Kelly, M. (2006). *The divine right of capital: Dethroning the corporate aristocracy*.

San Francisco: Berrett-Koehler, pp. 1 – 13.

IN AN ERA when stock market wealth has seemed to grow on trees—and trillions have vanished as quickly as falling leaves—it's an apt time to ask ourselves, Where does wealth come from? More precisely, where does the wealth of public corporations come from? Who creates it?

To judge by the current arrangement in corporate America, one might suppose capital creates wealth—which is strange, because a pile of capital sitting there creates nothing. Yet capital providers—stockholders—lay claim to most wealth that public corporations generate. Corporations are believed to exist to maximize returns to shareholders. This is the law of the land, much as the divine right of kings was once the law of the land. In the dominant paradigm of business, it is not in the least controversial. Though it should be.

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

Stockholders fund major public corporations—true or false?

False. Or, actually, a tiny bit true—but for the most part, massively false. In fact, most "investment" dollars don't go to corporations but to other speculators. Equity investments reach a public corporation only when new common stock is sold—which for major corporations is a rare event. Among the Dow Jones industrials, only a handful have sold any new common stock in thirty years. Many have sold none in fifty years.

The stock market works like a used car market, as former accounting professor Ralph Estes observes in *Tyranny of the Bottom Line.* When you buy a 1997 Ford Escort, the money goes not to Ford but to the previous owner of the car. Ford gets the buyers money only when it sells a new car. Similarly, companies get stockholders' money only when they sell new common stock. According to figures from the Federal Reserve, in recent years about one in one hundred dollars trading on public markets has been reaching corporations. In other words, ninety-nine out of one hundred "invested" dollars are speculative.[1]

That's today. But the past wasn't much different. One accounting study of the steel industry examined capital expenditures over the entire first half of the twentieth century and found that issues of common stock provided only 5 percent of capital.[2]

So what do stockholders contribute, to justify the extraordinary allegiance they receive? Very little. Yet this tiny contribution allows them essentially to install a pipeline and dictate that the corporation's sole purpose is to funnel wealth into it.

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

It's odd. And it's connected to a second oddity—that we believe stockholders *are* the corporation. When we say that a corporation did well, we mean that its shareholders did well. The company's local community might be devastated by plant closings. Employees might be shouldering a crushing workload. Still we will say, "The corporation did well."

One does not see rising employee income as a measure of corporate success. Indeed, gains to employees are losses to the corporation. And this betrays an unconscious bias: that employees are not really part of the corporation. They have no claim on wealth they create, no say in governance, and no vote for the board of directors. They're not citizens of corporate society, but subjects.

We think of this as the natural law of the market. It's more accurately the result of the corporate governance structure, which violates market principles. In real markets, everyone scrambles to get what they can, and they keep what they earn. In the construct of the corporation, one group gets

what another earns.

The oddity of it all is veiled by the incantation of a single magical word: *ownership.* Because we say stockholders own corporations, they are permitted to contribute very little, and take quite a lot.

What an extraordinary word. One is tempted to recall the comment that Lycophron, an ancient Greek philosopher, made during an early Athenian slave uprising against the aristocracy. "The splendour of noble birth is imaginary," he said, "and its prerogatives are based upon a mere word.[3]

A mere word. And yet the source of untold trouble. Why have the rich gotten richer while employee income has stagnated? Because that's the way the corporation is designed. Why are companies demanding exemption from property taxes and cutting down three-hundred-year-old forests? Because that's the way the corporation is designed. "A rising tide lifts all boats," the saying goes. But the corporation functions more like a lock-and-dam operation, raising the water level in one compartment by lowering it in another.

The problem is not the free market, but the design of the corporation. It's important to separate these two concepts we have been schooled to equate. In truth, the market is a relatively innocent notion. It's about buyers and sellers bargaining on equal footing to set prices. It might be said that a free market means an unregulated one, but in today's scheme it really means a market with one primary form of regulation: that of property rights.

We think of this as inherent in capitalism, but it may not be. It is true that throughout history capitalism has been a system that has largely served the interests of capital. But then, government until the early twentieth century largely served the interests of kings. It wasn't necessary to throw out government in order to do away with monarchy—instead we changed the basis of sovereignty on which government rested. We might do the same with the corporation, asserting that employees and the community rightfully share economic sovereignty with capital owners.

What we have known until now is capitalism's aristocratic form. But we can embrace a new democratic vision of capitalism, not as a system *for* capital, but a system *of* capital—a system in which all people are allowed to accumulate capital according to their productivity, and in which the natural capital of the environment and community is preserved.

At the same time, we might also preserve much of the wisdom that is inherent in capitalism. If we go rummaging through its entire basket of economic ideas—supply and demand, competition, profit, self-interest, wealth creation, and so forth—we'll find most concepts are sturdy and healthy, well worth keeping. But we'll also find one concept that is inconsistent with the others. It is the lever that keeps the lock and dam functioning, and it is these four words: *maximizing returns to shareholders.*

When we pluck this notion out of our basket and turn it over in our hands—really looking at it, as we so rarely do—we will see it is out of place. In a competitive free market, it decrees that the interests of one group will be systematically favored over others. In a system devoted to unconscious regulation, it says corporations will consciously serve one group alone. In a system rewarding hard work, it says members of that group will be served regardless of their productivity.

Shareholder primacy is a form of entitlement. And entitlement has no place in a market economy. It is a form of privilege. And privilege accruing to property ownership is a remnant of the aristocratic past. That more people own stock today has not changed the market's essentially aristocratic bias. Of the total gain in marketable wealth from 1983 to 1998, more than half went to the richest 1 percent.[4] Others of us may have gotten a few crumbs from this feast, but in their pursuit we have too often been led to work against our own interests. Physicians applaud when their portfolios rise in value, yet wonder why insurance companies are ruthlessly holding down medical payments. Employees cheer when their 401 (k) plans post gains, yet wonder why layoffs are decimating their firms. Their own portfolios hold the answer.

Still, decrying the system's ills is not the same as saying the stock market is devoid of value or that it should be eliminated. The stock market does have its worthwhile functions. Stock serves as a kind of currency with which companies can buy other companies. A high share price can also be the basis for a good credit rating, making it easier for firms to borrow at favorable rates. Most vitally, public markets create liquidity, which is what makes genuine investment in companies

attractive. Without an aftermarket for share trading, investors could cash out only when a company was sold or liquidated, which would make investing in a company like investing in a house. Money could be tied up for decades.

In making the value of companies liquid, the stock market has the effect of increasing that value. It's in part a function of auction. Because more bidders are available, a stock fetches a higher price, just as a first-edition Hemingway fetches a higher price on eBay than at a garage sale. But the auction function can get out of control when new wealth flows primarily to those already possessing substantial wealth. Because this wealth cannot fully be spent, it can only be reinvested, leaving more and more money to chase essentially the same body of stocks—causing them to artificially inflate in value. When that inflation becomes too large, the bubble bursts, often dragging the real economy down with it. Thus, while the stock market has its functions, it also has its dysfunctions.

Bubbles are one dysfunction. A second is the artificial overvaluation of financial capital and the devaluation of other forms of wealth. Progressive business theorist Paul Hawken describes it as a "worldwide pattern of decapitalization." "Capital," he wrote, "whether it be natural capital in the form of resources, or human capital in the form of low-wage workers, or local capital in the form of functional and healthy local economies, *is* being extracted and converted to financial capital at an increasingly accelerated rate."[5]

This process has accelerated dramatically in the last half-century, as the value of the stock market has increased over a hundredfold. But in that same period, forests have shrunk, water tables have fallen, wetlands have disappeared, soils have eroded, fisheries have collapsed, rivers have run dry, global temperatures have risen, and countless plant and animal species have disappeared.[6]

This same half-century, not incidentally, has been the time when major public corporations have come to dominate the world. It is also a time when the shareholder primacy that drives them has become increasingly out of step with reality — due to a number of massive changes in the nature of major corporations:

1. *Increasing size.* Today, among the world's one hundred largest economies, fifty-one are corporations.[7] They have revenues larger than nation-states, yet maintain the guise of being the "private property" of shareholders.
2. *The shrinking of ownership functions.* While we still call stockholders the owners of major public firms, they do not — for the most part — manage, fund, or accept liability for "their" companies. Ownership function has shrunk to virtually one dimension: extracting wealth.
3. *The rise of the knowledge economy.* For many companies, knowledge is the new source of competitive advantage. To allow shareholders to claim the corporations increasing wealth — when employees play a greater role in creating that wealth — is a misallocation of resources.
4. *The increasing damage to our ecosystem.* The rules of accounting were written in the fifteenth century, when to the Western mind nature seemed an unlimited reservoir of resources and an unlimited sink for wastes. That is no longer true, but the rules of accounting retain fossilized images of those ancient attitudes.

Major public corporations have evolved into something new in civilization—more massive, more powerful than our democratic forefathers dreamed possible. The major companies of their era, like the East India Company, were arms of the Crown. America was founded by similar, though often smaller, Crown companies. The founding generation in America seemingly felt that in bringing the Crown to heel, they had immunized themselves against corporate predation. This may be the reason that they left us few tools at the federal level for governing corporations: the word *corporation* itself appears nowhere in the Constitution.

At the state level, the founding generation did establish a system where corporations were chartered for purposes that served the public good—like constructing turnpikes—and were allowed to exist only for finite periods of time. But this system was overturned in the heyday of the Robber

Barons, after the Civil War, when corporations became private, cut themselves free from government oversight, assumed eternal life, and began to see shareholder gain as their sole purpose.

Today, as the name itself implies, public corporations are no longer really private. The major corporation, as president Franklin D. Roosevelt observed, "represents private enterprise become a kind of private government which is a power unto itself."[8]

Part I: Economic Aristocracy

If the stockholding class ruling these governments is a secular aristocracy, it functions like the secular monarchs that we call dictators functioned— attempting to reproduce aspects of privilege enjoyed in a previous era. Secular monarchs largely failed, because they lacked the sustaining myth of the divine right of kings. As fallen dictators from Mussolini to Marcos showed the world, power without myth does not long endure.[9]

The secular aristocracy today clings to its sustaining myths, for those myths provide the base of its legitimacy, without which the amassing of wealth begins to seem indefensible. The core myth—that shareholder returns must be maximized—is thus considered unchallengeable. It is a myth with the force of law. We might call it our secular version of the divine right of kings.

In tracing the roots of this myth, in part I, this book undertakes a venture into what French philosopher Michel Foucault would call an *archaeology of knowledge:* a foundational dig, examining the ancient conceptual structures on which aristocratic bias is built. The book explores six such structures—six principles—each serving to uphold the needs of property owners above all other needs.

1. *Worldview:* In the worldview of corporate financial statements, the aim is to pay property holders as much as possible, and employees as little as possible.
2. *Privilege:* Stockholders claim wealth they do little to create, much as nobles claimed privilege they did not earn.
3. *Property:* Like a feudal estate, a corporation is considered a piece of property—not a human community—so it can be owned and sold by the propertied class.
4. *Governance:* Corporations function with an aristocratic governance structure, where members of the propertied class alone may vote.
5. *Liberty:* Corporate capitalism embraces a predemocratic concept of liberty reserved for property holders, which thrives by restricting the liberty of employees and the community.
6. *Sovereignty:* Corporations assert that they are private and the free market will self-regulate, much as feudal barons asserted a sovereignty independent of the Crown.

Myths take many forms. In essence, they are stories we tell ourselves, like the story that discrimination based on property ownership is permissible, even mandatory, which is examined in chapter 1. It looks at the story built into financial statements, which decree that corporations must give shareholders as much income as possible, while they give employees as little as possible. It's a story that can be likened to the ancient story of the great chain of being, which pictured the interests of some persons as naturally higher on the chain than others, because they were closer to God.

Chapter 2 turns to the notion of privilege, which in the predemocratic age meant legal rights reserved for the few and denied to the many. Foremost among aristocratic privileges, in the era before the French Revolution, were rights to endless streams of income, detached from productive contribution. We find this same privilege reserved today for stockholders and denied to employees. For while stockholder productivity today is negative, employee productivity is positive and climbing, and has far outstripped employee gains.

Stockholder privilege rests on the notion that corporations are not human communities but pieces of property, which means they can be owned and sold by the propertied class. We see in chapter 3 how this leads to the unconscious assumption that persons who work in corporations

are, in a sense, property; the value of their presence is bundled into the value of the corporation when it is sold. This to some extent mirrors the ancient beliefs that wives belonged to their husbands, and vassals belonged to feudal lords.

In the predemocratic mindset, persons without property were not permitted to vote. And so it is with employees today, for stockholders alone govern corporations, as we see in chapter 4. The public corporation is a kind of inverted monarchy, with representatives of the share-owning aristocracy hiring and firing the CEO-king. It is a structure reminiscent of England after the Glorious Revolution of 1688, in which Parliament—which represented the landed class—first asserted power over the monarch.

That all of these myths and structures must be left in place, and not be tampered with by government, is a function of liberty. In chapter 5 we see that today's conception of the free market reserves liberty for property holders, even as it denies liberty to employees and the community.

In the final chapter of part I—chapter 6—we turn to the notion of sovereignty: the idea that stockholders are the corporation, which mirrors the ancient notion that the king was the state. The prerogative of the sovereign power is to have liberty within its own realm. Because the sovereign power is the source of law, it can do no wrong. It seems natural to us today that economic sovereignty rests with property ownership, because this once was true of all sovereignty, political and economic.

Part II: Economic Democracy

How do we begin to change such an entrenched and ancient system of discrimination? We begin first by seeing it for what it is, and naming it as illegitimate. For doing *so* allows *us* to reclaim our economic sovereignty — which means remembering that corporations are creations of the law, that they exist only because we the people allow them to exist, and that we create the parameters of their existence.

We begin also with imagination — with imagining a new framework — both institutional and conceptual — on which to ground a more democratic economy: new variations on financial statements, new property rights, strengthened human rights, new forms of citizenship in corporations, and enlarged corporate purpose. The first order of business is a new ideology to undergird these structures, for mechanisms are only effective to the extent that they find legitimacy in the public mind.

Articulating an ideology for economic democracy is the aim of the second part of this book. It draws on varied efforts to reform corporations, but its aim is also to focus those efforts more effectively, by grounding them in the larger project of democracy — the great project of the Enlightenment, the historical project of moving society from monarchy to democracy. Because economic democracy will take different forms from political democracy, this venture draws also on market principles.

If we study the era of the Enlightenment, in which America was founded, we find it did not begin with crafting laws and structures. It began with challenging the principles on which the monarchy stood, and articulating new principles of democracy. In that spirit, I suggest six principles for economic democracy, mirroring the six principles of economic aristocracy.

1. *Enlightenment:* Because all persons are created equal, the economic rights of employees and the community are equal to those of capital owners.
2. *Equality:* Under market principles, wealth does not legitimately belong only to stockholders. Corporate wealth belongs to those who create it, and community wealth belongs to all.
3. *Public good:* As semipublic governments, public corporations are more than pieces of private property or private contracts. They have a responsibility to the public good.
4. *Democracy:* The corporation is a human community, and like the larger community of which it is a part, it is best governed democratically,
5. *Justice:* In keeping with equal treatment of persons before the law, wealthy persons may not

claim greater rights than others, and corporations may not claim the rights of persons.

6. *Revolution:* As it is the right of the people to alter or abolish government, it is the right of the people to alter or abolish the corporations that now govern the world.

Intellectual principles like these may seem to be mere abstractions, airy things with little relevance to the real world. But as Michel Foucault observed, ideas are mechanisms of power. "A stupid despot may constrain his slaves with iron chains," he wrote, "but a true politician binds them even more strongly by the chain of their own ideas."[10] Ideas are the foundation of the social order. If we are to build a new order, we must build on the base of ideas.

The starting point is a change of mind, a process of enlightenment, which is the topic of chapter 7. It calls for collective agreement on the core problem of our economy: wealth discrimination. We might recall that battles against sexual harassment, unequal pay, and marriage inequality all gained power from recognition of their common source in sexism. In like manner, our separate economic battles—over issues like the environment, wealth inequality, and corporate welfare—can gain momentum from recognition of their common source in wealth discrimination. To help move us toward this awareness, we need new measurements of corporate success, new financial statements targeted not only at stockholders but at other stakeholders as well. Efforts now under way to develop these are explored in this chapter.

If equality is our aim, it takes tangible form in new rights, like the right of employees to share corporate wealth, a concept explored in chapter 8. Support for this view can be found in the theories of Adam Smith, John Locke, and Thomas Paine. This chapter looks at a few models of employee wealth sharing in progressive companies, and suggests how these might be furthered with new public policy initiatives. It also looks at another emerging economic right—the notion that community wealth belongs to all—and how it too can be furthered in public policy.

The legal barriers to such new rights are existing concepts of the corporation as the private property of shareholders, or the notion that shareholder rights derive from private contracts with which government must not interfere. These conceptions had their genesis in America's own process of feudalization in the nineteenth century, when power was privatized by the Robber Barons. The remedy may be an expanded notion of fiduciary duty, owed not only to stockholders but to other stakeholders as well. Chapter 9 shows that legal barriers to making this change are not as impenetrable as they seem, and small steps have already been taken with state stakeholder statutes.

Suggesting why we must move toward internal democratic corporate governance is the topic of chapter 10. If stakeholder theory commonly asks who is *affected* by the corporation, the more precise query is who is *governed* by the corporation. The answer is employees. This chapter makes the case that employees have a unique right to a voice in corporate governance, since the right to self-govern is one of the most fundamental human rights. Ultimately, this right must be recognized in law.

If we desire to make changes like this in the law, doing so will be difficult until we tackle the power of wealth in government, which is the topic of chapter 11, on the principle of justice. The "right" of wealth to govern is one of the most ancient aristocratic principles, intact even at America's founding, when governance by the rich and well-born still seemed natural. The privileges of wealth have arisen anew in recent decades, as corporations have increasingly claimed constitutional rights as "persons." A related concern is the mechanism by which much wealth concentration arises in the first place: inheritance.

In the final chapter of the book, chapter 12, we turn to the question of how to rouse public sentiment for reform by stirring up "a little rebellion," to use Thomas Jefferson's phrase. We look at the principle of revolution: the fundamental right of the people to alter or abolish the economic governments we call corporations. Corporate charter revocation, though little used today, is a right all states legally possess, and its very existence serves as a valuable reminder that citizens hold ultimate power over corporations. This raising of consciousness is imperative, and there are other ways it can be pursued by employees, business students, social investors, unions, activists, and

even CEOs.

Although it is a revolution we aim for, I suggest it will be a bloodless one, fought not at the barricades but in the press, the legislatures, and the courts. It will be (r)evolution—in other words, evolution. This means our ideal path to change should be both innovative and conservative, daring to build anew even as we preserve much of the old.

It may be that the only truly radical change we need is in our minds—in the collective pictures of reality we unconsciously hold. We accept that corporations are pieces of private property owned by shareholders, just as our ancestors believed that nations were private territories owned by kings. We live with these myths like buried shells, old bombs from an ancient war—the war we thought we had won, between monarchy and democracy.

To get at these deeper, unconscious ideas, a useful tool is metaphor. For that reason, this book employs the extended metaphor of aristocracy, which in another sense represents an ancient archetype—a set of archaic attitudes still alive inside our own minds. To begin to see those deep ideas, it helps to change the quality of our attention. To slow down a bit, become curious. See things we never thought to see, though they've always been there—right in front of our eyes.

Endnotes

1. In 1999, sales of new common stock were $105.7 billion, according to *Federal Reserve Bulletin* figures compiled in *Statistical Abstract of the United States, 2000* (Washington, D.C.: U.S. Census Bureau, 2000), 523. Also in 1999, the total value of all shares traded was $20.4 trillion; sales of new common stock represent less than 1 percent of all stock trading. This was typical of the 1990s.

2. Eldon S. Hendriksen, *Capital Expenditures in the Steel Industry,* 1900 *to 1953,* The Development of Contemporary Accounting Thought Series (New York: Arno Press, 1978), 143-177.

3. Karl R. Popper, The *Open Society and Its Enemies, Vol. 1: The Spell of Plato* (Princeton, N.J.: Princeton University Press, 1966 [originally published 1943]), 70.

4. Wolff, "Stock Ownership."

5. Paul Hawken, interview with Sarah van Gelder, "The Next Reformation," *In Context,* Summer 1995,41, 17-22; cited by David C. Korten, *The Post-Corporate World: Life After Capitalism* (West Hartford, Conn.: Kumarian Press, and San Francisco: Berrett-Koehler, 1999), 65.

6. The value of all stocks listed on exchanges in 1948 was $81.9 billion; in 1998 it was $10.5 trillion, a 128-fold increase, according to the 1996 and 1999 annual reports of the Securities and Exchange Commission, p. 211 (1996 report), p. 195 (1999 report). The description of environmental decline is paraphrased from *The State of the World 1998* report from the Worldwatch Institute, cited by Korten, *Post-Corporate* World, 67.

7. This fact was noted by David C. Korten in *When Corporations Rule the World* (San Francisco: Berrett-Koehler, and West Hartford, Conn.: Kumarian Press, 1995), 220. Korten cited 1991 GNP data versus corporate sales data, and found fifty of the one hundred largest economies were corporations; the number has since been updated to fifty-one.

8. Franklin D. Roosevelt, acceptance speech, Democratic National Convention, June 27,1936; quoted by Ralph Estes, *Tyranny of the Bottom Line: Why Corporations Make Good People Do Bad Things* (San Francisco: Berrett-Koehler, 1996), 88.

9. Francis Fukuyama, *The End of History and the Last Man* (New York: Free Press, 1992), 15. In a chapter titled "The Weakness of Strong States," RAND Corporation consultant Fukuyama observed, "The critical weakness that eventually toppled these strong states was in the last analysis a failure of legitimacy—that is, a crisis on the level of ideas."

10. Michel Foucault, *Discipline and Punish: The Birth of the Prison* (New York: Vintage Books, 1975), 102-103. Foucault wrote, “A stupid despot may constrain his slaves with iron chains; but a true politician binds them even more strongly by the chain of their own ideas ... this link is all the stronger in that we do not know of what it is made and we believe it to be our own work.... on the soft fibers of the brain is founded the unshakable base of the soundest of Empires.”