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Abstract

This paper uses earlier debates on managerial capitalism to set up and explore questions about the role and possible effects of fee-earning capital market intermediaries in present day capitalism. The question then becomes whether a new group of actors (the capital market intermediaries) taken a new leading role in the economy, in part by constraining the discretionary power of an old group of actors, the salaried corporate managers A broader analysis of social effects makes two key points: first, business models in activities such as investment banking, corporate law and private equity all generate substantial rewards for senior intermediaries; second, the different agendas of these different groups have the net effect of encouraging an economy of permanent restructuring with implications for the rest of us.

Keywords

Capital market intermediaries; Managerial capitalism; Investment banking; Private equity; Corporate restructuring; The City

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Introduction

This article is about understanding the role and possible effects of a new group of actors, the fee-earning capital market intermediaries, who have taken a much more prominent role in Anglo Saxon and European capitalism since the 1980s. The group includes corporate lawyers, hedge fund managers, private equity fund partners and investment bankers, who provide services to giant firms and initiate some corporate activity such as merger and acquisition (M&A), as well as operating and innovating within the capital market. The managerial revolution is relevant as a point of reference because that created a group of salaried managers in giant firms who supposedly took control from owners and allegedly imposed new priorities. The questions for analysis in this paper are about: whether and how a new group of actors, the capital market intermediaries have now taken a leading role, partly by constraining the power of the giant firm managers; and, if so, what are the broader effects?

Questions about intermediary power have already been raised in two recent literatures: first in the academic literature on the interaction of giant firms with a stock market which now demands shareholder value; second, in the lay literature produced by public interest critics of City power in Britain. From Morin (2000) to Roberts *et al.* (2006) an ethnographic literature has documented how giant firm managers in Europe as much as the USA must now justify their strategies to value seeking fund managers. The results have been interpreted in different ways, with Lazonick and O'Sullivan (2000) discerning new US corporate strategies of 'downsize and distribute', while Froud *et al.* (2006) emphasize how in the USA and UK a new emphasis on corporate narratives covers difficulties about raising returns. The lay literature on the UK is much more emphatic when recent books by journalists and former capital market and giant firm insiders all allege that capital market intermediaries are now running the show. If such lay accounts do not present conclusive evidence, they do indicate growing concern about the increasing influence of unaccountable intermediaries and the consequences for investors, employees and others.

The retired British investment banker, Philip Augar (2005) alleges that 'during my time, the profession appeared to move from putting the client first to putting itself first' (p.xiii) and observes that investment banks have become active promoters of deal driven activity like M&A. The former FTSE 100 director, Don Young, agrees and concludes 'what seems to be emerging is a strong sense that the intermediaries in the markets have been turning the game to their own advantage, at the expense of the 'real' shareholders, not to mention employees, customers, etc' (Young and Scott 2004, p.46). The journalist and former Conservative political advisor, Hywel Williams, sets this in a broader perspective as the post-Thatcherite triumph of a City elite: 'the City has won all the necessary battles for command and control. It now absorbs and directs the aims of all other power elites and thereby makes those elites subordinate to its own interests' (2006, p.215). The City is officially 'one of the glories of Britain' (p.165) and effectively dominates our whole economy and society.

In this paper we aim to add relevant argument and evidence and to frame the issues about the nature and significance of intermediaries by returning to the debates about the managerial class or elite. If the practice of general history is to use changing present day problem definitions to reinterpret the past, we see some scope for a kind of contemporary history that uses past problematisations to interrogate the present (Erturk *et al.*, 2006). The debates about managerial capitalism are relevant in several ways, as the next section will outline. First, it is a question of making visible a group whose existence was suppressed by the previous category system: the new intermediary group is invisible within the frame of ownership and control, just as the managerial group was invisible within the frame of employers and workers. Second, it is a question of trying to understand the role of a new group of actors (intermediaries) where the debates around managerial capitalism are helpful in framing questions, in identifying appropriate forms of analysis and avoiding overly-simplistic assumptions about the nature and effects of change. Because history does not repeat itself, we must consider differences as much as similarities. The next section uses a review of debates on managerial capitalism to open up new questions about intermediaries, which are then explored in the third and fourth sections as we analyse their role and potential effects.

Managerial capitalism and the new capital market intermediaries

The literatures on managerial capitalism are vast, diverse and include many texts that do not get into a canon that starts conventionally in the 1930s and 1940s with Berle and Means (1932) and Burnham (1941) and ends in the 1990s with a dispiriting amount of repetition and secondary misrecognition of supposedly classic texts. It was Tawney's influential 1921 book, *The Acquisitive Society,* which introduced a new language to register 'the divorce of ownership and work' or 'the separation of ownership and management' (p. 64, 202) and then argued that the rise of salaried professional managers was an important development which changed the nature of capitalism. His agenda-setting analysis of what was subsequently constructed as separation of ownership and control opened the way for the development of many different positions on how the rise of a professional managerial class enabled discretionary management strategies at enterprise level and new social compromises between capital and labour at national level as well as unaccountable elite projects.

The resulting literatures could be described as a series of explorations (starting from different assumptions and exploring different implications) which can be summarized by making three points. First, different discourses like economics and sociology assimilated managers as new actors into their *a prioris* so that pre-existing problematisations and preoccupations (with firm objectives in economics or class identity in sociology) were taken up in a new context. Second, there is unfinished business here because the arguments and empirics of authors like Nichols (1969) discredited hypotheses about a new managerial class but not conjecture about managerial elites. Third, despite these differences, the argument was always about connecting the internal economic agenda of a firm based group with external socio economic effects on the assumptions that shared social identity provided a basis for group cohesion of managers who were not working for themselves because managerial rewards were individually and collectively modest.

Economics started from the assumption that salaried managers were unitary calculating subjects with consistent preferences and executive discretion about goals and policy. Hence, for example, Marris' (1964) theory of managerial capitalism which supposed 'managers… maximize the rate of growth of the firm they are employed in subject to a constraint imposed by the security motive' (p.47) and rooted this in behavioural psychology about growth as the test of 'professional competence' and the basis for advancement of individual and group (p.102). From a politico-legal perspective, Berle enrolled managers rather differently as the subjects of history and the social basis for (new deal type) social compromises that civilized capitalism by reconciling different social interests. The classic Berle and Means text, which announced the separation of ownership and control, envisaged a kind of stakeholder firm whose technocratic managers would not serve shareholders but 'balance a variety of claims by various groups in the community' (1932, p.312). As for Berle in the 1950s and after, he believed that unionism, anti-trust legislation and such like had socialized corporations in ways that proved they could be 'checked by public conscience and disciplined by political intervention' (1960, p.157).

Empirical sociology produced a much more nuanced account which questioned any such premise about managers as subjects of history. Nichols (1969), for example, argued managers were a heterogeneous group with different values and calculative frames so that they could not plausibly be a 'new class' in itself or for itself: the influence of background was mediated by 'ideology, socialisation within the firm and the position of the firm within product market and institutional nexus. Thus, Nichols found few systematic differences between propertied directors and non-propertied managers in 'either economic policies or social values' (p.132) and criticized the 'one factor theory of economic behaviour' (p.150). Instead, Nichols observed the corporate world was a more complex place where 'the exercise of social (in contrast to mechanical) power and the nature of constraints to an actor's behaviour are more complex than many writers would seem to imply' (p.147).

If this disposed of the hypothesis that the whole group of managers was a class, it still left open the possibility that a small group of managers at the apex of corporate and other bureaucracies acted as an elite. Questions about unaccountable managerial elites were raised by Wright Mills' (1956) argument about how top US military, political and industrial executives pursued the national project of cold war. The managerial elite thesis was empirically corroborated by evidence on what Wright Mills called 'motive', arising from shared backgrounds and rotation between positions which could be demonstrated with tables and network diagrams, but this did not establish the stronger thesis about a coherent elite project.

If different authors take a bewildering variety of positions on what the rise of the (salaried) manager portends, the emphasis from the 1920s onwards is on their socio-economic agenda or the implications for the rest of society of purposive management calculation and action classically situated within the organisational frame of the giant firm (Chandler, 1977) From beginning to end, this went along with the claim that management rewards (individually and collectively) were modest and should remain so. Thus, Tawney in 1921 rhetorically identified the salaried 'managers… experts and technicians' as an intellectual proletariat and added the evidence that, in 1913, almost 90 per cent of colliery managers earned £500 a year or less, or roughly 10 times the standard manual wage of £1 week. Thirty years later, in America, where relativities have always been steeper, Berle (1960, p.4) argued that top corporate managers could no longer 'make a large fortune' and would have to content themselves with 'a comfortable salary and an excellent pension' which meant 'his son will have to go out and look for a job like anyone else'. Of course, top to bottom corporate pay differentials have changed significantly since then. UK giant firm CEOs in the FTSE 100 enjoyed large pay increases in the 1980s and 1990s which opened out the top to bottom differentials from 9:1 in 1980 to around 50:1 by 2000. In contrast, US S&P500 CEOs start from this kind of relativity in the early 1980s and then win large earnings increases so that they continue to earn at least five times as much as their British counterparts in the early 2000s as in the early 1980s (Erturk *et al.* 2005).

The pace of intellectual change is much slower than the rate of CEO pay increase because the old idea of social compromises survives in a new debate about forms of capitalism; just as agency theory in mainstream finance hangs on to ideas about discretionary objectives but turns them around so that managers are now villains not heroes. The argument about forms of capitalism from Hall and Soskice (2001) onwards develops and builds on Berles' idea of the firm as site of a national social compromise. Meanwhile, from the 1970s onwards, agency theory by US finance academics like Jensen and Fama (1983) represented the passing up of profit opportunities by managers as a big problem for shareholders.

Thus, the old debates about managers resonate in present day capitalism. But even more so, the old debates frame new questions about capital market intermediaries who are the new actors of the present day just as professional managers were the new actors of the 1920s and 1930s. After reading authors like Hywel Williams on the City and the more academic literature on fund managers, we can ask: to what extent are the intermediaries collectively unified and a coherent group? If not a class, are the intermediaries an elite; and, if so, do they have a projects? Are we entering an era of intermediary capitalism where corporate and other strategies are defined by the priorities of the functionaries of finance? It is much easier to ask these questions than to answer them because the publicly available evidence about intermediaries is much more modest than the evidence about managers of public companies. But, as the rest of this paper shows, it is possible to say something. The next section answers questions about 'who are the intermediaries and what do they now do?' by mapping a semi invisible and heterogeneous group and arguing about the socio economic implications and effects of their activity. The final section of this paper analyses intermediary business models within which senior intermediaries claim large rewards before the conclusion draws together the argument about intermediaries as a new elite group.

Who are the capital market intermediaries and what do they do?

Before we turn to complex issues about activity and effects, even the straightforward questions about defining and quantifying intermediaries are not easy to answer because they are collectively a group in the shadows of semi-visibility. As Tawney and his successors showed, the managers could always be counted in and through various official categories, but this is simply impossible for intermediaries in our time They include a variety of heterogeneous and partially overlapping occupational groupings whose numbers are difficult to count because there are often no established definitions of the group, nor any public sources providing basic information about employment, organisational structure and pay. It is therefore hardly surprising that the discussion of intermediary activity and its socio economic effects has been confusing and partial

Who are the intermediaries? In terms of definition, the intermediary group can be internally classified and externally delimited in many different ways according, for example, to whether they are intermediating financial or information flows or act as principals or agents around transactions. And when there is rapid innovation in financial intermediation, the classifications of one period may be inappropriate in the next. Against this background, we find it useful to distinguish two intermediary groups: responsive functionaries and proactive initiators.

(1) *Responsive functionaries* meet the operating and compliance requirements of a regulated, juridicalized market capitalism with huge, institutionalized fund flows into the secondary markets in shares and bonds, This group includes facilitators of compliance such as audit partners in accounting or remuneration consultants on executive pay, plus providers of specialist expertise such as corporate lawyers on contract or property rights as well as pension fund managers and stock market analysts involved in the routine management of pooled assets. Much of this is routine and all of it is necessary; the intermediaries provide constant advice and input to giant firm decision making, facilitating compliance with governance norms as well as communicating with capital markets.

(2) *Proactive initiators of deals, corporate restructuring and investment arbitrage opportunities* were traditionally led by investment bankers providing M&A advice and new issues but also now include hedge fund managers and other activist investors, as well as an assortment of traders and dealers on own account or bank pay roll. These change agents are the marine corps of the intermediary groups who live by deals and novelty. One part of this group deals with non-routine demands from corporate clients and may have a much larger role in shaping corporate agendas when the new breed of activists lives by forcing the next value-enhancing move; Though they provide services for public corporations, they also (or increasingly) operate in their own right as market actors with no obvious external client; that is, they undertake activities that are intended *inter alia* to raise their own revenues. Another

important part of this group is responsible for the hyper innovation within the capital markets that produces billion dollar turnovers in various kinds of coupons which both mediate transaction and are increasingly held by firms and households.

Such intermediary groups are generally co-located in activity clusters around the world's few major financial centres, including London, where official statistics allow us to measure the resulting employment in financial services. Information on deal and trading flows confirms London's status as a significant financial centre with, for instance, 70 per cent of international bond trading, 50 per cent of European investment banking (IFSL 2006a) and more than 40 per cent each of over the counter derivatives and credit derivatives trading (IFSL 2006b). The Centre for Business and Economics Research estimates that London has 41 per cent of all the 'City-type' financial services in the EU and that this in total sustained some 328,000 jobs in London in 2005 (CEBR 2006b). The three largest subgroups were of those working in equities and bonds, professional services and investment banking which each employed more than 50,000. This excludes those working in financial services in London who are not considered to be part of the activities of 'the City', but does include those in a junior as well as in a senior position in firms engaged in capital market intermediary activities.

If we are interested in the idea of capital market intermediaries constituting a new and important group, the numbers of senior intermediaries employed at a principal or partner level would be a more interesting indicator. Questions about the number of seniors in different intermediary groups are frustratingly difficult to answer because many intermediaries are not members of established professional groups or associations where numbers are collected, or they work in large organisations which provide very limited breakdown of the numbers involved in particular activities. It is fairly easy to determine that the top four law and accounting firms in the UK have a total of around 4,500 partners in 2004 (sources: Fame database; thelawyer.com). The IFSL also estimates that there are around 800 European-based hedge funds operating out of London at the end of 2005 (IFSL 2006b), implying that there are at likely to be at least a thousand hedge fund principals in London, on the basis that the larger funds have more than one principal. Such fragments do quickly help to show that there are many times more senior intermediaries than senior giant firm managers when the number of executive directors in the FTSE 100 companies is no more than 600. If we conjectured that principals and partners accounted for around 5% of the total numbers employed in City-type activities, this would imply at least 16,000 senior intermediaries.

If the problem with counting the senior intermediaries is the limits of the publicly available sources, the problem about analysing what they do is the limits of our understanding. This is especially so if we pose the question broadly to include the implications and effects of their activities. If we look back at the literature on managerial revolution, the master questions about the old group of managers remain relevant for the new group of intermediaries. The master question is whether (senior) intermediaries form a coherent or homogeneous group in terms of internal composition or in terms of external effects. This question about an elite in itself and for itself was traditionally posed in socio-functional terms so that the issues were two fold: first, does the group have a common social background or set of beliefs; and second, does the group have a common agenda or project which motivates both the actions of individual members and the group with strategic consequences for economy and society. One might more specifically also ask whether the rise of the intermediaries represents a return swing of the pendulum: if the cadre of salaried managers supposedly shifted corporate priorities away from profits (for owners) towards growth, does the cadre of intermediaries suppress managerial objectives and insist on value for shareholders? We would also recognize that both capitalism and our understanding of it have moved on in the past 30 years, so that social effects of an unintended kind might be produced outside a rationalist cause/effect circle where one coherent group agenda is realized as an outcome.

The different intermediary groups are fairly tightly networked by business relations around the giant firms who have traditionally been the main customers; just as many of the different senior groups are apparently internally networked, especially in activities like investment banking and trading where many expect to change employers. Thus, FTSE 100 companies publicly disclose which firms of ‘advisers’ provide their accounting services, banking, financial advice and financial PR and, in these four areas of advice, the four largest intermediary firms had signed up 100, 80, 61 and 58 respectively of the FTSE 100 in 2004. More generally, the City is always presented impressionistically as a heavily networked series of small worlds as in the following quote from a job search website:

> The (investment banking) industry is tiered and, at the very top, there are key events such as the International Monetary Conference where the top 300 to 400 bankers in the world go and where, if you can get an invite, you will meet very influential people. There are also the drinking clubs in London, such as the Overseas Bankers Club, where you should be seen if you really want to get on *(Andrew Hilton, director at the Centre for the Study of Financial Innovation)*
>
> (workthing/career-advice/networking/banking/networking, 31 July 2005).

But primary sources suggest and secondary sources confirm considerable cultural heterogeneity which almost certainly divides (senior) intermediaries into a whole series of fragmented sub groups. City banks regularly figure in the press through court cases about inappropriate behaviour or discrimination on pay and promotion (e.g. *Daily Mail*, 13 July 2004 or *The Scotsman* 11 January 2005) and overt sexism in the City has been a media issue at least since Bhattacharya’s 1999 article in the *Evening Standard* (22 October 1999). By way of contrast, FTSE100 corporations are more formally correct (even if their boardrooms are still mainly white and male); and professional service partners must be house-trained because they sell to and advise the FTSE officer class and must also manage a hierarchy of juniors employed on an up or out basis. In other areas of intermediary activity like trading, there is a less obvious relation to a client and the relevant reference group may be peers. After interviewing many elite City figures, Davis (2006) concludes that the City consists of a multiplicity of small groups constituting their own realities, where the relevant reference group may be fairly small and discrete: thus, analysts or fund managers may have intense interest in what their peers say and do, they have little interest in or commonality with other intermediary groups.

Prima facie, the heterogeneity is such that the intermediaries are implausible as a distinct new class in itself, but that leaves the important question about their effects on corporations and markets. Current understandings of these issues are framed in terms of finance theory and shareholder value ideology. If the role of capital markets is to allocate capital and risk efficiently to maximize the returns for investors, one hypothesis about the agenda of the intermediaries is that their increasing influence would contribute to shareholder value creation by constraining discretionary management strategies. Interestingly, the political economy literature on shareholder value and financialisation has now produced a body of empirical work which discredits the hypothesis: first, the Anglo Saxon cases (USA and UK) suggest very strongly that intermediary pressure does not raise rates of return which are governed by product market limits and does not always increase pay out ratios.; second, the French case suggests that managerial strategies of growth are not constrained because the efforts of demanding intermediaries in the secondary market are counterbalanced by facilitating intermediaries in the primary market.

In the UK and USA, shareholder value for owners has become a more explicit objective through the disciplinary interactions of analysts and fund managers with senior corporate executives (Roberts *et al.* 2006) who are then under pressure to deliver narratives of corporate purpose and achievement (Froud *et al*. 2006). Lazonick and O’Sullivan (2000) have argued that in the US case, pressure from activist investors changed giant firm priorities in the 1980s 'from retain and reinvest' to 'downsize and distribute'. But any broader empirical review suggests this conclusion is over simplified. To begin with, the larger part of the long term increase in total shareholder returns derives not from what managers do to increase earnings but from how the market values earnings through rising price earnings ratios: over the period 1983-2002, share price appreciation accounted for 63 per cent of total shareholder returns (TSR) in UK FTSE 100 firms and 70 per cent in the S&P500 (Froud *et al.* 2006, pp.77-8). The evidence on payout ratios is complex and the trends are different in the UK and USA. In the UK, there has been an upward shift in dividends paid from 13-20 per cent of cash in the 1980s to 20-35 per cent in the 1990s and early 2000s (pp.88-9) In the USA, the position is complicated by the substitution of debt for equity and by buy backs; but, if all cash distributions to capital providers are added together, there is a pattern of cyclical variation and no evidence of any secular US increase in (total) distributions over the 1980s and 1990s nor of any secular increase in rates of return on sales or capital employed (Froud *et al.* 2006, pp.87-9).

The French case is even more interesting because while the fund managers in the secondary market were asking French giant firms for higher returns; the investment bankers were facilitating managerial strategies of expansion by the same relatively unprofitable firms. As Morin (2000) noted, by the mid 1990s around one third of French shares on the secondary market were owned by foreign mainly American funds whose intermediary managers required French CEOs to explain and justify their strategies in the language of purposive value creation. There was considerable scope for improvement here because French giant firm rates of return on sales and capital employed were and are lower than in the UK or USA: between 1992 and 2002, FTSE 100 firms on average produced a 10.8 per cent pre-tax return on sales and a 12 per cent post-tax return on capital for investors, whereas CAC 40 French giant firms delivered 6.1 per cent and 4 per cent respectively (Johal and Leaver 2006). Yet in the same period, these firms have enjoyed much faster rates of sales growth thanks to managerial strategies of internationalisation which involved acquisition facilitated by equity and debt finance (O'Sullivan 2006) in deals which (if the future is like the past) are very unlikely to create value for the acquiring firm. French CAC 40 sales grew in real terms by 113 per cent between 1992-2002, compared with 75 per cent real growth for the German DAX 30 and a less impressive 53 and 31 per cent real growth by the FTSE100 and S&P500 respectively (Johal and Leaver 2006). French managerial strategies of building 'international champions' were thus decisively facilitated by another group of intermediaries, the investment bankers in the primary market, who advised on acquisition-led growth funded by new issues of debt and equity on the primary market.

The evidence so far considered is partial because it focuses on firm/capital market interaction not hyper innovation within the markets. But the evidence is important because it suggests that capital market intermediaries are not a unitary, calculating, collective subject with one straightforward agenda. This does not mean that intermediary activity has no effects, especially if we remember that discipline works not only to form self-acting identity as theorists of liberal governmentality argue but also to break down self-willed resistance as police and intelligence service interrogators understand. From this second point of view, the alternation of contradictory demands and rewards, threats and promises by different groups of intermediaries is simply a variant on the good cop/bad cop routine. The end result is to increase the volume of restructuring as the disciplinarians require new value creating moves which make money for investment bankers partly by undoing what they previously facilitated. All the different groups of intermediaries have a stake in an economy of permanent restructuring which is a practical project where deals (be it acquisition or demerger, new issues or buybacks, securitisation or rebundling risks) are the source of fees. Their individual motive within this process can be understood by focusing on intermediary business models whereby senior players claim large rewards.

Intermediary business models: organized for enrichment

In the managerial revolution literature, the discussion of organisation focuses on how organization is a response to external product market opportunities or challenges; hence Chandler's (1977) argument in the visible hand or his earlier thesis that m form solved the problems of managing diversified giant firms. In the case of intermediaries, we would argue that the focus should be shifted onto business models and the internal requirement of reward for seniors whose bonuses figure in media stories. The *Evening Standard* recently reported that 3,000 City bankers and traders would earn £1 million plus bonuses in 2005. But we know much less about the pay of intermediaries than we do about senior executive directors in giant public companies where corporate governance codes of practice now require extensive annual disclosure. But the nature and basis of rewards for senior intermediaries can be clarified y analysing intermediary business models which all allow a small number of senior employees to dip deep and claim a large part of revenue and profits.

Before we turn to consider empirics, we will briefly introduce our concept of business model. Business models include some viability requirement of 'cost recovery' (Williams *et al* 1995); that is, organisations must cover costs by relating expenditure and income over the medium to long term, when the private sector must also deliver a profit or surplus from income. However, a business model is not simply about meeting financial targets but also about securing credibility in the eyes of key stakeholders who define opportunity, framing options and evaluating success and, on that basis, satisfying politically and socially constructed stakeholder expectations which have important feedback repercussions on key variables such as share price in the private sector or the assessment of value for money in the public sector. In applying the approach to intermediaries we need to recognize, first, that it is not possible to generalize about one business model for intermediaries and, second, it is internal accountability and distribution which matter in intermediary business models.

There is no single intermediary business model because intermediary activities and organisational forms are so bewilderingly diverse. In terms of activity, routine auditing of FTSE 100 accounts is very different from the crisis management of investment bank advice during hostile takeover. Some activities, like own account trading, require constant innovation and new kinds of trades in the absence of property rights on previous innovation; while others involve selling to corporate clients in the box at Twickenham. The possibilities of revenue growth and the incidence of cyclicality are very different in such activities. And so are organisational forms when intermediaries sometimes work in public companies and more often in partnerships or private companies.

However, closer examination of business models in investment banking, law and private equity brings out two key commonalities. First, despite activity and organisational differences, intermediary business models all involve strong internal stakeholder accountability to senior members of the workforce (principals and partners) which in the case of intermediaries working for public companies always limits the claims of external shareholders. Second, regardless of differences in partner or principal formal right to surplus, all intermediary business models, under favourable conditions, allow a relatively small number of principals and partners to dig deep and capture substantial shares of turnover and profits. In this respect intermediary organizations are decisively different from the giant PLCs in the FTSE 100 or S&P 500 where multi-million salaries for the CEO or a small number of senior executives attract public attention but account for a small proportion of turnover or profits (Froud *et al.*, 2006, pp 63-4).

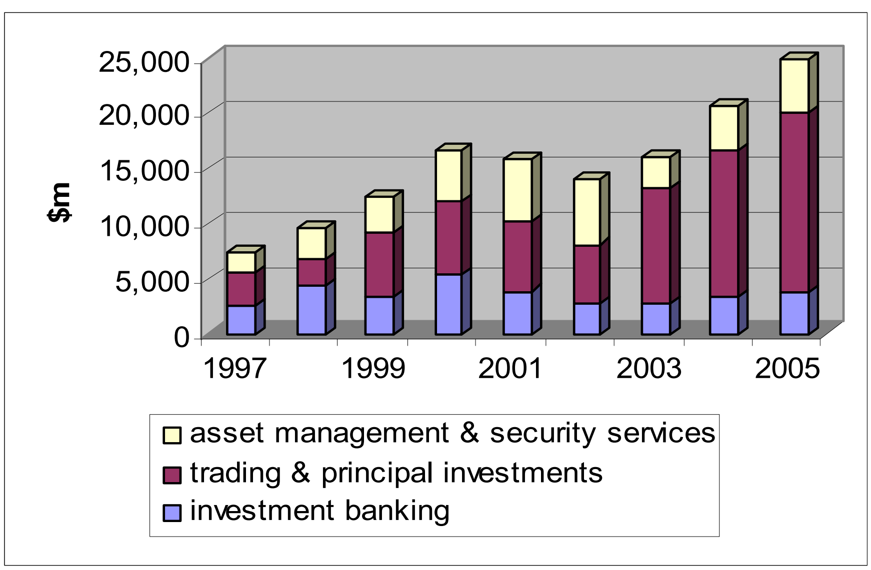
i) investment banking

The business model of major investment banks is explored here using industry sources and media commentary supported by detailed analysis of Goldman Sachs, a major stand-alone investment bank which is also a public company and, like other investment banks, a bundle of changing activities.

Traditionally, the investment banker principal was a corporate adviser in a firm whose two most important sources of revenue and profits were M&A advice and the related business of equity and debt underwriting (IFSL 2006a). Insider accounts from retired bankers like Augar (2004) or Freud (2006) represent large mergers as a fees bonanza for advisors with fees averaging 1.5% of deal value in 2000 (Freeman & Co, 2002). In the Mannesman takeover, Vodafone the acquirer paid total fees of $640m (*Business Week* 21 February 2000) out of which Goldman Sachs and Warburg Dillon Read were each expected to earn $75m (*Wall Street Journal,* 4 February 2000). Unfortunately, M&A and new issues are both inherently cyclical activities and increasingly less profitable as fat fees are split between a multiplicity of advisers.

With margins under pressure in old style investment banking, (*Banker,* 2 May 2006), many investment banks in the 2000s have built up newer, high margin activities of trading and principal investment where the investment banking principal typically manages the investment bank's own account dealing in ever more arcane coupons or undertakes asset management. By 2005, Goldman's traditional investment banking revenues had not fully recovered from the 2002-03 cyclical low (see Figure 1). However, the trading and principal investments segment has not only grown five fold since the late 1990s but also generates margins of more than 30 per cent in good years and of nearly 20 per cent at the trough. This revenue comes from investments and trading activities in commodities, mortgage-backed securities and derivatives, as well as equities and equity-related products and corporate and real estate merchant banking investments, including private equity (principal investments). Although Goldman Sachs is a public company, nobody outside the firm knows what mix of trading activities and strategies have driven recent record profits, and this opacity is sometimes a source of concern for the media (*The Banker* 2 May 2006).

Figure 1. Goldman Sachs' composition of revenues, 1997-20051



Source: Annual Report and Accounts, various years

Not all investment banks are stand alone public companies, just as not all banks have the same combinations of activities, but the business model is common because the employees claim a large share of revenue which is then very unequally divided via the bonus system to the benefit of a fairly small number of senior employees. Investment banks are different from other public companies because they are, as Augar describes them, 'in effect joint ventures between shareholders and staff' (p.58). They are constructed around the norm that employees get around half of the revenues, with shareholders meeting other costs out of their half. The 50 per cent norm is colloquially known as the 'comp ratio' by those in and around the business (see, for example, the conference call between Goldman Sachs' CFO and analysts (Thomson StreetEvents 2006). The ratio of 50 per cent of net revenue is remarkably generous considering that in activities like manufacturing and retail, the employees share of revenue is typically 10-35 per cent. In the huge literature on agency and governance few have noticed as Hywel Williams does that 'If the general truth is that shareholders – rather than employees – have any right to any residual part of a company's income, that idea is turned on its head in banking circles' (p.2006, p 183). Interestingly, much of the business risk is still born by the shareholders because firms (not employees) typically paid the fines for Wall Street malpractice after the post-2000 corporate scandals.

The traditional problems of cyclical variation in revenue are met primarily by paying low basic salaries and variable bonuses. According to Augar, base salaries for both senior and junior investment banking staff were kept low at around $100,000 in the early 2000s, 'but after bonuses, average compensation for the several thousand managing directors in the investment banks reached $3.2 million in 2000 and remained well above $1 million even during the bear market of 2002' (2004, p.59). If the *average* city bonus in a good year like 2005 was £23,000, the total value of bonuses paid out by the investment banks was £7.5 billion (CEBR 2006a) with heads of investment banking and trading each estimated to have received between £3 and £5 million (*Evening Standard* 30 November 2005). However, cyclical lay-offs means that investment banking is a medium risk business; insecurity is pervasive because the emphasis on innovation and overwork means careers are usually short and lifetime reward is powerfully influenced by a few good years at the top.

ii) corporate law

The senior lawyers are more modestly paid but live in a less threatening and more comfortable environment. The top four UK law firms by revenues (Clifford Chance, Linklaters, Freshfields and Allen & Overy) have retained partnership status, albeit with a partial shift to limited partnership which caps partner risk and also obliges them to publish accounts. The story here is of a different organisational form and activity but a similar result.

Table 1. Organisational structure and rewards in top four UK law firms, 2005

	Clifford Chance	*Linklaters*	*Freshfields*	*Allen & Overy*
Turnover (revenues) £m	914	805	780	666
Net profit £m	248	290.8	354.2	219.8
Margin %	29	36	45	33
Total no. of partners	580	463	506	434
Total no. of equity partners	381	345	506	335
Total no. of lawyers	2,480	2,013	2,115	2,263
Leverage	5.0	4.5	3.2	5.5
Profit per equity partner £'000	651	843	700	656
Profit per lawyer £'000	99	144	167	97

Source: *The Lawyer* (*www.thelawyer.com/uk100/2005*)

As seagulls follow the trawler, so corporate lawyers follow the 'deal flow' as it shifts between, say, new issues which create public companies and private equity which often means taking public companies private. The work involves selling services, with network contacts important in generating new and repeat business, as emphasized by insiders like Young and Scott (2004) and academics like Quack (2005) and confirmed by the lists of blue chip clients claimed by leading firms (e.g. *The Lawyer* 4 September 2000). The law firms are partnerships whose equity partners are formally entitled to all the profits. As in accounting, the partners are typically recruited internally from the ranks of salaried lawyers who do most of the work and are an expense chargeable against fees. The profits are considerable and, in 2005, the partners' share of the firm's revenue is at least one third in most cases. Consequently, at between £650,000 and £850,000 profit each (table 1), equity partners in law firms are the well-paid poor relations of the investment banking principals.

The filed accounts also illuminate the mechanics of the partnership business where partner profits depend on capping the number of partners and the pay of the rest of the workforce, while boosting the number of chargeable hours. The leverage ratio relates the number of lawyers to the number of partners: while in principle a higher leverage provides greater fee earning potential for partners, greater profits per partner can also be gained by working the lawyers harder rather than simply by having more of them. In recent years, the story has been partly one of overseas expansion through acquisition, with profit per equity partner remaining fairly stable overall though with some of the firms showing declines in 2005 compared with earlier years. For some firms the problem has been one of expanding the number of partners ahead of the revenue. For instance, between 2000 and 2004, Clifford Chance added 74 per cent more partners on growth of 62 per cent in revenues, while Linklaters more than doubled partner numbers on the back of 82 per cent revenue growth (*The Lawyer* UK 100 Annual Report 2004).

(iii) private equity

If law firms typically do similar things for new clients, private equity currently does new things on a rapidly expanding scale where rewards and risks are much greater. Private equity raises a fund from institutions or wealthy individuals, which is then invested as equity in several businesses whose purchase is financed mainly by issuing debt in a fairly standard ratio of 20 per cent debt to 80 per cent equity. The aim is to sell on within three to five years for the profit of the equity investors. If the businesses generate cash to pay down the debt and can be sold on at profit, the leveraged rewards for equity are considerable. Originally associated with high tech in the USA and SMEs or divisions of public companies in the UK, the funds have recently scaled up dramatically. Private equity funds range in size from more than $15 billion for the largest US players like Texas Pacific Group to less than £500 million; many of the largest fund raisers are now public companies although, like investment banks, they operate in a way that is distinctively different from standard notions of the corporation.

In this case our analysis is based on publicly available sources, supported by evidence on representative figures based on general discussion of typical distributions and range of variation with several senior industry figures who have direct experience of the industry over many years. The private equity organisation is a new kind of holding company (with a commitment to sell its holdings) whose labour requirement is modest. A management company with funds of £2 billion might have as few as 20 staff members, of whom a quarter are partners and many of the rest are relatively junior support staff. Nevertheless, between 50 and 70 per cent of the annual revenues are paid out to the employees. Table 2 provides illustrations of the structure and rewards of two sizes of private equity organisation, the first a mid-market fund that would typically raise between £250 and £500 million (with around 25 staff in total), and the second a large buyout fund where capital is usually in the range $8 to $16 billion (employing about 100 staff). The data is based on real funds, though suitably anonymized to conceal the identity of particular funds.

Table 2. Illustrations of the private equity business model

	Mid-market fund			***Large buyout fund***		
Funds under management	£250-£500 million			$8-$16 billion		
Revenue						
Management fees (% of committed capital)	1.75-2.25%			1.75-2.0%		
Carry (% carried interest on fund performance)	20%			20%		
	No.	No. with carry	% of carry	No.	No. with carry	% of carry
Staffing						
Full partners	6–10	All	100%	20-30	All	70-80%
Investment executives	5-12	None		40-80	Most	20-30%
Head office staff	5	None		15-20	None	
	Basic	Bonus	Carry (over 5 years)	Basic	Bonus	Carry (over 5 years)
Remuneration						
Full partners	£150k	£150k	£5-£15m	$600k	$2.4m	$50-$100m
Directors	£100k	£50k				
Senior executives				$150k	$50k	

Source: *authors' fieldwork.*

The private equity business model is '2 and 20' because the fund management company has two forms of income: first, a management fee, typically around 2 per cent per annum of the value of the committed capital; and, second, carried interest (known as the 'carry') which is normally about 20 per cent of the profits realized by the fund and usually paid out after the capital has been repaid to investors. The carry is intended to incentivize management and, where the fund performs well it offers the possibility of large returns. As table 2 shows, all the partners in both sizes of fund are entitled to a share of the profits: in the mid-market fund the 6 to 10 partners typically get all the carry, while in the larger fund up to 30 per cent is shared with senior investment executives. Where the fund management company is part of an investment bank or other institution, part of the carry is paid to that institution as a franchize fee of around 25 per cent, which can provide very good returns in exchange for little more than sponsoring the fund, in addition to the return on any proprietary capital committed.

As with investment banks, basic salaries for senior employees are typically set fairly low, but supplemented by a bonus which for partners may equal or exceed the basic. The significant rewards, however, come in the form of the carry where a partner in a mid-market firm could expect £5 to £15m after five years; for partners in the much smaller number of very large funds, the rewards might be of the order of £50-150m. It is however important to note that table 2 illustrates *successful* funds; as the literature on private equity shows, performance is highly variable with a significant number of firms producing very limited returns (Swensen 2000, Kaplan and Schoar 2005). The unsuccessful partner will have been well-paid for the life of the fund but will not have been rewarded at the end in a way that allows significant wealth accumulation; and, generally, unsuccessful funds cannot raise another. Private equity thus ratchets up the rewards and risk. This is partly exogenously determined by, for example, the availability of sensibly priced companies for the fund to buy, as well as the market for companies at the time when investments are realized via trade sale or IPO.

Conclusion

Then and now, the questions and conclusions about the old group of managers help us to understand the new group of intermediaries provided always we recognize the differences which separate then and now because capitalism and our own understanding of it have both moved on in the 85 years since Tawney first problematized managers as a social group.

This article has highlighted two differences. First in the old debates about managers as class or elite the argument was always about coherent group agendas like growth or projects like fighting the cold war, which perhaps continue into our own time if we consider French aggrandizement of national industry. By way of contrast, the power of intermediaries comes from multiple and contradictory sectional agendas whose effects of constraint and permissiveness do not cancel each other out but speed up the huge expansion of restructuring which, as we have argued elsewhere, means breach of implicit social contract for other stakeholders (Froud *et al.*, 2006, pp109-22). Second, in the old debates about managers, motive and organisation were understood to be other directed and outward looking as in Marris on growth or Chandler on m form. By way of contrast, intermediary business models are inwardly accountable and invariably designed to enrich a few seniors who can dig deep into revenue and profits. The social outputs of intermediary activity are thus restructuring and enrichment which is itself collectively a social process: as Piketty & Saez (2005) and Atkinson (2003) note high income groups in the US and UK have generally increased their share of incomes in economies where the value of just one form of restructuring (corporate M and A) accounts for 65-75% of fixed investment since 1980.

One of the great unresolved intellectual issues is about whether any group, project or social effect can format the dynamic and characteristics of capitalism in a period; or more specifically, to what extent are terms like 'managerial revolution' or Fordism illuminating rather than limiting. From this point of view, and on the basis of a partial preliminary analysis we would observe that finance meets resistance but it has permeated large sections of the firm and household economy in advanced capitalist economies. And, as Marx would have said, the *trager* or supports of this process are the intermediaries who are working for themselves, in contradictory ways, and producing powerful (unintended) effects in *an economy of permanent restructuring* (Froud *et al.* 2006) e where everything is for sale, where assets and risks can be bundled, unbundled and traded through coupons against a background of sharply increasing inequalities in income wealth and security. We need to research the different aspects of this transformation rather than rehearse a phrase like intermediary revolution but meanwhile we would argue that capital market intermediaries are in many ways the emblem of our present day capitalism.

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