Predatory Value Extraction

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What We Want: Sustainable Prosperity

Equitable and stable economic growth = “sustainable prosperity”

• **Growth**: real per capita productivity gains that can raise standards of living

• **That is stable**: employment and income not subject to boom and bust, sustained over four+ decades of working life and two+ decades of retirement

• **That is equitable**: gains from growth are shared fairly among those who contribute to creating value—including equitable use of the planet’s resources across nations and over generations
What We Got: Growing Economic Inequality

Gini Index, all US families 1947-2017

https://www.census.gov/data/tables/time-series/demo/income-poverty/historical-income-inequality.html
Extreme Concentration of Income at the Top

What We Need: The Value-Creating Economy

The Investment Triad:
Sustainable prosperity depends on *investments in productive capabilities*

- **HOUSEHOLDS:** as “supportive families” invest in the productive capabilities of the labor force
- **GOVERNMENTS:** as “developmental states” invest in infrastructure and society’s knowledge base
- **BUSINESSES:** as “innovative enterprises” invest in value-creating processes and products

How can the triadic interaction of these organizations result in a prosperous value-creating society?
Aligning Value Creation and Value Extraction for Sustainable Prosperity

• Government investments in infrastructure and knowledge make value-creating businesses possible.

• The livelihoods of over 80% of households depend on businesses to employ their labor productively.

• When value-creating employees generate product revenues that result in business profits, they should be first in line to extract, as higher wages & benefits, a fair share of the extra value they helped to create.

• The state should extract a fair share of business profits as taxes as reimbursement for government investments in infrastructure and knowledge.
From Triadic Value Creation to Predatory Value Extraction (PVE)

• But business profits can be gold mines from which “predatory value extractors” grab value far in excess of their contributions to value creation.

• Predatory value extraction (PVE) results in extreme income inequity and employment instability.

• USA is the world PVE leader. Key methods:
  • Public firms: stock buybacks on top of dividends
  • Private firms: debt to pay private equity dividends

“TAX THE RICH” IS ONLY Viable IF WE STOP THE LOOTING OF BUSINESSES BY PREDATORY VALUE EXTRACTORS.
PVE and the Growing Productivity-Pay Gap

The gap between productivity and a typical worker's compensation has increased dramatically since 1973

Productivity growth and hourly compensation growth, 1948–2017

<table>
<thead>
<tr>
<th>Period</th>
<th>Productivity</th>
<th>Hourly compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948–1973</td>
<td>95.7%</td>
<td>90.9%</td>
</tr>
<tr>
<td>1973–2017</td>
<td>77.0%</td>
<td>12.4%</td>
</tr>
<tr>
<td>2017–2020</td>
<td>246.3%</td>
<td>114.7%</td>
</tr>
</tbody>
</table>

$$$$$$$$$PRIVATE-EQUITY DIVIDENDS$$$$$$$$
1940s-1970s pay tracks productivity

- Retain-and-reinvest

1980s-2010s pay lags productivity

- Downsize-and-distribute

Career employment:
Key driver of the productivity-pay relation

Old Economy Business Model
Career-with-one-company norm: employees share in profits through job security, pay raises, defined-benefit pensions, and health coverage

New Economy Business Model
Insecure jobs, globalized labor, defined-contribution pensions

Massive stock buybacks, exploding top executive pay, billionaire hedge-fund activists

Disappearance of careers in companies means the erosion of middle-class employment opportunities
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The Buyback Economy

- US corporations hold a vast accumulation of productive capabilities that, daily, create value.
- The value creators are households as taxpayers, workers, and entrepreneurs.
- Predatory value extractors include corporate executives, investment bankers and hedge-fund managers.
- They extract value by accumulating corporate stock, with distributions of corporate resources to shareholders in the forms of cash dividends and stock buybacks, boosting stock yields.
- Stock repurchases are so massive in the United States that it can be called a “buyback economy.”
In the Name of “Maximizing Shareholder Value”

SHRINKING MIDDLE CLASS


1981-83: BB/NI%=4.4%
DV/NI=50.3%

2015-17: BB/NI%=62.3%
DV/N=54.8%

SEC Rule 10b-18
November 1982
In the Name of “Maximizing Shareholder Value”

25 Largest Repurchasers 2008-2017

Research agenda: analyzing how buybacks undermine attainment of equitable and stable economic growth in particular industries and companies within those industries.
In the Name of “Maximizing Shareholder Value”

- 2013-2017, S&P 500 firms did $2.6 trillion (56.1% of profits) in buybacks plus $2.0 trillion (41.9% of profits) in dividends.

- Buoyed by Republican tax cuts, each quarter of 2018 set a new buyback record, with over $800 billion in buybacks in the year.

SEC Rule 10b-18: A License to Loot

Rule 10b-18 adopted Nov. 1982

SEC Eases Way For Repurchase Of Firms’ Stock

Agency Assures It Won’t File Charges of Manipulation If Certain Rules Are Met

By Richard L. Hudson
Staff Reporter of The Wall Street Journal

Reagan’s SEC Chair
John Shad
SEC Rule 10b-18: Market Manipulation and Value Extraction

Top ten stock repurchasers, 2008-2017, and SEC Rule 10b-18 safe-harbor limit on buybacks per trading day, Calculated for August 17, 2018:

<table>
<thead>
<tr>
<th>Company</th>
<th>BUYBACKS, 2008-2017, $BILLIONS</th>
<th>25% ADTV LIMIT, 8/17/18, $MILLIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>APPLE</td>
<td>166</td>
<td>1,437</td>
</tr>
<tr>
<td>EXXON MOBIL</td>
<td>147</td>
<td>197</td>
</tr>
<tr>
<td>MICROSOFT</td>
<td>105</td>
<td>730</td>
</tr>
<tr>
<td>IBM</td>
<td>101</td>
<td>179</td>
</tr>
<tr>
<td>WALMART</td>
<td>68</td>
<td>131</td>
</tr>
<tr>
<td>ORACLE</td>
<td>67</td>
<td>200</td>
</tr>
<tr>
<td>CISCO</td>
<td>60</td>
<td>215</td>
</tr>
<tr>
<td>PROCTER &amp; GAMBLE</td>
<td>59</td>
<td>154</td>
</tr>
<tr>
<td>PFIZER</td>
<td>61</td>
<td>232</td>
</tr>
<tr>
<td>GOLDMAN SACHS</td>
<td>55</td>
<td>189</td>
</tr>
</tbody>
</table>
SEC Does Not Require Disclose on the Days on which Buybacks are done—And Rule 10b-18 Cannot Be Violated

July 2015: SEC Chair Mary Jo White responded to an April 2015 letter from US Sen. Tammy Baldwin

Value-extracting Insiders, Enablers, and Outsiders

- **Value-extracting insiders**: senior corporate executives incentivized by stock-based pay to engage in downsize-and-distribute rather than retain-and-reinvest
- **Value-extracting enablers**: institutional investors, mainly pension and mutual fund managers, holding over 60% of market cap of outstanding shares in the United States, incentivized to secure high yields on stock portfolios—and, absurdly, must exercise proxy votes
- **Value-extracting outsiders**: hedge-fund activists, holding small fractions of shares of companies, lobby proxy-voting services (ISS and Glass Lewis) to back board of director candidates who will pursue the activists’ agenda to “maximize shareholder value”
Value-extracting Insiders: Incentivized by Stock-based Pay

Average total pay and % shares of pay components, 500 highest-paid US executives in each year, 2008-2017
Sanctioned by the SEC since 2003, the proxy voting system requires fund managers to vote portfolio shares, and they rely on proxy advisers (mainly ISS and Glass Lewis) to recommend how to vote.
Value-extracting Outsiders: Take-home Pay of Hedge-fund Managers, 2016; Shareholder Activists Underlined

<table>
<thead>
<tr>
<th>Name</th>
<th>Hedge Fund</th>
<th>Take-home Pay</th>
</tr>
</thead>
<tbody>
<tr>
<td>James Simons</td>
<td>Renaissance Technologies</td>
<td>$1.5 billion</td>
</tr>
<tr>
<td>Michael Platt</td>
<td>BlueCrest Capital Management</td>
<td>$1.5 billion</td>
</tr>
<tr>
<td>Raymond Dalio</td>
<td>Bridgewater Associates</td>
<td>$1.4 billion</td>
</tr>
<tr>
<td>David Tepper</td>
<td>Appaloosa Management</td>
<td>$750 million</td>
</tr>
<tr>
<td>Kenneth Griffin</td>
<td>Citadel LLC</td>
<td>$500 million</td>
</tr>
<tr>
<td>Daniel Loeb</td>
<td>Third Point</td>
<td>$400 million</td>
</tr>
<tr>
<td>Paul Singer</td>
<td>Elliott Management</td>
<td>$400 million</td>
</tr>
<tr>
<td>Patrick Hannan</td>
<td>D. E. Shaw &amp; Co.</td>
<td>$400 million</td>
</tr>
<tr>
<td>David Shaw</td>
<td>Two Sigma Investments</td>
<td>$400 million</td>
</tr>
<tr>
<td>John Overdeck</td>
<td>Two Sigma Investments</td>
<td>$375 million</td>
</tr>
<tr>
<td>David Siegel</td>
<td>Two Sigma Investments</td>
<td>$375 million</td>
</tr>
<tr>
<td>Michael Hintze</td>
<td>CQS LLP</td>
<td>$325 million</td>
</tr>
<tr>
<td>Jeffrey Talpins</td>
<td>Icahn Capital Management</td>
<td>$300 million</td>
</tr>
<tr>
<td>Stanley Druckenmiller</td>
<td>Duquesne Family Office</td>
<td>$300 million</td>
</tr>
<tr>
<td>Brett Icahn</td>
<td>Icahn Capital Management</td>
<td>$280 million</td>
</tr>
<tr>
<td>David Schechter</td>
<td>Icahn Capital Management</td>
<td>$280 million</td>
</tr>
</tbody>
</table>

Take-home pay of the top 15 hedge-fund managers, USA, 2016 (top15 average=$606 million)

Top15 corporate executives in 2016
Average total pay=$120 million (93% stock-based)
Range: $83 million to $220 million
“Maximizing Shareholder Value” is a Theory of Value Extraction, Not Value Creation

• Economic activity and performance depend on resource allocation decisions.
• We rely on corporate executives to make resource allocation decisions that have profound influences on the operation and performance of the economy.
• **Stock-based compensation** enriches top corporate executives in the name of MSV, and gives them incentives to encourage speculation in and engage in manipulation of the price of their company’s stock.
• **Stock buybacks:** The prime mode of corporate resource allocation for the purpose of manipulating stock prices.
Investment in Productive Capabilities includes, First and Foremost, Investment in People

- Along with investment in plant & equipment, innovation requires investment in **training & retaining employees**, which may include investment in research & development, but is not confined to it
- To generate competitive products, and **create value**:  
  - executives who exercise strategic control must be able and willing to retain-and-reinvest;  
  - employees must be able and willing to engage in **organizational learning**;  
  - **financial commitments** must be made to sustain learning processes to yield competitive products.
The "Rich" Who Are Value Creators Will More Likely Be Willing to Pay a Fair Share of Taxes

• The inequality problem is in large part because of predatory value extraction by the combination of insiders, enablers, and outsiders.

• Regulatory solutions must deal with corporate governance: changing corporate allocate resources and returns to contribute to sustainable prosperity.

• Disempower predatory value extractors: for them, tax avoidance is the most creative work they do.

• The value-creating rich are likely willing to pay a fair share of taxes, with "fair" defined by what is good for humanity, not what makes the rich richer.