Workers and capitalists, unite!

Forget Marx: Now shareholders, including workers' pension funds, are at war with managerial talent, say ROGER MARTIN and MINHEA MOLDOVEANU

The New Class Struggle

In the 20th century, labour and capital fought a battle for control of the industrialized economy. Now, in the age of government and society as well. A new conflict has erupted. While business was a smoldering victory over the unions last century, it may not be as easy for the corporation to point the knowledge-worker-led revolution in business.

The rising global outcry over CEO compensation provides a hint of a new battle between capital and talent. Most shareholders grumbled indifferently when CEO pay packages in the United States soared by an average of 54 per cent between 2007 and 2008. After all, corporate profits were rising and stock markets were booming through the 1990s. However, in 2010, the same shares of profit, which were no less than 35 per cent to 37 per cent of corporate profits while CEO salaries hardly fell. Shareholders argue heatedly that companies must slash compensation and end the decade of unapologetic greed.

While CEO compensation has started to take a hit as options expire worthless, there is little to suggest that CEOs will be paid less. And yet, for all the talk of new techniques, the reason is simple. In the knowledge-based economy that we now inhabit, the value is in the education and information. Companies cannot generate profits without the ideas, skills, and talent of knowledgeable workers, and they have to hire people, not factories, and certainly not capital. In fact, capital is not as scarce as it used to be, especially in the more developed economies. But there is a shortage of talent, and it's getting more acute in North America. Even since these knowledge workers realized that demand outstripped supply, they have been wrestling for the profits from shareholders. The latter back then, but their returns continue to slide. The irony won't be lost on those who worked in a great industry when it began its fight against capital.

To paraphrase Karl Marx, the history of the struggle between capital and labor for the last 150 years is the history of the struggle for industrialization. The state for great economic war was set during the industrial revolutions of the 18th and 19th centuries, when numerous new products and technologies were introduced. Existing plants required large numbers of unskilled workers. The laborers pooled the profits from large-scale manufacturing, while laborers lived in near-poverty, with the profits of work. The world fought back the only way they could: They united. The process of collectivization resulted in the United States in the 1817, while in Europe and North America, unions used collective bargaining and industrial action to demand higher wages and better working conditions.

Despite business's efforts to break them, the unions became a force to reckon with in North America's automobile, mining, steel, and trucking industries. A union member in 1933 earned 225 per cent more than his counterpart in a non-unionized industry; by 1980, he earned 46 per cent more. Insurers, electricians, rubber workers, and others also grew rapidly and organizations became powerful. The union's power led to conditions and better wages. The union was not the only factor in the city's growth. It was a high impact partnership. As union power began to decline, investors used the opportunity to seize a bigger share of the economic benefits rather than share generously with their executive partners. CEOs of large American companies paid 33 per cent less in 1980 than they were in 1960. Every dollar of earnings they produced.

As capital expanded its victory over labour, the first skirmishes with talent started. Some managers and academics chose to move into industries where companies would not need financial backing to profit from their intellectual capital. In the 1970s and 1980s, managers built up management consulting firms almost entirely with intellectual capital, just as lawyers and accountants had done. The consulting firms convinced bright professionals to sign up with them because they offered higher starting salaries and signing bonuses than shareholders-owned companies did. Moreover, the firms split the profits among key employees. By the mid-1980s, the consulting firms had divided the intellectual gains in the battle for talent. More and more of the dominant top-selling companies were turning to the consulting firms.

In industries where shareholders' returns depended on key individuals (human capital) rather than the organization (structural capital), the sales began to demand, and get, more. Before the 1980s, fund managers received a fixed annual fee of less than 3 per cent of the assets they managed. Tired of seeing clients enroll huge returns on their advice, top fund managers began demanding 20 per cent of the increase in a portfolio's value every year (above a base return of 5 per cent to 7 per cent), in addition to a fixed annual fee. Clients agreed because fund managers had created lobbies, buyouts, and venture capital funds that delivered large returns. By the 1980s, top fund managers had become seriously rich.

A few capitalists saw what was happening and had no idea what to do. Jeffrey Katzenberg, chair of Walt Disney Studios, wrote a now infamous memo in 1991 that was leaked to the media. He asserted that the studio would pay all the capital and took all the risks, but movie stars, screenwriters, and directors — the "talent" — stripped of most of the profits. By 1994, Mr. Katzenberg and Disney had parted company.

Not even arch-capitalist Warren Buffett could make headway in the battle with talent. When he became chairman of the investment bank Salomon, Inc. in 1991, Mr. Buffett slashed the year's bonus pool by $110 million (U.S.) and boosted returns to shareholders. Soon the histrionics traders and investment bankers were leaving Salomon in droves and, without them, the company's fortunes fell.

Tensions between capital and talent have escalated sharply since the 1990s because of the nature of the economy has changed. The knowledge agenda — the managers themselves were — become more valuable to a company than its capital assets. CEOs in particular began to flex their muscles. Many managers used their increasing advantage during the Internet boom's worldwide wave of entrepreneurship.

Software engineers and journalists from the West Coast have now become the key drivers of the new economy. In the past century, the domain of power was shared between capital and labor. But the rise of knowledge workers has changed that. The new economy is a knowledge economy, and knowledge is the key to success.