The New Economy Business Model and the Crisis of US Capitalism

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Employment insecurity in the 2000s

The end of "the organization man"

+ The globalization of employment

+ The ideology of maximizing shareholder value

= Employment insecurity

William Lazonick, *Sustainable Prosperity in the New Economy?: Business organization and High-Tech Employment in the United States*, Upjohn Institute of Employment Research, July 2009.

What is the "New Economy business model"?

Characteristic features of the Old Economy and New Economy business models compared

	OEBM	NEBM
Strategy, product	growth by building on internal capabilities; expansion into new product markets based on related technologies; geographic expansion to access national product markets	new firm entry into specialized markets; sell branded components to system integrators; accumulate new capabilities by acquiring young technology firms
Strategy, process	development and patenting of proprietary technologies; vertical integration of the value chain, at home and abroad	cross-license technology based on industry standards; vertical specialization of the value chain; outsourcing/offshoring routine work
Finance	venture finance from personal savings, family, and business associates; NYSE listing; pay steady dividends; growth finance from retentions leveraged with bond issues	organized venture capital; IPO on NASDAQ; low or no dividends; growth finance from retentions plus stock as an acquisition currency; stock repurchases to support stock price
Organization	secure employment: career with one company; salaried and hourly employees; unions; DB pensions; employer-funded medical insurance in employment and retirement	insecure employment: interfirm mobility of labor; broad-based stock options; non-union; DC pensions; employee bears greater burden of medical insurance

In the 1990s a transition occurred from OEBM to NEBM that is now complete in US high-tech industry.

Exemplars of OEBM and NEBM in ICT

OEBM	***NEBM***
The Bell System	**Intel**
IBM	**Microsoft**
Hewlett-Packard	**Oracle**
Motorola	**Sun Microsystems**
Texas Instruments	**Cisco Systems**
Xerox	**Dell**
NCR	**Apple**
Cox	**Yahoo!**
Pitney Bowes	**Amazon.com**
	Google

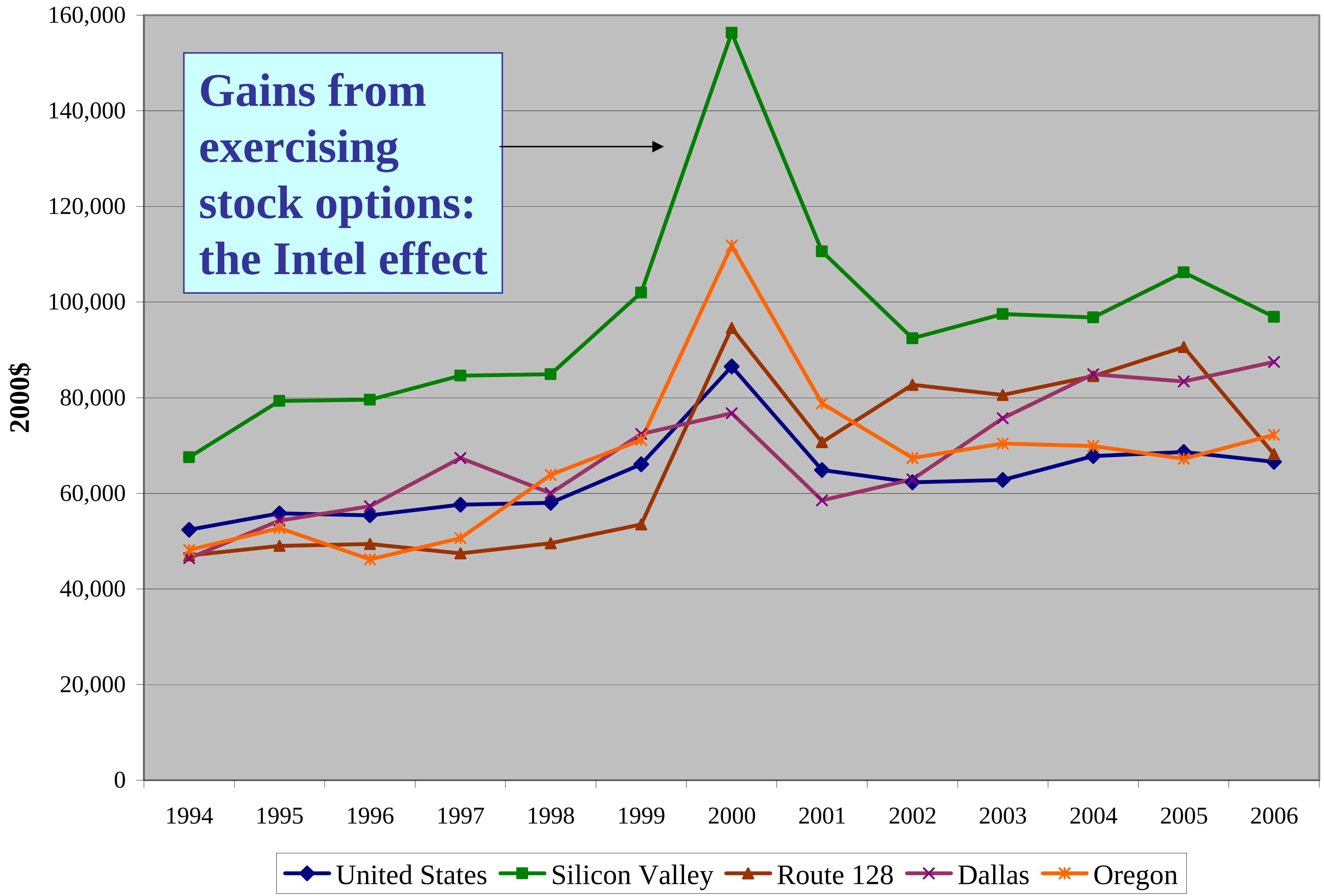
Transition from OEBM to NEBM: the critical case of IBM

- Dominated the computer market in the Old Economy
- Employed over 405,000 people, in 1985 when it still offered the expectation of "lifelong employment"
- But did away with lifelong employment in the early 1990s – cut employment from 374,000 in 1990 to 220,000 in 1994
- wanted younger workers: open systems, services, and software instead of hardware
- transformed its pension plans to attract younger workers
- led the transition from OEBM to NEBM

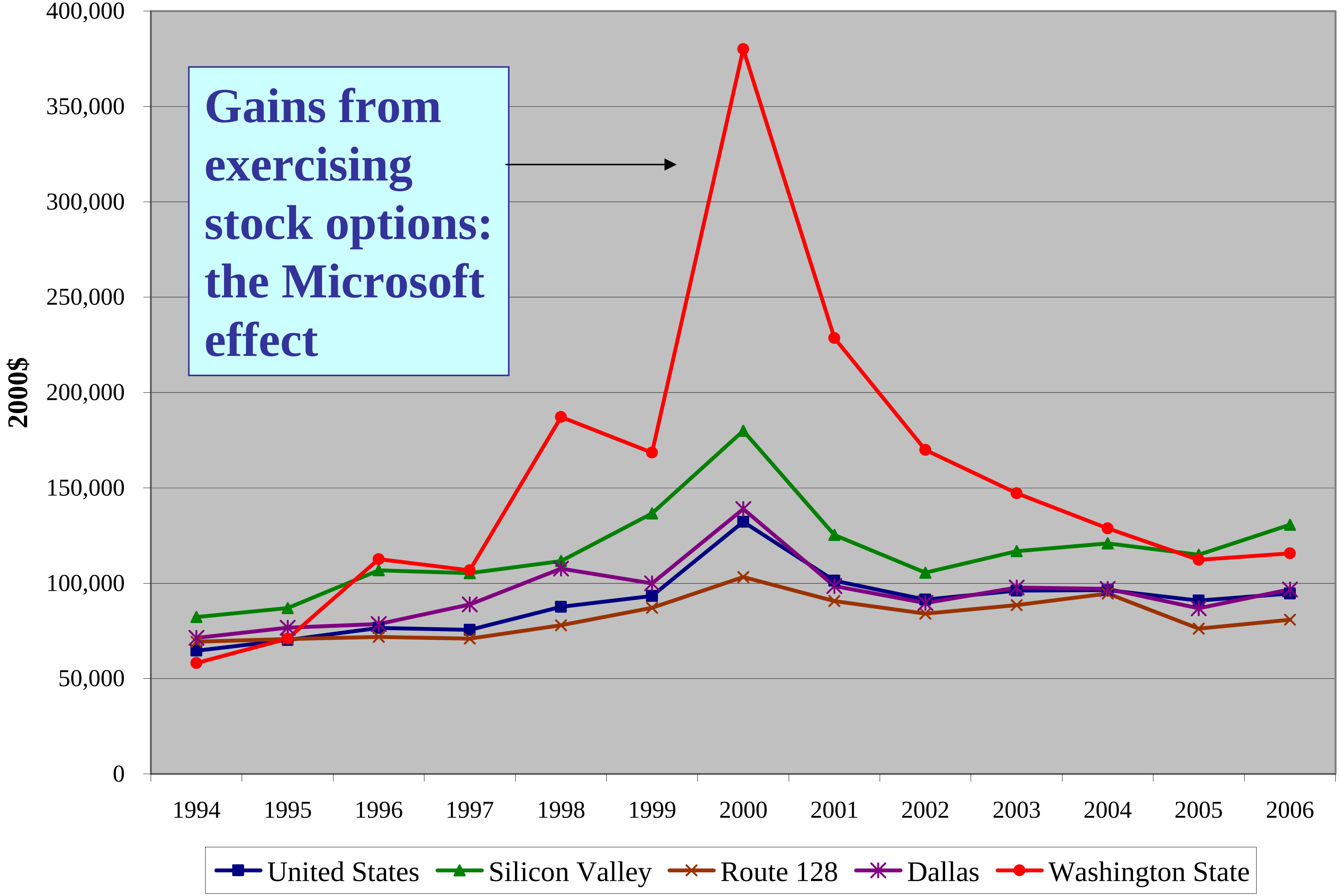
The end of “The HP Way”

- Hewlett-Packard a major electronics engineering company in the Old Economy; the pioneering company in what would become Silicon Valley
- “The HP Way” ensured that employees whose jobs had been restructured had an opportunity to remain with the company
- But moved into printers, based on open standards -- did not require career employees
- 1999: Spun off Agilent, and began to do away with the HP Way – process complete with Compaq acquisition in 2002 – HP now known for employee “churn”

Semiconductor wages, 1994-2006



Software publishing wages, 1994-2006



Stock options and CEO pay

Average gains (thousands of US dollars) per top5 executive from the exercise of stock options, selected ICT companies, 1995–2006

Year	Cisco	Dell	HP	IBM	Intel	Microsoft	Oracle	Sun
1995	4065	387	534	152	4892	2505	4301	727
1996	15,790	830	1074	5383	24,585	0	8302	2786
1997	3124	1977	2161	3764	12,516	4127	3620	4425
1998	5972	14,417	1114	10,239	40,137	3271	3752	11,515
1999	60,586	36,937	8732	24,457	4796	30,178	6754	5619
2000	51,302	98,791	4360	13,293	32,063	50,653	83,504	25,180
2001	11,884	75,151	0	29,296	4117	31,531	169,674	18,441
2002	805	28,612	127	943	3514	1405	0	5406
2003	1291	2103	502	2139	6298	6860	13,001	1323
2004	14,207	14,019	182	2876	6338	8564	8633	1432
2005	15,804	9364	2319	3550	4208	5	21,953	2397
2006	17,614	31,466	4903	3210	2929	0	12,998	564

Stock option gains from broad-based plans

Average gains (dollars) per employee (excluding the "top5") from the exercise of stock options, selected ICT companies, 1995–2006

	Cisco	Dell	HP	IBM	Intel	Microsoft	Oracle	Sun
1995	60,894	3833	2362	671	18,746	51,829	na	2468
1996	93,399	7194	2213	1823	16,010	79,022	7367	7992
1997	85,159	11,219	3156	3615	25,295	154,196	6588	7626
1998	92,947	40,547	2676	4066	75,890	238,377	5019	10,799
1999	193,476	126,639	6613	5790	56,589	369,693	5650	27,477
2000	290,870	84,818	17,987	4200	112,018	449,142	37,214	60,431
2001	105,865	76,122	1498	4011	18,235	143,772	88,723	46,763
2002	13,596	33,167	838	1195	10,413	95,310	6950	4550
2003	8917	10,739	936	1553	10,406	80,283	6193	1182
2004	32,804	12,216	638	1842	8405	50,690	7908	1960
2005	24,432	11,297	1739	1256	8347	14,500	6926	1187
2006	25,487	8724	6809	1857	3396	6208	9514	1249

Employees: CSCO 1995: 4086; 2000: 34,000; MSFT 1995: 17,800; 2000: 39,100

Globalization of the high-tech labor force

You only get stock options if you have a regular job

New competition for high-tech labor in 2000s: emergence of a highly qualified labor force in China and India

Global labor is not new: But the size – and quality -- of the Chinese and Indian labor supply is new

Offshoring: important for Asian development

But creates employment insecurity for US workers

In the context of NEBM, hardest hit are older (40+) high-tech workers

Economic insecurity of the US high-tech labor force

Vulnerability of educated and experienced high-tech labor

- **transformation of employment relations from a career in one company to interfirm labor mobility**
- **competition from qualified high-tech labor in Chin and India**
- **what US companies do with their profits?: repurchases stock – quest for shareholder value**
- **Why do companies do repurchases?**

“maximizing shareholder value”=outsized (and obscene) executive pay

Globalization at IBM

IBM:

- increased employment from 219,839 in 1994 to over 398,455 in 2008
- but the share of US employees in IBM's worldwide employment declined from 52.2 percent in 1996 to 30.2 percent in 2008
- in 2006 the net increase in IBM employees outside of the United States was 26,387, in 2007 37,961, and in 2008, more than 20,000
- One-quarter of IBM's 2007 employees worldwide were in the BRIC countries, with 74,000, or 19 percent of all IBM employees, in India alone

From 2000-2008, IBM repurchased $67.4 billion of its own stock: $18.8 billion in 2007 and $10.6 billion in 2008)

Project Match

- IBM highly profitable in 2008
- Yet laid off more than 4,000 workers in Feb. 2009, and announced 5,000 more in March
- End of February announced Project Match: "to help you locate potential job opportunities in high-growth markets where your skills are in demand."
- Project match eligibility limited to "satisfactory performers who have been notified of separation from IBM US or Canada and are willing to work on local terms and conditions." The localities are places like India, China, and Brazil

Globalization at HP

HP

- increased employment from 141,000 in 2002 to 172,000 in 2007
- decreased US employment from 67,350 in 2002 to 53,519 in 2007
- share of US employees in HP's worldwide employment fell from 48 percent in 2002 to 31 percent in 2007
- recently acquired EDS, bringing employment to 320,000, but will cut 24,600 as integration layoffs
- 2000-2008, HP repurchased $43.3 billion of its own stock:

$10.9 billion in 2007 and $9.6 billion in 2008

Cheerleaders for shareholder value: Disgorge the free cash flow

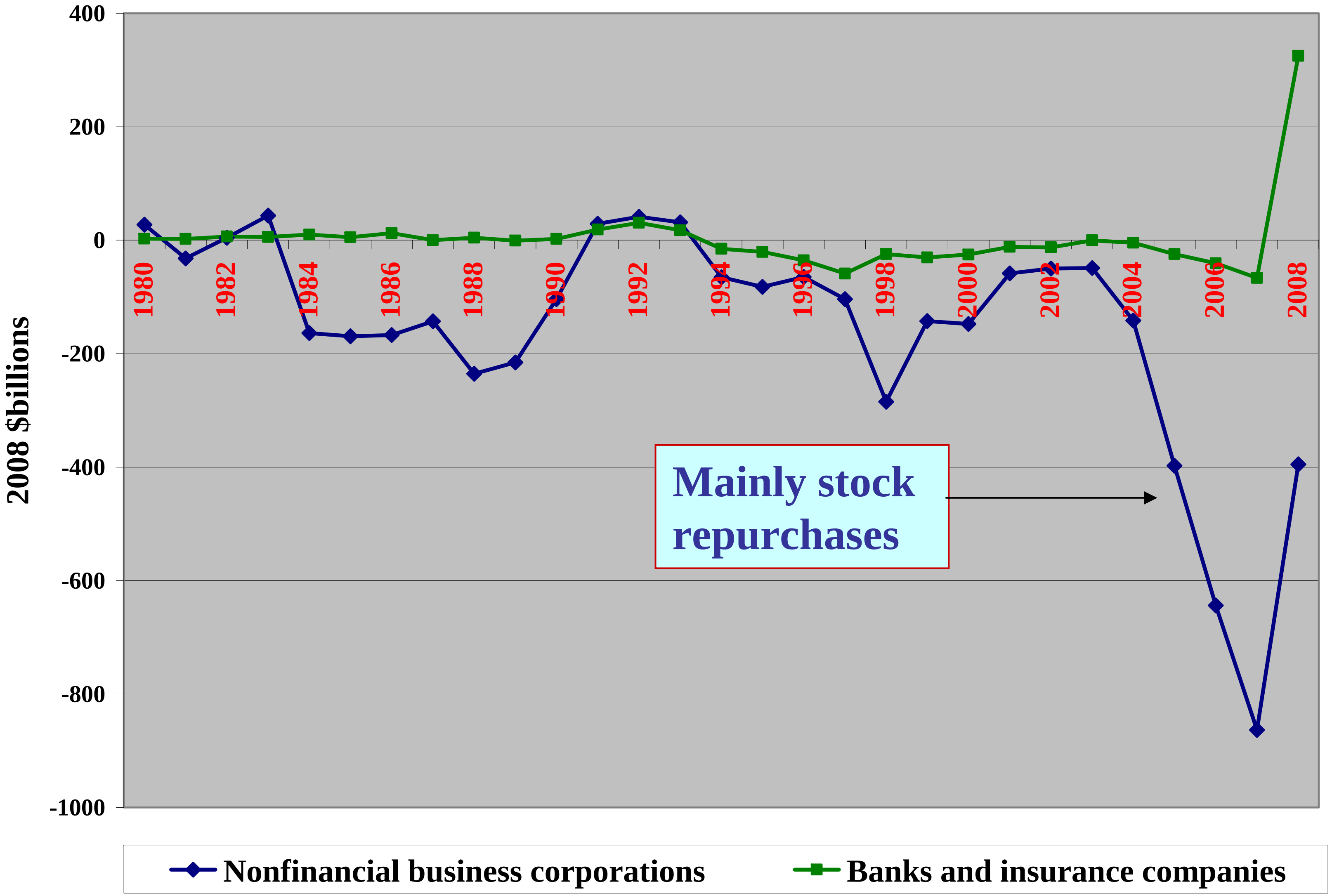
"Free cash flow is cash flow in excess of that required to fund all projects that have positive net present values when discounted at the relevant cost of capital. Conflicts of interest between share-holders and managers over payout policies are especially severe when the organization generates substantial free cash flow. *The problem is how to moti-vate managers to disgorge the cash* rather than investing it at below cost or wasting it on organization inefficiencies."

Michael C. Jensen (CAC-MSV*), AER, 1986, p. 323.

*** Chief Academic Cheerleader for Maximizing Shareholder Value**

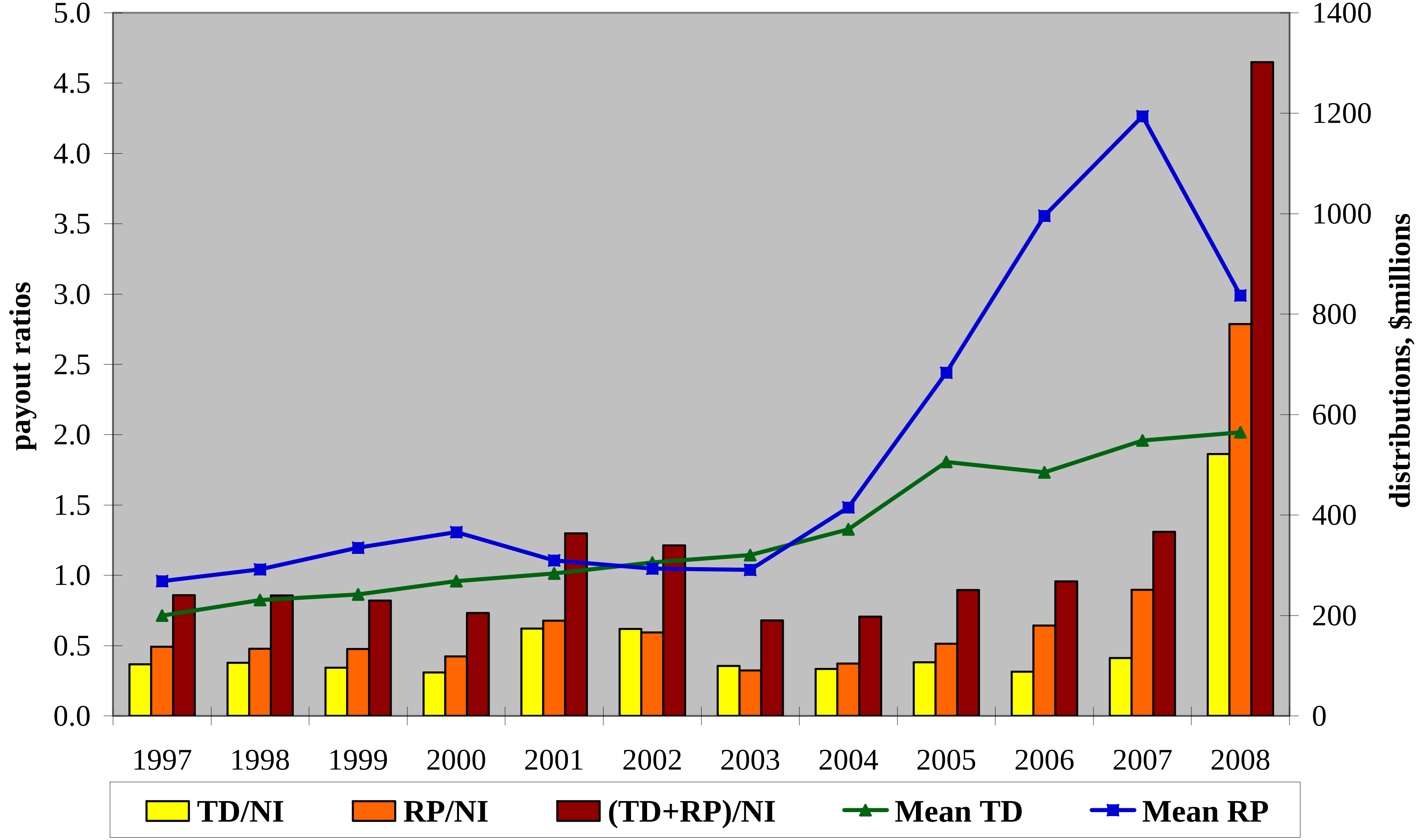
Disgorging the cash flow: net equity issues

Net corporate equity issues (billions of 2008 dollars) in the United States by non-financial corporate business and by selected financial sectors, 1980-2008

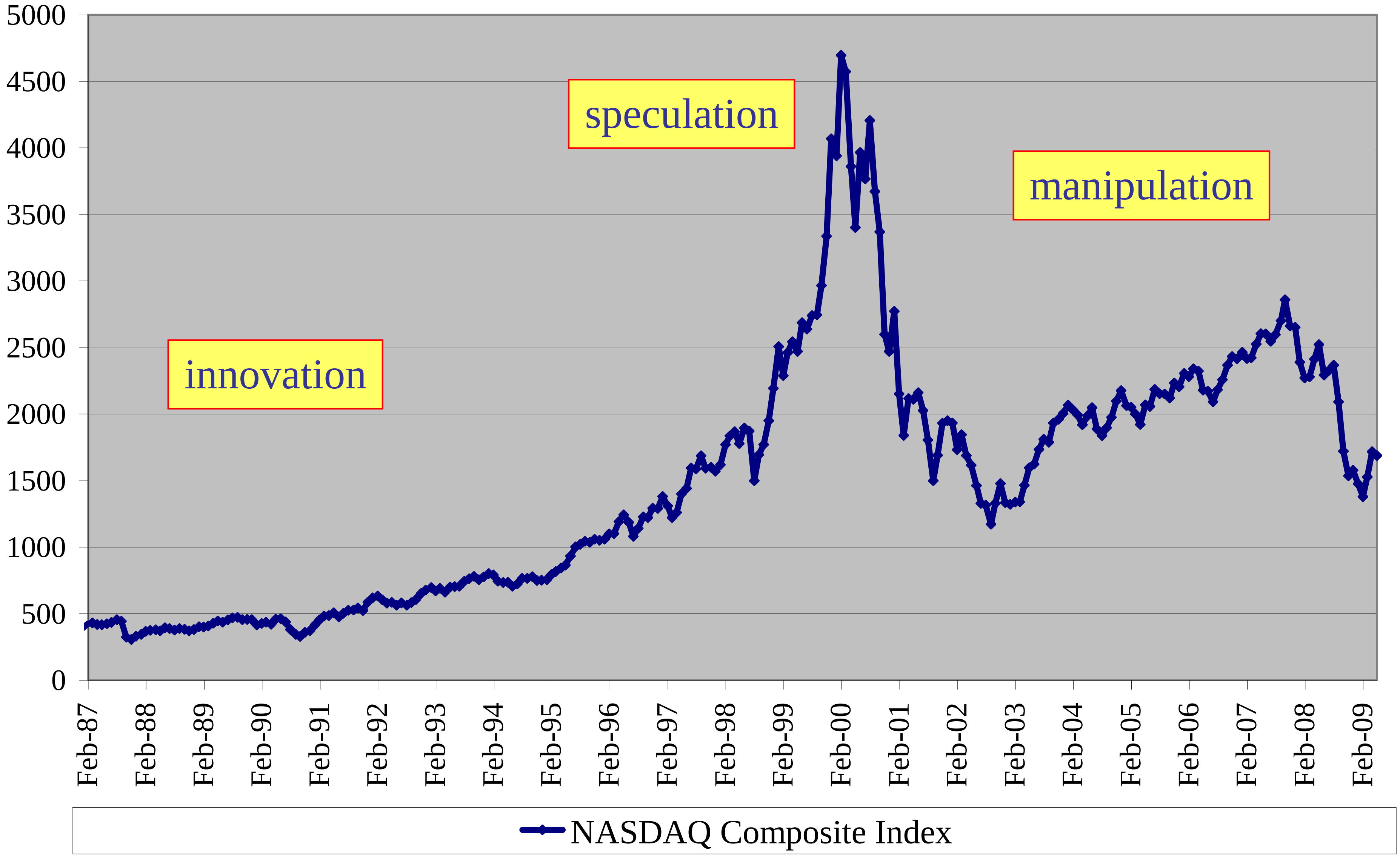


Disgorging the cash flow: Stock buybacks

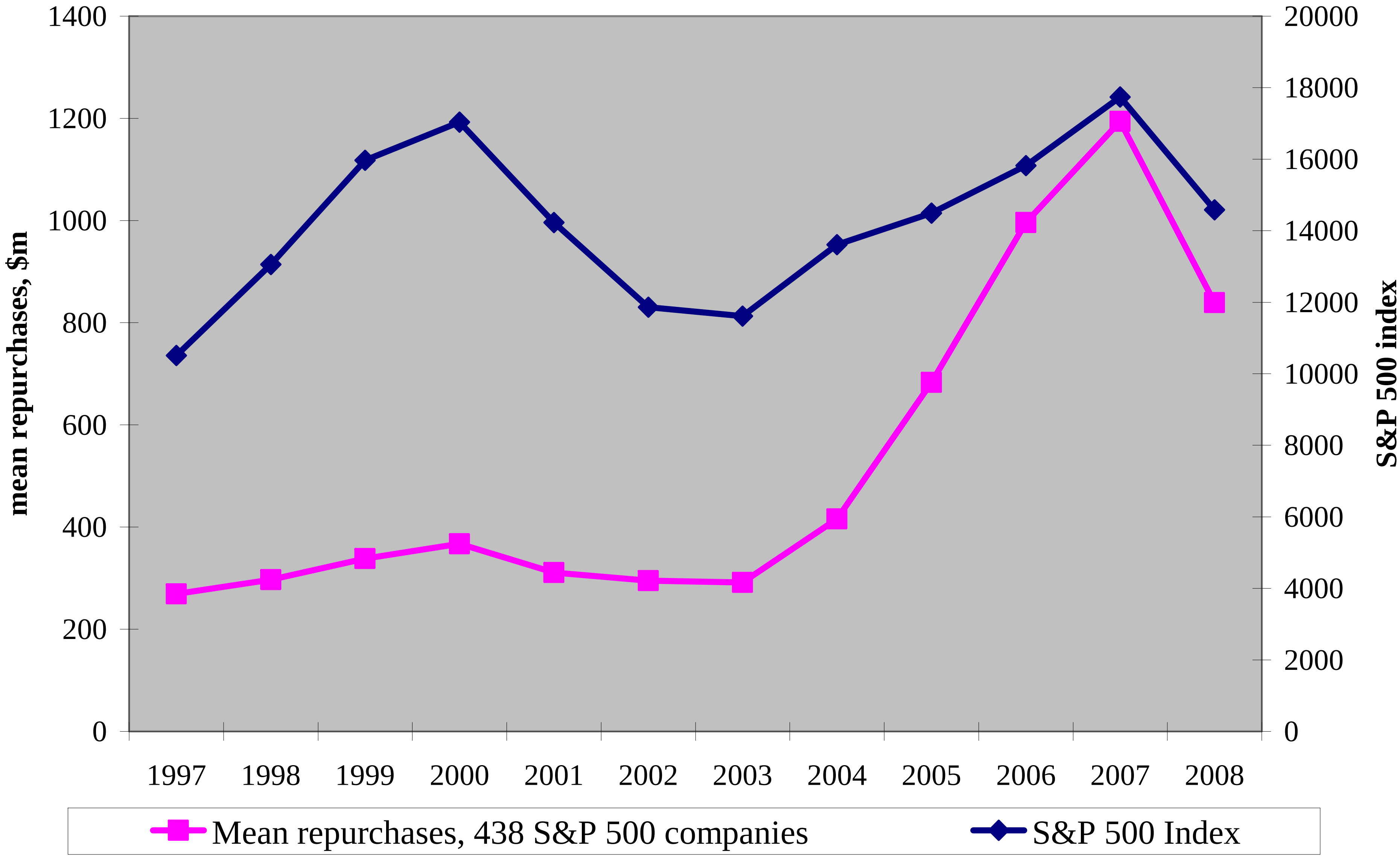
Ratios of cash dividends and stock repurchases to net income, and mean dividend payments of S&P 500 companies, 1997-2008
(438 corporations in S&P 500 Index in January 2008 with publicly listed in 1997)



Drivers of the stock market:
Innovation, speculation, manipulation



Manipulating the stock market



Top repurchasers 2000-2007, #1-25

RP Rank 2000-2007	Company	*Fortune* industry classification, 2007	*Fortune* rank, 2007	RP ($m) 2006	RP ($m) 2007	RP ($m) 2000-2007
1	EXXON MOBIL	Petroleum refining	2	29,558	31,822	108,304
2	**MICROSOFT**	Computer software	44	19,207	27,575	81,747
3	**IBM**	Information technology services	15	8,022	18,828	62,318
4	*BANK OF AMERICA*	Commercial banks	9	13,660	3,790	55,674
5	PFIZER	Pharmaceuticals	47	6,979	9,994	50,132
6	*GENERAL ELECTRIC*	Diversified financials	6	10,512	14,913	48,263
7	**CISCO SYSTEMS**	Network/communications equipment	71	8,295	7,681	43,129
8	**INTEL**	Semiconductors/electronic components	60	4,593	2,788	41,575
9	*CITIGROUP*	Commercial banks	8	7,125	663	37,141
10	PROCTER & GAMBLE	Household & personal products	23	16,830	5,578	36,324
11	**HEWLETT-PACKARD**	Computers, office equipment	14	7,779	10,887	33,721
12	*GOLDMAN SACHS*	Securities	201	7,817	8,956	30,186
13	JOHNSON & JOHNSON	Pharmaceuticals	35	6,722	5,607	26,694
14	**DELL**	Computers, office equipment	34	3,026	3,026	25,545
15	TIME WARNER	Entertainment	49	13,660	6,231	25,165
16	**ORACLE**	Computer software	137	2,067	3,937	23,939
17	*WELLS FARGO*	Commercial banks	41	1,965	7.418	23,243
18	**AT&T INC**	Telecommunications	10	2,678	10,390	21,628
19	*JP MORGAN CHASE*	Commercial banks	12	3,938	8,178	21,248
20	*MERRILL LYNCH*	Securities	30	9,088	5,272	21,028
21	PEPSICO	Food, consumer products	59	3,010	4,312	20,704
22	UNITEDHEALTH GROUP	Health care: insurance & managed care	25	2,345	6,599	20,678
23	AMGEN	Pharmaceuticals	173	2,000	5,100	20,361
24	WAL-MART STORES	General merchandisers	1	3,580	1,718	19,633
25	*MORGAN STANLEY*	Securities	21	3,376	3,753	19,050

Top repurchasers 2000-2007, #26-50

RP Rank 2000-2007	Company	*Fortune* industry classification, 2007	*Fortune* rank, 2007	RP ($m) 2006	RP ($m) 2007	RP ($m) 2000-2007
26	CHEVRON	Petroleum refining	3	5,033	7,036	18,815
27	ALTRIA GROUP	Tobacco	61	1,254	0	18,213
28	WALT DISNEY	Entertainment	67	6,898	6,923	17,815
29	*AMERICAN EXPRESS*	Diversified financials	75	4,093	3,572	17,643
30	UNITED PARCEL SERVICE	Mail, package, freight delivery	46	2,460	2,639	17,374
31	*LEHMAN BROTHERS*	Securities	37	2,678	2,605	16,672
32	CBS	Entertainment	181	6	3,351	16,519
33	HOME DEPOT	Specialty retailers	22	3,040	6,684	16,388
34	**TEXAS INSTRUMENTS**	Semiconductors/electronic components	185	5,302	4,886	16,296
35	MERCK	Pharmaceuticals	101	1,002	1,430	15,984
36	*WACHOVIA*	Commercial banks	38	4,513	4,196	15,664
37	3M	Miscellaneous	100	2,351	3,239	13,521
38	*WASHINGTON MUTUAL*	Savings institutions	97	3,039	3,497	13,271
39	MCDONALD'S	Food services	106	2,959	3,943	12,878
40	BOEING	Aerospace and defense	27	1,698	2,775	12,876
41	*ALLSTATE*	Insurance: property & casualty	64	1,770	3,606	12,334
42	*US BANCORP*	Commercial banks	122	2,798	1,983	12,313
43	ANHEUSER-BUSCH	Beverages	149	746	2,707	11,909
44	WELLPOINT	Health care: insurance & managed care	33	5,439	6,151	11,591
45	*PRUDENTIAL FINANCIAL*	Insurance; life, health	74	2,512	3,000	10,889
46	COCA-COLA	Beverages	83	2,416	1,838	10,589
47	KIMBERLY-CLARK	Household & personal products	136	762	2,813	10,002
48	CONOCOPHILLIPS	Petroleum refining	5	925	7,001	9,850
49	**COMCAST**	Telecommunications	79	2,347	3,102	9,489
50	CIGNA	Health care: insurance & managed care	141	2,765	1,185	9,434

What's Wrong With Buybacks

- **Wall Street banks did buybacks even as they were betting the company on derivative speculation, and ended up having to go to foreigners and the US government to bail them out.**

- **Leading ICT companies do huge buybacks with the profits from offshoring even as they lay off US workers, and even as they demand that the government invest more in the high-tech knowledge base to make "America" competitive.**

- **Oil companies do massive buybacks, while we pay high gas prices**

Sen. Charles Schumer: "They tell us they want to do more domestic production. They tell us they need to drill offshore. They tell us that they can find oil on the mainland. And what do they do with their profits? They buy back stock, simply to increase their share price." (July 31, 2008)

THE DISGORGED CASH FLOW IS NOT FREE

The disgorged cash flow is not free

- Leading pharmaceutical companies do buybacks that sometimes exceed R&D expenditures even as they argue in Congress against the regulation of US drug prices because they ostensibly need as much profits as possible to pump back into drug research.

- Health care companies do huge buybacks even as the nation's health care system is in crisis.

- Wal-Mart does huge buybacks even as it pays its close to 2 million "associates" wages that can hardly be called a standard of living

- If General Motors had banked the $20.4 billion distributed to shareholders as buybacks from 1986 through 2002 (with a 2.5 percent after-tax annual return) it would have $33.8 billion of its own cash to help keep it afloat and respond to global competition

A dumb idea

March 2009, John F. Welch, Jr., ex-CEO of GE, and a man who according to his 2003 autobiography speaks "straight from the gut", told a Financial Times reporter:

"On the face of it, shareholder value is the dumbest idea in the world. Shareholder value is a result, not a strategy…your main constituencies are your employees, your customers and your products."

He went on to reiterate: "It is a dumb idea. The idea that shareholder value is a strategy is insane. It is the product of your combined efforts – from the management to the employees."

Francesco Guerrera, "Welch rues short-term profit 'obsession'," Financial Times, March 12, 2009.