'Shareholder value' doctrine is killing European jobs

by William Engdahl

At the end of March, Jürgen Schrempp, chairman of Germany's largest industrial group, Daimler Benz, announced the company's worst annual results since the end of World War II, a book loss of DM 5.7 billion ($4 billion), and declared that for the first time, the company would pay no dividend. The reaction of stock market investors as well as major international credit rating agencies to Schrempp's grim report was overwhelmingly positive. Daimler-Benz shares began to be bought heavily, sending share prices 25% higher than May 1995 when Schrempp took over the firm.

This, despite the drastic management steps Schrempp has taken since he became chairman 12 months ago. He began with brutal cost-cutting steps at the Deutsche Aerospace (DASA) division, shedding thousands of engineering jobs; he dismantled AEG, a hundred-year-old German electronics and defense subsidiary; then he informed the Dutch government that Daimler-Benz was closing its Dutch Fokker aircraft subsidiary. Over the next 12 months, Schrempp has announced that similar reviews of the remaining 28 subsidiaries will be completed, with many more jobs expected to be on the chopping block.

The shareholder doctrine for national suicide

Why did investors respond favorably? Their motive was the growing evidence, from Schrempp's ruthless cost-reduction moves, that the foremost German manager had become a true-believer in a savage management doctrine which has been hegemonic since the late 1980s in Great Britain and the United States. The doctrine is known by the name "shareholder value." It has caused hundreds of thousands of permanent job losses and plant closings in British and U.S. industry in recent years.

Daimler-Benz, like most industrial companies in Germany, France, and continental Europe generally, had long prided itself on a socially conscious management approach, where job security, and social concern to keep companies operating, were paramount. In the past, Daimler would funnel profits from its successful divisions, such as the Mercedes-Benz car and truck unit, to support loss-making units such as AEG or Fokker. Concern was long-term industrial capacity, stability, and R&D, not short-term profit. "That practice will no longer be tolerated," a company spokesman told the German business daily *Handelsblatt* recently.

Schrempp, announcing the annual loss and future plans, told the press, "The severe measures in the past months have demonstrated that management has taken decisive steps in order to offer Daimler-Benz shareholders an attractive return."

As the Germany's foremost advocate of the "shareholder value" approach, Schrempp is rapidly being joined by top managers in Germany as well as France.

Ironically, "shareholder value" as a major management concern is sweeping continental European companies, at a time when it is under severe attack in the United States, as a short-sighted focus on one side of a company—maximum profit to stockholders—at the expense of long-term national and local and even company interest. The recent U.S. debate, shaped over years by U.S. Presidential pre-candidate Lyndon LaRouche, and now being taken up by Sens. Edward Kennedy (D-Mass.), Tom Daschle (D-S.D.), and Jeff Bingaman (D-N.M.), and, in a populist way, by loose-cannon Pat Buchanan, has shifted the national Presidential debate away from the budget-cutting austerity of the Gingrich Republicans,

How does "shareholder value" work in practice, and why would companies adopt such a drastic method? The practice evolved as a by-product of corporate and financial deregulation and the "leveraged buy-out" binge spearheaded by Michael Milken and Ivan Boesky, and practiced by all major Wall Street firms by the end of the 1980s. One argument used by the first generation of asset-strippers, was that complacent, comfortable executives in many companies had settled into a niche of annual returns, sales, market share, and product development, and were not doing everything possible to give immediate results to the "owners" of the company, the shareholders.

But the change was to involve far more than Milken's asset-strippers. Step by step, the business philosophy began to change, with the most dramatic move being the draconian announcement by General Motors in December 1991, that it would eliminate 74,000 jobs in order to give a better return to shareholders. GM stock rose sharply, and since then, American, and now, European companies, have rushed lemming-like to slash costs and maximize short-term returns to investors.

There are obvious ways to maximize short-term "value" to shareholders. Cost-reduction by writing off loss-making units like Fokker or AEG is one. Forcing a fraction of the workforce to meet the production of a far larger employee base, is another. Basing new plants in cheap-labor areas in Mexico or in Malaysia, is a third. But a company which invests an "undue" portion of its pre-tax profit into new plant and equipment at home, or expanded R&D, is often regarded by financial investors as ignoring today's shareholder value in favor of tomorrow's. The stock price of such a company falls.

Behind this all, is a radical transformation in the ownership of stock shares in the United States. Since the prolonged period of low Federal Reserve interest rates (1991-94), American families have fled traditional bank deposits into what are called mutual funds—large private pools of capital—to try to save for college or retirement. Today, total savings held by these U.S. mutual funds just passed the awesome level of $3 trillion, a sum equivalent in monetary terms to nearly 40% of all annual U.S. production and services. Only five of the thousands of such mutual funds control more than $1 trillion in assets, led by Fidelity Fund, Vanguard, and Merrill Lynch Fund.

These funds are rapidly replacing pension funds and insurance funds as the most rapidly expanding stock buyers. A record $55 billion of mutual fund money, put into stocks, helped to hold the Dow Jones Industrials at historic high levels in the past three months.

But if ever money was obsessed with short-term results, it is mutual funds. There are generally no requirements governing how long investors must hold such mutual funds, unlike other investments, which penalize premature withdrawals. Fund managers are rated ruthlessly by Wall Street and others, on their profit each three months. A rule of thumb is that a fund with poor profit for two quarters running, is in trouble. To maximize their wins, the fund managers, often the largest buyers of key stocks, ruthlessly demand that corporations do what is necessary to maximize shareholder value. This is now coming into Germany and the rest of conservative European business, as the same mutual funds increasingly "globalize" their investments, out of only U.S. securities, in order to maximize profits.

A demonstration in Dortmund-Mengede, Germany, in January 1996, against the closing of a hospital. The sign reads: "We demand that our jobs be kept!" According to the insane shareholder value doctrine, cutting the workforce means higher stock dividends—good news!

A European trend?

Schrempp is unfortunately not alone among leading European managers using this shareholder value as his guide, but he is perhaps the most extreme. He decided to dump Fokker only three years after he had been the key voice calling for Daimler to buy it. His argument was that each of Daimler's units must deliver a minimum 12% return on value to shareholders. This month, he announced that from now on, Daimler top executives would receive part compensation in company stock options, in order to give "performance incentive," as the cuts continue. Daimler-Benz set the stage for the internal revolution two years ago, when it agreed to accept U.S. corporate accounting and asset-disclosure rules in order to win the first listing by a major German company on the New York Stock Exchange. This has been used internally to drive the shareholder "revolution."

The management of other huge German firms are following the same strategy, including Veba AG, the chemical giant Hoechst, the huge electrical conglomerate RWE, the construction leader Philipp Holzmann AG. Funds, similar to U.S. mutual funds, except that they are run by the large German banks, are leading the push to advance shareholder value methods in German industry, as German banks adopt the British approach.

The largest such fund is Deutsche Bank's subsidiary, DWS. Dresdner Bank and the other large German banks have such funds as well. The result is a split with the 100-year tradition of the German "Universal Banking" system, in which large industry and big banks were linked by permanent shareholdings, and in which the bank often would step in to rescue one of its large company clients from shocks such as the 1994 Metallgesellschaft financial derivatives crisis.

Increasingly, these same banks are now demanding savage cost-reduction from companies in which they hold large shares. "At this point, no publicly listed German company can afford to ignore shareholder value," said Hamburg company consultant Klaus Rainer. The huge oil and chemicals group Veba AG recently hired the Boston Consulting Group to advise on maximizing "value." The outcome was the short-term decision that investment in the future will go only to those units where cash-flow earnings are larger than capital costs. The rest would be cut off, closed, or sold. In its Huels subsidiary, Veba cut 12,000 jobs as a result, and the Veba stock price began to rise on the Frankfurt Stock Exchange. Shareholder value was prime.

Ironically, the banks and insurance firms which have pushed shareholder value upon German industry, are among the companies on the stock exchange with the lowest "shareholder value" returns themselves, meaning that they will come under increasingly severe pressure, as well, to "take their own medicine," leading to a vicious downward cycle of layoffs in Germany. Leading German management consultant Roland Berger calculates that one result of this growing pressure will be a further permanent loss of 2 million jobs in Germany in the coming months.

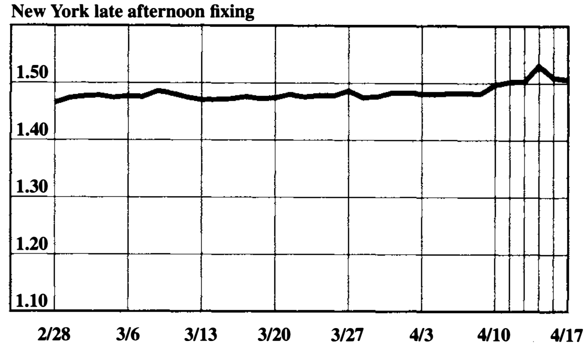
In conservative French banking and business circles as well, the shareholder value revolution has begun taking its toll. French banks and industry have long had cross-ownership, similar to what exists in Germany. But last summer, when France's Banque Pallas-Stern was failing, its largest shareholder, the giant Elf Aquitaine SA, refused to help out, despite a plea from the Bank of France. Elf Chairman Philippe Jaffre is a firm advocate of shareholder value, and helped collapse the troubled bank by selling Elf shares. Jaffre told press, "I only had in view the interests of my shareholders. This bank is not my problem." The large Groupe Suez in Paris is also employing the shareholder value method, as are other large French companies, driven by fear of losing favor with the global financial funds that can buy or sell on a moment's notice.

To date, unions in Germany and France are too stunned and terrified by the record 11% unemployment levels to even challenge the shareholder value destruction of industry and jobs. It remains to be seen how the U.S. debate changes that in coming months.

Currency Rates

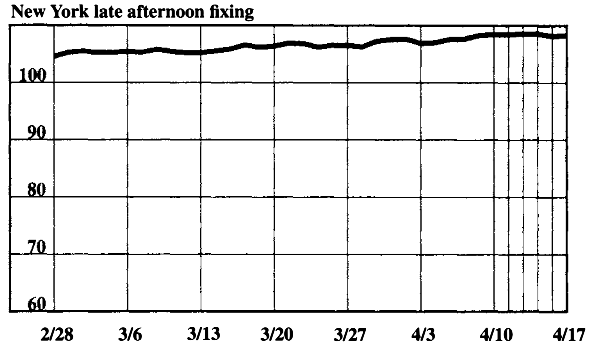
The dollar in deutschemarks

New York late afternoon fixing



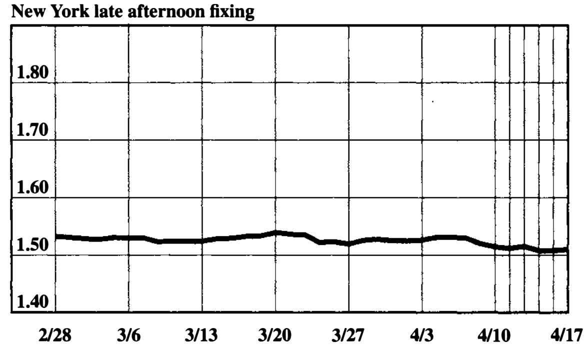
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing