

**BLACK
MARKETS...
and
BUSINESS BLUES**

THE MAN-MADE CRISIS OF 2007-2009
AND THE ROAD TO A NEW CAPITALISM

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INTRODUCTION

History never repeats itself. Men always do.

Voltaire

Then it hit us! Suddenly as we were driving through a section of Lake Worth, Florida in the January twilight, we entered a zone where there was not a living soul, not a sound, not a light, the eerie feeling of a graveyard at night. We were surrounded by hundreds of darkened houses, all modest, all foreclosed, all bearing a futile “For Rent” sign.

After a day spent writing in cold, analytical prose the concluding chapters of this book, the tragic reality of this financial crisis was suddenly overwhelming! Where were all those families on that night? What did the parents do about their children’s schooling? How did they cope with the hopelessness and humiliation of being evicted from their house with nowhere to go?

Continuing on the same street for a few kilometres, turning right on Southern Boulevard, crossing two small bridges, one enters Palm Beach’s most affluent area. Now, surrounded by properties ranging in value between \$5 million and \$50 million, with Conrad Black’s on the right, Bernard Madoff’s further down on the left, one drives between rows of luxurious properties, several of them owned by financial operators of all sort.

This chasm in wealth and living standards within the same small geographical space is remarkable and disturbing; it could be a harbinger of serious social problems. It is certainly the

manifestation of a bastard form of capitalism imposed on many societies over the last thirty years.

The financial crisis should be, must be, a *Eureka* moment, an epiphany, an eye-opener. However, this crisis may well fade away without some fundamental assessment of its causes. Influential players will seek to preserve the *status quo* in slightly modified form with a pinch of regulations, a drop of oversight added to the mix and perhaps, to divert public anger away from the politicians and real causes, some criminal trials and jail terms for the visible few, *à la* Martha Stewart, Kenneth Lay, Bernie Ebbers...“*Politics is a façade for the power of money*”, wrote Oswald Spengler in *The Decline of the West* (1922). That power will soon surge again unless...

Not to seize upon this crisis to ask radical questions and to reform the financial and economic system would be a serious mistake, a lost opportunity, and the assurance of economic pain and social unrest in a near future.

This book tells a sad tale. It is the story of how our economic system fell under the tutelage of financial markets. Misguided policies fostered by moneyed interests and the credo of market fundamentalism have produced an economic system that is short-sighted and prone to bubbles, abuses, and fiascos: the Savings and Loans of the early 1980s; the Leveraged Buy Out, junk bonds, Milken, Boesky of the late 1980s; the dot.com and telecom bubble, Enron, WorldCom, Global Crossing of the late 1990s and early 2000s; and now, the sub-prime, CDO, CDS, financial market implosion of the 2007-2009 season!

The black markets of finance, the unregulated, secretive, barely licit, parts of the financial markets, have thrived and infected the entire economic system, bringing greed and rot around and within business firms (the exchange-listed ones at the very least).

This book maps out how our industrial system was slowly nudged away from managerial capitalism, a model of the business firm that was dominant from the 1930's to the late 1970's.

That model was replaced by financial (or casino) capitalism. *A different concept of the corporation became prevalent, one that places “shareholders”, now a changing, transient and impatient cohort of funds, at the center of all business actions and decisions.*

This system gradually transformed many exchange-listed companies into soulless “properties”, obsessed by short-term profits and traded like vile commodities. **Business blues**, a feeling of unfairness and insecurity, became pervasive as company executives were richly paid to do the bidding of their financial masters.

We began studying this transformation of the business firm in the late 1980s and described the phenomenon in two strategy books published (in French) in 1993 and 2004. In those books, we showed how three distinct, but tightly related, markets were evolving in ways which forced companies to abandon their old ways of doing and managing. *The financial markets, the market for goods and services and the emerging “market for talent” combined and converged to shape a new kind of company with a new ethos, new priorities and different goals.*

This book describes the evolution of each of these three markets in chapters 1 to 8, which were written in the summer and fall of 2007 (with minor subsequent updates).

As the financial crisis began in the summer of 2007 and blew in full force in the fall of 2008, we undertook to show how this crisis was but *the culmination and acceleration of an economic transformation that began in the 1980s.*

Chapters 9, 10 then focus on the convoluted process that played a critical role in triggering the worldwide financial crisis of the 2007-2009 Season. *This financial crisis was clearly man-made.* It was not a “perfect storm”, not an act of God. The all too familiar duo of hubris and avarice played their number in the vast, rich, unregulated financial markets, in every nook and cranny of this wide-open domain. Unaware of the cumulative, correlated pressures that were building up in the system,

reassured by precise but inaccurate mathematical models, vaguely worried but soothed by the immense pay-offs, most players rushed onward until the music stopped.

When the first and weakest link, the sub-prime mortgage securitized notes, broke, the edifice that poor or corrupt financial engineers had designed fell like a house of cards. There were no back-up system, no built-in redundancies, no fail-safe mechanism. All parts of the worldwide financial system had become connected and interdependent. One piece failed, the whole system, brittle and vulnerable, collapsed.

We provide in chapter 11 some policy suggestions to avoid replications of a crisis of the same nature. This crisis, the latest in a series, will likely bring forth several measures of the sort we propose in chapter 11 of this book, to prevent an “*encore*” performance.

However until more fundamental changes are implemented, our societies will remain vulnerable to a flawed business system that places its short-term interests well ahead of common good.

This book proposes in chapter 12 some politically feasible policies to bring financial markets and business firms back to some sanity, to a longer-term perspective and fundamental values. For, indeed, contrary to a prevalent belief, *this system is the outcome of political decisions, not the product of some transcendental forces. Humans designed this system; humans can change it.*

What is required is nothing less than a new capitalism, a capitalism based on forms of business ownership which will bring back some level of trust and loyalty within companies, a long term perspective in their management and a due consideration of the stakeholders that give companies their legitimacy and purpose.