Apocalypse 2010?

Populist gadfly Jeff Gates wants today's CEOs to build a new middle class with stock ownership plans. Or else.

by Art Kleiner

Illustration by Lars Leetaru

One could argue that the modern American middle class was born in January 1914, when Henry Ford dramatically raised his autoworkers' minimum wage to $5 a day. Our current corporate governance crisis was probably born then, too. For even as other businesses began to follow Mr. Ford's example, his shareholders rebelled. Two of them, the machinist brothers John and Horace Dodge, sued him in 1916 for breach of fiduciary responsibility. He was expanding his plant, they complained, rather than releasing dividends to them.

The plaintiffs' lawyer pressed Mr. Ford on the witness stand: Hadn't he stated publicly that he had as much money as he needed? Yes, he said, he was one of the wealthiest men in the country. Then what, asked the lawyer, was he trying to do? Employ as many workers as he could, give them high wages, and provide the public the benefit of a low-priced car.

"And incidentally make money," added Henry Ford.

"*Incidentally* make money?" echoed the lawyer.

"If you give all that," said Mr. Ford, "the money will fall into your hands; you can't get out of it."

That remark added to Mr. Ford's public luster, but it lost him the case. Making shareholders wealthy in the short run, ruled the judge, should not be *incidental* to making everyone wealthy in the long run. And he ordered the Dodge brothers' dividends paid.

The debate on corporate ownership has followed the same basic lines ever since. Whose interests come first: those of shareholders, or those of the general public? Which group should be "incidental" to the other? Through most of the 20th century, the two sides held more or less equal sway — until the 1970s, when the shareholder-dominant view of governance moved far into the lead. By the year 2000, saying that corporations existed for some purpose *other* than return on investment to shareholders was enough to label you a crackpot in most financial circles. Then came the bubble burst of 2000, the ongoing boardroom scandals of 2001 and 2002, and a whole new current of critique of the "shareholder first" mind-set, which is still rippling out through waves of pro-and-con punditry as I write this.

In the midst of all the turbulence, one provocative voice has picked up Henry Ford's original point. The voice belongs to Jeff Gates, a lawyer turned employee-stock-ownership expert turned policy wonk turned investment banker turned gadfly, part-time politician, and writer. His two books are *The Ownership Solution: Toward a Shared Capitalism for the 21st Century* and *Democracy at Risk: Rescuing Main Street from Wall Street*, both published by Perseus Press, in 1998 and 2000, respectively.

Mr. Gates takes seriously the idea that large, mainstream markets depend on a large, mainstream middle class. In the last 30 years, he argues, American business has drifted away from that principle, which has paved the way not only for the Enron Corporation, Global Crossing, and Tyco International Ltd., but also for what he terms a kind of "legalized looting" endemic to our current economy, in which executive salaries rise dramatically and ownership becomes more concentrated, fueled by pension-fund capital that would otherwise be getting far better returns. If this trend continues, in Mr. Gates's view, we'll drain away not just much of our pension-fund asset base, but the American middle class itself. He has marshaled a daunting amount of data (along with a fair amount of Sturm und Drang rhetoric) to show how plausible that could be, even within the next 10 years, whether the Dow Jones average recovers in the short term or not.

In *Democracy at Risk* — a no-holds-barred, apocalyptic manifesto — Mr. Gates projects an apocalyptic financial crisis, which he thinks will be upon us by 2010 or so. There will be about 76 million baby boomer retirees beginning to cash in their 401(k) stock, only to find its value dropping dramatically as everyone tries to sell at once. Housing prices will drop, too, as boomers try to cash in that equity to a smaller base of buyers. Middle-class manufacturing jobs will long have been lost to China. Clerical and management jobs will dwindle away through the application of information technology and automation. A U.S. federal government crippled by thousands of billions of dollars in debt and a falling dollar due to trade deficits will see its credit rating slip. A draconian Social Security tax, unrepealable because it becomes the only source of retirement income that most baby boomers have left, will push more jobs abroad. Personal bankruptcies will mushroom. Three- and four-job breadwinners will become commonplace. So will the kind of environmental degradation that is generally associated with less-developed countries.

Stock for Stakeholders

Corporate leaders could prevent all this by going back to Henry Ford's original credo — or so implies Mr. Gates. But he goes further than Ford ever did. Henry Ford kept most of his company's stock for himself (buying it back from the Dodge brothers, for example, as soon as he could). Jeff Gates proposes a kind of "democratic capitalism" in which companies distribute their equity as broadly as possible. Only by spreading the wealth can you spread your customer base, he says, and let profits fall "incidentally" into your own hands.

If this reminds you of the rhet-

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oric of Employee Stock Ownership Plans (ESOPs) from, say, the 1980s, when they were championed as a vehicle for making corporations more vital by involving employees as full-hearted owner–participants, that's probably no coincidence. Mr. Gates is a long-standing proponent of and legal counselor to ESOP programs in the U.S. and elsewhere. His current prescriptions, however, extend far beyond that. For instance, corporations would routinely grant stock to customers, suppliers, and local community members, using computer-based networks (or perhaps a new form of "frequent customer" cards) to keep track of the recipients.

Anyone who bought a General Electric refrigerator, for example, might get a quarter-share of GE packed in with the ice-cube tray. Under such a system, people would gradually learn the ins and outs of ownership, and they would then become far more sophisticated in building their own portfolios (particularly as companies like J.P. Morgan Chase & Co. switched their emphasis from serving the wealthy few to serving the wealth-building many). By the time most people retired, they would have accrued a diversified portfolio of stock in all the companies they had regularly dealt with over their lifetimes. They would have assets, in short, on which they could live for years, and then pass on to their children, and they would have a far more personal relationship with capitalism that would also be a prevalent source of dignity and participation in the economy. Businesspeople would do all this not only because they were incentivized by new laws that Mr. Gates proposes, but for the sake of their own markets and revenues, and because they believed in the market as a democratizing force.

"The premise of this approach," said Mr. Gates in a recent conversation, "is that a genuine free enterprise democracy will only show up when there is genuine dialogue. It needs more robust feedback loops from the general public back to financial decision makers, so they're attuned to something more than the simplistic pricing of products and securities — so they're better attuned to the social, financial, and environmental needs of the large number of people who are influenced by their decisions." His new, more democratic forms of stock ownership would provide some of those feedback loops.

It all sounds terribly utopian, but Mr. Gates makes it sound almost plausible, as though it really could happen — until you remember that most businesses are steering as hard as they can in the opposite direction.

A buyer of a GE refrigerator might get a quarter-share of GE stock. Over time, everyone would be vested in the economy.

Seat at the Parade

Jeff Gates lives in Southern California, but he is by birth and temperament an American southerner. He grew up in Athens, Ga., the son of a business school dean, and graduated from the University of Virginia. He has craggy features (similar to those of the actor Billy Bob Thornton) and the cheerfully morose talkativeness of a William Faulkner character. He first became interested in ESOPs while at Hastings College of the Law in San Francisco during the early 1970s; in 1979, after a decade as an ESOP lawyer, he was recruited as counsel to Senator Russell Long, Democrat of Louisiana, the son of the legendary populist governor Huey Long and the long-standing chairman of the Senate Finance Committee.

"Russell Long was considered the brightest guy in the Senate, the best liked, the best debater, the most powerful," Mr. Gates says. "LBJ used to say, 'There are only three people needed to get things done in Washington: the president, the chairman of the Senate Finance Committee, and a messenger.' And I was hired to help think up the ideas that were [Senator Long's] passion."

Mr. Gates cut his policymaker's teeth there by writing many of the laws giving tax breaks to pensions, 401(k) plans, ESOPs, and ESOP investors. "Mea culpa," he now says, because many of those laws had the unintended consequence of giving pension-fund trustees and corporate managers incentives to focus only on short-term returns instead of long-term social and environmental benefits.

In 1985, when Senator Long retired and went into law practice with Paul Laxalt (a former Republican senator from Nevada), Mr. Gates went along for a few years, just long enough to discover his distaste for "influence peddling." From there, he joined an ESOP-oriented investment banking firm, and then went into law practice and international consulting.

Over the years, the impact of ESOPs on business culture in general has been minuscule, especially compared to the hype. And yet, there are now about 12,000 ESOPs in the U.S., and their track record is good (setting aside some high-profile failed-hope stories such as Avis's). Such companies as the SRC Holdings Corporation (see "Jack Stack's Story Is an Open Book," by Art Kleiner, *s+b*, Third Quarter 2001), United Parcel Service Inc. (despite its 1997 Teamsters strike and current labor tensions), and the Science Applications International Corporation (the defense contractor and high-technology firm commonly known as SAIC) have all thrived through the recent market doldrums, with ESOPs getting a fair share of the credit for sheltering these companies from the economic turbulence.

Environmental Impact

In the 1990s, Mr. Gates began to work closely with governments of former Iron Curtain countries, helping them write new finance laws. Then Stephan Schmidheiny, founder of the World Business Council for Sustainable Development, asked him why cross-border capital flows were so deadly for the environment. Mr. Gates offered to write a book if Mr. Schmidheiny, a billionaire, would fund it. That became *The Ownership Solution*. Written with a deliberately nonpartisan outlook, it is probably the only book in history to have been endorsed by a mix of leaders so eclectic: Senator Long, Senator Laxalt, Ralph Nader, Jack Kemp, and Mikhail Gorbachev.

The Ownership Solution is full of nuts-and-bolts political prescriptions. Mr. Gates argues that government contracting should favor broadly owned companies. He proposes more stringent antitrust action to discourage ownership concentration, pension-fund laws that favor investment in broadly held ESOP-based companies, and in-depth "ownership education" to help people at large become more sophisticated capitalists. But he stops short of calling for wholesale social change.

In *Democracy at Risk*, published two years later, Mr. Gates changed his tune. During his research for the second book, Mr. Gates discovered that the movement toward a "haves" and "have nots" society was bigger, was faster, and was gathering more momentum than he had imagined. Thus, he began writing more impassioned pleas against "legalized looting," as if he had personally discovered the Snopeses, Mr. Faulkner's corrupt merchant family, made real in the form of CEOs, pension-fund managers, and coupon-clipping wealthy families — or, as Mr. Gates puts it, "an hereditary aristocracy unlike anything ever seen in human history, financed with our tax-subsidized retirement savings." He calculates that at least $2 trillion has already accrued from pension funds into the bank accounts of just a few hundred wealthy families and senior executives. Mr. Gates assumes that baby boomers will erupt politically when they discover exactly how little prosperity is waiting for them, and how much has been extracted from their retirement portfolios.

If all this sounds a bit over the top, that's not surprising. Mr. Gates is a neo-populist; his rhetorical allies are people like Mr. Nader; the writers William Greider, Kevin Phillips, and Paul Hawken; and *Business Ethics* editor Marjorie Kelly — the kind of people who argue that corporate charters should be set for limited terms and renewed only if companies display some acceptable level of social responsibility. In 2000, Mr. Gates ran on the Green Party ticket for the U.S. Senate in Georgia, making headlines when he was arrested for protesting his banishment from a televised debate.

A Second Chance?

There's a temptation to get caught up in Mr. Gates's politics, and to charge him with political naivete, or with socialism, or simply with irrelevance. If the rich are going to get richer, and the poor are going to get poorer, doesn't that simply mean we should apply ourselves to getting richer? To Jeff Gates, there's no way to get there from here; the wage income available, even to the upper middle class, is far too small for most people to accumulate significant assets with.

To me, however, the most intriguing aspect of Mr. Gates's approach is the audacious idea — almost counterintuitive in today's economy — that a company can best boost its profits by spreading wealth beyond its boundaries. What if that turned out to be right? Under what circumstances might it work and might it not work? Can we imagine a cultural atmosphere in which CEOs and other senior executives turn their attention away from their own bonus-and-benefit packages and toward the question of the legacy they hope to leave behind?

"It sounds like CEOs and senior executives have everything to lose through the reforms you're talking about," I said to Mr. Gates.

"Oh, no, I think it's just the opposite," he said.

But when I pressed him, it took him a while to explain why. He started by talking about immediate business benefits. Pilfering and absenteeism go down; employees stay for life, innovating all the way. "Your people will begin to build assets, which will make them more loyal to you." And, he added, you're less subject to the kinds of downturns that hit companies like the Sunbeam Corporation or the Xerox Corporation when tricky accounting practices could no longer mask poor fundamentals. Then, "since you're involving your customers as shareholders, you build brand loyalty and more robust market demand." In other words, when your customers and suppliers and employees are truly your financial partners, they bring business to you.

Baby boomers will erupt politically when they find out how little prosperity awaits them.

But all of this seemed beside the point, and I told him so. "Here's what gets me up in the morning," he finally said. "How would it feel, as an executive, to go in each day knowing that the people you have hired genuinely feel that you're working on their behalf? That 20 percent of your shareholders showed up in your buildings every day? What would it mean to managers personally to create a vibrant center where people learn what it is to be fully human, where they make decisions to restore the natural environment, where they watch everyone becoming better off — psychologically, ecologically, and financially? And they can look back on their careers as corporate executives and tell their children, 'Hey, you know what? I did that.'"

Finally, he added, "You don't have to do the CEO analyst road show anymore."

In my own heart, I don't really believe that the crisis that Jeff Gates talks about will occur. Something will happen to get us out of it, by the skin of our teeth; hasn't that always happened before? And yet, I'd feel a lot more confident of the future if I knew that a fair number of companies were following his advice.

I have also read about what happened to Henry Ford in 1930, at the dawn of the Great Depression. Prodded by Herbert Hoover, he tried his familiar tactic again. He cut car prices and raised wages to $7 per day. This time, it didn't work; within a year, he had to drop his own minimum wage back below his once-sacrosanct $5. There were a lot of differences, of course, between 1930 and 1914, including a much stronger set of competitors (such as Alfred Sloan's General Motors). But I can't help thinking that if there had been a few more companies — a dozen? a hundred? — doing the same thing as Henry Ford, Mr. Ford might have had a chance, and the Depression could have lost some of its bite. If Jeff Gates is right, we may get another chance to find out. +

Reprint No. 02402