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Corporate Elites, State Restructuring and Equality

Abstract

In the aftermath of the economic crash of 2008/2009, the denunciation of 'crony' capitalism' has become part of a populist discourse which blames corporations for excessive compensation packages. This discourse establishes a direct causal mechanism between the rise in income inequality in the UK and the US, and the predatory behaviour of economic elites, especially financial elites. The promotion of shareholders interests, notably those of large institutional investors, has marginalized labour interests and increased wage dispersion. The role of corporate elites in the manufacturing of income inequality needs to be analysed in the context of financialized economies.

Keywords: income inequality, financialization, corporate elites, shareholder value.

Introduction

As income inequality has sharply increased in most OECD countries, especially in the UK and the US, with the top one per cent becoming richer much faster than the rest of society, the denunciation of 'predatory financial elites' has become widespread in popular discourses.

Economic elites theories, which endured a relative eclipse in the 1980s and 1990s (Savage and Williams 2008), are increasingly back in fashion, with a specific focus on financial elites (capital market intermediaries such as corporate lawyers, traders, analysts, hedge fund managers). But the story is complicated by crucial changes in property relations, with the distinction between income from capital (assets, bonds, stocks) and labour income (income based on wages) being increasingly blurred under changes in corporate governance models that promote shareholder capitalism, with a spectacular rise of institutional investors (Useem 1996). The promotion of shareholder capitalism in both the US and the UK helped align the interests between financial markets and managers (Clark 2009, Palley 2007, Aglietta and Reberioux, 2005). The UK and the US belong to the cluster of liberal market economies where the control of the firm is exercised from the outside by minority shareholders, and where the integration of employees into the decision making process is non-existent (Aglietta and Reberioux 2005: 59).

This essay is divided into four sections. First, it briefly presents the traditional view of corporate elites and finance capital. Second, it explores the links between the financialization, the promotion of shareholder's values and rising income inequality. Third, it reviews the main debates concerning the changing nature of corporate elites. To conclude, we summarize these debates.

Corporate elites and finance capital: the traditional picture

In the beginning of the 20th century, Hilferding (1981 1910), identified financialization as a crucial characteristic of capitalist societies. He singled out the tendency of different forms of capital (production and finance) to become amalgamated in large monopolies, with the financial component of capital dominating its industrial component, leading to the formation of capitalist monopolies and the rise of a 'financial oligarchy' (Lenin, 1916). According to

Carroll (2008: 44), Hilferding's analytical framework has been key to the critical sociology of economic elites especially - but not exclusively - through the analysis of interlocking directorates. The crucial point here is that capital relations underlie corporate elite networks. In the Fordist-Keynesian era, corporate elites were portrayed as forming an inner circle (Useem 1984), organized on a national basis, with banks being core institutions connecting disparate directors. For power elite theorists (Mills 1956, Domhoff 2010), the corporate community possesses tremendous enormous economic resources which give them "structural economic power". This economic power enables the corporate community to dominate the government through lobbying, campaign finance, appointments to key government positions, and a policy-planning network made up of foundations, think tanks, and policy-discussion groups. The CEOs and biggest owners in the corporate community, along with the top executives at the foundations, think tanks, and policy-discussion groups, work together as a leadership group: this is the power elite (Domhoff 2010). That there is an inherent organizational and structural cohesiveness amongst corporate elites is key to elite theorists, whose claims were traditionally backed up by studies of interlocking directorates showing that 'members have power of command and/or expertise that result from the intercorporate connections among large numbers of enterprises and they may be able to bring about a degree of co-ordination among their economies across the economy as a whole' (Scott, 2008: 37). According to Domhoff (2010), American business elites constitute highly integrated social groups whose members are able to transcend their own individual interests to promote their collective class interests. Useem (1980, 1984) also finds that corporate elites form a coherent community who socializes in exclusive schools, social clubs, formal associations such as boards of trustees and universities, thus allowing for the formation of class cohesion.

In sum, elite theorists assumed that there existed a symbiosis of interests between industrial and financial capital through in particular interlocking directorates, which enabled the business community to act with a single voice (Carroll 2008: 44-65, Burris, 2005). The business community - the managerial class identified by Berle and Means (1932) –was able to maintain a long- term compromise with labour interests and an activist state, in a context of strong economic growth.

Financialization and income inequality

As part of the post World War Two Keynesian framework, the activities of the banks were strictly regulated, their role being the promotion of industrial capital formation through money lending activities. This system broke down following the collapse of Bretton Woods and the ensuing battle of floating currencies with two major consequences: the subsequent emergence of transnational finance, and the resurgence of money capital, with the requirements to meet the expectations of the capital markets taking center stage (Thompson 2003: 366).

In strictly economic terms, financialization implied the increased importance of the financial sector relative to the real sector, the transfer of income from the real sector to the financial sector, as well as wage stagnation and increased income inequality (Palley, 2007, Resolution Foundation, 2011).

Rising income inequality was - and still is - explained by inequality in market income, mainly wages and salaries, and to a much lesser extent investment income. In the UK the share of the top1per cent of income earners increased from 7.1 per cent in 1970 to 14.3 per cent in 2005. In the US it increased from 8 per cent in 1970 to almost 18.5 per cent in 2005, almost the same level as before the First World War (OECD 2011: 347).

Financialization is also linked to globalization and has accentuated the 'global war for talent', with high pay packages for high skilled workers (Low Pay Commission 2011). According to Atkinson (2008), information technology and trade integration led to a rising demand for 'global stars', as opposed to national stars, those who are regarded at the very best in their profession, i.e., maximising shareholders' value.

In a financialized economy, the crucial criterion for selecting CEOs and senior managers is their ability to increase corporate profit margins, in order to keep investors happy. This has justified the explosion of executive pay in both the US and the UK. Indeed, although the US clearly leads the way in terms of widening income inequality, with the scale of the rise in the share of the top 1 per cent substantially larger than the rise in the corresponding share in other countries, the UK closely follows the US trajectory (Guardian 7th December 2011). In particular, the UK is second only to the US in the global league for CEO pay (The High Pay Commission 2011: 59).

Two further characteristics of the Gilded Age are of particular interest to labour economist and sociologists. First, and in contrast to traditional patterns, income inequality has skyrocketed not because "the poor are too poor", but because the "rich have become too rich". Second, "this new concentration of income is not driven by capital income but by entrepreneurial earnings" (Neckerman and Torche 2007: 337, OECD 2011). Importantly, "there is a growing disconnect between productivity and pay, with the benefits of economic progress flowing disproportionately to those at the very top of the labour market." (Gilbert 2011: 63).

The implementation of shareholder capitalism - the gist of which was to get the firm's managers to maximize profits on behalf of shareholders within the confines of the law- justified the explosion of top management compensation, stock options and the rise of merger acquisitions, thus marginalizing the interests of other stakeholders, mainly employees (Palley 2007, Fligstein and Shin 2007). In the US and the UK the decline in trade union power went hand in hand in hand with the financialization of the economy in the 1980s (Lapavitsas 2011, Thompson 2003). Fleigstein and Shin (2007) explain how the spread and implementation of shareholder values marginalized constituencies such as communities, workers and consumers. In both the US and the UK, the constant restructuring of the economy led to the closing down of entire industrial plants, and to the development of the service sector, particularly in the finance, real estate, and insurance parts of the economy (Resolution Foundation 2011). The spread of shareholder capitalism implied the minimization of employees through increased computerization. It also justified the implementation of a workforce flexibilization strategy through the systematic marginalization of trade unions and the generalization of individualized employee compensation. While medium and low wages stagnated and fell in real terms, executive elites continued to capture most of the added value of the economy, even after the crisis of 2008-2009.

The transformation of corporate elites

The Prime Minister's comments form part of a populist discourse according to which a financial/corporate elite, through the phenomenon of interlock directorates -'sitting on each others' remuneration committees'-, have awarded themselves tremendous compensation packages. This is also the case, albeit to a lesser extent, in the US, where in 2009 newly elected president Barack Obama announced a cap on senior executive pay for bailed out banks: 'We're going to examine the ways in which the means and manner of executive compensation have contributed to a reckless culture and quarter-by-quarter mentality that in turn have wrought havoc in our financial system'. (White House, press release 9 February 2009).

Thus the mainstream political discourse adds new meaning to the sociological tradition of elites studies, especially in the wake of the 2008/2009 Great Recession. The challenge for social scientists is to reveal the mechanisms and processes of economic power: as Scott (2008: 28), reminds us, 'the word elite should be only used in relation to those groups that have a degree of power.' Power, in a relational sense, is the capacity to make others do what they otherwise would not do: there is an asymmetrical relationship between principal agents and subalterns. Very crudely put, economic power is exerted when certain groups, individuals and organizations are able to capture economic resources to the detriment of other groups, individuals or organizations.

Three main challenges need to be addressed when attempting to identify corporate elites' power and mechanisms of domination. The first key issue concerns the impact of financialization on corporate elites. Second, and this an interrelated question, how have these elites changed? A fairly consensual is view is that today's economic elites have become meritocratic, socially porous, and transnational (Carroll 2008).

Third, and this is the most contentious issue underlying much debate around corporate elite power, do corporate elites form a cohesive community with a strong sense of its own interests?

While traditional elites studies emphasized the role of old boy networks based on similar socialization experiences (i.e. exclusive schooling, clubs and interlocking directorates), scholars have identified a radical transformation of economic elites since the early 1980s, as a result of deregulation, financialization and globalization (Hall 2009, Savage and Williams, 2008, Carroll 2008, Moran 2008, Folkman and al. 2007, Davis 2000). Corporate elites have become more meritocratic, more transnational, and more socially porous (Carroll 2008).

The decline of old-boys network

Financial elites in the City of London used to build upon a lineage of merchant banking families that contributed to the development of London as an international financial centre serving the interests of the British Empire, forming 'gentlemanly capitalism in which trust and confidence between financiers was read off their shared social backgrounds, most commonly at Oxbridge' (Hall 2009:176). But the traditional City elite was challenged by the invasion of foreign - especially American, and later European - banks (Moran 2008). This change in ownership broadened beyond traditional merchant style- activities (providing advice to clients and supporting mergers) to include a wide range of products and services, thus transforming the working practices and professional backgrounds of financial elites. The financial sector became increasingly complex, diversified and specialized; new roles reflected the sheer diversity of the range of financial products, especially securities and derivatives, on offer (Carruthers and Kim, 2011). Indeed, most of the industry profits come from the creation, sales and trading of complex products. As financial economics has become highly mathematical, thanks to the development of quantitative scoring methods to help predict financial risks, there has been an increased appetite in the industry for masters and doctoral-level graduates of science, engineering, math and physic programmes, whose 'talents have made them well-suited to the design of complex instruments, in return for which they often make starting salaries five times or more what their salaries would have been had they stayed in their own fields' (Kedrosky and Stangler 2011: 6).

Internationalization

Corporate elites have also been portrayed as becoming increasingly global and cosmopolitan as the transnationalization of finance capital has led to a partial disarticulation of national elite networks (Carroll 2008: 57). Particularly influential in this school of thought is Sklair's analysis of the transnational capitalist class (2001). Sklair argues that the 'culture-ideology of consumerism' is the project of a global bourgeoisie who aims to overcome a crisis created by over- production in the global capitalist system and a chronic lack of real spending power - as opposed to borrowing via credit cards and bank loans - among consumers (Sprague 2009: 502). Similarly, Robinson and Harris (2000) analyze the rise of a transnational capitalist class who is beginning to merge as a global bourgeoisie through corporate mergers and banking interests. The study of global corporate interlocks in which a director serves on the board of two (or more) corporations from different countries has enabled to identify the rise of a transnational corporate elite (Carroll and Fennema 2002, Kentor and Jang 2004). Staples (2006) finds even stronger evidence of the rise of a global corporate elite when focusing on the transnational links that 'now increasingly occur *within* corporations between corporate directors' (320), as opposed to transnational links between corporations. Finally, Klassen and Caroll (2011), Caroll (2008), argue that while a transnational business community has not yet completely transcended national corporate elite networks, transnational firms increasingly predominate within these national networks, articulating national with transnational elite segments and forming a nascent transnational class.

But the greatest debate concerns the cohesiveness of corporate elite networks. Transnationalization, the gradual decline of traditional old boys networks due to changing working practices allegedly led to a loss of internal cohesion.

A resilient 'small world'?

Two questions need to be addressed: first, is there an internal homogeneity of the network in terms of social composition and set of beliefs? Second, do corporate elites pursue a similar agenda which motivates both the actions of individual members and the group with strategic consequences? (Folkman et al. 2007).

First, there has been clearly much greater diversity in terms of membership of corporate elite networks, at least since the late 1980s. Analysing the rise of a new class of financial intermediaries - audit partners, consultants on executive pay, investment bankers, corporate lawyers, hedge fund managers, traders and dealers, Folkman et al (2007) conclude that there is considerable cultural heterogeneity among financial elites. The complexity of the investment chain has also structural consequences in terms of socio-economic relations: financial elites - stockbrokers, analysts, company managers, fund managers - have sometimes strikingly different interests, as pointed out by Davis (2006, 2000) and Moran (2008). In a world where ‘everything is for sale’, financial elites engage in public relations war, as Davis’s case study of the Granada takeover of Forte in 1995-1996 shows.

This said, there remains a strong tendency for banks to recruit only from elite colleges and business schools. This in turn reinforces a strong sense of ‘collective self-worth verging on hubris’ (Carruthers and Kim, 2011:250). Indeed, the capacity to mobilize, choreograph and control networks of different types of financial actors such as corporate finance boutiques, hedge funds and corporate law firms is crucial for delivering complex financial services and products to clients (Hall 2009: 181).

Corporate elites belong to a small world composed of a close network of nodes and dyads, and this network seems to be quite resilient and stable over time (Nguyen 2010). Analysing the London Stock Exchange, Davis writes that ‘financial markets are exclusive places, with a few significant players, and are dominated by personal networks’ (2006: 8). The dominant players are institutional investors, which hold most of the shares in major FTSE companies. CEOs and senior executives hold regular, confidential meetings with investment managers. In practice, investment fund managers do not always need to monitor the behaviour and performance of CEOs through boards meetings.

Indeed, there is a constant recycling of non executive directors (Froud et al. 2008, Cohen, Frazzini and Malloy, 2011). Davis, Yoo and Baker (2003) also show that despite the upheaval in commercial banking and corporate governance in the 1980s, the level of connectivity between board members has remained extremely stable, with members of the inner circle knowing each other and holding regular meetings. Cohen, Frazzini and Malloy (2007 and 2010) argue that shared educational backgrounds between financial elites (fund managers, analysts, corporate board members) enable members to gather crucial economic intelligence, which in turn improves the quality and accuracy of analysts and portfolio managers' recommendations about stocks.

Conclusion

Do corporate elites form a cohesive community? This question has been at the core of elite and pluralist debates in the 1950s and 1960s, with pluralists such as Dahl(1961) and Poslby (1963) insisting that economic elites remained divided and therefore did not hold any significant degree of power compared to other groups in US society. To a large extent, these questions continue to shape intellectual and political debates concerning the role of corporate elites in today's capitalist societies. It has been argued that financialization and the triumph of shareholders ideologies had decimated the traditional managerial elites in the 1980s and early 1990s, though the wave of hostile takeovers that characterized US capitalism in the 1980s were replaced by friendly mergers in the 1990s. But power had decisively shifted away from senior executives and CEOS to institutional investors, or more precisely financial professionals mainly interested in quick returns on their investment (Mizruchi 2010). In other words, financial intermediaries are opportunistic actors who use network connections to maximize investment returns, but have no idea of acting in the interests of the business community, a diagnosis shared by Davis (2000 and 2006). Reich (2009) also believes that corporate elites obey a logic of ruthless competition, with each firm trying to establish a competitive advantage over its rivals in order to attract investors and consumers. Reich derides ‘conspiratorial theories’ based on the notion that greedy corporate elites - big business and Wall Street - have colluded to keep median wages low while racing away at the top (2009:141). Instead, the marginalization of stakeholders such as employees and communities is the result of structural shifts in the economy in the 1970s, with a power shift to consumers and investors.

In contrast to this functional/pluralist account, Aglietta and Reberioux (2005) explain how the return of shareholder value led to the rise of a managerial elite whose aim was ‘to get a maximum cash flow from the firm into its own pockets by taking advantage of stock market liquidity’. For Aglietta and Reberioux, shareholder values serve as an ideological smokescreen that justifies the explosion of compensation packages for a network of managers, investment bankers, law firm partners and management consultants, who rotate between firms and who occupy overlapping positions on boards of directors and remuneration committees. The net effect of the interventions of financial professionals in the process of corporate restructuring is the marginalization of employees. Shareholders use financial market pressures on firms to transfer risks to workers through wage and employment adjustment; profitability increases but wages stagnate in real terms, and the concentration of wealth in the hands of the few increases. That corporate elites have been able to exert a form of economic power that has been prejudicial to labour interests in the context of financialization has become a fairly consensual view, at least in the UK (Gospel and Pendleton 2003).

A second interrelated question concerns the legitimacy of corporate and financial power after the Great Recession. The prestige of financial elites has been tarnished for two reasons: first, because the nation state came to the rescue of the banks, socializing the losses incurred, and second, because these elites have so far been unable to come up with a viable plan in terms of regulation of their own activities and pay packages. As a group, financial intermediaries have shown none of the restraint or the discipline that could have been expected of a class conscious of its own long-term interests. This is precisely this incapacity to act for the interests of the group as a whole that paradoxically ‘unleashed the most rapacious parts of the corporate elite’ (Moran 2008:76). Unable to transcend sector or individual interests, corporate elites have become the symbol of social Darwinism run amok, and have been placed on the defensive as a result. This explains why at least in the UK, some top executives in the public sector have had to bow to popular pressure and give away their bonuses (no such pressures have yet materialized in the US). Mizruchi (2010) and Reich (2009) agree that the logic of ruthless competition has become a self-destructive force for the US capitalist class. Loss of efficiency has been ultimately conducive to a loss of legitimacy for corporate elites, at least for now.

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