The Washington Post

Mitt Romney, a symbol of the 'talent economy'

By Roger L. Martin October 19, 2012

The American electorate finds it hard to warm up to Mitt Romney. Theories abound as to why — his stiff hair, his stiff delivery, his business jargon, his Mormon faith. These may all be contributors. But the deeper reason may be that he represents a befuddling and powerful new economic force that voters have never seen before in a presidential campaign: talent that gets rich by managing money.

For most of the 20th century, politicians' relationship to labor was pretty simple. Democratic candidates fought to protect labor against predatory capital, and Republican candidates protected capital so it could create economic growth and jobs.

The waters muddied late in the 20th century, when the relationship between labor and capital changed. As management guru Peter Drucker predicted in 1976, American workers eventually owned the means of production through their pension funds, so the interests of labor were no longer entirely at odds with the interests of capital.

But if labor and capital had shifted from opposite sides of the table to an uneasy alliance, who was now on the other side? It was a new economic force: talent.

Until the mid-1970s, capital kept a tight lid on the power of talent — the unique, differentiated labor that drives many organizations. Movie talent was reined in by the

studio system, in which a 1950s Screen Actors Guild president and later U.S. president, Ronald Reagan, toiled. Sports talent was reined in by the “reserve clause” in players’ contracts that prevented athletes from leaving the team that owned their rights. And chief executive talent worked for a pittance compared to today’s chief executives. Talent was simply paid as relatively high-end labor, with its salaries unrelated to the value it created for the enterprises that employed it.

Then, in the 1970s, talent woke up, attaching its compensatory fate to the prosperity of the business for which it toiled. Movie stars and directors started to demand — and receive — a percentage of a film’s box office revenue or profit. Athletes collectively demanded — and received — a share of the gross revenue of their sports leagues. And chief executives started to insist that they get paid based on how much they increased the stock price for shareholders.

As chief executives were paid more and more, capital complained, labor concurred, and President Bill Clinton responded by trying to limit the way in which chief executive talent extracted value from the companies they led. In 1993, Congress passed a bill that limited to $1 million the amount of a chief executive’s salary that a corporation could deduct for tax purposes. The measure was meant to prevent chief executive talent from capturing value that otherwise would have gone to shareholders. As is often the case, the law didn’t quite work the way it was intended: Limiting chief executives’ cash compensation simply spurred a greater use of stock option compensation. The competition for top talent meant that companies needed to find a way to pay them, one way or another.

But these forms of newly mobilized talent — movie, sports and boardroom stars — turned out to be mere pikers compared with the money-managing kingpins on Wall Street. These were the leveraged-buyout (LBO) and hedge-fund managers who charged their capital providers 2 percent of the assets they managed plus 20 percent of the profits made. Call it the “2&20” formula. This formula became one of the greatest generators of new wealth in America. And it was the source of Romney’s fortune, estimated at about $250 million.

For almost the entire history of America, the route to riches was to build a business that sold real products or services to real customers. Depending on the era, it might have been a railroad, steel, retail, energy, real estate or technology empire. By the end of the 20th century, technology, media and real estate were the best ways to get rich.

As the 21st century dawned, a new actor had snuck onto the stage. Sixteen LBO and hedge-fund managers had made the Forbes 400 list, a good snapshot of the sources of U.S. wealth. Sure, they were near the bottom — but they got there not by building businesses but by managing other people's money and getting compensated on the 2&20 formula. This was only a taste of what was to come. By 2012, 56 hedge-fund or LBO-fund managers had made the Forbes 400 list (eight were in the top 50) by managing money on the 2&20 formula. The second-most-frequent method was building a technology company.

Just around the time that 2&20 talent ascended to the pinnacle of the economic heap, perhaps unsurprisingly, America got its first 2&20 presidential candidate: Mitt Romney. Like those 56 members of the 2012 Forbes 400, his wealth stems from managing other people's capital.

How do they do it? How do the 2&20 titans get to the top of the list in greater numbers than anybody else? By treating labor and capital as adversaries. For hedge funds in particular, the question is not: How can I serve capital best? It is: How much of the investment returns can I extract for myself before the investor earns his returns?

For Renaissance Technologies founder James Simons, who routinely ranks among the top hedge fund-managers in personal compensation, with north of $2 billion a year, the answer is to charge 5 percent of assets under management annually and 44 percent of upside rather than a piddling 2&20.

For LBO funds such as Romney's former firm, Bain Capital, the story is more nuanced.

Indeed, some LBO funds can legitimately say they have fixed and expanded ailing businesses. But for many of them, their dominant game plan is to grind down and lay off labor to improve the sale value of the companies they buy and flip. As we've seen during the presidential campaign, it has been tough to convince voters that Bain Capital did more of the former than the latter.

Romney's challenge, in selling himself and his private-equity experience, is that talent of this sort is a tiny sliver of America, the very definition of the 1 percent. And the reason the 1 percent is widening the gap in income inequality is that it is extracting more and more value for itself. Unlike capital historically, hedge-fund and LBO talent trades and tolls value rather than building it. To them, the 47 percent is there for grinding down. And the owners of capital are there for greater tolling, especially if you are able to grind down the 47 percent.

Voters may not yet have put their fingers on the reason, but I think that is why they simply haven't warmed up to Romney. Many Americans can be wooed by a politician who ensures that labor gets a fair shake from the capital for which it toils. Many other Americans can support a politician who prefers an environment in which capital builds value and jobs. But only a few get excited about a politician whose instincts are to ensure that talent gets to exploit labor and capital to the maximum possible extent.

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