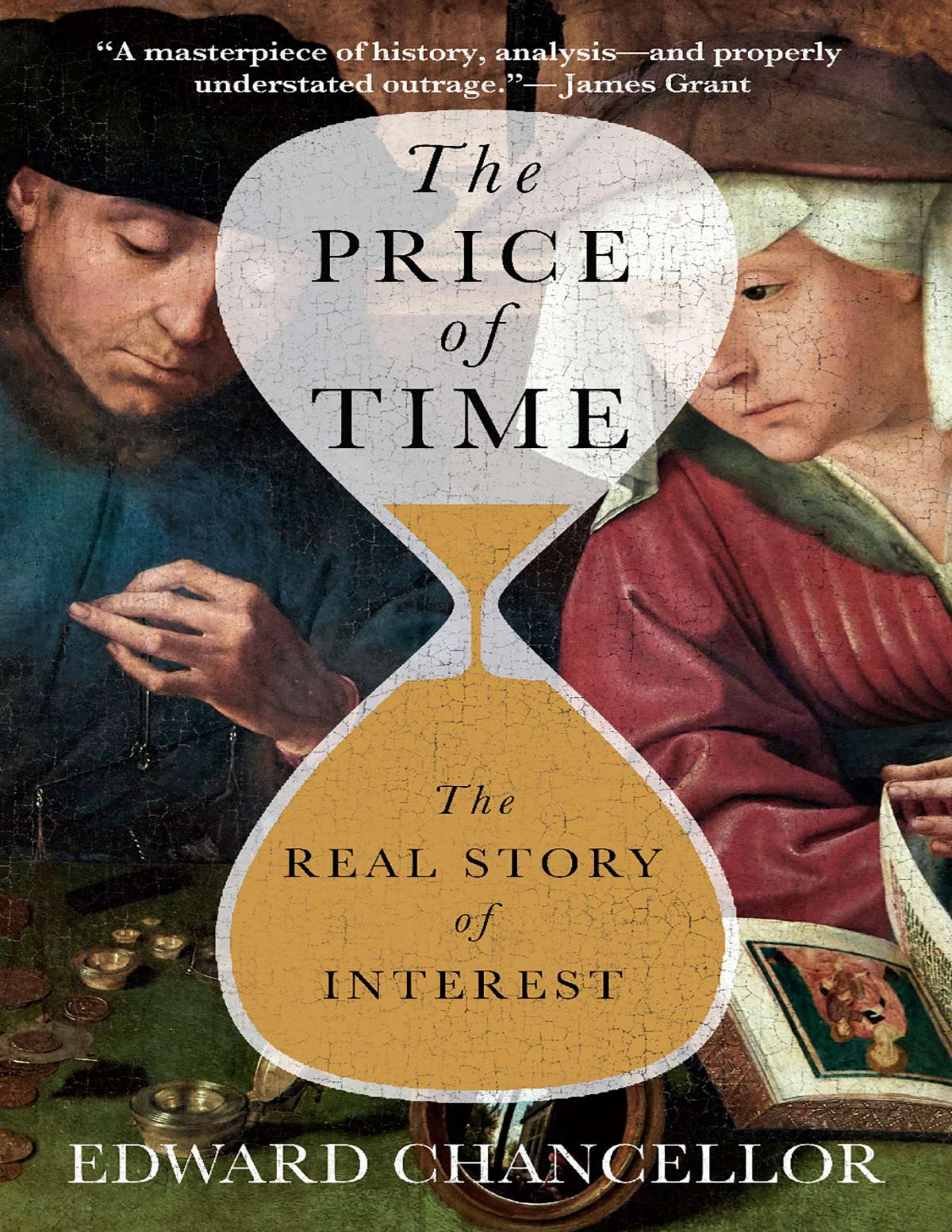

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11

The Promoter's Profit

When a nation is running to decay and ruin, the merchant, and monied man, do what you can, will be sure to starve last.

John Locke, 1691

Financial capital, once cut loose from its original role as a modest helper of a real economy of production to meet human needs, inevitably becomes speculative capital geared solely to its own self-expansion.

Paul Sweezy, 1994

In 1892, the General Electric Company was formed from the merger of Thomas Edison's business with an electric conglomerate, Thomson-Houston, managed by a businessman named Charles Coffin. From the outset, the company was a creature of Wall Street.[1] Shortly after its establishment, General Electric under Coffin's management bid for its main competitor, Westinghouse Electric. As Thomas Lawson, the Boston banker who defended Westinghouse, wrote, General Electric's 'high-priest was J. Pierpont Morgan; its home, Wall Street; its owners, the principal votaries of the "System"'.[2] The System that Lawson referred to was the means by which the savings of ordinary people were 'always at the absolute service and mercy of the votaries of frenzied finance'.

Here's how the System worked. Workers deposited their savings at a bank or invested with an insurance company; those savings were then funnelled via the Morgan network to provide the capital for the amalgamation of American businesses, such as General Electric. Morgan's immense power came from his control of the public's savings. 'The goose that lays golden eggs,' wrote Justice Louis Brandeis, 'has been considered a most valuable possession. But even more profitable is the privilege of taking the golden eggs laid by somebody else's goose. The investment bankers and their associates now enjoy that privilege. They control the people through the people's own money.'[3]

Interest comprises the greatest part of the costs of finance. Naturally, Wall Street is most active when golden eggs can be had cheaply. Following the financial crisis of 1873, interest rates in the United States declined for more than a quarter of a century. In the decade when General Electric was founded, US Treasury bond yields fell below 2 per cent and one-year deposits earned a measly 1 per cent. Financial regulation added an extra fillip to the bond bull market. The National Banking System, created in the 1860s, limited the number of notes that a bank could legally issue to its holdings of Treasury bonds. But Treasuries were in short supply owing to a string of federal surpluses – the US national debt fell by half between 1880 and 1893. Strong demand from National Banks sent the yields on some Treasuries below zero. This was the first and only time that long-term interest rates turned negative prior to the twenty-first century.[4]

Easy money enabled Wall Street to consolidate swathes of American industry. It was around this date that Arthur Hadley, the Yale economist who connected interest with natural selection, defined interest as 'the price paid for the control of industry'.[5] The ostensible reason for business amalgamations was to replace destructive competition with more orderly and profitable monopolies, or trusts, as they were known. Among the American industries to come under the control of trusts during this period were coal and iron, electric-car lighting apparatus, cement, plug tobacco, cotton yarn, matches, electric storage batteries, sewer pipes, chemicals, sugar, Cuban tobacco, Bourbon whiskey, paper, silver-plate, steam pumps, petroleum, rubber goods, flour, glue, leather, rubber boots and shoes, and varnish.[6]

Trusts gave birth to the so-called 'robber barons', business tycoons named after medieval feudal lords who, from their castles on mountain passes, extracted tolls from passing merchants. The latter-day robber barons, said Brandeis, set tolls at the highest level that the traffic could bear.

Most prominent among them was John D. Rockefeller, who forced competitors to sell out to his Standard Oil, known as the 'Anaconda' for its strangulating grip on the oil industry. Another was Edward H. Harriman, who started his career as a 'pad-shover' or quotation boy on Wall Street and became America's most powerful railway magnate after Morgan arranged the merger of his Union Pacific company with the Great Northern and several other railroads in 1901.

In the same year that Harriman's Northern Securities Company was created, Morgan amalgamated Carnegie Steel, itself the product of a merger between Andrew Carnegie's steel mills and Henry Frick's coke-mining operations, with a number of other steel concerns. The result was the United States Steel Corporation, whose very name flaunted its market dominance. The Corporation, as it was known on Wall Street, was not just the world's largest steel producer, its capitalization was greater than any other company. When it went public, US Steel was capitalized at $1.4 billion, more than double the book value of its plants and other assets.[7] This 'over-capitalization' anticipated profits that would accrue to its monopoly, and also signalled that at a time of low interest rates investors placed a higher value on those future profits.

Most of the profits made from forming trusts, however, fell to the denizens of Wall Street.[8] The trick was to acquire a company on leverage, 'water' the stock (increase its capitalization), merge operations with other concerns and float the amalgamated business at a higher price on the stock market.[9] Investors were provided with cheap stock loans to boost demand for the shares at the IPO. In his *Theory of Business Enterprise* (1904), Thorstein Veblen claimed that the managers of public companies had become versed in the arts of stock manipulation:

> the certainty of gain … seems rather more assured in the large-scale manipulation of vendible [i.e., traded] capital than in business management … Indeed, so secure and lucrative is this class of business, that it is chiefly out of gains accruing, directly and indirectly, from such traffic in vendible capital that the great modern fortunes are being accumulated.[10]

In an influential book, *Finance Capital*, published in 1910, Rudolf Hilferding came up with the concept of the 'promoter's profit'. The

Austrian-born Marxist, who twice became Germany's finance minister in the 1920s, observed that share prices rose and fell in inverse relationship to the rate of interest. (Brandeis likewise observed that 'easy money tends to make securities rise in the market. Tight money nearly always makes them fall.') Hilferding made a more original observation: when the returns on industry were above the cost of borrowing, financiers were poised to reap windfall gains.[11] The lower the interest rate, the higher the promoter's profit.

Wall Street in Morgan's heyday was more interested in financial chicanery than in directing capital towards the country's economic development. Only a small part of the $375 million of securities issued in the early 1900s by the Harriman-controlled Union Pacific Railroad was spent on fixed assets, with the rest going 'mainly to supply funds for engaging in illegal combinations or stock speculation'.[12] Pierpont Morgan himself had little interest in new technologies, and famously turned down a request for capital from William Crapo Durant, the founder of what later became General Motors. Most of Morgan's loans were supplied against the collateral of existing businesses rather than directed towards new investment.

The easiest way to manipulate stocks was by applying leverage. That's where the House of Morgan ruled supreme. In the first decade of the 1900s, the amount of outstanding railway debt more than doubled.[13] As debt levels rose, the quality of debt declined. Nevertheless, low interest rates created an insatiable demand for rail securities. At the turn of the century, hundred-year railway bonds were issued to yield 3.5 per cent.[14] For Brandeis, the heavily indebted New Haven Railroad exemplified all that was wrong with American finance. As this Morgan-controlled trust consolidated railroads across New England, its debt load increased twentyfold.[15] Brandeis claimed that the New Haven's financial backers paid less attention to railroad operations than to the market value of its securities. Maintenance capital spending was cut, and dividends that hadn't been earned were paid with borrowed money.

The New Haven finally ran into the buffers in 1910 after Wall Street became weighed down with what Morgan called 'undigested securities'. The New Haven's share price crashed, bringing losses to thousands of small investors. By this date, the American public had had enough of

'Morganization'. The trust movement was seen to be supported by 'vested interests' (Veblen's coinage) that had bought up Washington. In *Other People's Money*, first published in 1914, Brandeis inveighed against 'financial recklessness', the 'mad pursuit of monopoly' and the 'curse of bigness' – big railroad systems, big industrial trusts, big utilities and big banks. In the year that Brandeis' best-selling polemic appeared, a number of current and former directors of the New Haven Railroad, including John D. Rockefeller's brother William, were indicted for conspiracy to monopolize the interstate traffic of New England. By this date, the great Pierpont Morgan was dead.

Trusts were not confined to America. German industry was dominated by cartels for coal, chemicals, sugar, etc.[16] In Britain, there was even a cartel of bed manufacturers, known as the 'Bedstead Alliance'.[17] Some cartels operated across national borders. The giant German electrical concern AEG divided the world market with its American counterpart, General Electric. Leading explosives manufacturers joined together to form the International Dynamite Trust.[18] Writing on the eve of the Russian Revolution, Vladimir Lenin described monopolies penetrating into every sphere of economic life.[19] Capital, said Lenin, no longer raised living standards in the countries in which it originated, but was exported abroad where it served to increase the power of monopolistic corporations. At home, a chronic lack of demand from underpaid and underemployed workers brought about economic stagnation. 'The rentier state is a state of parasitic, decaying capitalism,' wrote Lenin.[20]

The future Soviet leader laid out these thoughts in his 1917 essay *Imperialism, The Highest Stage of Capitalism.* The highest stage of capitalism was expected to be its last. Lenin's prediction was not realized. Fast-forward a hundred years, however, and we observe striking similarities between the financial conditions of the early twentieth century and those of the post-Lehman era. Once again, the 'price paid for the control of industry' was at an all-time low, creating the conditions for a wave of anti-competitive mergers. Once again, Wall Street's efforts were directed towards the manipulation of share prices, and the promoter's profit was extracted at the expense of productive investment. And once again, workers felt the pinch and talk of economic stagnation filled the air.

'THE GOLD-DIGGERS' SONG'

In early May 2018, the chief executive of Sainsbury's, a leading British grocery chain, was waiting to be interviewed on television about his company's pending $10 billion acquisition of a rival supermarket. As the cameras started to roll, CEO Mike Coupe was inadvertently captured singing under his breath the lyrics of a 1933 Ginger Rogers' number: 'We're in the money / Come on my honey / Let's lend it, spend it, send it rolling along.' 'The Gold Diggers' Song' was an appropriate anthem for the greatest and, for bankers at least, most lucrative takeover boom in history.

Mergers and acquisition activity bounced strongly back after the global financial crisis. The merger 'tsunami', as President Obama's anti-trust enforcer called it, prompted no response in Washington. The US Justice Department failed to file a single anti-trust case in 2014.[21] Over the course of the following year, global mergers topped $5 trillion for the first time, with the United States accounting for roughly half this total. Deal sizes were also getting larger. Nearly seventy 'mega-deals' valued at over $10 billion were completed that year. 'We are prompting issuers to think outside the box – in terms of the art of the possible,' a JP Morgan banker told Bloomberg in November 2014.[22]

More important than Washington's passivity towards nascent trusts was the collapse in corporate borrowing costs. Mergers were facilitated by a 'strong appetite from debt investors (particularly for quality credits) and low interest rates [which] enabled acquirers to obtain financing on attractive terms'.[23] Large companies could borrow at a lower rate than they earned on their capital, creating an opportunity for bankers to extract a 'promoter's profit'. Debt figured prominently in the March 2015 acquisition of food giant Kraft by ketchup-maker H. J. Heinz, itself a leveraged buyout controlled by Brazilian financiers 3G Capital and Warren Buffett's Berkshire Hathaway. This bloated food giant was not created to slather the world with more ketchup and mayonnaise. Rather, the aim was to boost returns by adding debt and cutting costs. Over the following couple of years net debt increased by more than half and per-share earnings nearly doubled.[24]

Kraft Heinz was one of a number of so-called 'platform companies', similar to the trusts of the robber baron era, which used debt to finance anti-competitive mergers. Other notable platform companies included the beer giant Anheuser-Busch InBev (also controlled by the Brazilian 3G), cereal-maker Post Holdings, together with a number of healthcare companies. No platform company soared higher than Valeant Pharmaceuticals. The brainchild of Michael Pearson, a former McKinsey consultant, Valeant acquired more than twenty medical and drug businesses, including contact lens-maker Bausch & Lomb. The Canadian-listed company boosted its profits by slashing costs and pushing through large price hikes on its portfolio of patented drugs.[25] Acquisitions were funded with debt. By 2015 Valeant's long-term liabilities approached $30 billion, up three times in as many years, and yet despite this debt load the company's borrowing costs remained below 6 per cent.[26] By October 2015, Valeant's stock was up more than fifteenfold since the start of the decade, and Michael Pearson's equity-linked compensation package was said to exceed $1 billion.

The merger wave brought about a rise in corporate monopolies, the like of which had not been seen since the Gilded Age of the late nineteenth century. The number of listed US companies halved in the two decades prior to 2016.[27] An academic study found that three-quarters of American industries had become significantly more concentrated.[fn1] As in the late nineteenth century, low interest rates once again played the key role in the consolidation of US industry. Economists at the University of Michigan found that price-fixing cartels are more influenced by the level of interest rates than by any other factor. Cartels tend to form at times of low interest rates and break up when rates are high.[28]

Firms in industries with the greatest increase in concentration enjoyed higher profits. But, as Adam Smith observed, monopolies don't serve the public good. Rather, monopolies create barriers to entry which discourage the establishment of new firms and innovation.[29] Rising industry concentration was associated with higher pay for senior executives, a decline in workers' bargaining power, and falling investment and R&D. Economists at the National Bureau of Economic Research found that while 'low interest rates have traditionally been viewed as positive for economic growth … extremely low interest rates may lead to *slower* growth by increasing market concentration.'[fn2]

PRIVATE EQUITY

As with corporate mergers, leveraged buyouts pick up when the ‘cost of corporate control’ declines. Greenspan’s easy money regime at the turn of the century sparked a buyout bonanza. Private equity firms amassed multibillion-dollar war chests with which they acquired firms at spiralling valuations, piling more leverage on to their buyouts than ever before, and taking quick profits by selling fast (‘flipping’) or cashing out with debt-funded dividend deals. Some buyouts at the time were financed entirely with debt.

This lucrative business lasted as long as the credit markets remained open. After the music stopped in 2008 private equity faced its long-awaited reckoning. Thanks to even easier monetary conditions in the aftermath of the Lehman bankruptcy, however, the reckoning was avoided. Apart from a few high-profile bankruptcies (such as that of the energy company TXU, the largest-ever buyout, in 2007, which went belly-up seven years later with debts of $40 billion) relatively few leveraged buyouts went bust. Most pre-crisis buyouts were able refinance their loans on even more favourable terms.

Ten years after Lehman’s bankruptcy, the buyout industry was doing better than ever. Thanks to cheap debt, low default levels and rising asset prices, private equity had delivered double-digit returns for investors over the previous decade. Starved of opportunities to earn decent returns elsewhere, investors beat at the doors of the top buyout firms. One private equity fund that sought to raise $2 billion ended up with three times as much. Another fund closed with record cash commitments of nearly $25 billion. Megadeals were back in favour, such as Bain Capital’s $18 billion purchase of Toshiba’s microchip business, completed in May 2018. Buyout deals took place at higher earnings multiples and with more leverage. By 2018, private equity worldwide was sitting on an estimated trillion dollars of dry powder to finance future deals.[30]

Private equity claimed to have a more long-term approach to managing businesses than was found in the public markets. But the industry’s penchant for enhancing returns with leveraged ‘dividend deals’ and flipping companies for a quick profit belied such claims. The buyout business model normally involved acquiring healthy firms and putting them through the financial wringer: juicy returns derived from applying leverage. Research suggested that most buyouts saw little improvement in operations or business strategy. A 2018 study found that most private equity firms actually cut long-term investment. 'This [buyout] harvest is all about wealth extraction, not wealth creation,' concludes one commentator.[31] No set of individuals benefited more from the Fed's easy money than the buyout barons. None was less deserving.

BUYBACKS

The great management consultant Peter Drucker once wrote that profits were not the rationale of business decisions, but rather the test of their efficacy.[32] What Drucker meant was that if a company does its job well, delivering goods or services to customers at competitive prices, then profits should be forthcoming. From the early 1980s onwards, however, the corporation's purpose was redefined. It was no longer about serving customers or even making profits. Instead, companies were told to pursue 'shareholder value', a management philosophy aimed at maximizing the market value of the company's equity.

In the name of 'shareholder value' senior executives were handed free stock options and other equity-linked incentives. Now they had skin in the game, management interests were said to be aligned with those of shareholders. Under President Roosevelt's New Deal, it was made illegal for companies to acquire their shares in the market, this being regarded as a form of stock manipulation. But this law was repealed in 1982, at around the date when interest rates embarked on their multi-decade decline. Under the mantra of shareholder value, managements were encouraged to replace 'expensive' equity with 'cheap' debt. As long as the cost of borrowing was low enough, executives could boost their company's earnings by repurchasing their shares with debt (see box, p. 165). Since companies with robust earnings growth performed well in the stock market, senior executives earned windfall gains from this simple feat of financial engineering. The promoter's profit was back.

From the turn of the century, the cost of debt in the United States was held below the cost of equity. This 'funding gap' provided the impetus for share buybacks. After the global financial crisis, the funding gap grew even larger. 'As the cost of equity still remains high relative to the cost of debt,' commented one Wall Street strategist, 'it makes sense for companies to de-equitize – use cheap financing to buy back their own shares.'[33] The monetary authorities had hoped that companies would use their access to cheap debt to boost investment. But a very low interest rate, combined with a tax structure that favoured debt over equity, noted the OECD, 'works directly against long-term investment'.[34]

Managements of large public companies, laden with equity-linked incentives, preferred the certain and immediate rewards of leveraging current profits to the more doubtful returns from investing in the future. Buybacks and capital spending were inversely related; as share repurchases took off investment declined.[35] American firms spent more on buybacks in the post-crisis period than they invested in their operations.[36] As a share of cash flow, corporate investment fell to an all-time low in 2014.[37] The Office for Financial Research, an independent offshoot of the US Treasury, warned that financial engineering was detracting 'from opportunities to invest capital to support longer-term organic growth'.[38]

This problem was encountered at first hand by Richard Fisher, President of the Dallas Federal Reserve, and one of the few 'hawks' on the Fed's Open Markets Committee. Fisher told colleagues in 2012 that Texas Instruments, one of the largest firms in his district, had issued debt securities at the lowest rates in history but not a single job had been created. Instead, all the money was spent on share buybacks. Another company in the Dallas area, Fisher added, was specifically instructed by its board to cut capital spending in order to 'buy more stock because of the economics that these low interest rates make possible'.[39]

Buybacks: How the Game Works

Imagine a company – let's call it FinEng Corp – with sales of $1 billion and a 5 per cent profit margin. The $50 million of profits are taxed at a 30 per cent rate. The company has 500 million shares outstanding and shareholders' equity of $500 million. The shares trade at 15 times earnings. The corporate incentive plan provides senior executives with 50 million stock options, which strike at the current market price. At this point, FinEng has no debt.

Given these details, we know that the company's post-tax profits are $35 million and its return on equity is 7 per cent. The earnings per share are 7 cents ($35 million divided by 500 million.) On a multiple of 15, the shares trade at $1.05. The company's market capitalization is $525 million.

Management now decides to use leverage to repurchase half its outstanding shares. To keep things simple, let's assume the buyback occurs at the current market price. FinEng borrows just over $260 million at 5 per cent. Given that interest payments are tax deductible, the effective interest cost is around $9 million. After interest costs, post-tax profits are reduced to less than $26 million.

That doesn't sound too good.

The impact on earnings per share (EPS) is very positive, however. Post-tax profits of $26 million divided by half as many shares produce 10.3 cents of EPS, an increase of nearly 50 per cent. Given that investors appreciate EPS growth, the stock is re-rated to 17.5 times earnings. As a result, the share price climbs above $1.80, up more than 70 per cent, and the shares are now trading at a substantial premium to book value. The value of executive stock options increases by more than $35 million.

Although the chief executive has not developed any new products, increased investment or done anything else to improve the company's long-term prospects, she shares in this bonanza. And why not? FinEng's return on equity has climbed to 10 per cent, up 3 points. Given that the company is still not highly leveraged, the Fed is keeping interest rates low and credit spreads are tight, the board of directors decides to authorize another large buyback, and rewards its high-performing CEO with another grant of stock options.

The numbers in the FinEng case study are hard to follow for anyone unfamiliar with corporate finance, but the important point is that the use of low-cost debt to repurchase shares artificially boosts profitability and stock valuations. Given that executive compensation is generally linked to measures that are enhanced by financial engineering – such as returns on equity, EPS growth and stock performance – senior management has a strong incentive to play the game. Short-term investors, bankers and senior corporate executives benefit from this financial engineering, but no one else is better off.

The impulse for buybacks also came from outside the firm. Companies that underperformed in the stock market became takeover targets for competitors or private equity firms. Hedge funds, with their outsize performance fees, had a strong incentive to promote buybacks. 'Activist' investors launched publicity campaigns and proxy battles to push managements into buying back still more shares. Even the most profitable companies, such as Apple, attracted their attentions. When Apple repurchased its shares, the iPhone-maker chose to borrow rather than spend the billions of dollars of cash on its balance sheet.

At the time of Lehman's bankruptcy, buybacks basically ceased, but they returned with a vengeance once the crisis was past. Ten years later, annual spending on share repurchases by S&P 500 companies was running at $720 billion, up by nearly a half on the pre-crisis level. Over the previous decade, America's largest public companies spent more than half their total profits on buybacks.[40] In fact, share repurchases were mostly funded with cheap debt rather than operating cash flow. Trillions of dollars of buybacks effected a 'slow-motion leveraged buyout of the entire [stock] market'.[41] Thanks to the miracle of financial engineering, the earnings per share of S&P 500 companies grew faster than reported profits and sales.[42] Even companies with declining profits were able to report a rise in per-share earnings.[43] Some firms, including Exxon and IBM, operated what were in effect Ponzi schemes by distributing more in buybacks and dividends than they earned by way of profit.[44]

THE FINANCIALIZED FIRM

Under the influence of shareholder value, the distinction between financial and non-financial corporations was eroded. Corporate finance took precedence over ordinary business operations as the financial operations within firms accounted for an increasing share of profits.[45] As one commentator put it, 'the productive activities of the modern corporation are therefore incidental to the restructuring of corporate balance sheets and the making of money by buying and selling subsidiaries.'[46] Thorstein Veblen would have understood what was going on.

General Motors was once the epitome of US industry. As the car maker's post-war CEO Charlie Wilson commented, 'what was good for our country was good for General Motors.' Half a century later, General Motors was an emblem of this financialization. Prior to the financial crisis, the Detroit car manufacturer ran a mortgage business (GMAC) that specialized in subprime lending and spent tens of billions of dollars repurchasing shares.[47] A month after Lehman's failure, GM filed for bankruptcy – an event induced as much by pension liabilities as falling car sales. Yet only a year after emerging from Chapter 11 administration, GM spent heavily to acquire a subprime car-financier.[fn3] And as the car industry faced the challenge of shifting to the manufacture of electric vehicles, GM was once again diverting billions of dollars to buybacks.[48]

Another iconic American company, John Deere, found better ways to mint money than by beating ploughshares. The 'Bank of John Deere' became one of the largest farm lenders in the United States, providing farmers with loans for seeds, chemicals and fertilizers. The credit business accounted for a third of Deere's net income.[49] In the post-crisis period, Deere repurchased more than $12 billion-worth of shares and nearly doubled its debt load.[50] At around the same time, AT&T became the most leveraged non-financial company in the world after its 2016 acquisition of HBO owner, Time-Warner. Ma Bell's net debt of around $250 billion (including off-balance-sheet liabilities) was equivalent to the combined sovereign debts of Thailand and Portugal.[51]

THE FINANCE CURSE

A reasonable case could be made for maximizing shareholder value in the 1980s, when corporate America was dominated by cumbersome conglomerates. But after more than thirty years of corporate restructurings, shareholder value was little more than cover for financial engineering – the process of manufacturing profits on Wall Street rather than in the real world. As in Pierpont Morgan's day, most bank loans were provided against existing collateral rather than used for productive investment. In Jan Toporowski's clever aphorism, 'in an era of finance, finance mostly finances finance.'

What was good for Goldman Sachs, however, wasn't necessarily good for America. The 'Dutch disease' describes the damage done to an economy when it becomes excessively dependent on commodities. The 'financial resources curse' turns out to be equally debilitating.[52] Countries, such as the United States and Britain, whose current account deficits were funded with cheap foreign loans experienced a loss of export competitiveness. Their economies shifted away from manufacturing towards services – banking in particular – which generated less productivity growth. Spain was afflicted with the finance curse in the years leading up to the financial crisis – and centuries earlier, when its domestic trade was corrupted by massive imports of South American silver.[53]

In 2015, the Bank for International Settlements warned that finance was crowding out the real economy. More bank loans went to sectors with plenty of collateral, such as real estate, which generated little by way of efficiency improvements. Manufacturing and businesses that required lots of R&D were starved of credit. Beyond a certain point, the BIS concluded, 'the growth of a country's financial system is a drag on productivity growth. That is, higher growth in the financial sector reduces real growth.'[54] The Bank of England agreed with this analysis: 'Financialization has polluted the entire physical investment process, the labour markets, and the innovation cycle of firms,' noted the Bank's chief economist Andrew Haldane. 'The damage it inflicts on investment in physical and human capital [factories and workers] is hugely important, because that's what slows down growth.'[55] No mention was made of the role played by the Bank of England's monetary policy in promoting the financialization of Britain's economy.

Financial engineering contributed to a startling rise in US corporate borrowing. The IMF's 2017 *Financial Stability Report* recorded that

American corporations had taken on nearly $8 trillion of debt and other liabilities since 2010. AT&T was the poster child for this corporate plunge into debt. The IMF noted that corporate interest cover (the ratio of profits to interest payments) had fallen to levels last seen prior to the financial crisis, despite the fact that the prime lending rate – the short-term rate paid by large corporations – had collapsed.[56] More than half the corporate cash flow was used for 'financial risk-taking' (mergers and acquisitions, buybacks and dividends) leaving less for 'economic risk-taking' (investment and R&D).[57] Such activity, warned the IMF, 'is associated with intermittent large destabilizing swings in the financial system'. In plain English, the risks of another financial crisis were rising.

By this date, Valeant's game was up. A common problem with corporate roll-ups, such as Valeant, is that they must complete ever larger acquisitions to continue growing their earnings. In the second half of 2015, Valeant's stock price collapsed after its policy of hiking drug prices attracted the attention of lawmakers on Capitol Hill. The decline in its share price and a rising cost of borrowing brought Valeant's acquisition spree to an end. Questions were raised about its solvency. After the Securities and Exchange Commission started investigating the drug-maker's accounting practices, CEO Michael Pearson was sent on medical leave. By this date, Valeant's shares were down 95 per cent from their peak.

Having gorged in the credit markets, the Kraft Heinz Company was also sick. Within two years of the merger, the food giant's net debt had swollen to $33 billion, up by more than half. Leverage initially helped boost its earnings per share. Investors received large payouts, but less profit was retained to support the ongoing operations. As with Valeant, Kraft Heinz's presentations to shareholders came under scrutiny. Sales of its processed foods flagged. The company's Brazilian managers had proved more adept at borrowing and cutting costs than managing brands. In early 2019 the value of Kraft Heinz's brands was written down by $15 billion and its share price plunged.[58]

This write-down was the tip of an iceberg. When a company acquires another business at a premium, an intangible asset known as 'good will' is recorded on its balance sheet. In more conservative times, good will was amortized gradually over the years. In the age of financial engineering, however, it remained on the balance sheet until it was deemed bad. After the latest merger mania, companies around the world reported some $7 trillion of good will on their balance sheets. During the next downturn much of this evanescent value will likely have to be written off.[59]

Shortly before Kraft Heinz took its multibillion-dollar write-down, two famous American retailers went to the wall. In March 2018, Toys ‘R’ Us closed its doors. Back in 2005, the toy store had been acquired by a private equity consortium. Weighed down with debt, management failed to adapt to online competition. The roll-out of new megastores was deemed unaffordable and existing stores became shabby. Profits waned, leverage climbed, and interest payments became pressing. The planned IPO was shelved. Toys ‘R’ Us was eventually put out of its misery by a group of hedge funds, the owners of its secured debt, who reckoned it was worth more to them dead than alive. Thirty-three thousand workers lost their jobs.[60]

Sears filed for bankruptcy six months later. For more than a decade, the venerable department store had been controlled by a hedge fund manager named Eddie Lampert. The former Goldman Sachs trader merged Sears with another retailer, Kmart, sold off its real estate, reduced costs and spent billions on buybacks. After taking over as chief executive, Lampert ran the Illinois-based store chain from his $40 million mansion on Creek Island, Florida. While marketing expenses were slashed, Sears continued paying interest on its loans (Lampert’s own hedge fund was the largest creditor) and rent to its landlord (in which Lampert retained an interest). Unable to cope with online competition, Sears slithered towards bankruptcy.[61] While Lampert failed as a retailer, he succeeded in extracting more than a billion dollars from his involvement with Sears and Kmart.[62]

THE LIGHTS GO OUT AT GENERAL ELECTRIC

In the post-war years, General Electric was a sprawling conglomerate, dull but solid. As much as General Motors, the company exemplified corporate America. In fact, the chief executives at both firms were called Charles Wilson: ‘Engine Charlie’ ran General Motors and ‘Electric Charlie’ ran General Electric. In 1981, Jack Welch took over as chief executive at GE. A chemical engineer by training, Welch turned out to excel at financial alchemy. During his two decades at the helm, he returned the firm’s culture to its origins in the 1890s, when corporations operated 'at the absolute service and mercy of the votaries of frenzied finance'.

General Electric became a model of financialization. Welch streamlined its business, disposing of subsidiaries that lacked dominant market positions and buying up firms that competed with retained operations. Tens of thousands of employees were laid off, earning Welch the sobriquet 'Neutron Jack' (since the buildings were left standing after the workers had been terminated). He built up a financial services division, GE Capital, that in time accounted for more than half the conglomerate's profits.

Divisional heads were instructed to run their businesses to maximize the share price and were handsomely rewarded for doing so. During Welch's tenure, GE reported more than a hundred consecutive quarters of earnings growth – an impossible feat achieved through the use of 'cookie-jar' accounting. While earnings increased eightfold under Welch's watch, the stock price soared more than forty times.[63] On several occasions Welch was named *Fortune* magazine's CEO of the year, and in 1999 he was crowned 'manager of the century' by the magazine. Alongside fulsome praise came material rewards – some $400 million in stock-related pay, and lavish perks on his retirement in 2001.

Most investors believed Welch was worth every penny. Yet financial engineering structurally weakened General Electric. During the subprime crisis the financial services division nearly bankrupted the company, which was bailed out by the Federal Reserve. Welch's successor, Jeff Immelt, dismantled GE Capital. But he also buckled to the demands from a corporate activist for more buybacks. In the years after 2008, at a time when several of GE's divisions were being hollowed out, $46 billion was expended on share buybacks. After Immelt left in 2017, it was revealed that GE had paid dividends in excess of free cash flow. Regulators announced that its power-generation business had boosted profits by selling customer credits to the finance subsidiary. Commitments on the sale of a life-insurance business, spun off years earlier, added a further $15 billion to its mountain of pension liabilities. In 2018, GE's credit rating was downgraded to a notch above junk. By the end of the year, its shares were down more than 90 per cent from their peak under Welch. Losses on recent buybacks ran to nearly $20 billion.[64]

The rise and fall of General Electric provides a case study in the perils of financialization. The profits created by financial engineering and the valuations applied to those profits are chimerical, while the costs only become clear in the long run. Running a company with the sole aim of maximizing the share price often leads to bad corporate decisions. In retirement, even Welch acknowledged that shareholder value was probably 'the dumbest idea in the world'.[65]