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FINANCIALIZATION: NEW ROUTES TO PROFIT, NEW CHALLENGES FOR TRADE UNIONS

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DISPOSABLE JOBS, VANISHING EMPLOYERS

> *After investment opportunities have been carefully researched and selected, there are three stages in Eurazeo's "production cycle":*
> - *the structuring of the investment and acquisition;*
> - *the follow-through on the investment and the creation of value in the acquired entity;*
> - *the disposal of the investment*
>
> 'Goals/Strategy' of Eurazeo, France's largest private-equity fund[1]

One of the most significant features of the last quarter-century has been the progressive de-linking of the established relationship between wages and productivity. Productivity continues to grow but wages no longer keep pace with profits and productivity. In the advanced capitalist countries the wages-productivity-profit nexus was the foundation of collective bargaining in the long wave of growth after the Second World War. The erosion and breakdown of that link, the re-emergence of significant poverty in advanced capitalist countries, and the persistence of 'jobless growth' have generated significant discussion, often in the framework of the debate on globalization. Yet to understand the fundamental power-shifts that are subjecting workers to continuous restructuring and constant employment instability we must address the question of *financialization*.

Broadly, financialization refers to both the enhanced importance of financial versus real capital in determining the rhythm and returns expected from investments, and the increased subordination of that investment to the demands of global financial markets. Under these financial imperatives firms in the manufacturing and service sector have essentially become "a bundle of assets to be deployed or redeployed depending on the short-run rates of returns that can be earned."[2] Investors in the manufacturing and non-financial services sectors now demand rates of return equal to those obtainable in global financial and stock markets, rates unthinkable even a decade ago. The head of Deutsche Bank has stated that return rates of 20 per cent on investment should be the eventual target for investors.

These new financial imperatives reinforce - and are reinforced by – an institutional and ideological transformation in corporate management. Over the past two decades there has been "a fundamental change in the incentives that guide the decisions of top managers, from one that linked long-term managerial pay to the long-term success of the firm, to one that links their pay to short-term stock price movements."[3] This included phenomenally high executive salaries tied to "the prioritizing of 'shareholder value' together with the rise of institutional investors, the alignment of the interests of managers with those of shareholders through the use of stock options."[4] The combined effect of these changes was to drastically shorten the planning horizons of corporations and the introduction of management strategies to enhance 'shareholder value' while undermining real economic performance. Such strategies include restructuring and cost-cutting to reduce jobs and eliminate productive capacity for the purpose of generating cash for share buy-backs to further boost share prices. This is exemplified by the restructuring and mass lay-offs in the US that coincided with non-financial companies purchasing US$870 billion of their own stock from 1995 to 2001.

Of course, companies have always sought to maximize profit. What is new is the drive for profit through the elimination of productive capacity and employment. Transnational food processors, for example, now invest a significantly lower proportion of their profits in expanding productive capacity. Financial markets today directly reward companies for reducing payroll through closures, restructuring and outsourcing. This reflects the way in which financialization has driven the management of non-financial companies to "act more like financial market players."[5]

As manufacturing companies become more like financial players, *real* financial players such as private-equity funds, hedge funds and real estate investment trusts (REITs) have become significant short-term owners of manufacturing and services companies - acquiring, restructuring and disposing of these companies as liquid assets regardless of actual productivity and profitability. Over the past decade private-equity funds have mobilized trillions of dollars for the acquisition of companies in virtually every industrial and service sector, leading *The Economist* to declare: "Today, the private-equity industry has moved from the fringe to the centre of the capitalist action."[6]

Workers in virtually all sectors face the threat of rapidly changing ownership and the imposition of restructuring plans and short-term targets that are based on a financial market logic that places no value in real production, productivity or jobs. In just the first eight weeks of 2006, hedge funds and private-equity funds made over 4,000 deals involving the acquisition and disposal of US$473 billion in assets. Among the ‘assets’ exchanged were manufacturing and service operations employing hundreds of thousands of workers. This includes, for example, 3,000 workers employed in the European Beverages Division of Cadbury Schweppes, the world’s largest confectionery company. In what is now a familiar pattern in the food and beverage industry, Cadbury Schweppes sold its European Beverages Division to two private-equity funds, Blackstone Group International and Lion Capital LLP in February 2006 US$2.2 billion. As a result, the workplaces of 3,000 workers were instantly transformed into another financial asset in Blackstone’s US$45 billion portfolio (which exercised control over the workplaces of 300,000 workers as of November 2004). This – together with the examples of layoffs and closures we discuss below – illustrates the visceral employment impact of financialization.

In all of those sectors where the IUF has members – food, beverages, hotel and catering, agriculture and tobacco – we have seen the financialization of companies and the intrusion of new kinds of investment capital, particularly private-equity funds and real estate investment trusts (REITs). In the following discussion of financialization and its impact on workers and their unions in the IUF sectors, we deal specifically with examples from the food, beverage and catering sectors.

FINANCIALIZING FOOD

Faced with declining sales and falling profits, workers and their unions would traditionally brace themselves for a battle against wage cuts and layoffs. In today's financialized environment, job destruction accompanies rising sales and record profits. For example, on 22 February 2006, Heineken announced that second-half profits had increased 56 per cent over the previous year while announcing that 1,000 jobs would be cut in the next 12 months. Two days later the transnational brewery firm, Inbev, announced a 15.3 per cent increase in earnings to €3.3 billion, and plans to cut 360 jobs. The motivation is clear: increased profits are quickly translated into larger payouts to shareholders (including senior managers who themselves hold stock options) and plans for further restructuring involving layoffs and closures feed a financial market that thrives on shifting wealth away from productive investment .

This is precisely the logic that underpins the "Nestlé Model” expounded by Nestlé Chairman and CEO, Peter Brabeck-Letmathe. On 23 February 2006 Nestlé announced a 21 per cent increase in net profits and a 12.5 per cent dividend payout, together with the allocation of CHF 1 billion for a new round of share buy-backs in addition to the CHF 3 billion share buy-back launched only three months earlier. At the same time Nestlé workers throughout the world face diminished job security and jobs destruction through outsourcing, casualization, production transfers and plant closures.[7] Thus the Nestlé model conforms precisely to the observation that: "In the name of creating 'shareholder value', the past two decades have witnessed a marked shift in the strategic orientation of top corporate managers in the allocation of corporate resources and returns away from 'retain and reinvest' and towards 'downsize and distribute'."[8]

Unlike Nestlé, the major transnational food company Danone recognizes and negotiates with unions at every level, including at the international level where the IUF has negotiated a number of agreements with the company. Nonetheless, management decisions are driven by the same logic of this new financialized environment. ‘Liquidity’ generated through extensive restructuring and closures involving significant job losses were channeled into €558 million in share buy-backs in 2005, further boosting share prices. The announcement of record profits/dividends for the past year coincided with allocation of another €600 to €800 million for share buy-backs in 2006.

Another major transnational food corporation, Kraft Foods, announced simultaneously on 30 January 2006 a 23 per cent increase in fourth quarter earnings (“beating Wall Street expectations”) and the elimination of 8,000 jobs (8 per cent of its global workforce) over the next two years. While it is unclear which production sites will be closed, what *is* clear is that plants will be closed regardless of their viability, profitability or performance. The message to Kraft workers is that as core business is continuously redefined, commitment even to established product lines will be subordinated to the imperatives of financial markets. Only three days before Kraft’s announcement that its “portfolio” was being streamlined, 10 plants in Canada were sold to two US private equity firms, Sun Capital Partners and EG Capital Group which created a new company, CanGro Foods, to run these operations as new “financial products” in their asset portfolio.

This financialization of major transnational food companies like Nestlé, Danone and Kraft involves continuously shifting definitions of core business that justify further reductions in productive investment and employment, including spinning off important parts of their operations (both manufacturing and services) to be rotated through an endless round of investment portfolios.

This destructive process is illustrated by the closure of the Leaf confectionary plant in Turku, Finland in May 2005. When the Finnish company, Huhtamaki, transformed itself into a specialized global packing company in 1999, it sold Leaf to the Dutch confectionery and bakery company CSM, which then sold Leaf to two private equity funds, Nordic Capital and CVC Capital Partners, in March 2005. Shortly after this acquisition it was announced that the Leaf plant in Turku would be closed and 460 workers laid-off – a move that shocked both the union and public opinion. The country is accustomed to industrial transformation, having seen entire sectors (e.g. textiles) rise and fall. What was new and shocking was the closure of a plant with high levels of productivity and profitability. "Nobody could imagine", said the chief shop steward at the plant, "that such a large and profitable unit would be shut down.” The closure announcement was followed by a threat to cut wages by 50 per cent, prompting union members to stop work. The management was forced to back down on the wage cuts, but the union's challenge to the closure, arguing that the plant was both profitable and viable, was ultimately irrelevant in a decision determined by the financial imperatives driving the new owners of Leaf.

Since 1990, Nordic Capital, a relatively small investment fund of €1.5 billion has acquired a portfolio of 21 companies, ranging from biotech, pay TV and pharmaceuticals to furniture, and three food companies, including Leaf. In the same period, it has "divested" 25 companies. Nordic Capital's investment criteria define the "ambition" of the firm "to be an active owner for three to seven years, and then to realize capital gains for its investors." This three to seven year cycle of acquisition and disposal constitutes the private-equity industry's *long-term* investment horizon – an ambition that is then aggressively imposed on the manufacturing and food processing industry. The much larger private-equity fund involved in the acquisition of Leaf and the liquidation of its profitable plant in Turku, CVC Capital Partners ("specializing in large scale leveraged buyouts") has mobilized US$18 billion since 1981 for acquiring and disposing of 220 companies. Its current portfolio of 38 companies includes seven food companies and one catering company.

'IMPATIENT' CAPITAL: GENERALIZING INSECURITY

> "…[T]he lion's share of NFC [non-financial corporation] finance is now provided on the shortest of terms. NFCs must disgorge over half of the cash flow they need to sustain investment and innovation over the long term, then compete with all other agents, foreign and domestic, to get it back. *This is impatient capital in its most extreme form*. It forces NFCs to either cut investment and innovation or face rising indebtedness. And it sustains cost-cutting pressure and 'low-road' labor relations, which retard wage and employment growth and thus constrain the growth of aggregate demand."[9]

As 'impatient' capital penetrates sectors such as food and beverages, hotels, and catering, it accelerates layoffs, casualization and outsourcing. Moreover, it adds heightened volatility to a destructive mix which is profoundly destabilizing for workers and their unions. We are no longer negotiating with hoteliers or food manufacturers with a long-term stake in their companies as it has traditionally been understood, but with shifting coalitions of investors whose only reference is a global financial market with an entirely new set of rules. One of the many consequences of this is that unions seeking to bargain changes in conditions, negotiate the impact of restructuring, or challenge closures run up against new financial power-holders who are not interested in arguments about improvements in production or services, increased productive capacity, new product lines, long-term viability of markets, consumer needs etc. Every investment is viewed as a portfolio of financial assets, not a place of employment.

This phenomenon is apparent in the hotel industry where major hotel properties have been rapidly acquired by real estate investment trusts (REITs). In the US, where REITs first emerged, unions have found themselves in conflict with multi-billion dollar hotel REITs that have no real interest in actually operating hotels. In Japan the REIT market grew to US$14 billion in just four years, and it is predicted that in the Asian region as a whole new REIT markets will grow to US$140 billion in the next 10 years.

Like private equity funds, REITs are geared towards maximizing financial returns (mainly from inflated rents) and are in fact *legally obliged* to deliver rates of return to investors which make them organically incapable of operating and sustaining hotels as viable places of employment. The rapid growth of REITs globally (also called PIFs in the UK and SIICs in France) aggravates the employment instability which already characterizes the sector and therefore add to the challenges facing hotel unions.

The far-reaching impact of financialization on unions is typified by the struggles waged at the transnational airline catering company Gate Gourmet, where the company's acquisition by the private-equity firm Texas Pacific Group set management on a direct collision course with catering workers and their unions.

Gate Gourmet, the catering division of SwissAir, was bought by Texas Pacific Group in the wake of the airline company's bankruptcy in 2002 - the same year Texas Pacific Group, together with Bain Capital and Goldman Sachs Capital Partners, acquired the global fast food chain Burger King. Gate Gourmet's then CEO welcomed the sale with these words: "Through a combination of strategic acquisitions and organic growth, Gate Gourmet should experience continued success."

At the time of its acquisition by Texas Pacific Group, Gate Gourmet employed over 25,000 workers in 29 countries with 140 flight kitchens. For 2005, the figures are 22,000 workers and 109 flight kitchens. The path to "organic growth" at Gate Gourmet began with a meticulously planned assault on trade unions beginning with the well-known struggle at Heathrow Airport in the UK, which was kicked off by the company stealthily hiring hundreds of contract workers in a restructuring program centered on mass dismissals and a dramatic degradation of employment conditions. The anti-jobs, anti-union offensive then moved to Germany's Düsseldorf airport, where (at the time of writing in late February 2006), members of the IUF-affiliated Food and Allied Workers' Union NGG have been on strike since 7 October 2005 over the company's refusal to negotiate wages and compensatory measures for increasingly arduous working conditions.

In a clear challenge to Germany's established collective bargaining framework, the company has been demanding enterprise-level concessions on working hours, holiday leave and shift pay despite the fact that these are negotiated at industrial sector level. A compromise negotiated between the union and local company management in early December 2005 was unilaterally scrapped by Gate Gourmet corporate headquarters, leaving the workers no alternative to continuing with their strike. There are now indications that the anti-union offensive is targeting other Gate Gourmet sites in Europe.

A crucial part of the challenge that food workers' unions face is that the private-equity funds and REITs that own and control the workplaces that employ their members do not see themselves as employers. In many systems of jurisprudence they are not defined as employers and do not incur the legal obligations binding on employers. Confronted by unions over layoffs or closures, they can plausibly deny responsibility. Gate Gourmet stridently denies that the management decisions which led to the Heathrow and Düsseldorf confrontations have anything to do with Texas Pacific Group - while acknowledging its "fiduciary obligation" to the investor company. Texas Pacific Group, for its part, emphatically rejects all responsibility for industrial relations within Gate Gourmet or any other company in its portfolio (consisting of companies with aggregate employment of a quarter-million workers). As the NGG learned at Düsseldorf airport, they are attempting to negotiate with an employer disguised as a financial entity free of the constraints, laws and obligations which formerly bound employers to operate within the negotiated systems of industrial relations established over many years of struggle.

The employers' vanishing act becomes complete when these new financial entities (private-equity funds, investment funds, venture capital funds, hedge funds, REITs, etc.) are missing from the data and publications produced by UN agencies on growth, investment and employment.

Even those programs specializing in areas such as world investment, transnational corporations and employment have not taken full account of the role of private-equity funds, either quantitatively or qualitatively. *Yet up to one-fifth of non-public sector workers in the UK, for example, are now employed in companies controlled by private-equity funds.*[10] These powerful financial interests simply do not figure in UNCTAD's *Statistical Handbook* ,*Trade and Development Report* or its *World Investment Report* series.[11] UNCTAD's *Trade and Development Report 2005*, which addresses the issue of "new forms of global interdependence", fails to recognize the global impact of financialization. Its analysis is based on the assumption that: "Overly restrictive monetary policy may lead investors to prefer investing in financial assets over extending productive capacity."[12] This fails to take into account the reality – illustrated in the above examples and directly experienced by our union members – that the preferences of investors and decisions to shift away from productive capacity is driven by the imperatives of financial markets and the power exercised by new forms of financial capital.

If these private-equity funds were recognized as TNCs (given their extensive control over manufacturing and service companies globally) and included in UNCTAD's top 100 non-financial TNCs, they would easily displace the top 10 corporations.[13] General Electric, ranked first in UNCTAD's list, controls less foreign assets and employs fewer workers overseas than either Blackstone, Carlyle Group or Texas Pacific Group. Even UNCTAD's new list of the top 50 financial TNCs (included for the first time in the *World Investment Report 2004*) only examines financial TNCs in terms of a narrowly defined financial service sector and limits employment data to that sector.[14] This neglect of the role of investment trusts as employers is also evident in the ILO's *World Employment Report* series. The *World Employment Report 2004-05* explores the impact on productivity of labour and capital mobility, and the relationship between employment stability and productivity, without taking into account the financial imperatives that drive this flexibility and the growing impossibility of employment stability in a financialized world.[15] Elsewhere in ILO publications and programs, explicit reference to private-equity trusts and venture capital is made only in connection to financing employment *creation*.[16]

The 'vanishing employer' as a politico-legal and institutional phenomenon arising from financialization in turn poses serious questions about the foundations on which social policy is developed in organizations such as the ILO.

BACK TO BASICS: REASSERTING THE ROLE OF THE ILO

Where does that leave workers whose employers may be vanishing but who still (for the moment) report to work at Gate Gourmet, Kraft or Leaf? Should they seek a "social dialogue" with CVC Capital Partners? Pursue a global framework agreement with Texas Pacific Group? Organize a forum in which hotel unions exchange "best practices" with the REITs? The absurdity of these propositions points to the very real and very complex challenges unions are confronted with when challenging these new forms of power.

Unions traditionally use their organized strength to negotiate power through collective bargaining - a process involving direct negotiations with an employer. As employers become less tangible and the employment relationship is increasingly obscured, their power to generate social destruction and generalize insecurity increases. In this situation unions must organize and mobilize in new ways to make the employer *visible* and enforce the bargaining relationship so that power is once again negotiated.

The IUF recognizes the urgent need to develop organizing and bargaining strategies to defend our members in this fundamentally changed environment. This is among the essential tasks of the trade union movement. We also clearly recognize the need to reshape the financialized environment in which this organizing and bargaining now takes place.

Radical changes, however, do not necessarily render established tools obsolete. We would suggest, for example, that the standards-setting role of the ILO acquires more, not less relevance in a financialized world. Efforts to dilute the ILO's role in developing and actively promoting universal standards, transposed into national law, must be firmly resisted. There is a proactive role for the ILO today to ensure that mechanisms are created or revitalized at national level to impose employer responsibility and liability. Developing new and enforceable definitions of the "employment relationship" to reflect the fundamental changes brought about by financialization is an urgent priority.

A wider political task consists in restoring the wages-productivity-profit link which financialization has broken. Advancing this agenda means rejecting assertions about powerless national governments, or the declining relevance of national regulation. Financialization is not a spontaneous, anonymous process arising from technological change or global information flows. It is a political project involving the active intervention of national governments. The last quarter-century of 'deregulation' involved the introduction of a vast array of new legal mechanisms and regulations *by national governments* to protect the interests of investors and shareholders. This must be dismantled; and new legal mechanisms and regulations must be introduced nationally to subordinate investment capital to democratic requirements established in international human rights standards. This wider project of democratic political renewal is also one of the fundamental tasks of the IUF and the international labour movement as a whole.

NOTES

[1] See the website of Eurazeo: http://www.eurazeo.com/uk/01_qui/objectif-strategie.php
[2] Neil Fligstein and Linda Markowitz, "Financial Reorganization of American Corporations in the 1980s," in W. J. Wilson (ed), *Sociology and the Public Agenda*. Newbury Park: Sage, 1990, p.187.
[3] James Crotty, "The Neoliberal Paradox: The Impact of Destructive Product Market Competition and 'Modern' Financial Markets on Nonfinancial Corporation Performance in the Neoliberal Era," in Gerald Epstein (ed) *Financialization and the World Economy*. Northampton, MA: Edward Elgar, 2005.
[4] Ozgur Orhanggazi, "Financialization and capital accumulation in the non-financial corporate sector: A theoretical and empirical investigation", (forthcoming), p.7.
[5] Engelbert Stockhammer, "Financialization and the Slowdown of Accumulation," *Cambridge Journal of Economics*, 28, 2004, pp.719-741.
[6] "The new kings of capitalism", *The Economist*, 25 November 2004.
[7] Documented on the IUF's *Nestlé Watch* website.
[8] William Lazonick and Mary O'Sullivan, "Maximizing Shareholder Value: A New Ideology for Corporate Governance," *Economy and Society,* Vol. 29 No. 1, 2000, pp.13-35.
[9] Original emphasis. James Crotty, *The Neoliberal Paradox: The Impact of Destructive Product Market Competition and Impatient Finance on Nonfinancial Corporations in the Neoliberal Era*, Political Economy Research Institute Research Brief, July 2003, p.6.
[10] "Private equity under government scrutiny", *London Stock Exchange*, 20 February 2006; British Venture Capital Association Chairman's Speech, APG for Private Equity and Venture Capital, 1 November 2004.

[11] While the *World Investment Report 2004* includes data on transactions by two US-based REITs on cross-border merger & acquisition deals with values of over US$1 billion, but provides no critical analysis of the significance of REITs or private-equity trusts for FDI flows.

[12] UNCTAD, *Trade and Development Report, 2005: New Features of Global Interdependence*. Geneva: United Nations, 2005, p.29.

[13] UNCTAD, Annex table A.I.9. The world's top 100 non-financial TNCs, ranked by foreign assets, 2003. *World Investment Report 2005*. Geneva: United Nations, 2005.

[14] UNCTAD, Annex table A.I.12. The top 50 financial TNCs ranked by total assets, 2003. *World Investment Report 2005*. Geneva: United Nations, 2005.

[15] *World Employment Report 2004-05: Employment, Productivity and Poverty Reduction*. Geneva: ILO, 2005.

[16] For example, one of the few detailed studies on equity is a report by Ebony Consulting International (Pty) Ltd, *Private Equity and Capitalisation of SMMEs in South Africa: Quo Vadis?* Social Finance Programme & InFocus Programme on Boosting Employment through Small Enterprise Development Working paper No. 34, Employment Sector, International Labour Organisation. Geneva