drew heavily on the work of Marx, who, like Adam Smith a century earlier, had noted that the joint stock company is an organisational form which "transform[s] the actually functioning capitalist into a mere manager" and the "owner of capital into . . . a mere money-capitalist" whose interest in the firm is purely pecuniary.[18] It is an organisational form, in other words, in which the interest of shareholders tends to be predominantly, if not wholly, financial in nature and to which financialization is, in that sense, inherent. In joint stock companies the tangible, productive assets are owned by a corporate entity, a legal person "completely separate" from the company's shareholders.[19] The shareholders, the great majority of whom are pure *rentier* investors who take little or no active part in management or the monitoring of management, have no direct proprietary interest in those assets.[20] They own a quite separate and autonomous piece of intangible financial property in the form of a saleable right to revenue (dividends) to which control rights are usually attached. Intangible revenue rights of this sort, of which the corporate share is but one example, have a market value of their own based on the capitalised value of the anticipated income streams. In the case of corporate shares, this value is quite separate and different from the value of the corporation's assets. The value of all these intangible revenue rights, which Marx referred to as "fictitious capital", is inherently speculative in nature as it is derived not from their concrete properties as physical objects or from the value of any tangible assets underlying them, but from their anticipated *future* earning power – from a capitalisation of the revenues that are *expected* to accrue to them in the future. This is especially true of shares, the rate of return on which is not usually fixed in advance.[21] As a result, joint stock companies and their shares have, unsurprisingly, from their inception been associated with the fraudulent manipulation of expectations, with speculative bubbles, periods of frenzied company promotion and, of course, spectacular financial collapses.[22]

In this respect, the "corporate revolution" of the late 19th and early 20th centuries was no exception. There was a dramatic decline in owner-management, a massive increase in the number of joint stock corporations and volume of intangible financial property, and no shortage of fraud and financial manipulation. What attracted Hilferding's attention, however, was the way in which the changes in the dominant property forms had paved the way in Germany and the US, though not in the UK, for the domination of many sectors of production by a small number of financiers and industrialists. Using a wide variety of

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16 R Hilferding, *Finance Capital* (London: RKP 1981 ((first published 1910)). Hilferding mixed Marxist economics with Social Democratic politics and twice served as the Minister of Finance in 1920s Germany. In *Finance Capital*, he argued that the concentration and centralisation of capital was leading to the domination of industry and commerce by large banks (finance capital) and that this was generating a socialisation of production.

17 L Hannah, *The Rise of the Corporate Economy* (London: Methuen 1976).

18 K Marx, *Capital* (London: Lawrence & Wishart, 1974), vol. 3, chs 23 and 27.

19 P Davies, *Gower's Principles of Modern Company Law* 6th edn (London: Sweet & Maxwell 1997), p. 79.

20 See P Ireland, "Capitalism without the capitalist: the joint stock company share and the emergence of the modern doctrine of separate corporate personality" (1996) 17 *Journal of Legal History* 40.

21 See Marx, n. 17 above, vol. 2, ch. 1; vol. 3, chs 23 and 27. Marx's concept of fictitious capital was used and developed by Hilferding in *Finance Capital* (n. 16 above), pp. 107–16. See also P Ireland, I Grigg-Spall and D Kelly, "The conceptual foundations of modern company law" (1987) 14 *Journal of Law & Society* 149.

22 See J Taylor, *Creating Capitalism: Joint-stock enterprise in British politics and culture, 1800–1870* (Woodbridge: Boyden Press 2006).

devices – preference and non-voting shares, debentures, voting trusts and holding companies – these financiers were able to organise the financialized ownership structures of the new corporate behemoths in such a way that they were able to exercise disproportionate power, dominating them with minority holdings. "Taking possession of six large German banks", Hilferding wrote, "would mean taking possession of the most important spheres of large-scale [German] industry."[23] Moreover, these financiers usually exercised control in a quite direct manner. In the US, for example, people like J P Morgan were famous for dominating boards using nominees and complex networks of interlocking directorships.[24] The form of capitalism which emerged from this, one in which productive activity (industry) was dominated by what came to be called "high finance", Hilferding dubbed "finance capitalism".

The conservative critique of financialized governance

The changes wrought by the corporate revolution and the emergence of finance capitalism on the ways in which productive activity was conducted – the processes whereby the governance of industry was financialized – were highly controversial, especially in places such as Germany[25] and the US where grave concern was expressed at the power of the so-called "money trust".[26] There emerged from this two rather different agendas for reform. One of them was rather narrow in focus and conservative in nature; the other was not only much wider in scope but markedly more radical.

In many respects, the conservative reform agenda which emerged resembles the reform agenda which has risen to dominance in recent years. Its focus was the fate of the small investor and, more especially, the fate of the small, non-controlling minority shareholder. In the UK, where industry was never dominated by finance in the same way as in the US and Germany but where the growing separation of ownership and control in large joint stock corporations had manifested itself even earlier,[27] concerns had long been expressed about the failings of "shareholder democracy" and the fate of the "private investor vis-à-vis the

23 See Hilferding, n. 16 above, p. 368. Hilferding later partially qualified this claim following criticisms that he had exaggerated the strength of the banks. In his introduction to the new German edition of the book, however, Eduard Marz defended Hilferding's position, arguing that while his critics may have been right on specific points, the substance of Hilferding's thesis was sound: see T Bottomore, "Introduction" to Hilferding, n. 16 above, p. 6. More recently, Alexander Dyck has also defended this view: "Comment" in R Morck (ed.), *A History of Corporate Governance Around the World* (Chicago: Chicago UP 2007), p. 277. The key to the power of the German banks lay in bearer shares.

24 For a contemporary account of this, see L Brandeis, *Other People's Money and How the Bankers Use It* (New York: Stokes & Co. 1914). See also M Becht and J Bradford DeLong, "Why has there been so little blockholding in America?", in Morck, n. 23 above, p. 613.

25 In 1908, one German commentator, Ruhland, argued that "the word capitalism denotes today a social system in which the liberty and practice of usury is more or less completely legalized . . . money interests predominate . . . trade and robbery, gain, usury, and extortion merge into each other": quoted in G Edwards, *The Evolution of Finance Capitalism* (London, New York & Toronto: Longman's, Green & Co. 1938), p. 73.

26 The direct domination of American industry by a plutocratic financial and industrial elite (the "money trust") underlay the investigations of the Pujo Committee in 1912–13, Brandeis' *Other People's Money* (n. 24 above), and also, some argue, Frank Baum's *The (Wonderful) Wizard of Oz* (Chicago & New York: George M Hill 1900).

27 See L Hannah, "The divorce of ownership and control from 1900: re-calibrating imagined global historical trends" (2007) 49 *Business History* 404. For a critique of Hannah's view, see B Cheffins, *Corporate Ownership and Control* (Oxford: OUP 2008), ch. 7.

public company".[28] It was, however, in the US, where financial property and share ownership spread very rapidly during the course of the 1920s but where financial institutions retained de facto control of many corporations, that the conservative critique of financialized corporate governance was elaborated and developed.

It was widely believed that the financiers and investment banks that controlled many of the leading American corporations were not only engaging in self-seeking financial manipulations such as stock-watering and insider-dealing, but appropriating a disproportionate share of the profits of industry at the expense of the ordinary (middle-class) investor. This fear animated popular works such as Louis Brandeis' *Other People's Money* and William Z Ripley's *Main Street and Wall Street*.[29] It also inspired the early work of Adolf Berle. In the 1920s, when Berle was working as a corporate lawyer on Wall Street and beginning to forge a career as an academic, he became increasingly concerned about the behaviour of the managers of the largest US corporations. In a series of law journal articles, the earliest of which were gathered together in *Studies in the Law of Corporation Finance*,[30] he highlighted the vulnerability of the small, "enforced" or "public" investor in the face of increasingly absolute and often finance-dominated, managerial power.[31] Many of the directors of the large corporations which increasingly dominated American industry, Berle argued, were not only feathering their own nests but channelling the proceeds of industry to controlling minority shareholders – meaning, in most cases, to financiers and investment banks – at the expense of the small investor. Indeed, so absolute had the powers possessed by corporate managers become, they were in many cases, Berle suggested, able to determine the very content of the property rights vested in shareholders.[32]

Initially, Berle looked to the judiciary and to self-regulation by stock exchanges and investment banks to remedy these problems, seeking a significant strengthening of the fiduciary duties owed by directors to shareholders. It needed to be emphasised, he argued, that these duties were owed to *all* shareholders, not merely controlling minorities.[33] It wasn't long, however, before Berle recognised the limits of the common law and self-regulation in

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28 H B Samuel, *Shareholders' Money* (London: Sir Isaac Pitman & Sons 1933), p. vii. Samuel's book, written from the perspective of the small shareholder, criticised the reforms implemented in the Companies Act 1929 and proposed a range of new legislative reforms aimed at investor protection. For pithy observations about the inability of shareholders in mid-19th-century British railway companies to control directors and their vulnerability to fraud, see Herbert Spencer's "Railway morals and railway policy" (1654) 100 *Edinburgh Review* 420. In this context, see also F W Hirst, *The Stock Exchange* (London: Williams & Norgate 1911); and H Withers, *Stocks and Shares* 3rd edn (London: Smith, Elder & Co. 1914). According to Withers, the shareholder was "merely a necessary appendage who provides capital, takes his dividends when he can get them, and has even less voice in the management of the company than the average elector has in the conduct of the Foreign Office". It was "just as well that this should be so", given their ignorance, pp. 57–9.

29 Brandeis, *Other People's Money*, n. 24 above; W Z Ripley, *Main Street and Wall Street* (Boston: Little Brown 1927).

30 Adolf Berle, *Studies in the Law of Corporation Finance* (Chicago: Callaghan & Co. 1928).

31 Berle used the term "enforced", "public" investor to refer to those who had no choice but to put their savings "into the channels of corporation finance", either directly or indirectly through the medium of insurance companies, investments trusts, commercial banks or savings banks. Berle argued that two developments had put the small enforced investor at risk. Firstly, the lifting of earlier restrictions on managerial power which had resulted in managers acquiring "absolute powers" subject only to "embryonic . . . social controls". And, secondly, the processes whereby "concentrated minority interests" or "controlling minorities" – which he clearly associated with investment banks – had gained control of corporate assets and income streams, Berle, *Studies*, n. 30 above, pp. 43–5, 190.

32 They were, in particular, able to remove or dilute the voting rights of shareholders, concentrating power in a minority of the shares, the so-called "management stock", thereby facilitating "bankers' control"; Berle, *Studies*, n. 30 above, p. 42.

33 It was his emphasis on the protection of the shareholder interest that led Berle into his celebrated debate with another American corporate lawyer, Merrick Dodd.

this context and began to call for greater state regulation, becoming one of the leading advocates of the measures contained in the New Deal legislation.[34] Believing that the ownership of financial property was the only means whereby "men [could] carry the burdens of those parts of life which, in the nature of things afford no chance to labour: childhood, sickness, old age", Berle was very anxious to protect the holdings of the growing number of middle-class investors.[35] Indeed, he wanted not only to secure the integrity of financial property but to broaden its base; to create what he later called a "people's capitalism", something similar to the shareholding democracies sought by politicians today.[36] He wanted, says his biographer, Jordan Schwarz, to be the "Marx of the shareholder class"; to make the stock exchange "more like a savings bank and less like a roulette wheel".[37]

The radical critique of financialized governance

Although the financial world has, of course, changed a great deal since 1930, there is much in this conservative critique of financialized corporate governance that is familiar. In recent decades the corporate governance agenda has come once again to focus on the question of how shareholders and investors might be protected from the financial frauds and malfeasances perpetrated by overly powerful, largely unaccountable managers. There emerged from the first finance capitalism, however, a much more radical critique of the financialized forms of industrial governance spawned by the corporate revolution, one which was critical not merely of certain undesirable aspects of financialization but of financialization *tout court*. Leading the assault was the economist and sociologist Thorstein Veblen, the principal critic and grand theorist of American finance capitalism.[38]

Veblen argued that, with the rise of the joint stock corporation, "*industry*" – the technical processes concerned with the efficient production of useful goods; what he referred to as the "use of the industrial arts" – had fallen under the control of "*business*" – which was concerned with making money rather than things. For Veblen, "business" in this context meant "finance".[39] Increasingly, he argued, industrial processes were being managed not primarily to enhance productive efficiency and maximise output, but to secure pecuniary gains for the owners of financial property. One result of this – and of the rapid growth in the number of and markets for corporate securities – was what Veblen called the shift from a "money economy" in which product markets were dominant to a "credit economy" where capital markets were dominant.[40] Another was that money-making was becoming increasingly disconnected from what is now often referred to as the "real" economy. Large fortunes were being made not from improving productive techniques but from the creation of corporate securities (fictitious capital) through the capitalisation of

34 On this and the Berle–Dodd debate, see W Bratton and M Wachter, "Shareholder primacy's corporatist origins: Adolf Berle and *The Modern Corporation*" (2007) Georgetown Law Centre (Business, Economics and Regulatory Law), Research Paper 1021273.

35 This quotation is taken from the "The New Individualism", the famous Commonwealth Club address that Berle (and his wife) wrote for Franklin Roosevelt in September 1932: see B Bishop Berle and T Jacobs, *Navigating the Rapids 1918–71* (New York: Harcourt 1973), pp. 61–70. Berle used very similar words in one of his replies to Dodd: see "For whom corporate managers are trustees: a note" (1932) 45 *Harvard Law Review* (1932) 1365, at 1368.

36 See A Berle, *New York Times Magazine*, 1 November 1959; and *Power without Property* (New York: Harcourt 1959).

37 J Schwarz, *Liberal: Adolf A Berle and the vision of an American era* (New York: Free Press 1987), pp. 57–8, 62.

38 F G Hill, "Veblen, Berle and the modern corporation" (1967) 26 *American Journal of Economics and Sociology* 279, at 281.

39 Ibid., at p. 281.

40 T Veblen, *The Theory of Business Enterprise* (New York: Mentor 1958 (first published 1904)).

presumptive revenue streams and subsequent manipulation of their market values.[41] The problems associated with joint stock companies and the intangible revenue rights that they spawned – fraud, financial manipulation, speculation – had hitherto been confined to the relatively small joint stock sector of the economy.[42] With the corporate revolution, they were generalised.[43] For Veblen, with his technocratic bent,[44] worse still was the fact that the pursuit of financial gain by business often led to the "conscientious sabotage" of industry by corporations using their monopoly powers to reduce output and fix prices at artificially high levels – "manoeuvres [which] were disserviceable not only to community but to concerns as going business organisations".[45] Far from furthering productive efficiency, Veblen concluded, the rise of modern corporate enterprise and the domination of industry by business was impeding it.[46]

By the 1920s, by which time the direct personal control exercised by financiers like Morgan was being replaced by the impersonal, bureaucratic routines of investment banks, the focus of Veblen's assault on the financial control of corporations had shifted somewhat and in so doing acquired a rather modern ring. "Business enterprise" and "particularly American business enterprise", he argued, "habitually looks to the short run". Managers were sacrificing long-term productive gains in favour of "an enhanced rate of earnings for the time being".[47] As before, this operated against the best interests of the community, which lay "in the efficient management of . . . concern[s] as . . . industrial enterprise[s]" and was "best served by an unhampered working out of the industrial system at its full capacity without interruption or dislocation".[48] By contrast, the short-term financial interests of the "absentee owners" of industry were often best served by obstructing productive activity and conspiring against the full use of the "industrial arts; by 'deranging and retarding' the industrial system".[49]

By this time, Veblen's attack on the financial control of industry and resulting subordination of productive activity to pecuniary goals had elided into a thoroughgoing attack on the financial property forms through which this control was exercised. The classic liberal justifications for absolute property rights, he argued, simply did not apply to passive, financial property. The new absentee owners of industry had delegated the

41 Promoters, Veblen argued, would inevitably be tempted to try to maximise perceptions of the presumptive revenue streams in order to create securities with the highest possible capital value – what Hilferding later referred to as "promoters' profit". Managers would be tempted to "induce discrepancies . . . favourable for the purchase or the sale [of corporate securities], between the actual and the putative earning-capacity of the corporation's capital". The result was that corporations were "in good part managed for tactical ends" rather than for "the benefit of the corporation as a going concern": see Veblen, *Business Enterprise*, n. 40 above, pp. 7–8, 80.

42 See Taylor, *Creating Capitalism*, n. 22 above and accompanying text.

43 As indicated above, intangible financial property – rights to receive future revenues – are inherently speculative in nature: see text preceding n. 21.

44 He was, for example, a member of The Technical Alliance, founded in 1919 by Howard Scott.

45 See Joseph Dorfman, *Thorstein Veblen and his America* (New York: Viking Press 1934), pp. 227–8.

46 Veblen described these processes in *Absentee Ownership* (New York: Viking Press 1945 (first published 1923)). See also T Veblen, *The Engineers and the Price System* (New York: Huebsch 1921).

47 Veblen, *Absentee Ownership*, n. 46 above, p. 214.

48 Veblen, *Business Enterprise*, n. 40 above, p. 78; T Veblen, *The Vested Interests and the Common Man* (New York: Huebsch 1919) , p. 93.

49 Veblen, *Vested Interests*, n. 48 above, pp. 97–8, 105. Hence Veblen's claim that business had become a parasitic growth on industry. And that the investment bankers and corporate financiers had become as restrictive of further economic development as the old landed elite. As long as business controlled industry, he argued, productive activity would inevitably be accelerated and slowed down with a view enhancing business profits.

traditional powers of ownership to managers, retaining "only its rights and immunities".[50] "Ownership" in the new corporate order had come to be radically "depersonalised" and "no longer carrie[d] its earlier duties and responsibilities". It had been stripped of the "essential part of its ordinary functions" and had come to "take the shape of an absentee ownership of anonymous corporate capital". Corporate shareholders had been reduced to the status of "anonymous pensioners" whose personal identities were irrelevant "even to the concern itself". They were, in effect, "anonymous creditors", "anonymous outsiders", who not only resembled bondholders rather than "real" owners, but whose "sole effective relation to the enterprise [was] that of a fixed 'overhead charge' on its operations".[51] They were the owners of rights to receive a "free income" drawn from "the . . . product of the underlying community".[52]

By the 1920s, more and more commentators were echoing these views about the changing status of the corporate shareholder and the blurring of the lines between debt and property, and credit and capital.[53] Although British industry had never fallen under financial control in the same way as American and German industry,[54] a very similar and equally radical critique of the *rentier* and financialized industrial governance emerged. Noting the growth of intangible financial property forms like the share, for example, the sociologist L T Hobhouse, one of the intellectual inspirations of the New Liberalism, drew a distinction between what he called "property for use" and "property for power", the latter referring to the stocks and shares of the "joint-stock system" which conferred income rights on their holders. Property for use had been "virtually abolished" in the productive sphere, Hobhouse argued, while property for power – "these investments, this capital" – had become "the governing force in the lives of thousands and millions of men scattered throughout the world". With financiers controlling and "shuffling" the "abstract pieces of capital" of the "mass of investors",

> the institution of property ha[d], in its modern form, reached its zenith as a means of giving to the few power over the life of the many, and its nadir as a means of securing to the many the basis of regular industry, purposeful occupation, freedom and self-support.[55]

The critique of the *rentier* found its most developed British expression, however, in the work of the Labour Party intellectuals and Fabians, R H Tawney and Harold Laski. In 1921 in his influential book, *The Acquisitive Society*, Tawney, clearly drawing on Veblen, launched a fierce attack on what he saw as the inherently pernicious and parasitic nature of intangible financial property forms such as the share.[56] Like Veblen, he argued that the traditional justifications for private property rights were inapplicable to property forms of this sort which divorced gain from service and reward from work. Unlike rights to tangible personal

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50 Veblen, *Absentee Ownership*, n. 46 above, p. 331.

51 Veblen, *Vested Interests*, n. 48 above, pp. 44–5.

52 Ibid., pp. 163–4.

53 See e.g. F Wood, "The status of management stockholders" (1928) 38 *Yale Law Journal* 57.

54 See e.g. D H Robertson, *The Control of Industry* (London: Nisbet 1923), pp. 81–2.

55 L T Hobhouse, "The historical evolution of property in fact and in idea", in C Gore and L T Hobhouse (eds), *Property: Its duties and rights; essays with an introduction by the Bishop of Oxford* 2nd edn (London: Macmillan 1922 (1st edn 1914)), pp. 23–4. Hobhouse, who taught at LSE, was one of the intellectual inspirations for the New Liberalism of the Liberal Party under Asquith and Lloyd George. Hobhouse argued that as property was acquired not only by individual effort but by societal organisation, it followed that it entailed obligations to society. This helped to justify redistributory policies and measures such as the new state pension.

56 R H Tawney, *The Acquisitive Society* (London: G Bell 1921). Tawney was a Christian Socialist, Fabian and member of the Labour Party. He also taught at the LSE where he was for many years a professor of economic history. He crossed paths with Veblen when he visited the US.

possessions, which could be defended on functional grounds as "indispensable to a life of decency and comfort" and as encouraging industry and individual initiative, these new intangible, passive property forms – the rights to revenue which had proliferated in recent decades – were "functionless". Indeed, in directing productive activity towards "acquisition" rather than "service to society", they were positively *dys*functional, dissipating creative energy, "corrupting the principle of industry" and distorting productive activity. In order that industry might be redirected along a more productively rational and socially beneficial path, the rights acquired through share ownership had to be attenuated and management turned into a "profession" akin to medicine and law.[57] Shareholders had to be stripped of their rights of control and relegated to the status of "creditors paid a fixed rate of interest". This would release industry from financial control and enable it to be reorganised in productively functional ways, something which, Tawney argued, would entail the adoption of different organisational forms and rights structures in different contexts.

A few years later, Harold Laski echoed these sentiments in his *Grammar of Politics*.[58] For Laski, as for Tawney, the justification and moral basis for property rights lay in their ability to perform socially useful functions. The problem was that with the rise of the joint stock corporation there had been a massive growth in functionless property. An "investing class" not involved in management had emerged, "freed from the legal obligation to labour" and "maintained in parasitic idleness".[59] Although this class inevitably tended to be "idle and wasteful", it had come to "dominate [society's] institutions". As a result, functionless property, whose objective was "simply the maximum profit", had become "the controlling factor in industrial production". With this, the "notion of function" had all but "disappear[ed] from the direction of industrial enterprise", as had the "ideal of service". Like Tawney, Laski believed that for industry to be "informed by a purpose relevant to the general well-being" it had to be "made a profession . . . informed by a principle of public service" and that for this to happen "certain changes" were "immediately . . . necessary", most notably an "alteration of the character of the owner of wealth into a person to whom a fixed dividend is paid for the use of his wealth".[60] By removing the functionless owner

57 Tawney was by no means the first to do this. Louis Brandeis, for example, had written in 1912 of the need to redefine business as a profession "which is pursued largely for others and not merely for one's self" in which "the amount of financial return is not the accepted measure of success". Among the criteria of excellence of performance selected by professions was "service to the community": L Brandeis, "Business – a profession" (October 1912) *System*, later republished in L Brandeis, *Business – A profession* (Boston: Small Maynard 1914).

58 H Laski, *A Grammar of Politics* (London: Allen & Unwin 1925). Laski devoted lengthy chapters to "Property" (ch. 5) and "Economic institutions" (ch. 9). Like Tawney and Hobhouse, who taught him, Laski was based at the LSE. He was a Fabian and member of the Executive Committee of the Labour Party. Both his and Tawney's work were read in the US. Laski also, of course, engaged in correspondence with Oliver Wendell Holmes.

59 Ibid., pp. 175, 185–6. "No one, I think", Laski wrote, "can seriously pretend that the average investor in modern business takes the slightest interest in the working of the concern from which he draws his profit. He is not searching for new methods. He does not keep himself abreast of technical discoveries and seek to enforce their use upon the management. He rarely attempts criticism of the company's operations except when he is deprived of his expected dividend; and the case is rare for him to attempt opposition to any person nominated as a director of the company. As a definite factor, indeed, he is practically obsolete . . ."; p. 484.

60 Ibid., pp. 201–9. For Laski, this attenuation of the rights of corporate shareholders was quite defensible. The distinction drawn between "owning and earning" was, he argued, "morally legitimate". Property forms granting people rights to receive part of the product of the labour of others lacked "the moral penumbra which entitle[d] them to respect". As far as he was concerned, the "abolition of the rights" of functionless property was necessary to reorient industry towards "service" and part of "the necessary path to justice". Like Tawney, Laski did not deny the right of investor–shareholders to receive an income on their capital, arguing that the state needed to protect not only the welfare of the producer and consumer but that of "the investing public". Capital was not, however, to be regarded as "the natural residuary legatee of profit" and was to receive only a fixed and limited return; pp. 184–5, 208, 477, 483.

in this way, Laski believed, the character of industry would be altered and the process of production could be "infuse[d] with the sense of responsibility it now lacks". This was a transformation, he argued, which would have to be "accomplished in very various ways", differing between industries and entailing a range of measures from outright nationalisation to public regulation. While Veblen's concerns about the governance of industry were almost entirely productivist and technocratic, however, both Tawney and Laski were also concerned about the experience of workers and the dignity of labour and sought to factor this into their proposals. Laski, for example, envisaged that any surpluses remaining after workers had been paid, investors remunerated and new investments made would be divided in equal parts between the investors, labour and management, and that workers should and would be involved in "the direction of the industry". He therefore proposed that one half of the seats on a company's board of directors be reserved for the elected representatives of labour and management.[61]

Diluted radicalism: corporate governance and the depression

Despite their influence within the Labour Party, the agenda for radical reform sketched by Tawney and Laski was not turned into concrete proposals. The Labour Party's contributions to the debates surrounding company law reform which preceded the passing of the Companies Act 1929, for example, were muted and narrow in focus.[62] In the US, however, diluted versions of the radical critique of financialized corporate governance emerged and attracted considerable support during the course of the Depression. These diluted versions of the radical reform agenda were evident in E Merrick Dodd's contributions to the Berle–Dodd debate and also in the closing chapters of Berle and Means' famous *The Modern Corporation and Private Property* which clearly drew on the work of Veblen, Tawney and Laski, albeit without attribution.[63]

Dodd, Berle and Means all recognised that the great majority of the shareholders in the large joint stock corporations, which were coming increasingly to dominate industrial production, were *rentiers* – owners of "passive property" who bore little resemblance to traditional "owners". The sheer size and economic power of these joint stock corporations and the growing distance between them and their shareholders had led to a situation in

61 Laski, *Grammar*, n. 58 above, pp. 209, 433. In his chapter on economic institutions, for example, Laski explored various possible organisational forms. Industries "urgently affected by a public character", "monopolistic in their nature", had "to be operated for use and not for profit". Here nationalisation was "the only possible method of government", though there was still considerable room for experimentation in its specific form. Other industries, like agriculture, were producing "urgent commodities which are not naturally monopolistic". Here there "may clearly be a large place for the individual producer". Still other industries were producing "commodities not invested with a public character" and here "the forms of industrial government may be as various as human ingenuity can suggest". Laski did not, therefore, "envisage anything like the disappearance of private enterprise", though its ambit would be smaller and it would be subject to much more rigorous public regulation. In all cases, "the public regulation of industry was essential"; pp. 436, 481.

62 Although both Tawney and Laski were two of the Labour Party's most influential thinkers at this time and both contributed to the 1929 manifesto, *Labour and the Nation*, the document makes little use of these ideas. Nor did the party's contributions to the debates surrounding what became the Companies Act 1929: see B Clift, "The Labour Movement and Company Law Reform 1918–45" (1999), Political Economy Research Centre (Sheffield), Research Paper 1, pp. 8–12.

63 A Berle and G Means, *The Modern Corporation and Private Property* (New York: Macmillan 1932). Berle and Means' work is, one writer suggests, permeated by "Veblenite echoes": see D M Wright, "The modern corporation – twenty years after" (1951–52) 19 *University of Chicago Law Review* 662. Berle was familiar with Veblen's work and cited him in a paper delivered shortly after the latter's death: see A Berle, assisted by G Means, "Corporations and the public investor" (1930) 20 *American Economic Review* 54. Berle, who "was not given to false modesty", conceded that *The Modern Corporation and Private Property* was not wholly original: see Schwarz, *Liberal*, n. 37 above, p. 62.

which it was clearly arguable that it was no longer appropriate to see these corporations as "private enterprises" to be run solely in the shareholder interest. On the contrary, they increasingly resembled s*ocial* or *public* institutions, a view which, as Dodd pointed out, was hard to square with the idea that they were the private property of shareholders, but perfectly defensible if one took separate corporate personality more seriously and treated them as genuinely separate entities. From this perspective, it was a short step to arguing that corporate directors owed duties not only to shareholders but to employees, consumers, creditors and society as a whole.[64] Further support for this potentially radical re-conceptualisation of the corporation came from the ever-expanding army of corporate managers, who, seeking to justify and legitimate their own growing power, began to try, as Brandeis, Tawney and others had advised, to establish themselves as a "profession". They did this in part by claiming that their job was not simply to make money for shareholders but to reorient productive activity towards "service to the community".[65]

One of the most interesting contributions to these debates was made by William O Douglas, who was shortly to become first a member and then chair of the Securities and Exchange Commission, and, later, a member of the US Supreme Court. Douglas likened the institutions of high finance to "termites" who fed off industrial enterprises. They were "interested only in immediate profit", seeing corporations as mere "pieces of paper – conglomerations of stocks, bonds, notes, debentures". Under their pernicious influence, productive industries had ceased to be "vital processes in economic society" and become "channels of money which [could] be diverted and appropriated by those in control".[66] Writing in 1934 about the new legislative framework for securities regulation, Douglas observed that many saw it as a triumph for the small investor over these predatory financiers and bankers, and that the main criticism which had been levelled at it was that it would not work to protect investors in the manner hoped. In fact, Douglas argued, a much more serious criticism could be made of the new framework: that in focusing exclusively on the protection of investors it was hopelessly backward-looking. The Securities Act, Douglas suggested, was at root "a nineteenth century piece of legislation" which was trying to turn the clock back by restoring shareholder control while failing to address the "fundamental problem of the increment of power and profit in our present forms of organization". As such, it stood at odds with the more collectivist thrust of the rest of the New Deal, which sought "greater mastery of the forces of competition and monopoly, consumption and production, prices and costs, profits and losses". What was needed, Douglas suggested, was an approach which, rather than trying to "more closely assimilate [the investor] into the enterprise", sought instead to harness the "instruments of production not only for the ancient purpose of profit but for the more slowly evolving purpose of service in the sense of the public good". For Douglas, corporate self-governance and the pursuit of profit needed to be "coupled with a slowly increasing and more articulate form of public control", with "constructive planning and organization conditioned by the requirements of the public good". In other words, state regulation needed to focus not only on the protection of the investor but on the protection of the public at large.[67]

Implicit in these ideas, of course, was a rejection of the principle of shareholder primacy and of the view that corporate governance was a simple matter of shareholder

64 See E Merrick Dodd, "For whom are corporate managers trustees?" (1932) 45 *Harvard Law Review* 1147; Berle and Means, *The Modern Corporation*, n. 63 above, book 4.

65 See e.g. H C Metcalf (ed.), *Business Management as a Profession* (Chicago: A W Shaw & Co. 1927). The books of Veblen, Tawney and Laski all featured in the "selected reading list" at the end of the book.

66 W O Douglas, *Democracy and Finance* (New Haven: Yale UP 1940), pp. 6–12.

67 W O Douglas, "Protecting the investor" (1934) 23 *The Yale Review* 521.

protection. Also implicit in them was a much more socialised conception of corporations and a rejection of the view that they were purely private enterprises. Indeed, some believed that the gradual socialisation of industrial governance was going to be a more or less inevitable consequence of the corporate revolution. There was, John Maynard Keynes had written in the mid-1920s, an inevitable tendency for "joint stock institutions, when they have reached a certain age and size, to approximate to the status of public corporations rather than that of individualistic private enterprise". This "tendency of big enterprise to socialise itself", he argued, surfaced when "the owners of the capital, i.e. its shareholders, are almost entirely disassociated from the management", with the result that "the direct personal interest of the latter in the making of profit becomes quite secondary". At this point, Keynes argued, managers became more concerned about the stability and reputation of the institution, whereupon shareholders had to satisfy themselves with "conventionally adequate dividends".[68] Later, in *The General Theory*, Keynes expressed implicit approval of this relegation of the shareholder interest. Observing that interest rewarded "no genuine sacrifice", and anticipating an end to the scarcity of capital, he foresaw the gradual "euthanasia of the *rentier*". He also provided a critique of financialization and financial markets, analysing the tendency of investors, and especially "professional investors", to seek short-term gain by outguessing the market, rather than long-term gain by focusing on the underlying productive fundamentals of businesses and assessing the "probable yield of an investment over its whole life". The growing power of these investors and of financial markets was causing "speculation" to dominate "enterprise", especially in the US, something which was not only damaging to investment in productive plant and equipment but a source of serious instability. Because there was "no clear evidence from experience that the investment policy which is socially advantageous coincides with that which is most profitable", Keynes concluded that the state, which was better placed to take a longer view and to take account of the general social interest, should take greater responsibility for "directly organising investment", advocating a "somewhat comprehensive socialisation of investment to secur[e] an approximation to full employment" and to channel resources away from speculation towards productive activity.[69]

Managerialism and the waning power of finance

Although a re-conceptualisation of the corporation as a social or quasi-social institution – something which would have required, amongst other things, a substantial revision of shareholder rights and directors' duties – was never institutionalised into Anglo-American law, it was a view of the corporation which gained considerable ground in the years after the Second World War. Underpinning its advance was a gradual decline in the power of finance. In the US, this was in part a product of the various legislative interventions of the New Deal era.[70] In fact, however, the grip of finance over American industry was already weakening in the 1920s as American corporations became financially more self-sufficient

68 J M Keynes, *The End of Laissez-Faire* (Amherst: Prometheus Books 2004 (first published 1926)).

69 J M Keynes, *The General Theory of Employment, Interest and Money* (1936), chs 12 and 24, reprinted in E Johnson and D Moggridge (eds), *The Collected Writings of John Maynard Keynes* (London: Macmillan), vol. 7. See also J H Davis, "Keynes on the socialization of investment" (1992) 19 *International Journal of Social Economics* 150.

70 These interventions are central to Mark Roe's claim (in *Strong Managers, Weak Owners* (Princeton NJ: Princeton UP 1994)) that diffused stockholder ownership in the US is a "political product"; that law "prohibited or raised the cost of institutional influence in industrial companies", "fragment[ing] financial institutions so that few institutions could focus their investments into powerful inside blocks of stock". In his view, "[American] politics never allowed financial institutions to become powerful enough to control operating firms, prefer[ring] Berle–Means corporations to the alternative of concentrated institutional ownership, which it precluded"; p. 22. On the ways in which the legislative measures of the 1930s limited the power of high finance, see Douglas, *Democracy*, n. 66 above.

and less dependent on outside finance, and as their shareholders rapidly grew in number, a development which tended, as Berle and Means famously documented, to separate ownership not only from management but from control.[71] By the 1930s, Berle and Means suggested, both the *internal*, shareholder-based controls over managers – the various mechanisms and processes operating within the corporation to secure ultimate shareholder control – and the *external*, market-based disciplines to which they were subject – those derived from product and capital market competition – had become less effective.[72]

It was on this basis that so-called "managerialist" theories of the corporation emerged. Broadly, these theories asserted that, with the internal and external constraints on them loosened, corporate managers no longer needed to profit maximise and had acquired considerable discretion in the determination of corporate goals. "Sectional" managerialists suggested that these newly liberated managers were pursuing their own self-interest and were likely to continue to do so in the future;[73] by contrast, "non-sectional" managerialists suggested that they were beginning to balance a range of different interests and that this trend was leading to the emergence of genuinely "socially responsible" corporations.[74] By the 1950s and 1960s non-sectional managerialist ideas had become commonplace, underpinning claims that corporations were becoming more "socially responsible" and "soulful".[75] In 1955, for example, L C B Gower, doyen of post-war British company law, suggested that the emphasis that some still placed on "the profit-making element in corporate activity" now had "a slightly old-fashioned ring".[76]

In the US, the rise of the idea of the socially responsible corporation found principal expression in increasing corporate philanthropy and, more radically, in demands for the creation of multi-constituency boards.[77] In Europe, where the trade union and labour movements were significantly stronger and where there was a greater willingness to question the legitimacy of existing property relations, the debates about corporate social responsibility followed a slightly different path, focusing on one particular non-shareholding constituency, the employee, and on "industrial democracy", finding their most notable expression in the draft 5th Directive on employee representation.[78] Many of the arguments for industrial democracy, while not seeking the relegation of corporate shareholders to creditor status, had the effect of diluting their rights through alterations to voting structures and the composition of corporate boards. They also tapped into the

71 See P Sweezy, "The decline of the investment banker" (1941), reprinted in Sweezy, *The Present as History* (New York: Monthly Review Press 1953), p. 189; see also P Sweezy, "Investment banking revisited" (1982) 33(10) *Monthly Review* 1. Sweezy, a Marxist economist, was the son of the vice president of the First National Bank of New York, which was headed by George F Baker, a close friend of J P Morgan. He attended LSE in the early 1930s intending to study under Hayek, but his views took a slight leftward turn after he had attended lectures delivered by Harold Laski.

72 Berle and Means, *The Modern Corporation*, n. 63 above, part 4.

73 J Burnham, *The Managerial Revolution* (London: Putnam 1941).

74 T Nichols, *Ownership, Control and Ideology* (London: Allen & Unwin 1969).

75 See e.g. C Kaysen, "The social significance of the modern corporation" (1957) 47 *American Economic Review* 313–14.

76 L C B Gower, "Book review of Emerson & Latcham, *Shareholder Democracy* (1954)" (1955) 68 *Harvard Law Review* 922, at 927.

77 The idea of directors appointed to represent the public interest is to be found in Douglas, *Democracy*, n. 66 above, p. 42. In the 1960s and 1970s, the case for multi-constituency boards was pressed by people like Ralph Nader and Christopher Stone: see C A Harwell Wells, "The cycles of corporate social responsibility: an historical retrospective for the twenty-first century" (2002) 51 *University of Kansas Law Review* 77.

78 See Lord Wedderburn, "The legal development of corporate responsibility: for whom will corporate managers be trustees?" in K J Hopt and G Teubner (eds), *Corporate Governance and Directors' Liabilities* (Berlin & New York: Walter de Gruyter 1985), p. 3.

broader conception of "the company" now associated with stakeholding and found in the jurisprudence of Japan and a number of European countries, in which the idea of the company as a separate entity is taken more seriously and its interests treated as something more than just the financial interests of shareholders.[79]

Crucially, by this time, the power of finance and financial property owners had been significantly weakened by the new international financial architecture put in place at Bretton Woods. One of the main goals of Keynes and his American counterpart Harry Dexter White, the two principal architects of the agreement, was precisely to reduce the power of finance. In restricting and regulating the international movement of capital, White acknowledged, the new arrangements would significantly diminish the rights and power of finance and financial property owners. It would mean "less freedom for owners of liquid capital" and place "restriction[s] on the property rights of the 5 or 10 percent of persons in foreign countries who have enough wealth or income to keep or invest some of it abroad".[80] In similar vein, Keynes recognised that the implementation of capital controls of this sort would precipitate "keen political discussions [about] the position of the wealthier classes and the treatment of private property". He believed, however, that the control of capital movements was a pre-requisite of effective domestic economic management and necessary in the wider public interest.[81] Finance was to be the servant not the master. This assignment of "second-class status"[82] to the financial sector helped to lay the foundations not only for the ideas about socially responsible corporations, but for the Keynesian social compromise of the post-war years, with its emphasis on state macroeconomic management, full employment and social security and welfare. As Dumenil and Levy say, Keynesianism represented "a real encroachment on the prerogatives of finance".[83]

It is important not to overstate the extent to which corporate managers abandoned the shareholder interest and to which corporations really acted in a socially responsible manner during this period. Finance was by no means stripped of power and, despite the dampening of competition associated with rising levels of industrial concentration, the adoption of multi-divisional management structures by many large corporations saw the emergence

79 In Germany, for example, the courts developed the notion of "enterprise interest" (*unternehmensinteresse*). German ideas about the company as an enterprise whose interests encompass a number of different groups, including employees, have a long history: see A B Levy, *Private Corporations and their Control* (London: Routledge 1950), vol. 1, pp. 177–8. German finance capitalism has played a role here, for, as Wedderburn says, "the concept of a 'general collective interest' (other than the aggregated interests of individual proprietary shareholders)" was fortified in Germany by the place of the banks. The same, he suggests, "may well have been the case in Italy and France, in part through stronger 'Statist' interventions in the markets and a long tradition of credit management through the banks": Lord Wedderburn, "Companies and employees: common law or social dimension?" (1993) in *Labour Law and Freedom* (London: Lawrence & Wishart 1995), p. 81, at pp. 89–95.

80 H D White, "Preliminary draft proposal for a UN stablization fund (April 1942)" in J K Horsfield (ed.), *The International Monetary Fund 1945–65, vol 3: Documents* (Washington: IMF 1969), pp. 66–7. The goal, in the words of Henry Morgenthau, American Treasury Department secretary, was to "drive the moneylenders from the temple of international finance": quoted in E Helleiner, *States and the Re-Emergence of Global Finance* (Ithaca: Cornell UP 1994), p. 4.

81 "Letter to Roy Harrod (19 April 1942)", in Johnson and Moggridge, *The Collected Writings,* n. 69 above, vol. 25, pp. 35, 149. Keynes was not opposed to finance per se, differentiating the active financier who sensed opportunities for investment in particular productive sectors from the parasitic coupon-clipper (whom he described as an investor without a function) living off interest payments and dividends.

82 Lawrence Krause, quoted in Helleiner, *States*, n. 80 above, p. 4.

83 G Dumenil and D Levy, "Costs and benefits of neoliberalism: a class analysis" in Epstein, *Financialization*, n. 14 above, p. 23

within them of decentralised "profit centres" which competed for capital.[84] It is equally important, however, not to understate the increased room for manoeuvre that corporate managers undoubtedly possessed. By their own accounts, they were under little pressure to maximise the short-term financial performance of companies at the expense of their longer-term productive health, and were relatively insulated from investor and capital market pressures.[85] The description of the corporate world provided by people like J K Galbraith, with its technocratic managers and vestigial shareholders divorced from management and too numerous and dispersed to wield significant influence, was not, therefore, without substance.[86] Neither were the claims that managers were coming to accept that they owed responsibilities to employees, consumers, local communities and society at large, as well as to shareholders.[87] In the long post-war boom, the diminished power of finance, together with the relative strength of labour, undoubtedly impacted on corporate practices and culture. When a revised edition of *The Modern Corporation* appeared in 1968, Berle described corporate managers as "administrators of a community system" and argued that the American corporation should no longer be seen as a "business device" but as a "social institution".[88] As Young and Scott put it, in the 1970s "managers seemed to value the life and enduring success of the enterprise as the fundamental end". Satisfactory shareholder returns "*resulted* from pursuing this prime goal".[89]

The formal legal structures of governance – shareholder rights, directors' duties and the like – changed very little, however. There was no radical reform of company law. It is "remarkable", Wedderburn observes, that the development of the ideas of corporate social responsibility in the post-war decades "had no significant impact on the common law formulation of directors' duties".[90] Paradoxically, this was in part because of the ambivalence of many on the left. In the 1920s, Keynes, a Liberal, had dismissed the need for changes of this sort. There was, he had argued, "no so-called important political question so really unimportant, so irrelevant to the reorganisation of the economic life of Great Britain as the nationalisation of the railways". This was because "the battle of socialism against unlimited private profit [was] being won in detail hour by hour" as a result of the tendency of big enterprises to socialise themselves.[91] Views of this sort persisted in the 1950s and 1960s. Thus, Anthony Crosland, a leading figure among the new breed of Labour Party intellectuals, insisted that there was no need to pare down shareholder privileges or to nationalise key corporations because passive and dispersed shareholders had neither the

84 See E Herman, *Corporate Control, Corporate Power* (Cambridge: Cambridge UP 1981).

85 See D Young and P Scott, *Having Their Cake . . . How the city and big bosses are consuming UK business* (London: Kogan Page 2005), ch. 1.

86 See e.g. J K Galbraith, *The New Industrial State* (Princeton: Princeton UP 1967).

87 According to Gower, writing in 1969, it had become "common form" for managers "to declare that industry owes duties to employees, consumers and the nation, as well as to shareholders": L C B Gower, *Company Law* 3rd edn (London: Stevens 1969), p. 522.

88 "Preface to revised edition", A Berle and G Means, *The Modern Corporation and Private Property* (New York: Harcourt 1968).

89 Young and Scott, *Havng Their Cake*, n. 85, p. 20.

90 Wedderburn, "Companies", n 79 above, p. 90.

91 Keynes, *Laissez-Faire*, n. 68 above. Keynes criticised state socialism "not because it seeks to engage men's altruistic impulses in the service of society, or because it departs from laissez-faire, or because it takes away from man's natural liberty to make a million, or because it has courage for bold experiments. All these things I applaud. I criticise it because it misses the significance of what is actually happening; Because it is in fact little better than a dusty survival of a plan to meet the problems of 50 years ago, based on a misunderstanding of what someone said a 100 years ago."

desire nor the ability to exercise their control rights. For him, as for many others, radical legal reform was not necessary to socialise the corporation. The key to change lay, rather, in the education and culture of the managers who were in de facto control.[92] As the debates surrounding the Bullock proposals demonstrated, the support for industrial democracy and worker representation on the boards of directors of large corporations was also less than wholehearted among the trade union and labour movements.[93] The leading labour lawyer Otto Kahn-Freund, for example, argued that co-determination could be achieved either "in the land of collective bargaining on the pluralistic pattern" or "in the land of company law on the unitary pattern", ultimately rejecting the latter as "alien to the TU movement" and as a denial of the fundamental conflict of interest between capital and labour.[94] Others thought otherwise, however, and revived parts of the radical agenda sketched by Tawney and Laski, pressing hard not only for industrial democracy but for legal reforms which would have had the effect of diluting the rights and privileges of shareholders. There was "no reason", argued Bill Wedderburn, "not to equate [the shareholder's] position with that of a well secured creditor"; the law should "not treat the shareholder as a 'proprietor' entitled to control".[95] George Goyder expressed a similar view.[96]

Resurgent finance and the rise of the shareholder value corporation

As it turned out, they were right to do so, for the picture changed dramatically when, beginning in the 1970s, finance began to reassert its power. There were many different aspects to this resurgence. Central to it was the dismantlement of the restrictive international financial framework instituted by Bretton Woods and its replacement by a new, highly liberal order which greatly increased the options open to, and bargaining power of, finance, and paved the way for the endless money-market innovations of recent decades.[97] At the same time, financial property owners, who had previously been for the most part dispersed and fragmented, began to re-unite and re-concentrate in financial institutions, enabling

92 C A R Crosland, *The Future of Socialism* (London: Jonathan Cape 1956); and *The Conservative Enemy* (London: Jonathan Cape 1962). Claims of this sort were boosted by the belief that because the duty of directors was to act in the best interests of "the company" rather than those of shareholders, they could act in a socially responsible manner without violating the law. The courts, however, steadfastly stuck to the 19th-century identification of "the company" with its shareholders: see *Parke* v *Daily News Ltd* [1962] Ch 927.

93 The Committee of Enquiry into Industrial Democracy, chaired by Alan Bullock, was set up in 1975 in response to the EC's 5th Directive which sought to introduce something resembling German-style co-determination throughout Europe. The committee reported in 1977, the majority report recommending equal representation for shareholders and workers, plus a third group of "independent" directors; the minority report proposed German-style, minority worker representation on the top board of a two-tier structure. Much of the trade union opposition resulted from a preference for "pure" collective bargaining.

94 O Kahn-Freund. "Industrial democracy" (1977) 6 *Industrial Law Journal* 65. Kahn-Freund argued that the Bullock Report was underlain by a "reification of the company" and by the belief that it was a "self-perpetuating entity" whose interests transcended those of any of its component elements. It thus denied that the company and its shareholders were one and the same thing. Kahn-Freund argued that "the so-called interest of the company [was] always identical with an interest of its shareholders, not *the* interest but *an* interest"; the company's interests were inevitably opposed to those of its workers in ways they could never be opposed to those of its shareholders or creditors.

95 See K W Wedderburn, *Company Law Reform* (London: Fabian Society 1965); P Davies and Lord Wedderburn, "The land of industrial democracy" (1977) 6 *Industrial Law Journal* 197, supporting the Bullock proposals.

96 G Goyder, *The Responsible Company* (Oxford: Blackwells 1961). Goyder called for "participating" and "responsible" companies, membership of which would extend beyond shareholders to employees, consumers and the community. He recognised that this required "a certain subordination of the shareholders' interest" but thought that morally they were only entitled to a fair return on their investment, and not necessarily a perpetual one.

97 For an excellent account of the dismantlement of Bretton Woods, contesting the traditional account that it was the result of unstoppable technological and market forces, see Helleiner, *States*, n. 80 above.

shareholders to utilise the rights still vested in them much more effectively. During the course of the 1980s and 1990s, with labour significantly weakened, the policies pursued by more and more governments around the world became, under the mantle of neoliberalism, dominated by the concerns and interests of financial property owners.[98] From this there emerged the "new finance capitalism" and the "second financial hegemony".[99]

In the corporate context, the rise of institutional investment was especially important. In the 1950s–60s heyday of the socially responsible corporation, the great majority of shares in places such as the US and the UK were held directly by individuals who were for the most part dispersed and passive. Gradually, however, shares came increasingly to be concentrated in the hands of institutions and, with this, the control rights attached to shares – the rights which some had deemed irrelevant and redundant only a few years earlier – once more became a source of considerable power. In recent decades, armed with these rights, the institutional representatives of the owners of financial property have become collectively much more active, particularly in financial markets, developing strategies for (re)shaping corporate goals and practices. Encouraged by the agency theories developed by financial economists such as Michael Jensen, for example, they have been instrumental in getting corporate boards to make share options and other performance-related bonuses a significant part of executive remuneration. As many have noted, this has served to focus the attention of managers on share price and re-aligned their financial interests with those of shareholders, albeit in a very particular way. These changes have also, of course, contributed to the controversies surrounding the enormous pay rises which have been awarded to executives, often without any discernible connection to performance.[100]

The focus on share price has been reinforced, especially in the US and the UK, by other developments, most notably the rise of the hostile takeover and consequent emergence of an active "market for corporate control".[101] This market is not confined to corporate takeovers of other corporations. Beginning in the early 1980s, there emerged a growing number of specialist takeover firms which were prepared to borrow heavily in order to gain control of corporations which were then "restructured", their presumptive income streams recapitalised, and their securities resold at a profit.[102] After dwindling during the downturn of the late 1980s and early 1990s, debt-financed purchases of public companies of this sort – so-called leveraged buy-outs (LBOs) – had a second coming and by the early years of the new century, new actors, private equity firms, were regularly taking over medium-sized public companies or divisions of large private corporations before restructuring them and selling them on.[103] Although takeovers of this sort have brought major financial gains for

98 On the links between finance and the rise of neoliberalism, see D Harvey, *A Brief History of Neoliberalism* (Oxford: OUP 2005); G Dumenil and Dominque Levy, *Capital Resurgent* (Cambridge MA: Harvard UP 2004).

99 Davis, "A new finance capitalism?", n. 15 above; Dumenil and Levy, *Capital Resurgent*, n. 98 above, pp. 7–10, 156–67.

100 See Froud et al., *Financialization*, n. 9 above, pp. 49–64. See also I Erturk, J Froud, S Johal, A Leaver and K Williams, "Agency, the Romance of Management Pay and an Alternative Explanation" (2006), CRESC Working Papers Series, No. 23.

101 Between 1980 and 1990, for example, nearly one-third of the Fortune 500 firms received takeover bids and over 10% received hostile bids. In recent decades, mergers and acquisitions involving public companies buying other public companies have become an increasingly important activity for large corporations in the US and UK: see D Zorn, F Dobbin, J Dierkes and M-S Kwok, "The new new firm: power and sense-making in the construction of shareholder value" (2006) *Nordiske Organisationsstudier* 3.

102 Firms of this sort were not new. In the UK, for example, firms such as Slater-Walker and Hanson Trust and individuals such as James Goldsmith had pioneered similar activities in the 1960s and 1970s.

103 On the LBOs of the earlier period, see D Henwood, *Wall Street* (London & New York: Verso 1997), pp. 265–85; for an excellent and accessible account of the way in which today's private equity firms operate, see R Peston, *Who Runs Britain?* (London: Hodder & Stoughton 2008), chs 2 and 3.

both their organisers and for target company shareholders, there is little evidence that they have produced long-term improvements in the performances of the companies concerned. Indeed, the overall verdict of studies of the long-term impact of takeovers is overwhelmingly negative. This is, perhaps, unsurprising, because, as Froud et al. observe, "for all its prestige, the private equity business model is almost exactly like used-car trading", where capital is borrowed, cars purchased and cosmetically (but not mechanically) fixed up, before being resold for a quick profit over and above the cost of the borrowed money.[104] Whatever their benefits, or lack thereof, however, there is no doubt that the institutionalisation of the hostile takeover and growth of the market for corporate control has added greatly to the capital market pressures on managers, reshaping what they say and do by creating an environment in which everything is permanently up for sale. Indeed, in large American and British corporations in particular, managers have come to mimic corporate raiders, speaking and acting like financial market participants who see their enterprises as mere bundles of saleable assets capable of being bought and sold at will.

The managerial obsession with share price has been further fuelled by other developments. For example, with institutions clamouring for information upon which to base their investment decisions, in recent years security analysts have grown in number and importance.[105] This has served to divert the attention of managers from simple profitability to "meeting the estimates" for profitability used by these analysts: share prices have to be protected at all costs. This has been reflected in the increased concern shown by corporations with earnings and performance management, in the marked increase in earnings preannouncements, and in the implementation of investor relations programmes aimed at keeping the expectations of analysts in line with the firm's own forecasts. It has also become increasingly important for firms to have a plausible narrative about their strategy and performance.[106] They have thus learned how to construct corporate "narratives of strategic purpose" and to deliver numbers which corroborate their stories and meet the expectations of analysts – to "keep it going" – even if it entails using accounting gimmicks and dodges, and revenue manipulations of various sorts.[107] In short, firms have quickly learned how to play the new games into which financialization has propelled them, seeking to (appear to) maximize performance on whichever measure happens to be most favoured at any given time.[108]

The result has been a dramatic shift from the situation in the 1960s and 1970s when "firms were, by their own accounts, relatively insulated from investor preferences", to a situation in which firms are intensely sensitive to the assessments of financial market participants and to the signals emitted by the markets themselves. With financial markets playing an ever more influential role, corporate strategies have become increasingly tied to

104 Froud et al., *Financialization*, n. 9 above, p. 122; see also Peston, *Who Runs Britain?*, n. 103 above, pp. 64–7.

105 See E Zuckerman, "The categorical imperative: securities analysts and the illegitimacy discount", (1999) 104 *American Journal of Sociology* 1398; and "Focusing the corporate product: securities analysts and de-diversification" (2000) 45 *Administrative Science Quarterly* 591.

106 This is one of the main themes of Froud et al., *Financialization*, n. 9 above. In the US, this has contributed to the replacement of the CEO–COO (chief executive officer–chief operating officer) dyad by the CEO–CFO (chief finance officer) dyad, in which the key task of the CFO is to manage investor relations, market expectations and share price. As a result, lawyers, investment bankers and consultants have been recruited as CFOs, less for their technical expertise or financial integrity as for their public relations skills and "deal-making talents": see D Zorn, "Here a chief, there a chief: the rise of the CFO in the American firm" (2004) 69 *American Sociological Review* 345.

107 Froud et al., *Financialization*, n. 9 above, p. 9. See also T Smith, *Accounting for Growth* (London: Century Business 1996).

108 See Zorn et al., "The new new firm", n. 101 above.

a narrowly financial view of how firms should be run, one in which maximising stock price trumps all other goals. The result has been a shift from a "managerial" to an "investor capitalism",[109] and the rise of a shareholder value conception of the corporation and radically financialized corporate culture and form of governance. With this, says Rakesh Khurana, the image of the ideal executive has been transformed "from one of a steady, reliable caretaker of the corporation and its many constituencies to that of a swashbuckling, iconoclastic champion of shareholder value". "The ideals of professionalism", established in American business schools in the 1920s and aimed at creating "a managerial class that would run America's large corporations in a way that served the broader interests of society rather than the narrowly defined ones of capital and labour", have been swept away, relegating managers to the status of "hired hands".[110] The gospel of shareholder value has, moreover, extended its tentacles well beyond Anglo-American jurisidictions into places such as Germany and Japan.[111] It is against this backdrop that the idea of corporate governance, which first emerged in the 1980s, has rapidly risen to the status of a key technology for controlling management in the interests of investors.

Markets, neoliberalism and the mechanics of contemporary financial power

The importance of business schools and elite networks in cultivating this new, highly financialized corporate culture should not be underestimated.[112] In the UK, for example, there is clear evidence that "outside", "independent", non-executive directors have played an important role in transmitting the shareholder value culture at board level. As a number of commentators have noted, the non-executive director (NED) has become the new mechanism of directorial "interlock". NEDs do not represent the interests of specific financiers or investment banks in the same way as the nominee directors of the early 20th century, but instead enforce the general priorities of financialization.[113]

It is, however, financial markets, under whose constant shadow executives now work, that have been the key mechanism through which financial imperatives have been imposed on corporations and their executives. Indeed, herein lies one of the major differences between the finance capitalism of the early 20th century and the new finance capitalism of the early 21st. While in the former power was exercised directly by financiers and investment banks *within* corporations through board representation and thus operated at the level of the individual company, financial power is now predominantly exercised from *without*, through

109 M Useem, *Investor Capitalism* (New York: Harper Collins/Basic Books 1996).

110 R Khurana, *From Higher Aims to Hired Hands: The social transformation of American business schools* (Princeton: Princeton UP 2007), pp. 3–4, 20. There has also emerged the idea of "management . . . as a process that can be applied to all situations" in which "an affinity with what is being managed is no longer deemed necessary": Young and Scott, *Having Their Cake*, n. 85 above, p. 11. As I write, the records and reputations of many of the swashbuckling heroes of the 1990s and early 2000s – like Sir Fred ("the Shred") Goodwin of Royal Bank of Scotland – are being hastily reviewed.

111 There is a vast and well-known literature on "convergence": see e.g. J McCahery, L Renneboog, P Moerland and T Raajimalers (eds), *Corporate Governance Regimes: Convergence and diversity* (Oxford: OUP 2002). For a couple of interesting recent contributions, see G Davis and C Marquis, "The globalization of stock markets and convergence in corporate governance" in R Swedberg and V Nee (eds), *The Economic Sociology of Capitalism* (Princeton: Princeton UP 2005); R Dore, "Japan's conversion to investor capitalism" in H Whittaker and S Deakin (eds), *On a Different Path? The managerial shaping of Japanese Corporate Governance* (Oxford: OUP forthcoming 2009), ch. 5.

112 See e.g. G Davis, M Yoo and W Baker, "The small world of the American corporate elite, 1982–2001" (2003) 3 *Strategic Organisation* 301.

113 J Froud, A Leaver, G Tampubolon and K Williams, "Everything for sale: how non-executive directors make a difference" in M Savage and K Williams (eds), *Remembering Elites* (Oxford: Wiley-Blackwell 2008), arguing that directorial interlocks are "now about cultural homogenization around the corporate norm that everything is for sale (at the right price)".

the arms-length mechanism of the (stock) market. This is a form of control which not only combines concentration with liquidity, but which is ubiquitous, operating at the level of the corporate sector as a whole. It is precisely this ubiquity and lack of commitment which has enabled Anglo-American finance to wield such effective disciplinary power. The indirect power that it exercises contrasts with the more direct, but in certain respects less effective, forms of power exercised by finance in places such as Germany. Indeed, paradoxically, the more direct forms of financial control, which predominated in the early 20th century when Hilferding formulated his theories about finance capitalism and which are still to be found in jurisdictions with "blockholding", are now widely seen as problematic, for blockholding, it is argued, creates risks for minority shareholders and inhibits the operation of the market for corporate control, shackling capital to particular firms and diminishing the disciplinary and efficiency-enhancing power that it can exercise in markets.[114] On the other hand, of course, the rootedness and relative lack of mobility of this more "committed" capital also enhances the status and bargaining position of non-shareholding groups, facilitating both a more relational and more stakeholder-oriented conception of the corporation – with longer-term productive and strategic horizons – and a more "welfarist" version of capitalism.[115]

The key role played by markets in the exercise of contemporary financial power also accounts for the close links between resurgent finance and neoliberalism, with its supposition that free markets – private, contractual economic ordering and the unregulated forces of supply and demand – are the best way to maximise not only freedom but also growth, wealth and welfare. For neoliberalism champions precisely the kind of market mechanisms through which modern finance exercises its coercive power, hence claims that finance was the instigator of the transition to neoliberalism and that neoliberalism is best seen as the "ideological expression of the reasserted power of finance", its economic grand narrative.[116]

The market roots of resurgent financial power also enable us to understand why the rise of the shareholder value conception of the corporation was neither prompted nor accompanied by significant changes to the substance of company/corporate law itself. As we have seen, even when managerialist ideas were at their zenith, they were founded not on legal changes diluting shareholder rights but in the space opened up, and opportunities created, by the inability of shareholders effectively to exercise the rights they possessed. In

114 In recent years, commentators in the US have spent much time pondering why the Anglo-American, stock market-based, public corporation, with its dispersed shareholdings and "separation of ownership and control", hasn't emerged elsewhere, particularly in the civil law jurisdictions of continental Europe. Various explanations have been offered. Some have attributed it to the absence in those jurisdictions of "high quality" corporate law offering adequate protection to investors, particularly minority shareholders. This, it is argued, inhibits the growth of external finance and capital markets and encourages blockholding: see the three articles by R La Porta, F Lopez-de-Silanas, A Shleifer and R Vishny, "Legal determinants of external finance" (1997) 52 *Journal of Finance* 1131; "Law and finance" (1998) 106 *Journal of Political Economy* 1113; and "Investor protection and corporate governance" (2000) 57 *Journal of Financial Economics* 3. Much of this work is underlain by the assumption that the exclusively shareholder-oriented Anglo-American corporation is inherently superior and economically more efficient and that it would triumph if economic forces were allowed to operate without impediment. From this perspective, which is itself premised upon an unspoken belief in a politically neutral and autonomous, market-based, transhistorical and (potentially) determining economic rationality, it is the absence (rather than the presence) of Anglo-American structures which needs to be explained, hence the tendency to attribute their failure to emerge in certain jurisdictions to legal, political and cultural *impediments* – such as inadequate investor protection or the "anti-shareholder" ideologies of social democracy.

115 See nn. 3 and 4 above. This is one of the themes of the vast "models/varieties of capitalism" literature which has grown up in the last couple of decades: see e.g. P Hall and D Soskice, *Varieties of Capitalism* (Oxford: OUP 2001).

116 See Dumenil and Levy, "Costs and benefits", n. 83 above, p. 17; Dumenil and Levy, *Capital Resurgent*, n. 98 above, pp. 1–3, 11–18; Harvey, *Brief History*, n. 98 above, ch. 3.

similar vein, the recent resurgence in shareholder power has been rooted not in any enhancement of shareholder rights but in the renewed ability of shareholders, re-united and re-concentrated in institutions, to use the rights they already possessed to impose themselves on corporations and corporate executives, both directly and indirectly through the medium of financial markets – within a largely unchanged company law regime.

Indeed, in this context, the most important rule changes have probably occurred in the rules regulating international capital flows and securities markets – in particular takeovers – rather than in company law itself. In the UK, for example, the development of the City Code on Takeovers and Mergers has been particularly important, especially general principle 7 and rule 21 on non-frustration, which place decisions on the fate of takeover bids in the hands of target-company shareholders, reducing management to the role of providing information and persuasion.[117] As Paul Davies has pointed out, institutional shareholders find it much easier to influence changes to the rules regulating securities markets than they do those of company law, for the latter are subject to the normal legislative process "where institutional investors would be only one among a number of powerful influences on the ultimate shape of the legislation", while the former have generally "been devolved to regulators which are closer to the market participants, notably the Stock Exchange and, now, the Financial Services Authority, for the listing rules and the City Panel on Take-overs and Mergers for the rules on take-overs".[118] In terms of the global spread of financialized, shareholder-oriented corporate governance, it is not insignificant that general principle 7 has been adopted in many jurisdictions around the world and is a central plank of the EU Directive on Takeovers.[119] Nor is it surprising that many in Europe saw the Directive as an attack not only on their less financialized and shareholder-oriented modes of corporate governance but on their social democratic, social market versions of capitalism, and as a result fiercely opposed it.[120]

The dominance that finance and financial interests have gained in recent years has reached well beyond the corporate realm, however. It was vital, Harold Laski argued in 1926, that the state should act to prevent corporate management from being "dominated . . . by the speculative financier".[121] In recent decades, not only has the state permitted this to happen, it has itself come to be dominated by financial interests, and speculative financial interests at that. "Guiltlessly rapacious and mentally pugnacious", wrote the journalist and former Conservative Party political advisor Hywel Williams in 2006. He continued:

> Britain's financial and business elites at least display the virtue of candour about their ultimate goals: the making of money for themselves . . . The City has won

117 The Code was developed by the City Panel on Takeovers and Mergers and is now in its 8th edition (2006).

118 P Davies, "Shareholder value, company law, and securities markets" in K J Hopt and E Wymeersch (eds), *Capital Markets and Company Law* (Oxford: OUP 2003), p. 261, at p. 277.

119 See A Dignam, "The globalisation of general principle 7: transforming the market for corporate control in Australia and Europe"(2008) 28 *Legal Studies* 96.

120 A Nilsen, *The EU Takeover Directive and the Competitiveness of European Industry* (Oxford: Oxford Council on Good Governance 2005). Also of considerable importance, though not discussed here, are the measures which have been taken to try to entrench investor rights through constitutional and quasi-constitutional means. New regulatory frameworks have been established aimed at giving them "a level of fixity outside of politics" so that they are immune to political pressures and changes in state policy. Because of their constraining effects on states of these rules, they have come to be described as representing a new form of (neo)liberal constitutionalism. The object of this "new constitutionalism", as Stephen Gill has called it, is to "provide political anchorage for capital in the long term . . . through political and legal mechanisms that are difficult to change": see S Gill, "Globalisation, market civilisation, and disciplinary neoliberalism" (1995) 24 *Millennium: Journal of International Studies* 399; and D Schneiderman, "Investment rules and the new constitutionalism" (2000) 25 *Law & Social Inquiry* 757.

121 Laski, *Grammar*, n. 58. p. 476.

> all the necessary battles for command and control. It now absorbs and directs the aims of all other power elites and thereby makes those elites subordinate to its own interests.[122]

More recently, the British financial journalist, Robert Peston, whose media star has risen as rapidly as that of the neoliberal economy has fallen, has echoed these sentiments.[123] The triumph of finance is also reflected in the way that in many parts of the world neoliberal ideas about markets, the state and the nature of individuals have become embedded in popular consciousness.[124] In recent decades, beginning in places such as the US and the UK but gradually spreading elsewhere, neoliberal ideas have come increasingly to dominate policy-making, as reflected in the search, wherever possible, for market-based solutions to social and economic problems. As their prominence in news bulletins shows, the gyrations of the financial markets have come increasingly to be seen as the key barometer of economic and social well-being.

Capitalism unleashed: wealth inequality and the new power elites

Who have been the winners and losers in this "unleashed capitalism"?[125] Unsurprisingly, with managers under pressure to distribute a larger proportion of profits as dividends and forced to target their activities at raising the market value of corporations, shareholders and financial property owners have been major beneficiaries. In many OECD countries the share of national income accruing to financial institutions and *rentier* owners of financial property was markedly higher in the 1980s and 1990s than it had been in the 1970s.[126] In the US, in the 1980s, corporations began to abandon their earlier policy of "retain and invest" and to replace it with a policy of "downsize and distribute".[127] The increase in the proportion of post-tax income distributed to shareholders which resulted, however, is relatively modest compared to that in the UK where there has been a marked upward shift in pay-outs from 13–20 per cent in the 1980s to 20–35 per cent in the 1990s and early 2000s.[128] Further financial gains have, of course, come in the form of the huge growth in the value of shares, though many of these have been wiped out in recent months.

The redistribution of the proceeds of industry away from labour to capital which has accompanied the rise of neoliberalism and the shareholder value corporation has made an important contribution to the significant growth in income and wealth inequalities which has occurred in recent years, both within and between nations.[129] In the 1980s, the trend towards greater equality which began in the 1930s came to an abrupt end and by the turn of the century the levels of inequality in countries like the US and the UK were returning to those of the pre-1914 period. This has happened despite the significant rise in the proportion of households in the developed world owning shares and other forms of

122 H Williams, *Britain's Power Elites* (London: Constable & Robinson 2006), p. 215

123 Peston, *Who Runs Britain?*, n. 103 above. Peston is particularly scathing about the subservience of New Labour to financial interests and the City. He sees the Government's handling of the debates in early 2007 about the minimal taxes being paid by one particular group of financial intermediaries – partners in private equity firms – as an exemplification of this.

124 See Harvey, *Brief History*, n. 98 above, chs 1 and 2.

125 A Glyn, *Capitalism Unleashed* (Oxford: OUP 2006).

126 Epstein, *Financialization*, n. 14 above, pp. 4, 6: Dumenil and Levy, "Costs and benefits", n. 83 above; G Epstein and A Jayadev, "The rise of rentier incomes in OECD countries", in Epstein, *Financialization*, n. 14 above.

127 W Lazonick and M O'Sullivan, "Maximising shareholder value: a new ideology for corporate governance" (2000) 29(1) *Economy & Society* 13.

128 Froud et al., *Financialization*, n. 9 above, pp. 68, 87–8.

129 See Dumenil & Levy, *Capital Resurgent*, n. 98 above. In the developed world, especially notable is the growing rift between the top and the middle of the income and wealth range.

financial property, directly and indirectly. The suggestions that finance was being "democratised" and that a "shareholding capitalism" was emerging were always greatly exaggerated: the ownership of financial property remains very heavily concentrated in the wealthiest 5–10 per cent of the population.[130]

The benefits of financialized corporate governance have not, however, been showered only on shareholders and other owners of financial property. A number of other groups have profited hugely from financialization and the changes associated with the rise of the shareholder value corporation. The most visible beneficiaries, of course, have been corporate executives, whose remuneration has skyrocketed in recent decades. Despite claims that new forms of remuneration and mechanisms for determining executive pay – in which allegedly "independent", non-executive directors play key roles – have ensured that pay is more closely linked to performance, research suggests that the link between executive pay and performance remains very weak, whereas that between pay and firm size is strong.[131] Indeed, as some commentators have pointed out, some of the mechanisms which have been touted as the guarantors of "good governance" – disclosure and the use of remuneration committees, for example – have, if anything, ratcheted pay up and served to disconnect it still further from any meaningful assessments of performance.[132] As a result, while the 1990s, with its bull-market, is often portrayed as a decade in which managers heroically created value for shareholders and, by implication, for all of us ("we're all shareholders now"), in reality they were for the most part simply enriching themselves. From this perspective, the rhetoric of "shareholder value" and "efficiency" which has been used to justify rising executive pay merely tries to conceal what has really been going on: managerial "rent seeking" or "value skimming", "the quiet, unnoticed enrichment of the few", something "quite different from the difficult process of value creation . . . which dominates the rhetoric of shareholder value". All value skimming requires is an elite structural position, where you "can take advantage of ownership rights, deals or operations close to a large income stream".[133]

It is their proximity to large corporate income streams that also distinguishes many of the other less visible groups who have benefited from financialization and the emergence of the shareholder value corporation – a diverse bunch of corporate advisors and service-providers, securities analysts, hedge fund operators, private equity firms, city lawyers and investment banks. Some of these financial intermediaries are largely reactive, responding to corporate demands; others are proactive deal-makers. Thus, some of them, like the takeover firms described earlier, actively initiate mergers and acquisitions and make money from financial innovations, constructing and capitalising new revenue streams to create new securities ("securitisation"). As Erturk et al. say, the "high paid intermediaries such as the hedge fund principals and investment bankers of the 2000s" who have "earn[ed] fees from the increased velocity of financial dealing and the larger scale of corporate restructuring plus the supporting legal and accounting services [these] require", "have become an increasingly important group of elites".[134] These groups have a stake in an "economy of permanent restructuring", for it generates fees and income from trading, dealing, investing, advice and

130 See P Ireland, "Shareholder primacy and the distribution of wealth" (2005) 68 *Modern Law Review* 49.

131 Froud et al., *Financialization*, n. 9 above, pp. 90–4.

132 This is partly because above average performance by some corporations is used to justify higher pay for CEOs, which is then used in turn to justify higher pay for all through comparability increases: see Erturk et al., *Financialization at Work*, n. 14 above, p. 21. See also, K W Wedderburn, *The Future of Company Law: Fat cats, corporate governance and workers* (London: Institute of Employment Rights 2004), highlighting the very narrow gene pool from which non-executive directors are drawn.

133 See Froud et al., *Financialization*, n. 9 above, pp. 54–64, 94.

134 Erturk et al., *Financialization at Work*, n. 14 above, pp. 21, 27.

consultancies. They live on deals and novelty, making money from everything from acquisitions and de-mergers to new issues, from buybacks and securitisation to the re-bundling of risks. It is these intermediaries who have been largely responsible for the hyper-innovation in the capital markets that, for many years, produced billion-dollar turnovers in financial property dealings involving the various revenue rights held by firms, households and financial institutions. These are the groups who have played a key role in generating a finance-oriented corporate culture in which everything is for sale if the price is right: companies, assets and risks can be all be "bundled, unbundled and traded through coupons".[135]

If the big winners have been few in number, the losers have been many. The rise of the shareholder value model of the corporation has been costly for many other corporate stakeholders. Financialized corporate governance has led to the hollowing out of many corporations through downsizing, re-engineering, outsourcing and the like. In the words of one commentator, the "serial restructuring" which has accompanied the worship of shareholder value has "elevate[d] breach of implicit stakeholder contract into a guiding principle of management".[136] What the more privileged members of the working class in the developed world gained as owners of modest amounts of financial property – gains which in many cases have now been all but erased – they often lost in other ways. The emergence of a "neoliberal order under the aegis of finance" has contributed to the destruction of the old compromises and social alliances; to deregulation followed by re-regulation in financial interests; to higher unemployment and downward pressure on wages (whose real growth has slowed and, at times, stagnated); to reductions in job security; to the dismantling of social protection systems; to higher income and wealth inequality (testaments to the growing share of the social product accruing to the owners of financial property in the form of dividends and interest); to the financialization of everyday life; and to unpredictable currency fluctuations, reckless capital movements, growing financial instability and to what now looks like a financial crisis of major proportions. As Doug Henwood says, it is "odd that workers should be asked to trade a few extra percentage points return on their pension fund, on which they may draw some decades in the future, for 30 or 40 years of falling wages and rising employment insecurity".[137] For the less privileged (non-financial-property-owning) workers of the less developed world, of course, the consequences have been even more severe and at times disastrous.[138]

It is arguable, however, that the biggest loser has been the productive economy, for when "speculation dominates enterprise" resources are likely to be poorly allocated from a productive and social perspective. The financialization of recent decades has seen a bias towards quick short-term gain rather than new, long-term productive investment. This has been reflected since the early 1980s in the marked reduction in world growth rates from an average of 4.8 per cent in 1960–80 to 2.9 per cent in 1980–2000,[139] and in the slowdown in the growth of labour productivity from 2.5 per cent to 0.8 per cent over the same period.[140] Many have expressed concern about what they see as the profound and largely

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135 P Folkman, J Froud, S Jophal and K Williams, "Working for themselves?: Capital market intermediaries and present day capitalism" (2007) 49 *Business History* 552. See also F Dobbin and D Zorn, "Corporate malfeasance and the myth of shareholder value" (2005) 17 *Political Power and Social Theory* 179.

136 Froud et al., *Financialization*, n. 9 above, p. 100.

137 Henwood, *Wall Street*, n. 103 above, p. 293.

138 For two highly accessible and graphic accounts of the consequences of the workings of contemporary capitalism for the majority of the world's population, see P Mason, *Live Working or Die Fighting: How the working class went global* (London: Harvill Secker 2007); and M Davis, *Planet of Slums* (London: Verso 2006).

139 World Bank, *World Economic Indicators* (Washington: World Bank 2005).

140 See B Bosworth and S M Collins, *The Empires of Growth: An update* (Washington: Brookings Papers on Economic Activity, Brookings Institution 2003).

negative effects of financialization on the operations of non-financial corporations.[141] Some of these concerns have been voiced by academics,[142] and in the context of the debates surrounding corporate governance have commonly taken the form of support for, on economic grounds, stakeholder over shareholder-oriented corporations.[143] More recently, however, the expressions of concern about the damaging effects of over-powerful finance and the new governance culture on productive firms and the "real" economy coming from businesspeople and business commentators have grown. In 2007, for example, Martin Wolf of the *Financial Times*, described by Lawrence Summers as "the world's preeminent financial journalist" and well-known for his support for free markets and globalisation, wrote two articles expressing grave concerns about the economic and social effects of "unfettered finance", arguing that the new "global financial capitalism" had brought "the triumph of the global over the local, of the speculator over the manager and of the financier over the producer".[144] In similar vein, the business consultants Don Young and Pat Scott recently lamented the shift in managerial emphasis from the health of the "underlying business" to shareholder value, arguing that it has had a corrosive effect on productive performance and on levels of innovation and enterprise.[145]

Corporate theory and the legitimation of financial power

Despite the negative effects of this increasingly financialized regime of governance on production and "real" investment – and despite the extremely lopsided distribution of its pecuniary benefits, the social and psychological harms it has inflicted[146] and its contribution to successive financial crises[147] – it has garnered a remarkable amount of academic support. Financial economists with their agency theories and "efficient capital markets", management specialists with their ideas about corporate "re-engineering", and corporate law scholars with their contractual theories of the corporation[148] have all offered it intellectual sustenance. In this process, shareholder primacy has come to be justified less on

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141 See e.g. J Crotty, "The neoliberal paradox: the impact of destructive product market competition and 'modern' financial markets on nonfinancial corporation performance in the neoliberal era", in Epstein, *Financialization*, n. 14 above, p. 77, identifying a "neoliberal paradox". The demand that managers extract more income from and raise the stock prices of US corporations has come at a time, Crotty argues, when economic growth has been stagnant and market competition fierce. This has led non-financial corporations to cut wages and benefits, to engage in financial frauds and deceptions and to move into finance themselves. This, he argues, has had a very negative effect on general, long-term economic prosperity.

142 See, for example, the diverse contributions to a special issue of the journal *Economy and Society* (on shareholder value) in 2000. See also the contributions to Epstein, *Financialization*, n. 14 above.

143 In the UK, see Kay and Silbertson, "Corporate governance", n. 5 above; J Parkinson, "Company law and stakeholder governance" in G Kelly, D Kelly and A Gamble (eds), *Stakeholder Capitalism* (Basingstoke: Macmillan 1997). In the US, see M Blair and L Stout, "A team production theory of corporate law" (1999) 85 *Virginia Law Review* 247.

144 M Wolf, "The new capitalism", *Financial Times*, 19 June 2007; and "Risks and rewards of today's unshackled global finance", *Financial Times*, 27 June 2007. Wolf has now made some suggestions about how the problems might be resolved in his *Fixing Global Finance* (Baltimore: Johns Hopkins UP 2008).

145 Young and Scott, *Having Their Cake*, n. 85 above, ch. 11. See also A Kennedy, *End of Shareholder Value* (Cambridge MA: Perseus 2000).

146 See e.g. the work of R Sennett, such as *The Corrosion of Character* (New York: Norton 1998); O James, *Affluenza* (London: Vermillion 2007); and A Offer, *The Challenge of Affluence* (Oxford: OUP 2006).

147 Even before the recent crash, it is reckoned that there had been more than seventy severe financial crises in developed and developing countries since 1980.

148 From the 1980s, more and more scholars, chanting the mantras of the law and economics movement, vigorously re-asserted the economic superiority of shareholder-oriented corporations, abandoning all notions of corporations as social institutions in favour of a conception of them as contractual fictions. For a critique of these theories, see Ireland, "Defending the rentier", n. 7 above.

the old-fashioned – and, as many have pointed out, highly problematic – grounds of shareholder "ownership" rights and more on the instrumental grounds that shareholder-oriented corporations are more efficient and able to deliver higher rates of growth than their rivals.[149] In a process of "collective sense-making", academics from a number of different disciplines have "cobbled together" a "new myth of the efficient firm" which endorses and promotes this model of the corporation on the basis of its alleged economic superiority.[150] Just as neoliberalism has been successfully portrayed as serving the wider social interest, so too has the Anglo-American, shareholder value corporation. A governance regime which has operated primarily in the interests of a small financial elite – a minority of substantial property owners and various capital market intermediaries – has been portrayed as operating in the interests of society as a whole. Elite power has been dressed up as efficiency.[151]

There is no doubt, however, that the support for financialized corporate governance and, indeed, for financialization more generally has also been fuelled by the belief that with the spread of both financial property and asset (especially home) ownership, the latter in a rising market, a genuine property-and-share-owning democracy, a real "people's capitalism", was being constructed. When Veblen, Tawney, Laski, Keynes and others launched their assault on the *rentier* class, it was composed of a narrow, (upper-)middle-class substratum. Nowadays, with governments encouraging the development of an "equity culture", the *rentier* class – at least in the developed world – has come to embrace a much larger proportion of the population. As a result, even though the financial property holdings (direct and indirect) of the great majority are very modest indeed,[152] more and more people have come to see themselves as having a stake in the financialized economy, and this has made it easier to build political support for shareholder-oriented corporate governance and other aspects of neoliberal policy. It has also made it easier to depict the current, narrowly drawn, investor-focused agenda for corporate governance reform as in the interests of all.

In many ways, this agenda for reform resembles the conservative agenda of the early 20th century. As we have seen, commentators such as Brandeis, Ripley and Berle did not object to the financialization of corporate governance per se. On the contrary, they saw it, amongst other things, as a way of spreading the "ownership" of industry to the middle classes. What they objected to were abusive financial practices and the unequal distribution of financialization's benefits: the lion's share of the rewards were being appropriated by a small number of financial property owners, the financiers and investment bankers exercising minority control. In similar vein, in the last decade or so much energy has been expended trying to eradicate accounting and executive malpractice within an essentially unchanged, exclusively shareholder-oriented governance regime. Indeed, in recent years the account of the nature of the corporate governance problem implicit in this agenda has been indirectly reinforced by the promotion of financial literacy education, a process aimed at getting the masses to engage in financial planning – to find out how to become sufficient owners of financial property to provide for themselves in old age – and to manage their debts. It is not insignificant that the OECD, producers in 1999 of the Principles of

149 See P Ireland, "Company law and the myth of shareholder ownership" (1999) 62 *Modern Law Review* 32.

150 Zorn et al., "The new new firm", n. 101 above.

151 The law-and-economics inspired scholarship which has dominated the field of corporate law in recent decades explains the changes which have taken place in corporate governance in terms of an evolution towards "efficiency": see Hansmann and Kraakman, "The end of history", n. 10 above. By contrast, economic sociologists explain the changes in terms of changing power configurations: see e.g. G Davis, "New directions in corporate governance" (2005) 31 *American Sociological Review* 143; Dobbin & Zorn, "Corporate malfeasance", n. 135 above.

152 See P Ireland, "Shareholder primacy", n. 130 above ; see also Ireland, "Defending the rentier", n. 7 above.

Corporate Governance, produced in 2005 a lengthy study of financial education and literacy. The vision which is being promoted is one of shareholder-oriented corporations, operating in a world of open financial markets and financially literate coupon clippers, for whom personal security is achieved not through social insurance but through ownership of assets (homes) and financial property (private pensions).[153]

Until recently, expressions of doubt about this vision had been marginalised. Gradually, however, mainstream commentators have begun to voice concerns about the effects and unequal distribution of the benefits of financialization. In early 2008, for example, after Northern Rock's collapse but before the financial earthquake, Robert Peston examined, and lamented, the growth in income and wealth inequalities, arguing that the money accruing to the "super-rich" – who with their hedge funds and private equity firms were to be found "to a large extent in the financial sector" – had become "absurdly large". We were, he argued "reconstructing a UK where the share of the national income taken by those at the pinnacle of the income scale is at levels not seen for a century"; not seen, in fact, since the era of the "first" finance capitalism.[154] What seems to have most concerned Peston, as it had Berle eighty years earlier, was not so much financialization per se but the unfair distribution of the benefits of financialized corporate governance and the impact of these inequalities on the ability of small investors to provide for themselves in old age. Thus, for Peston, "the success of private-equity and other private purchasers of businesses represents the distribution of wealth from the many – the millions of us who entrust our savings to pension funds and other institutions – to the few".[155] As the super-rich had effortlessly become richer, "millions of people ha[d] been obliged to contribute more cash than they ha[d] ever done to guarantee even a modest income on retirement". Not only that,

> some of the hard-pressed company pension schemes that were once a model of enlightened paternalism [we]re now being transferred to specially created new companies backed by the super-rich – who s[aw] in them an opportunity to make a fortune for themselves, though not for pensioners.

Since then, of course, many of these already modest pensions have further shrunk, victims of the market meltdown.[156]

It is clear, however, that Peston was aware, even at this early stage of the unfolding crisis, that the problems were more fundamental. Thus, he describes the growing inequalities in wealth as "not healthy for democracy". "Behav[ing] as though the UK is permanently on probation", the operators of hedge funds and private equity firms had overseen the "reinvention" of Britain as a tax haven in which tax avoidance had been raised to such levels that the payment of taxes had been reduced to a voluntary, almost charitable, activity.[157] Not only that, the "new super-rich" had "the means through the financing of think-tanks

153 For an unrestrained extension of this vision, in which financial markets and financial products become the solution to more or less everything, and in which the enrichment of financial intermediaries seems somehow to become the basis of social security and justice, see R Shiller's *The New Financial Order: Risk in the 21st century* (Princeton: Princeton UP 2004).

154 Peston, *Who Runs Britain?*, n. 103 above, pp. 9, 11, 14 and ch. 1 more generally.

155 Ibid., p. 91. The activities of private equity firms have generated "a massive transfer from the have-littles to the have-loads"; p. 77.

156 Ibid., p. 22. In keeping with his concern for the small (middle-class) investor and his/her modest investments, Peston is critical of "the inadequate stewardship of public companies by the funds on which we depend for our retirement"; p. 50. They are "wimps".

157 The financier principally responsible for persuading Gordon Brown of the merits of private equity, Sir Ronald ("Ronnie") Cohen, became so embarrassed by the low levels of taxes that the beneficiaries of private equity deals were paying that he publicly suggested that they should be taxed at a higher rate than "real" venture capitalists; ibid., p. 59.

and the ownership of the media to shape government policies or to deter reform of a status quo that suits them". This led Peston to declare himself "rather less enthusiastic to be a cheerleader for the uber-capitalists".[158] Equally importantly, Peston was also clearly aware that, contrary to the standard rhetoric, the activities of financial institutions did not always, or even usually, bring productive benefits. Thus, he distinguished private equity firms, "which tend to flog off property and assets as quickly as possible after a takeover has been consummated", from "real venture capitalists", "genuine entrepreneurs" and "owners of small businesses" who create and nurture enterprises over a period of time. "American-style venture capital", according to Peston the source of much of the country's economic dynamism in recent years, was qualitatively quite different from the private equity to which Gordon Brown and New Labour had pandered. Brown's support for them, he says, was a case of "mistaken identity". Far from being good for the underlying productive enterprises,[159] private equity firms tend to view them "in a very impersonal and blinkered fashion"; as "property and chattels, and statistics about cash flows and market shares". They display "little empathetic understanding of a business as a social institution wholly dependent on its people". Private equity firms, Peston argues, are better at financial engineering than they are at successfully running businesses in the long-term.[160] It is hardly surprising that the impact of their activities on workers is unfortunate: they ruthlessly sweat all assets, human as well as capital.[161]

The resurrection of the rentier and corporate governance reform

The current crisis has made it abundantly clear that the reform of corporate governance entails much more than eradicating a bit of executive and financial malpractice, remedying a few distributional inequities and providing better mechanisms for protecting investors. The economic paradigm upon which the neoliberal vision of the future is based – a vision to which the financialized, shareholder-oriented corporation is integral – is collapsing. Much of the fictitious capital value created in recent years has proved to be transient, disappearing in a matter of months amidst an orgy of wealth destruction; so too has much of the increased "value" embodied in real estate. The attempts to broaden and deepen financial property ownership, fuelled by a mixture of working-class aspiration and – in the face of declining state pension provision – working-class need, has not generated increased security for the great majority of people. On the contrary, finance has not only demanded cutbacks in both private and public investment and growth-restricting macroeconomic policies,[162] but encouraged the reckless credit expansion, speculation and corporate rapaciousness from which we are now suffering. Financialized corporate governance has done little to boost the real physical, social and productive investments upon which society's ability to provide

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158 Peston, *Who Runs Britain?*, n. 103 above, pp. 14–15

159 Ibid., pp. 59–61, 96.

160 Ibid., pp. 46, 55–7, 77. "Much of the evidence 'proving' that private equity is good for business is", Peston argues, "of questionable depth and robustness". For a succinct account of how money is made by private equity, see pp. 64–7. "None of it", Peston observes, "is rocket-science"; p. 76. Much of the money made by these firms is attributable to the rising stock market, not outstanding management: ". . . a substantial proportion of the colossal profits made by private-equity firms over the past few years is no more the result of business genius than the profits made by someone who bought a house in central London in 2000 and sold it [in 2007]": pp. 31, 57.

161 See, for example, his account of the experience of the cleaners at Travelodge, taken over by Pemira. The cleaning time they were allowed per room was cut from 40 minutes to 25 minutes and then to 20 minutes. Only a fraction of this 100% productivity increase was distributed to them. Permira and its investors, on the other hand, made a cash profit of around £450 m: Peston, *Who Runs Britain?*, n. 103 above, pp. 44–5; see also pp. 13–14.

162 On this, see Harvey, *Brief History*, n. 98, ch. 1.

adequately for its members – and especially the young, old and sick – ultimately depends. For many, the private pension dream cultivated in places such as the US and the UK is rapidly turning into a nightmare.

Indeed, it is becoming clear that what Robert Parenteau has called the "financialization in the extreme"[163] encouraged by the attempts to spread an equity culture has made an important contribution to the collapse. As financial institutions and intermediaries "searched for new opportunities to create coupons and earn fees", they used the "financialized masses" as "feedstock".[164] People were encouraged to borrow to buy houses they couldn't afford, sometimes on a buy-to-let, interest-only-mortgage basis, and many of them then borrowed more money against the rising value of those houses. Seeing money to be made from creating and selling securities, the financial institutions which issued the mortgages, packaged the underlying prospective income streams into bonds – securitised them – and sold them on to institutional investors seeking good rates of return, aided by rating agencies who gave the new securities their unequivocal stamp of approval. Many of the money managers who bought the securities were themselves operating with borrowed money and the sales generated further piles of cash which the selling institutions could then lend. Amidst this credit explosion, billions were, of course, made from fees and consultancies, in salaries and bonuses, and from selling, lending and trading. "Finance fed finance."[165]

The crisis and the responses it has dragged from governments around the world has already shifted the centre of gravity of the policy agenda. In recent months much has been written about the need for more stringent financial regulation and for restraints to be placed on finance and financial markets. Many have called for an updated Bretton Woods; others are proposing margin requirements and Tobin-style taxes on turnover. What is required, however, is much more radical and fundamental reform, not merely a stabilisation, patching up and slowing down of the old system. Such reform might seem less likely than it was in the 1930s when both labour and the left were stronger. However, the political landscape has already changed and will change further as the crisis unfolds and the full extent of the structural problems become apparent. Until now, for example, the growing inequalities in society have been accepted by most people, in significant part, one suspects, because of the sustained economic expansion, relatively low levels of unemployment and sense of prosperity created by rising house prices and the ability to borrow against them. Will this continue? When the dust settles, how many people will continue to believe that asset and financial property ownership – equity in homes, private pensions and the like – can really provide them with security in unemployment, sickness and old age?[166]

In the corporate governance context, it needs to be recognised that the current agenda for reform, with its focus on the protection of investors in exclusively shareholder-oriented

163 R Parenteau, "The late 1990s' US bubble: financialization in the extreme", in Epstein, *Financialization*, n. 14 above, p. 111.

164 Erturk et al., *Financialization at Work*, n. 14 above, pp. 26–7.

165 Ibid., p. 26. One of the problems currently facing us is the fact that debt commitments have finally and significantly outstripped the income flows needed to service them. This is in part because borrowed funds have been used disproportionately to fund speculation and compensatory spending, and insufficiently to finance productive spending – spending which enhances the income-generating capacity of individuals and firms: see R Pollin, "Socialization of investment and euthanasia of the rentier: the relevance of Keynesian policy ideas for the contemporary US economy" (1996) 10 *International Review of Applied Economics* 49 at 55. The most systematic treatment of debt accumulation and the tendency towards financial crisis was undertaken by the American economist Hyman Minsky, whose work has received renewed attention as a result of the current crisis.

166 It is worth remembering that while we have come to see high returns to *rentiers* as both necessary (not least for pensioners) and as a good thing, Keynes envisaged and welcomed falling rates of interest and returns to financial property, leading to the "euthanasia of the *rentier*".

corporations, not only does not address many of the issues with which corporate governance should be concerned, but is part of the problem. The present conjuncture offers a historic opportunity for a root-and-branch overhaul of this agenda. The emergence and rise of the idea of the socially responsible corporation took place against the backdrop of a finance weakened by the 1930s slump, Bretton Woods and the strong state regulation of the post-war years. With finance already weakened by the current crisis and likely to be weakened still further, we now have an opportunity to re-radicalise the agenda for corporate governance reform. Where might this process start?

In the conclusion to *The General Theory*, Keynes offered little in the way of concrete policy proposals, but he did provide some important pointers as to the general goals that policy should be seeking to realise. Principal amongst them was a reduction in the returns accruing to *rentiers*; a lowering of the rate of interest. "The *rentier* aspect of capitalism", he argued, was "a transitional phase" which would "disappear when it ha[d] done its work". He therefore looked forward to, and called for, the "euthanasia of the *rentier*", of the "functionless investor", and with it "the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity value of capital". He thought this process would occur not suddenly but as a gradual "continuance of what we have seen recently in Great Britain". That it would therefore require "no revolution" was something Keynes considered "a great advantage". We should, he argued, be aiming for a situation in which the functionless investor "no longer receive[d] a bonus", at which point we could pursue policies which would allow "the intelligence and determination of executive skill of the financier [and] entrepreneur . . . to be harnessed to the service of the community on reasonable terms of reward".

Keynes linked this policy theme to another, the "somewhat comprehensive socialization of investment", arguing that the establishment of "certain central controls in matters which are now left in the main to individual initiative" and a "large extension of the traditional functions of government" would be "necessary to ensure full employment". For Keynes, these "necessary measures of socialization" would save, rather than destroy, capitalism. He welcomed this, for he rejected the system of "State socialism" which had emerged in Eastern Europe, with its full state-ownership of the means of production, and sought to retain "a wide field for the exercise of private initiative and responsibility", believing that this would preserve the "advantages of efficiency" which came from "decentralisation and the play of self-interest". He made it absolutely clear, however, that the "preservation of existing economic forms" would require their radical reform.[167] He recognised, in other words, that "leashing capitalism was the only way to save capitalism".[168] Events have not proceeded as Keynes hoped and envisaged. In recent decades, rather than doing the decent thing and quietly expiring, the *rentier* has been resurrected, with the result that speculation has indeed come to dominate enterprise in exactly the ways he feared; and it has done so, one suspects, on a scale that he would have found hard to imagine. Having failed to die peacefully and without fuss, the "*rentier* aspect of capitalism" is in need of more forcible smothering, if not elimination. What follows is, in the manner of Keynes, an attempt briefly to identify the general direction in which we should be heading using the critiques, debates and agendas for reform which were sketched, but not fleshed out, in the inter-war years in the wake of the first finance capitalism.

In a recent interview with *The Times*, Lord Myners, Gordon Brown's Financial Services Secretary (or City Minister), called for fundamental changes in the way that banks are operated. In a furious onslaught on Britain's leading bankers, Myners argued that they had

167 Keynes, *General Theory*, n. 69 above, ch. 24.

168 R Pollin, "The resurrection of the rentier" (2007) 46(July–August) *New Left Review* 140 at 142, reviewing Andrew Glyn, *Capitalism Unleashed* (2006) and whose title I have borrowed.

been guilty of serious mismanagement and been "grossly over-rewarded". They had "no sense of the broader society around them".[169] Some of these criticisms could, of course, be extended to much of the corporate sector. Given the rapacious financialized corporate culture which has developed in recent decades, however, it will not be enough merely to urge executives voluntarily to act in a socially more responsible manner – as the Government has thus far done in the banking context with little discernible success. Much more than an extension of the currently fashionable ideas about self-regulatory corporate social responsibility which have recently risen to prominence – alongside a ruthlessly shareholder-oriented model of the corporation – will be needed.[170] One of the starting points for a programme for corporate governance reform must, therefore, be a radical reconceptualisation of the large joint stock corporation as a social or quasi-social institution and a corresponding reshaping of the duties of directors and the structures of corporate regulation. To be effective, this will require a radical reassessment of the status and rights of corporate shareholders along the lines suggested by writers such as Veblen, Tawney and Laski in the 1920s and Wedderburn and Goyder in the 1960s. In large corporations, the control rights currently vested in shareholders should be attenuated or eliminated altogether, and shareholders reconceptualised as creditors or quasi-creditors entitled to a return, which might be fixed or fluctuating, but not to exclusive control rights. At the same time, the composition of corporate boards should be radically revised. The Bullock Report should be dusted off, the idea of worker–directors revived, and the possibility of multi-constituency boards (with representatives of consumers and other groups) considered in an attempt to socialise corporations and to democratise our economic institutions in a rather different way from that envisaged by advocates of the equity culture. As we try to flesh out these ideas, rather than working to a single blueprint to be applied in all cases, there should be a process of experimentation of the sort advocated by Tawney and Laski. Finally, as Keynes argued, there should indeed be a "somewhat comprehensive socialization of investment". Ironically, in the UK the basis for this has already been put in place by the Government as it has reluctantly but steadily increased its holdings of bank shares.[171] As I write, the Government's pleas for banks to start lending again are becoming ever more desperate. We already have de facto nationalised the banks, commentators are arguing; why doesn't the Government recognise this and turn them into public utilities?[172] Such an approach would not only make it easier to offer short-term sustenance to the economy, but in the longer term ensure that investment decisions were guided not by the whims of speculative global financiers seeking a quick return but by the needs of society.

These sorts of reforms above would not supplant capitalism. As Robert Pollin says, there would still be contradictions: "after all capitalism cannot function if capitalists are not getting something that they consider to be adequate profits". However, such a programme would, as Pollin says, "put capitalism back on its leash" and is a more feasible option than trying to construct a socially democratic, welfarist version of capitalism "trapped inside a

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169 Interview, *The Times*, 24 January 2009.

170 On the nature of contemporary ideas about CSR, see P Ireland and R Pillay, "Corporate social responsibility in a neoliberal age" in P Utting and J Carlos Marques (eds), *Corporate Social Responsibility and Regulatory Governance: Towards inclusive development?* (Basingstoke: Palgrave Macmillan 2009 (forthcoming)).

171 It is worth remembering that Hilferding believed that the growing control that a small number of banks exercised over industry would facilitate the "socialization" of productive activity: *Finance Capital*, n. 16 above.

172 There is, of course, a sense in which there has already been a massive "socialization" of investment, though, as Simon Jenkins has recently pointed out, it has involved "giving money unconditionally to banks" to "reliev[e] the debts of private financiers", rather than investment in productive industry. "When trucks loaded with Darling's loot arrived at the Square Mile", he argues, "the banks should have been properly nationalized": "Common sense has no place on the Brown–Darling Titanic", *Guardian*, 28 January 2009.

neoliberal straightjacket". Moreover, "what would satisfy capitalists as an adequate level of profits depends on the overall political, social and moral climate", and that climate is changing.[173] The political challenges would, of course, still be formidable. An assault on the *rentier*, on finance and financial capital, is an assault on the power of money and the prerogatives of class power, and in recent years, these interests have vigorously opposed even the mildest of social and economic reforms. The ideological challenges will also be considerable. In a letter written in January 2008 to members of the G20, the British Chancellor of the Exchequer, Alistair Darling, revealed the extent to which the British Government remains wedded to a neoliberal economic paradigm. While recognising the need for "significant" institutional reform, Darling was anxious not only to "restore trust and confidence" in capital markets, but to "retain faith" in specifically "open" and "innovative" financial markets. He thus sought to stress the benefits that such markets had brought to the world economy and the role they still have to play in dealing with "climate change", the "retiree boom" and "investment in developing countries". There was, he conceded, a need "to reduce the likelihood of systemic failures", but no need for systemic reform. It was simply a matter of addressing "specific failings". Thus, we require "more active, informed and capable boards", "better due diligence and care of clients' interests", and "improved ethics"; we need "prudential" regulation of "appropriate . . . scope and reach"; we must "increase efficiency in the operation of financial markets". We need, in other words, more of the same, only better. Aware, perhaps, that one or two people might have their doubts about the adequacy of this reform agenda, Darling added that we also need to have "a fuller explanation of the benefits" of an open financial system.[174] He could not have made it clearer that there is a major battle of ideas to be fought which will not be easy to win. It is worth remembering, however, Keynes' observation that Bretton Woods saw what had previously been seen as "heretical" – capital controls – suddenly "endorsed as orthodox".[175] These are unusual times and the range of political possibility is far greater than it has been for many, many years.

173 Pollin, "Resurrection", n. 168 above, p. 150.

174 A Darling, "UK objectives for the G20 in 2009", letter to G20, 7 January 2009. It would be strangely comforting to think that Darling doesn't really believe this stuff and is merely trying to revive the financial services industry upon which Britain has become increasingly economically dependent. Gordon Brown echoed these sentiments at Davos, 31 January 2009.

175 Quoted in Helleiner, *States*, n. 80 above, p. 25.