Why All the Fuss About Stockholders?

BY MARJORIE KELLY

Where does wealth come from? More precisely, where does the wealth of public corporations come from? Who creates it?

To judge by the current arrangement, one might suppose capital creates wealth—which is odd, because a pile of capital creates nothing. Yet capital-providers, stockholders, lay claim to all wealth public corporations generate. They also claim the more fundamental right to have corporations managed exclusively on their behalf. Corporations are believed to exist for one purpose: to maximize returns to shareholders. This message is reinforced by CEOs, *The Wall Street Journal,* business schools, and the courts. It is the guiding idea of the public corporation, and the law of the land—much as the divine right of kings was once the law of the land. Indeed, the notion of "maximizing returns to shareholders" is universally accepted as a kind of divine, unchallengeable truth.

It is not in the least controversial. Though it should be.

What do shareholders contribute, to justify the extraordinary allegiance they receive? They take risk, we're told. They put their money on the line, so corporations might grow and prosper. Let's test the truth of this with a little quiz: Stockholders fund public corporations—True or False?

False. We speak as though it were true: "I have invested in AT&T," we say—imagining AT&T as a steward of our money, with a fiduciary responsibility to take care of it. In fact, dollars don't go to AT&T, but to other speculators. "Investments" reach a public corporation only when new equity is issued—a rare event.

Public corporations need capital to operate—$555 billion in 1993, for example. According to the Federal Reserve, equity contributed 4 percent of that. Borrowing provided 14 percent; retained earnings, 82 percent. From 1987 to 1994, corporations *bought back* more equity than they issued. Dividends flowed out in generous streams: $1.2 *trillion.* Capital gains piled up. But the flow of funds the other way was nil.

Well, yes, critics will say—that's recently. But stockholders are pocketing gains today, because they funded corporations in the past.

Not so. Take the steel industry. A study by Eldon Hendrickson examined capital expenditures from 1900 to 1953, and found that common stock provided *only 5 percent of capital*—over the entire first half of the 20th century. Equity capital is one relatively minor source of funding, vital at a certain point. Yet it entitles holders to suck out all wealth, forever. Equity investors essentially install a pipeline, and decree that corporations' sole purpose is to funnel wealth into it. The pipeline is never to be tampered with—and no one else is to be granted access (except CEOs, whose function is to keep it flowing).

With the exception of initial public offerings, the commotion on Wall Street is not about funding corporations. *It's about extracting from them.*

The productive risk in building businesses is borne by entrepreneurs and their initial venture investors, who do contribute real investing dollars, to create real wealth. Those who buy stock at sixth or seventh hand, or 1,000th hand, take a risk—*but it is a risk speculators take among themselves, trying to outwit one another, like gamblers.* It has little to do with corporations, except this: Public companies are required to provide new chips for the gaming table, into infinity.

It's odd. And it's connected to a second oddity—that we believe stockholders *are* the corporation. When we say "a corporation did well," we mean its shareholders did well. Employees might be shouldering an outsized workload, getting by without health insurance, doing without a raise for three years—still we will say, "the corporation did well." One never sees rising employee income as a measure of corporate success. Indeed, gains to employees are losses to the corporation. Employees can go to work for twenty years, using all their energy to create wealth for a company—yet not really be considered part of that corporation. They have no claim to wealth they create, no say in governance, and no vote for the board of directors.

Investors, on the other hand, may not know the names of the companies they "own." They may not know where "their" companies are located, or what they produce—and they may hold stock for only a day. Still, corporations exist to enrich them alone. Only those who own stock can vote, like an earlier time in America, when only those who owned land could vote. Employees are disenfranchised.

We think of this as the natural law of the free market. It's really the government-made law of the corporation. And it violates free market principles. In a free market, everyone scrambles to get what they can, and keeps what they earn. In the artificial construct of the corporation, one group gets what another earns. One group contributes nothing, never lifts a finger, and takes no responsibility ("limited liability")—yet has a "legitimate" right to siphon off all wealth. Another group does all the work, and makes the corporation a success—yet counts itself lucky not to be thrown off the premises in a layoff.

The oddity of this is veiled by the incantation of a single, magical word: "ownership." Because we say stockholders "own" corporations, they are permitted to contribute nothing, and take everything.

What an extraordinary word. One is tempted to recall Lycophron's comment, during an early Athenian movement against slavery. "The splendor of noble birth is imaginary," he dared to say, "and its prerogatives are based upon a mere word."

Author's Note: I'm working on a book about this and would like to find colleagues to discuss early drafts. E-mail MarjorieHK@aol.com, or fax 612/962-4706. Don't call! Let's be old-fashioned and write.

SAYS WHO?

Capital corporations needed in 1993:
$555 billion.

Amount provided by stockholders: 4%

Federal Reserve statistic, from Bureau of the Census, Statistical Abstract of the United States 1994.