BOOK CHAPTER

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Corporate Governance and Inequality: The Impact of Financialisation and Shareholder Value

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ABSTRACT

This analysis considers the dimensions of financialization of the international economy and how this has produced a more intensive and integrated mode of accumulation. With the increasing translation of corporations into financial entities, how the dominant shareholder primacy mode of corporate governance has served to compound inequality is examined. The damaging impact of maximising shareholder value is investigated, both in terms of the long term prospects of corporations, but also in aggressively producing increased inequality in the economy and society. Finally the ultimate paradoxical outcome of agency theory and shareholder value is highlighted as the explosion of executive reward in the last two decades in the Anglo-American countries.

Keywords: Corporate Governance, Inequality, Agency Theory, Maximising Shareholder Value

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OUTLINE

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Introduction

The tranquillity of the World Economic Forum (WEF) at Davos in 2015 was disturbed by a startling report from the anti-poverty charity Oxfam that global wealth is becoming concentrated heavily among a tiny super-wealthy elite. The vast publicly funded global stimulus effort to revive economies following the financial devastation caused by the global financial crisis has not prevented a surge in the concentration of wealth in the period 2010-2014. (Figure 1) Oxfam employing Credit Suisse data show that 2010 proved an inflection point in the global distribution of wealth and that by 2014 the richest one per cent of people in the world possessed 48 per cent of global wealth, leaving the other 99 per cent of humanity with the remaining 52 per cent (Oxfam 2015; Credit Suisse 2015).

However the projections for the near future were even more alarming with the continuing increase in the wealth of the richest one per cent and the reduction of the wealth of the bottom 99% till 2016 when the richest one per cent will have seized more than half the wealth in the world (Figure 2). Of course there is extreme inequality within the 99 per cent of the population who are not super rich, and much of the international research and policy has focused upon the persistence of absolute poverty in the world with hundreds of millions of people still living in hunger which the new UN development goals are focused upon. But the poor are very widespread in the world, and Credit Suisse estimates that 3.4 billion people more than 71 per cent of all adults in the world have wealth below US$ 10,000.

An issue that has received less attention is the extreme range of wealth in the richest one per cent. Oxfam and Credit Suisse illustrate that there is a category of the super-rich who have wealth comparable to the GDP of many countries, and that the wealth of the super-wealthy is advancing very rapidly: for example the 388 richest billionaires in the world in 2010 had the same wealth as the total wealth of 50 per cent of the world's population. But by 2014 the richest 80 billionaires had as much wealth as the total wealth of 50 per cent of the world's population. The United States dominates the ranks of the super-rich in all categories from billionaires to ultra-high net worth (UHNW) individuals (US$50 million plus), to millionaires (Credit Suisse 2015: 26-7). The United States has 46 per cent of the global millionaires, and has 48 per cent of the UHNW rich. A claim could reasonably be made that not only is inequality becoming extreme within the United States, but that the United States is leading the world towards increasing inequality.

Figure 1

Share of global wealth of the top 1% and bottom 99% respectively

Figure 2

Share of global wealth of the top 1% and bottom 99% respectively: The trend 2014-2020

In recent years the rediscovery that extreme inequality is returning to advanced economies has become widespread. What is at issue is the causes of this inequality. It is becoming clear that the wider population, particularly in Anglo-American economies have not shared in the growing wealth of the countries concerned, and that the majority of this wealth is being transferred on a continuous and systemic basis into the hands of the very rich. As the financialisation of these economies has continued, with the rapid growth and transmission of financial flows and the penetration of finance into every aspect of human activity, it is those who already have considerable accumulations of wealth who seem to benefit most, and this acute increase in inequality is particularly evident in the United States. Janet Yellen, Chair of the Board of Governors of the US Federal Reserve has stated:

> "The distribution of income and wealth in the United States has been widening more or less steadily for several decades, to a greater extent than in most advanced countries… The past several decades have seen the most sustained rise in inequality since the 19th century after more than 40 years of narrowing inequality following the Great Depression. By some estimates, income and wealth inequality are near their highest levels in the past hundred years, much higher than the average during that time span and probably higher than for much of American history before then. It is no secret that the past few decades of widening inequality can be summed up as significant income and wealth gains for those at the very top and stagnant living standards for the majority. I think it is appropriate to ask whether this trend is

> compatible with values rooted in our nation's history, among them the high value Americans have traditionally placed on equality of opportunity… to the extent that opportunity itself is enhanced by access to economic resources, inequality of outcomes can exacerbate inequality of opportunity, thereby perpetuating a trend of increasing inequality" (Yellen 2014:1; Morelli et al 2014; Atkinson, Piketty and Saez 2011; Saez and Zucman 2014).

While the Anglo-American economies are seeing a return to the extremes of inequality last witnessed in the 19th century, the causes of this inequality are changing. In the 19th century great fortunes often were still inherited, or derived by entrepreneurs from the ownership and control of productive assets. By the late 20th century as Atkinson, Piketty and Saez (2011) and others have highlighted, the sustained and rapid inflation in top income shares have made a significant contribution to the accelerating rate of income inequality:

> "Most countries experience a dramatic drop in top income shares in the first part of the twentieth century in general due to shocks to top capital incomes during the wars and depression shocks. Top income shares do not recover in the immediate post-war decades. However, over the last thirty years, top income shares have increased substantially in English speaking countries and in India and China but not in continental European countries or Japan. This increase is due in part to an unprecedented surge in top wage incomes. As a result, wage income comprises a larger fraction of top incomes than in the past" (Atkinson, Piketty and Saez 2011:3).

Explanations for the increasing rate of inequality have focused upon changes in political economy as occurred in the Reagan and Thatcher administration neo-liberal reforms, macro-economic transformations and recurrent financial crises, the impact of globalisation, and the replacement of progressive by regressive taxation as Atkinson, Piketty and Saez have examined. However one dynamic for the rapid and widespread intensification of inequality which has been relatively ignored is the transformation of corporate governance in the later decades of the 20th century from a technocratic managerialist professionalism which regarded the objectives of the corporation to deliver value to all stakeholders, enhancing the prosperity of the economy and society in the process, to a much narrower and doctrinaire sense of shareholder primacy in which maximising shareholder value became the sole objective of the corporation: "In recent years a growing consensus has emerged in favour of the shareholder-oriented model of the corporation. Increasingly, this model is justified not on the basis of shareholder ownership rights but on efficiency grounds: whoever the immediate and direct beneficiaries of shareholder orientation, it is argued; it ultimately indirectly benefits everyone by ensuring the maximization of aggregate social wealth. The prevalence of this view has caused the distributional dimensions of corporate governance to be neglected" (Ireland 2005:1)

As the financialisation of the economies of the advanced economies has proceeded, and corporations themselves have increasingly been transformed into financial entities, the ownership of all financial assets has increasingly skewed towards the very rich. From the end of the recession in 2009 through 2011 (the last year for which Census Bureau wealth data are available), the 8 million households in the U.S. with a net worth above $836,033 saw their aggregate wealth rise by an estimated $5.6 trillion, while the 111 million households with a net worth at or below that level saw their aggregate wealth decline by an estimated $0.6 trillion (Fry and Taylor 2013:2). Whilst increasing inequality has accompanied financialisation and globalisation throughout the world, it is in the Anglo-American world that many of the impulses towards financialisation and globalisation have originated, and specifically the dynamics of corporate governance and equity markets, once captured by the doctrines of shareholder primacy and the imperative of maximising shareholder value, were at the centre of the insistent production of increased inequality.

This analysis will consider the dimensions of financialization of the international economy and how this has produced a more intensive and integrated mode of accumulation. With the increasing translation of corporations into financial entities, how the dominant shareholder primacy mode of corporate governance has served to compound inequality is examined. The damaging impact of maximising shareholder value is investigated, both in terms of the long term prospects of corporations, but also in aggressively producing increased inequality in the economy and society. Finally the ultimate paradoxical outcome of agency theory and shareholder value is highlighted as the explosion of executive reward in the last two decades in the Anglo-American countries.

Financialization

Financial innovations and financial cycles have periodically impacted substantially on economies and societies, most notably in the recent global financial crisis (Clarke 2010;

Rajan 2010; Phillips 2009; Dunbar 2011; Akerlof and Shiller 2009; Das 2011; Sorkin 2009; Johnson and Kwak 2010). However, the new global era of financialization is qualitatively different from earlier regimes. Global finance is now typified by a more international, integrated and intensive mode of accumulation, a new business imperative of the maximisation of shareholder value, and a remarkable capacity to become an intermediary in every aspect of daily life. Hence finance as a phenomenon today is more universal, aggressive and pervasive than ever before (Krippner 2005; 2012; Epstein 2005; Davis 2009).

The costs and benefits of the rapid financialisation of advanced industrial economies have been debated for some time (Martin 2002; Erturk et al 2008; Langley 2008; Davis 2009). Competing definitions of "financialization" highlight different dimensions of the problem:

- the growing dominance of capital market financial systems over bank-based financial systems;
- significant increases in financial transactions, real interest rates, the profitability of financial firms and the share of national income accruing to the holders of financial assets (Epstein 2005);
- the explosion of financial trading with a myriad of new financial instruments;
- the "pattern of accumulation in which profit making occurs increasingly through financial channels rather than through trade and commodity production" (Krippner 2005);
- the ascendancy of "shareholder value" as a mode of corporate governance (Aglietta and Reberioux 2005);
- the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies (Dore 2008).

These dimensions are extremely wide ranging, causing Dawe to comment "Financialization is a bit like 'globalization', a convenient word for a bundle of more or less discrete structural changes in the economies of the industrialized world" (van der Zwan 2013). Multiple changes in the structural transformation of finance are occurring at three levels: financial markets and institutions increasingly displacing other sectors of the economy as the source of profitable activity; the insistent financialisation of non-financial corporations through a regime of maximising shareholder value and the emphasis on financial metrics; and the penetration of finance into every aspect of life as people are increasingly incorporated into financial activity. In the US, UK and Europe the assets of financial institutions have grown vastly relative to GDP, as finance has positioned itself at the centre of all economic and social life (Figure 3).

Figure 3

Financial Assets in Multiples of GDP

The international expansion of financial markets and institutions amounts for Krippner to a new "pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production" (Krippner 2005). The finance sector has progressively increased its share of GDP, and even for non-financial corporations the pursuit of interest, dividends and capital gains outweigh any interest in productive investment. As non-financial corporations have become increasingly drawn into a financial paradigm, they have less capital available for productive activity despite increasing profits from financial activity (Lazonick 2012). A combination of the accumulation of debt and the volatility of asset prices has increased systemic risk, leading to the increasing intensity of boom–bust cycles (Becker et al 2010).

These financial pressures are translated into the operations of corporations through the enveloping regime of maximising shareholder value as the primary objective. Agency theory has provided the rationale for this project, prioritising shareholders above all other participants in the corporation, and focusing corporate managers on the release of shareholder value incentivised by their own stock options. In turn this leads to an obsessive emphasis on financial performance measures, with increasingly short-term business horizons. However, as financial gains are realised they are not reinvested in advancing the corporation's productive activity, but distributed to shareholders in dividend payments and share buy-backs (van der Zwan (2013: 108; Lazonick 2012). While enriching executives and shareholders, corporations' innovative and productive future is threatened by the increasing impact of financialisation.

Finally the overwhelming embrace of finance is experienced in the increasing dependence of people on financial services and transactions in everyday life. The increasingly universal significance of defined contribution superannuation schemes, property mortgages, credit cards and mass-marketed financial services has created a world in which the apparent "democratisation of finance" has led to a convergence of finance and lifestyles (van der Zwan 2013:111). However, in contrast to the public welfare and savings regimes of the past which were intended to mitigate lifecycle risks, the contemporary immersion in a profoundly financialised personal world acutely exposes individuals to the recurrent risks of the financial markets. This accumulation of an unrelenting international expansion of financial markets, the insistent financialisation of corporate objectives and values, and the subordination of whole populations to financial services exploded in the 2008 global financial crisis (Reich 2008; Posner 2010). It was in this hollowing-out of the social responsibility of business that the US business corporation emerged as primarily a financial instrument. In this new financialized, de-materialized and de-humanized corporate world agency theory could be purveyed as the primary theoretical explanation, and shareholder value as the ultimate objective with impunity. In turn these new conceptions of the theory and objective of the firm became vital ingredients in the further financialization of corporations, markets and economies (Weinstein, 2012).

Corporate Governance and Compounding Inequality

There were very different paradigms of corporate governance before the arrival of financialisation in recent decades and the imposition of the grim hegemony of shareholder value. An emerging collective conception of the corporation is conveyed in the early work of Berle and Means (1932) who identified the collective nature of the corporate entity, the importance of managing multi-dimensional relationships, and the increasing accountability of the corporate entity with profound obligations to the wider community. Paradoxically Berle and Means left an ambiguous legacy (Cioffi 2011), that was subsequently interpreted in two alternative and sharply contrasting theorizations, one collective and collaborative, the other individualistic and contractual (Weinstein 2012). Throughout much of the 20th century the large modern enterprise was represented as a social institution, an organisation formed through collective action, and technological advance with wide social and economic purposes (Galbraith, 1952; 1967; Chandler, 1977). Chandler is identified with the conception of the large corporation as an integrated, unified, collective entity that could not possibly be reduced to the sum of individuals it comprises (Weinstein 2012). Then in the later decades of the 20th century the view of the enterprise as a simple contractual arrangement, a nexus of contracts, and a mode of interaction between individuals became ascendant, providing the theoretical framework for the ultimately hegemonic agency theory and its insistence on shareholder primacy and shareholder value (Weinstein 2012; Aglietta and Reberioux 2005; Coase 1960; Alchian and Demsetz 1973; Jensen and Meckling, 1976).

The modern corporation as typified by Berle and Means manifested the separation of ownership and control, where professional managers were able to determine the direction of the enterprise and shareholders had "surrendered a set of definite rights for a set of indefinite expectations" (Berle and Means 1932:244). After the New Deal and the end of the Second World War, US managers seized the opportunities newly open to them, and many US corporations grew massively in scale and market domination achieving a pre-eminent position in the world economy. A new managerial mode of coordination of enterprise, technology, and planning had arrived transcending the market (Chandler 1977).

This was the era of Galbraith's *New Industrial State* (1967) in which corporate growth and brand prestige appeared to displace profit maximisation as the goal of technocratic managers (Henwood 1998:259). In a technocratic milieu the shareholder was rendered "passive and functionless, remarkable only in his capacity to share without effort or appreciable risk, the gains from growth by which the technostructure measures its success" (Galbraith, 1967:356). This Galbraithian idyll was disintegrating by the time of the severe recession of the early 1970s, with the incapacity of US corporations to compete effectively with Japanese and European products in important consumer market sectors, accompanied by a push by Wall Street towards conglomerate formation in the interests of managing multiple businesses by financial performance. "Over time purely financial interests have increasingly asserted their influence over hybridised giant corporations" (Henwood 1998:262).

While the nexus of contracts theory preceded agency theory, and was the intellectual foundation upon which it was based, it was the cruder aspects of agency theory that became the dominant paradigm in business and law. The insistence on the collective and public nature of the new corporations which Berle and Means convincingly made and others including Galbraith and Chandler developed, invited a response from economists and lawyers who retained a belief in private property, free markets and shareholder rights. This was a determined and successful effort to impose “the reprivatisation of the corporation” (Ireland, 2005; Weinstein 2012).

The impact of these different modes of corporate governance upon the distribution of wealth become clear when Picketty and Saez (2003) now famous graph of the income share of the top ten decile in the United States is considered (Figure 4). Following the dramatic fall of the income share of the top ten decile in the rigours of the New Deal, the Second World War, and post-war reconstruction, there was a long stable period in the income share of the top decile lasting from 1947 through to 1977 which coincides with the period the technocratic and egalitarian paradigm of the purposes of the corporation was in the ascendant. However as the tenets of financialisation, shareholder value and executive stock options begin to take off in the late 1970s with the publications of Jensen and Meckling (1976), Fama (1980) and Fama and Jensen (1983) there is a sudden and prolonged surge in the income reward of the top decile which continues to the present day, and is beginning to threaten the level of inequality in the United States not witnessed since the 19th century. This is not to suggest their very widely cited articles, which have dominated finance and economics for decades, were particularly influential in producing this sudden and atavistic return to extreme inequality, however their work certainly interpreted these changes in a benign light, and totally neglected their damaging social and economic outcomes.

Figure 4

Top Ten Decile Income Share in the US 1917-2007

Management theory and practice for some decades has been overwhelmed by this narrow and constricted view of the modern corporation. Agency theory, the dominant intellectual justification for the principle of shareholder primacy and the practice of maximising shareholder value, has become “a cornerstone of ... corporate governance” (Lan and Heracleous 2010: 294). Agency theory is often regarded not only as the dominant current interpretation, but as an eternal and universal explanation of corporate governance. In fact agency theory is of recent origin, and is very much a product of the Anglo-American world. Rooted in finance and economics, it has somehow managed to penetrate not only policy and practice but the essential understanding of corporate law regarding directors’ duties. In classical agency theory the central role of the board of directors is to monitor managers (the agents) to ensure their interests do not diverge substantially from those of the principals (the shareholders), and to devote the company to maximising principals return (Fama 1980; Fama and Jensen 1983; Jensen and Meckling 1976). Yet, despite its pre-eminence, agency theory is not only profoundly simplistic, but deeply flawed:

- Agency theory focuses on an oversimplification of complex financial and business reality
- Agency theory damagingly insists upon the single corporate objective of shareholder value
- Agency theory misconceives the motivations of managers
- Agency theory ignores the diversity of investment institutions and interests
- Agency theory debilitates managers and corporations, and ultimately weakens economies
- Agency achieves the opposite of its intended effect.

As Didlier Cossin (2011), Professor of Finance at IMD, Switzerland has observed:

"Most financial models taught today rely on false mathematical assumptions that create a sense of security even as failure approaches... The list of flawed theories (including agency theory)…are all finance models based on over-simplifying complex choices. This pretence that mathematical models are the solution for human problems is dangerous and is not only at the core of finance theory but is also in the heads of many corporate and financial managers. Given the tremendous changes in financial systems, these theories must be scrutinised and then abandoned as models for the future."

Not only does agency theory dangerously over-simplify the complexities of business relationships and decisions, but it damagingly demands a focus on a single objective. Agency theory asserts shareholder value as the ultimate corporate objective which managers are incentivised and impelled to pursue: "The crisis has shown that managers are often incapable of resisting pressure from shareholders. In their management decisions, the short-term market value counts more than the long-term health of the firm" (Segrestin, and Hatchuel 2011)

Agency theory daring not to enter the "black box" of the firm itself, from a distance hopelessly misconceives the motivations of managers, reducing their complex existence to a de-humanised stimulus/response mechanism: "The idea that all managers are self-interested agents who do not bear the full financial effects of their decisions (Jensen, and Meckling 1976) has provided an extraordinary edifice around which three decades of agency research has been built, even though these assumptions are simplistic and lead to a reductionist view of business, that is, comprising two participants – managers (agents) and shareholders (principals)" (Pye and Pettigrew 2005).

Agency theory tends to ignore the diversity of investment institutions and interests, and their variety of objectives and beneficiaries. As Lazonick (1992) has argued institutional investors are not monolithic and different types of institutional investors have different investment strategies and time horizons. Corporate governance becomes less of a concern if a share holding is a very transitory price based transaction, and much share trading today is computer generated, with rapid activity generated by abstract formulas. While life insurance and pension funds do have longer term horizons, and often look to equity investments to offer durable and stable returns, the behaviour of other market participants is often focused on the shorter term, and more interested in immediate fluctuations in stock prices than in the implications of corporate governance for the future prospects of a company:

"Pension fund managers can generally take a longer-term perspective on the returns to their portfolios than can the mutual-fund managers. Nevertheless even the pension funds (or insurance companies) are loath to pass up the gains that, in a speculative financial era, can be made by taking quick capital gains, and their managers may feel under personal pressure to match the performance of more speculative institutional investors. The more the institutional investors focus on the high returns to their financial portfolios needed to attract household savings and on the constant restructuring of their portfolios to maximize yields, the more their goals represent the antithesis of financial commitment. Driven by the need to compete for the public's savings by showing superior returns, portfolio managers who invest for the long term may find themselves looking for new jobs in the short term" (Lazonick 1992).

Maximising Shareholder Value

Maximising shareholder value has proved a debilitating philosophy throughout large listed U.S. corporation for some decades. The corrosive impact of shareholder value imperatives is felt in every business sector, even the most successful such as the U.S. information technology and finance industries. U.S. information technology companies, which led the world in 1990s innovation (Microsoft, IBM, Cisco, Intel, Hewlett-Packard), “spent more (much more except Intel) on stock buybacks than they spent on R & D in 2000-2009” (Lazonick 2012). In the 2007/2008 global financial crisis, “many major US financial firms (including Citigroup, Merrill Lynch, Lehman Brothers, Wachovia, Washington Mutual, Fannie Mae), many of whom subsequently failed, had previously used up precious reserves in order to fund stock buybacks, which in turn made already over-compensated executives even wealthier.” Lazonick asks why did senior executives willingly diminish the financial strength and resilience of major corporations in this reckless way?

“The ideology of maximizing shareholder value is an ideology through which corporate executives have been able to enrich themselves. The economists’ and corporate executives’ mantra from 1980 until the 2007-2008 meltdown of shareholder value and the need to ‘disgorge…free cash flow’ translated into executive option grants and stock buybacks, and resulted in increasing dramatically those executive options’ value” (Lazonick 2012).

The power of the shareholder value model “has been amplified through its acceptance by a worldwide network of corporate intermediaries, including international law firms, the big accounting firms, and the principal investment banks and consulting firms – a network whose rapidly expanding scale give it exceptional influence in diffusing the ... model of shareholder-centred corporate governance” (Ireland 2005:77).

The self-interest and irresponsibility inherent in the practice of pursuing shareholder value reached its zenith with the reckless excesses of the global financial crisis. William Bratton and Michael Wachter relate the activities of financial sector firms in the years and months leading to the financial crisis of 2007−2008:

“For a management dedicated to maximizing shareholder value, the instruction manual was clear: get with the program by generating more risky loans and doing so with more leverage. Any bank whose managers failed to implement the [high risk strategy] got stuck with a low stock price. . . .Unsurprisingly, its managers laboured under considerable pressure to follow the strategies of competing banks” (Bratton, and Wachter 2010)

This irresponsible behaviour has been widely recognized in post-crisis inquiry reports, and regulatory reforms across most jurisdictions now recommend that executive remuneration systems should be redesigned to take into account risk strategy and promote long-term performance and responsibility (Blair 2012). And yet even after the prolonged international reform process in the years following the financial crisis, the concept of shareholder primacy, and the concomitant insistence that the only real purpose of the corporation is to deliver shareholder value, has survived as an almost universal principle of corporate governance, and often goes unchallenged. This self-interested, tenacious and simplistic belief is corrosive of any effort to realise the deeper values companies are built upon, the wider purposes they serve, and the broader set of relationships they depend upon for their success. The obsessive emphasis on shareholder value is an ideology that is constricting and misleading in business enterprise, and is intended to crowd out other relevant and viable strategies for business success.

The primacy traditionally accorded to shareholder interests is most often justified on the basis that it is the means by which corporate law can most effectively secure aggregate social welfare (Hansmann and Kraakman 2001). This view was perhaps most clearly and familiarly expressed by the economist Milton Friedman (1970) that “the social responsibility of business is to increase its profits.” However, the question of whose interests should shape corporate operations and strategy has become contested under the corporate social and environmental responsibility movement. Should companies pursue the collective interest of shareholders exclusively or should they include other interests and wider social and environmental claims in their own right?

As Margaret Blair persuasively argues, “to anyone who has worked for a corporation or observed the ways that corporations can externalise some of their costs onto employees, customers, or the communities where they the idea that maximising share value is equivalent to maximising the total social value created by the firm seems obviously wrong’. The long-run maximization of share value is not the equivalent to maximising total social value. On the contrary, the in-the-long-run argument simply “fails to make a case that shareholders’ interest should be given precedence over other legitimate interests and goals of the corporation . . . Neither in theory nor in practice, is it true that maximizing the value of equity shares is the equivalent of maximizing the overall value created by the firm.” (Blair quoted by Ireland 2005 p 143)

This suggests that shareholder primacy is more accurately seen as a device for achieving a particular distribution of the product of productive activity than as a mechanism for achieving economic efficiency. Its vigorous re-assertion, like the adoption of neo-liberal policies more generally, involves “a shift in the internal social relationships within states in favour of creditor and rentier interests, with the subordination of productive sectors to financial sectors and with a drive to shift wealth and power and security away from the bulk of the working population” (Ireland 2005:31).

As the Board of Governors of the Federal Reserve (2014) indicate the ownership of all financial assets in the U.S. is heavily skewed towards the top 5 per cent of the population who by 2013 possessed more than 60 per cent of these assets, while the bottom 50 per cent of the population barely have any financial assets (Figure 5). However Wolff (2012) highlights that U.S. financial securities and business equity are the most heavily skewed financial assets in their distribution, with just 1 per cent of the population owning 64 per cent of financial securities and the next 9 per cent of the population owning 30 per cent of these assets. Similarly with business equity one per cent of the U.S. population own 61 per cent of business equity and the next 9 per cent of the population own 31 per cent of business equity. Therefore in essence the elevated mantra of the maximisation of shareholder value effectively boils down to devoting corporations to the financial interests of 1 per cent of the U.S. population, and at best 10 per cent of the population. The crudeness of the avarice and recklessness that underlies the maximisation of shareholder value is most clearly demonstrated in the massive, continuing and irresponsible inflation in executive pay during the last three decades.

Figure 5

Share of All Financial Assets by Net Worth Group in US

Figure 6

US Distribution of Investment Assets 2010

5. Executive Pay

It is important to remember that though hundreds of millions of dollars are routinely paid to the leading CEOs and financial institution executives in the United States, and though the country remains the second richest on earth in GDP (after China), the political economy of the U.S. is deeply disfigured by the mounting, severe, and very visible inequality. While CEO salaries inflated through the roof in the era from the 1990s to the present day, average earnings in America actually went down (EPI 2015). In this re-invention of inequality the U.S. led the world "The share of total income going to top income groups has risen dramatically in recent decades in the United States and in many other (but not all) countries"(Atkinson, Picketty and Saez 2011:6). How did this insistent inequality reappear in the industrial world, what are its causes, and what are the consequences?

Executive remuneration began to explode in the late 1980s and early 1990s when executives began to be encouraged to align their thinking more closely with shareholders by receiving equity based pay. Jensen and Murphy (1990a and 1990b) asked the rhetorical question "Why pay executives like bureaucrats?" The apparent answer to this question was to load executives up with equity pay until this became the lion's share of their remuneration (Hall 2003). The purpose was to focus and enhance executive's performance on achieving returns to shareholders: equity based compensation was intended as the silver bullet to achieve higher rates of shareholder value. However the critical flaw in this plan is that executives, who were running the company and could influence the performance of the company to serve their own purposes, effectively seized control of their own reward structures:

"Flawed compensation arrangements have not been limited to a small number of 'bad apples'; they have been widespread, persistent and systemic. Furthermore, the problems have not resulted from temporary mistakes or lapses of judgement that boards can be expected to correct on their own; rather they have stemmed from structural defects in the underlying governance structure that enables executives to exert considerable influence over their boards. The absence of effective arm's-length dealing under today's system of corporate governance has been the primary source of problematic compensation arrangements. Finally, while recent reforms that seek to increase board independence will likely improve matters, they will not be sufficient to make boards adequately accountable; much more needs to be done" (Bebchuk and Fried 2005:2).

During the boom years of the 1990s there was a rapid and sustained escalation in CEO salaries in the United States, and any expected adjustment downwards in executive reward with the market crash of 2001, and the halving of the market capitalisation of many large corporations, did not occur. Though there were more stringent efforts to link CEO compensation to performance, U.S. CEO reward remained at incredibly high levels whether the companies they managed did well or not. Extremely lucrative share option schemes continued, and if the options packages became more sophisticated, there were many devices such as backdating widely employed to ensure executives extracted the best possible reward from their options. This pattern has continued to the present day: whatever reductions in their remuneration (if any) CEOs experienced during the financial crisis were quickly restored in the period after the crisis, and soon were as extravagant as they had ever been before. Stock options in the US proved the route to enriching not just brilliant software entrepreneurs but any CEO of an S & P 100 who stayed in office long enough to massage the company accounts.

Figure 7

Top five US CEOs annual remuneration vs. top five US fund managers CEOs 2013

Figure 7 indicates the total remuneration of the five highest paid CEOs in the US in 2014. Included in the compensation figures are base salary, bonuses, benefits, long term incentive plans, and profits from cashing out on stock options where this information was accessible. U.S. executive salaries are the most inflated in the world, followed by the UK, while executive salaries in Europe are generally more modest, and in Japan are much lower. Claims that such extravagant salaries are required to incentivise U.S. CEOs and create greater alignment between their interests and those of the shareholders scarcely stand scrutiny: despite the sophisticated formulas often employed in complex compensation packages, all too often extravagant CEO salaries have little connection to performance measured in terms of shareholder returns, peer performance, or any measure of stakeholder values. Of course CEO salaries are only a part of wider structures of inequality that have become more extreme in recent years, and rewards for executives in the finance sector have become even more astronomically inflated (Figure 7) with billions of dollars being paid to the small group of top hedge fund directors. (When the leaders of the hedge funds were hauled into the U.S. Congress House Committee investigating the financial crisis George Soros admitted that "more regulation of the financial system is needed in order to reign in the greed that ultimately creates unsustainable economic bubbles" *New York Times* 13 November 2008). As Thomas Piketty's *Capital in the 21st Century* (2014) graphically demonstrates western economies led by the United States have been drifting back into levels of inequality not witnessed since the 19th century. The irony is that as the US has become one of the most unequal societies in the world, there has been a rediscovery of philanthropy with both Bill Gates and Warren Buffet eager to give their vast $70+ billion fortunes away to help solve the most deep-seated problems of the world. Mark Zuckerberg has responded to this by channelling some company stock and his own money into public education. But earlier in the 20th century both corporations and individuals were taxed at a level that enabled governments to meet these problems of social need and equality of opportunity, not the super-rich.

The essential problem is not the unrestrained and absolute growth in CEO reward, however morally dubious that is in organisations where CEOs are expected to be setting an example of ethical behaviour rather than greed, it is the wider impact of the obsessive focus on CEO reward systems in Anglo-American corporations. Firstly there is the debilitating displacement of goals as the *objectives* of the corporation under the leadership of equity incentivised CEOs switches from the single minded focus on the development and success of the company to highly individualistic CEO strategies on how to align the performance of the corporation with the maximisation of their personal earnings. Secondly how the arrogation of an increasing share of the wealth of the corporation by the CEO impacts upon *relationships* with other employees, shareholders and the wider community, as CEOs become increasingly remote from the material concerns of the rest of the people.

The displacement of CEO goals is not a recent problem but occurred in earlier periods in different forms, for example in earlier periods of merger and takeover activity, often the most insistent driver was CEOs' ambition, since they associated acquisitions with higher rewards for themselves. Similarly the sustained lack of capital investment in US and UK industry in the 1970s and 1980s was partly due to the self-interest of management: "The problem was not only the high cost and mobility of capital. The problem was also the willingness of many top managers of industrial corporations to take advantage of the permissive financial environment to appropriate huge levels of compensation for themselves while neglecting to build organizational capabilities in the companies they were supposed to lead" (Lazonick 1992:476). However the displacement of goals since the introduction of equity-based pay for CEOs has become systemic, and now agreeing the elaborate design the CEO remuneration package is one of the principal roles of boards of directors. For example in the celebrated downfall of WorldCom the report prepared for the District Court of New York stated: "The Audit Committee spent as little as six hours per year in overseeing the activities of a company with more than $30 billion in revenue, while the WorldCom Compensation Committee met as often as 17 times per year" (Breedon 2003:31).

Figure 8

Ratio of CEO-to-worker compensation in the United States 1965-2014

As critical as the detachment of US executives from their corporations and shareholders' interests that occurred from the 1990s, was the distance that grew between the rewards and lifestyle of executives and their employees and other stakeholders. In 1980 the ratio of CEO and worker compensation in the US was approximately 50:1, and by 1990 this had risen to a ratio of 109:1. With the meteoric rise in executive pay in the 1990s the ratio expanded inexorably to an unprecedented 376:1 in 2002 (Figure 8). After the fall-out from the Enron and WorldCom collapses and the introduction of the Sarbanes Oxley regulation there was a sharp dip in this ratio, which quickly recovered with the excesses that led to the global financial crisis. The post-crisis regulatory intervention put a check of executive excess for a short while, but with the public stimulus led recovery CEO salaries returned to a ratio of 303:1 compared to worker pay. Though there was productivity growth during this era almost all the benefits went to top management: as Dew-Becker and Gordon who examined the distribution of the benefits of growth in the US comment 'Our results show the dominant share of real income gains accruing to the top 10 per cent and top 1 per cent is almost as large for labour income as total income … It is not that all gains went to capital and none to labour; rather, our finding is that the share of gains that went to labour went to the very top of the distribution of wage and salary incomes' (2005:77). In two decades US workers saw no measurable improvement in their wages, while US executives enjoyed the experience of becoming multi-millionaires en masse. This is hardly a recipe for a well integrated and orderly economy and society, and it is not surprising that the US now has among the worst social and health problems of any advanced industrial country.

The elaborate structures designed to link executive reward to performance has often compounded the problems rather than alleviating them, and too often CEO compensation is not due to achieving results but has amounted to rewards for failure (Trade and Industry Committee 2003). Essentially the extraordinary elevation in executive reward that occurred in the 1990s (and has continued since) in the United States had little to do with the productive efforts of the executives themselves, and was fuelled by the longest running bull market in history. The sustained rise in share prices in this period reflected institutional savings flows and momentum investing, together with falling interest rates. Stock options became an accelerator mechanism providing risk free bonuses to senior management. "Corporate governance in the 1990s operated against a background of rising share prices, the capital market was not an agent of discipline but a facilitator of painless general enrichment through rising share prices; amidst increasing confusion about what management could do in a world whose stock market was running on narratives (not discounted cash flows) and encouraging CEOs to pose as heroes … Many CEOs in the decade of the 1990s profited personally from using the language of value creation to cover the practice of value skimming" (Ertuck et al 2004).

When companies do use objective criteria for setting CEO compensation these criteria are not designed to reward managers for their own contribution to the firm's performance, as bonuses are typically not based on the firm's operating performance or earnings increases relative to its industrial peers, but on metrics that cannot distinguish the contribution of industry wide or market wide movements. In fact conventional stock options allowed executives to gain from any increase in stock price above the grant-date market value, even when their company's performance might have significantly lagged that of their peers.

Figure 9

Change in CEO pay and Average Worker Pay in the UK 1980-2013 (UK £)

There is a real danger that the excessive compensation secured by US executives is becoming the benchmark for executive reward in other regions of the world where up till now executive rewards have remained modest in comparison, and executive have pursued a balanced set of corporate objectives rather than their personal remuneration. The out of control inflation in executive pay in the United States threatens to impact upon executive reward internationally, beginning with the UK where CEO salaries were a small fraction of US CEO salaries until 1998 when a sharp and sustained inflation in CEO pay occurred (Figure 9). In the past there was some resistance to this as business executives in Europe and Asia were less enamoured to the short term orientations of the U.S. counterparts, and identified with the sustained successof the companies they led rather than celebrating their own reward. However more European and Asian executives look upon swollen US executive salaries as a benchmark to aspire towards. Already a higher proportion of executive pay is being offered in equity-based compensation and in incentive payments in other parts of the world, which were significant stages in the acceleration of the inflation of US executive pay. It may be questioned whether executive performance pay should be in the form of stock options at all, since these create an incentive for management to manage performance of financial results in order to maximise share price. Pay for performance in the form of bonuses might better be linked to the underlying drivers of performance that impact on the financials, and to non-financial performance indicators in a more balanced scorecard. The focus could then be upon management for sustainability, rather than short term performance management aimed at the stock price (Clarke 2016a).

6. Conclusions

The debate in corporate governance for the last two decades has focused on how to align executive performance with shareholder value. Many of the developments in reform, regulation, standards and best practices were inspired by this single principle. This in effect was an atavistic return to narrow 19th century views of the purposes of the corporation, but in the contemporary context of an increasingly financialised conception of the corporation and its objectives. The result has been a mode of corporate governance that has aggressively compounded inequality in the economy and society, and directed corporations to the interests of a very small and very rich section of the community. The tenet of maximising shareholder value, to the extent that it has been adhered to by corporations, has devoted the value generated by corporate activity to servicing the increasing wealth of rich shareholders rather than the interests of all stakeholders in the corporation. At the pinnacle of this effort and driving the dynamic of the unequal distribution of value are CEOs who in the U.S., and increasingly in other countries, have been massively rewarded for their efforts. This system is unacceptable not simply because it is amoral and inequitable, but because it is incapable of conceiving of and acting on the essential purposes of corporations defined as the "delivery of long-term value in financial, social, environmental and ethical terms (UN 2015; Clarke 2016b).

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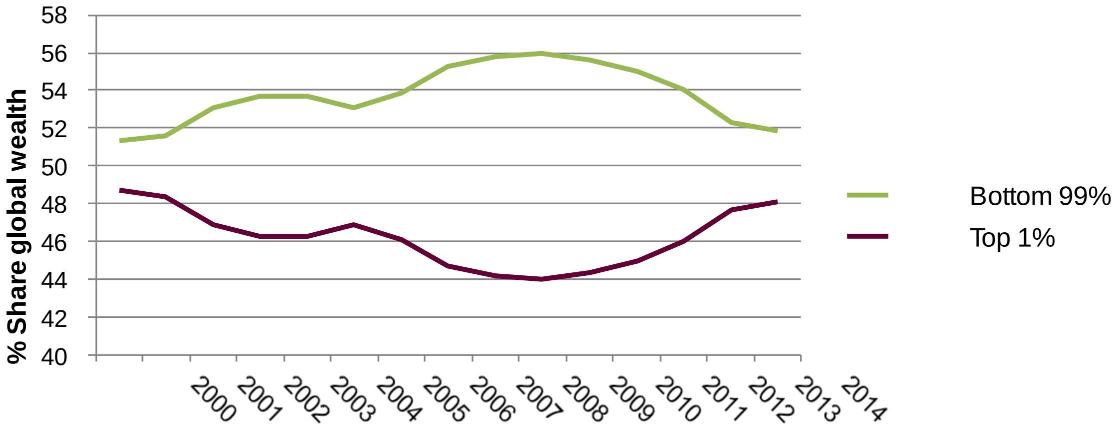
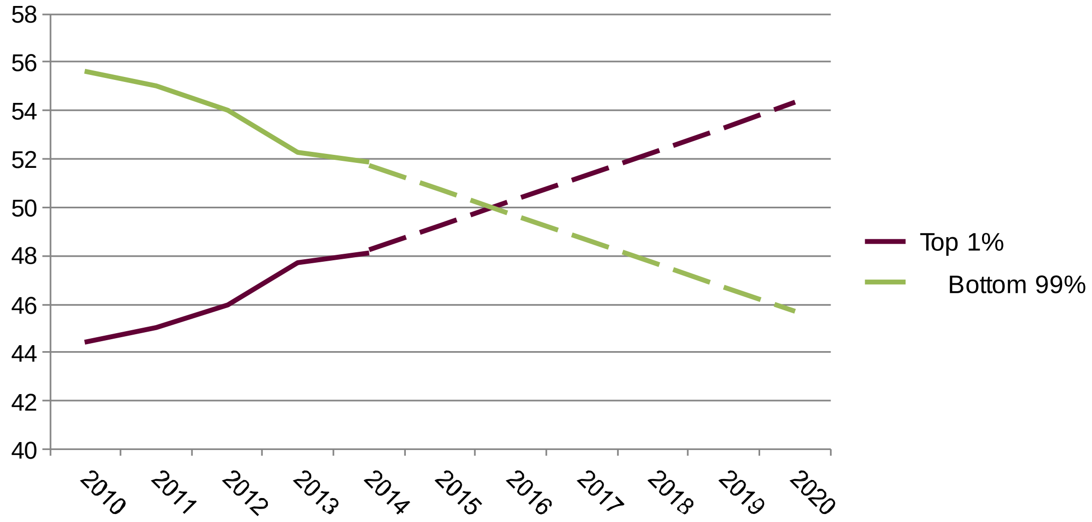
FIGURES

Figure 1 Share of global wealth of the top 1% and bottom 99% respectively



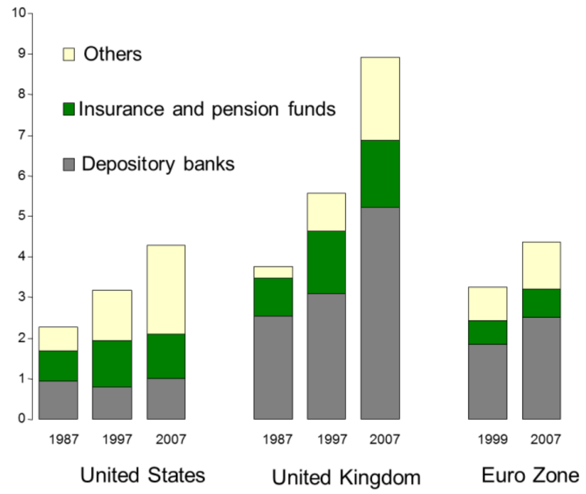
Source: Credit Suisse *Global Wealth Report* 2015; Credit Suisse Data 2000-2014; Oxfam Issue Briefing, Wealth: Having it All and Wanting More, January 2015

Figure 2 Share of global wealth of the top 1% and bottom 99% respectively; the dashed lines project the 2010–2014 trend. By 2016, the top 1% will have more than 50% of total global wealth.



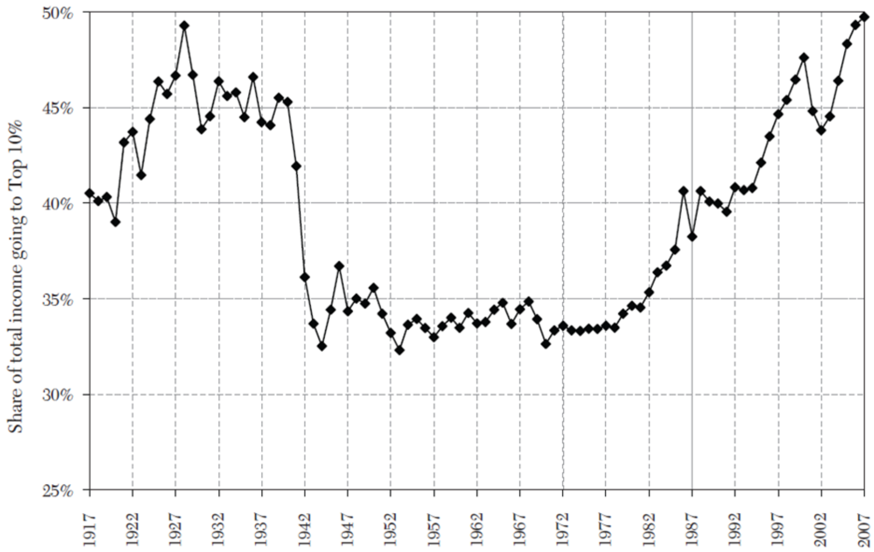
Source: Credit Suisse Global Wealth Report 2015; Credit Suisse Data 2000-2014; Oxfam Issue Briefing, Wealth: Having it All and Wanting More, January 2015

Figure 3 Financial Assets in Multiples of GDP



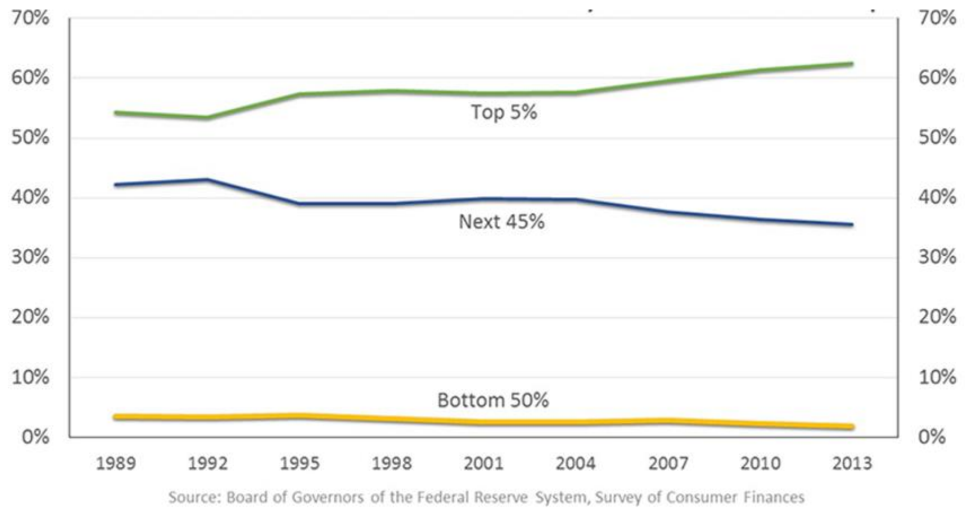
Source: IMF, Annual Report (2008)

Figure 4 Top Ten Decile Income Share in the US 1917-2007



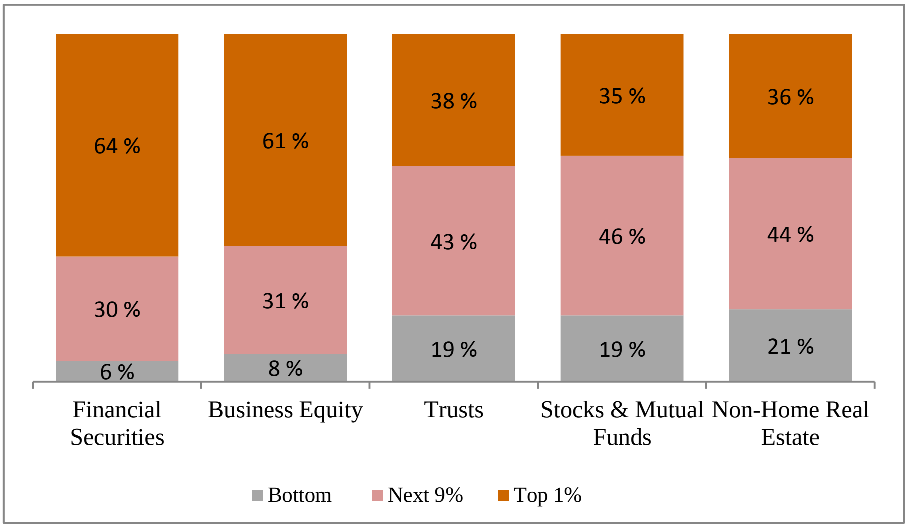
Source: Picketty and Saez (2003) Updated to 2007.

Figure 5 Share of All Financial Assets by Net Worth Group in US



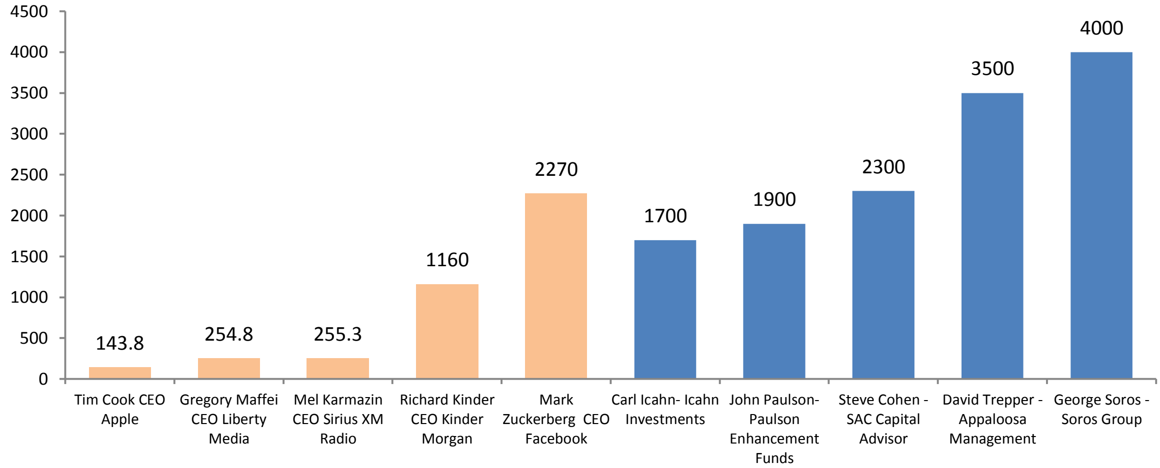
Source: Board of Governors of the Federal Reserve System, survey of Consumer Finances 2014

Figure 6 US Distribution of Investment Assets 2010



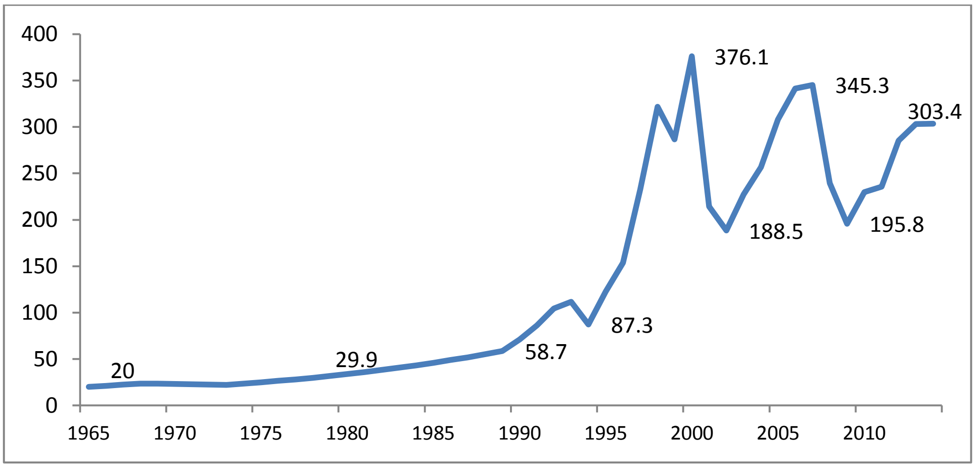
Source: Wolff, E. N. (2012). The Asset Price Meltdown and the Wealth of the Middle Class, National Bureau of Economic Research Working Paper No 18559, New York: New York University http://www.ecineq.org/ecineq_bari13/FILESxBari13/CR2/p17.pdf G.W. Donhoff (2013), Wealth, Income and Power, Who Rules America? http://www2.ucsc.edu/whorulesamerica/power/wealth.html

Figure 7 Top five US CEOs annual remuneration vs. top five US fund managers CEOs 2013



Source: Forbes (2014), CEO Compensation, 25 Highest Earning Hedge Fund Managers and Traders http://www.forbes.com/sites/nathanvardi/2014/02/26/the-highest-earning-hedge-fund-managers-and-traders/; World of CEOS available at http://www.worldofceos.com/dossiers

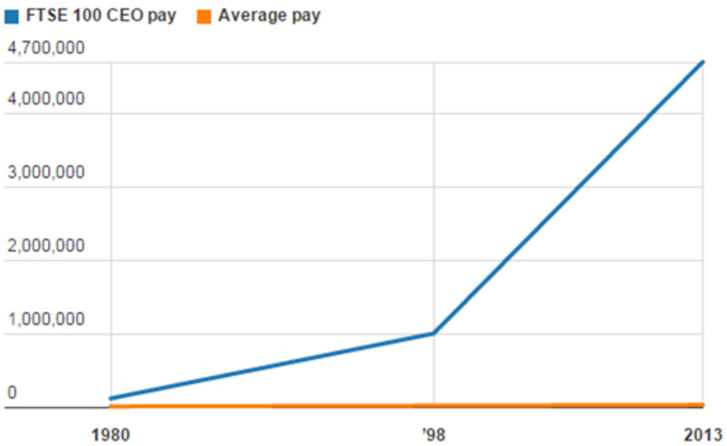
Figure 8 Ratio of CEO-to-worker compensation in the United States 1965-2014



Note: CEO annual compensation is computed using the options realized compensation series, which includes salary, bonus, restricted stock grants, options exercised, and long-term incentive payouts for CEOs at the top 350 U.S. firms ranked by sales.

Source: Economic Policy Institute 2014. Authors' analysis of data from Compustat's ExecuComp database, Current Employment Statistics program, and the Bureau of Economic Analysis NIPA tables

Figure 9 Change in CEO pay and Average Worker Pay in the UK 1980-2013 (UK £)



Source: High Pay Centre, *Reform Agenda: how to Make Top Pay Fairer*, Final Report, 2014
http://highpaycentre.org/files/Reform_Agenda_Final_Report.pdf