Silicon Valley Social Media Giants Are Raping Their Own Employees

A new report finds that big companies could have given their workers thousands of dollars' worth of raises with the money they spent on their own executives shares.

ANNIE LOWREY

LUCAS JACKSON / REUTERS

Stock buybacks are eating the world. The once-illegal practice of companies purchasing their own shares is pulling money away from employee compensation, research and development, and other corporate priorities—with potentially sweeping effects on business dynamism, income and wealth inequality, working-class economic stagnation, and the country's growth rate. Evidence for that conclusion comes from a new report by Irene Tung of the National Employment Law Project and Katy Milani of the Roosevelt Institute, who looked at share buybacks in the restaurant, retail, and food industries between 2015 and 2017.

Their new paper contributes to a growing body of research that might help to explain why economic growth is so sluggish, productivity so low, and increases in worker compensation so piddling, even as the stock market is surging and corporate profits are at historical highs. Companies are working overtime to make their owners richer in the short term, more so than to improve their longer-term competitiveness or to invest in their workers.

Buybacks occur when a company takes profits, cash reserves, or borrowed money to purchase its own shares on the public markets, a practice barred until the Ronald Reagan administration. (The regulatory argument against allowing the practice is that it is a way for companies to manipulate the markets; the regulatory argument for it is that companies should be able to spend money how they see fit.) In recent years, with corporate profits high, American firms have bought their own stocks with extraordinary zeal. Federal Reserve data shows that buybacks are now equivalent to 4 percent of annual economic output, up from zero percent in the 1990s. Companies spent roughly $7 trillion on their own shares between 2004 and 2014, and have spent hundreds of billions of dollars on buybacks in the last six months alone.

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The new Roosevelt and NELP research examines public firms in three major but notoriously low-wage industries— food production, retail, and restaurants—weighing buybacks against worker compensation. Unsurprisingly, Tung and Milani found that companies were aggressive in purchasing their own shares. The restaurant industry spent 140 percent of profits on buybacks between 2015 and 2017, meaning that it borrowed or dipped into its cash allowances to purchase the shares. The retail industry spent nearly 80 percent of profits on buybacks, and food-manufacturing firms nearly 60 percent. All in all, public companies across the American economy spent roughly three-fifths of their profits on buybacks in the years studied. “The amount corporations are spending on buybacks is staggering,” Milani said. “Then, to look a little deeper and see how this could impact workers in terms of compensation, was staggering.”

How much might workers have benefited, if companies had devoted their financial resources to them rather than shareholders? Lowe’s, CVS, and Home Depot could have provided each of their workers raises of $18,000 a year, the report found. Starbucks could have given each of its employees $7,000 a year, and McDonald’s $4,000 to its nearly 2 million employees.

“Workers around the country have been pushing for higher wages, but the answer is always, ‘We can’t afford it. We’d have to do layoffs or raise prices,’” Tung said. “That is just not true. The money is there. It’s just getting siphoned out of the company instead of reinvested into it.”

The report examines the period just before President Donald Trump’s $1.5 trillion tax cut came into effect, leading to an even greater surge of buybacks and thus an even greater surge of new wealth for the owners of capital, as wages have continued to stagnate. The tax legislation cut both the top marginal corporate tax rate from 35 to 21 percent—dropping the estimated effective tax rate on profitable businesses to just 9 percent, well below the effective tax rate for households—and encouraged firms to bring money back from overseas.

What did publicly traded corporations do with that money? Buy back shares and issue dividends, mostly. There was strong anecdotal evidence that would be true even before the law passed. At a *Wall Street Journal* CEO confab held last fall, the former Trump economic adviser Gary Cohn asked a room of executives, "If the tax reform bill goes through, do you plan to increase your company's capital investment? Show of hands." Most participants sat still, prompting Cohn to ask, "Why aren't the other hands up?" Surveys showed that corporations were planning to shunt money to shareholders, rather than putting it into research, mergers and acquisitions, equipment upgrades, training programs, or workers' salaries.

Since then, analyses from investment banks and researchers have estimated that between 40 and 60 percent of the savings from the tax cut are being plowed into buybacks. One analysis of companies on the Russell 1000 index—which consists of big firms, much like the Standard & Poor's 500 does—found that companies directed 10 times as much money to buybacks as to workers. As such, Milani and Tung said they expect the math on corporate spending on shareholders versus workers to become even more exaggerated in the coming years.

Not all economic and financial analysts see buybacks as problematic. "Far from being starved of resources, S&P 500 companies are at near-peak levels of investment and have huge stockpiles of cash available for even more," argue Jesse M. Fried and Charles C.Y. Wang in the *Harvard Business Review*. "The proportion of income available for investment that went to shareholders of the 500 over the past 10 years was a modest 41.5 percent—less than half the amount claimed by critics." Plus, if buybacks merely transferred money from businesses to investors who then reallocated that money to other, more dynamic businesses, the overall effect on the economy might be muted.

But more and more analysts disagree. Larry Fink, who runs the BlackRock, the huge money-management firm, has argued that buybacks are bad for companies and even bad for democracy. "Society is demanding that companies, both public and private, serve a social purpose," he wrote in an open letter. "To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."

Analysts argue that buybacks hurt corporate America, American workers, and American growth in a few ways. For one, buybacks are a sign of short-termism among executives, the argument goes, boosting shareholder value without boosting the underlying value, profitability, or ingenuity of a given firm. Companies do not get *better* because of buybacks; it is just that shareholders get richer. In an exhaustive financial analysis of buybacks, the consultancy McKinsey found that companies would generally be better off issuing dividends or increasing investment instead. Buybacks also might distort earnings-per-share calculations and other measures of profitability and value.

A related issue is that buybacks draw money away from investment; a dollar spent repurchasing a share is a dollar that cannot be spent on new machinery, an acquisition, entry into a new market, or anything else. Researchers at Deloitte point out that buybacks and dividends have soared as a share of GDP, whereas investment in equipment and infrastructure has remained unchanged. And new research by Germán Gutiérrez and Thomas Philippon of New York University suggests growing business concentration, a lack of competition, and short-term thinking on the part of investors have all contributed to firms "spend[ing] a disproportionate amount of free cash flows buying back their shares," fostering an environment of "investment-less growth."

Then there is the effect on workers. Chief executive officers are the workers who benefit the most from buybacks, Milani and Tung argue, given that they are often primarily compensated with stock. On the other hand, salaried, hourly-wage, and contract employees generally get nothing when companies buy their own shares. With the purchasing power of the minimum wage low, unions all but defunct in the private sector, and less and less competition among employers, workers have no recourse to demand more money, even if there is plenty to be distributed to them. Buybacks have perhaps thus helped stoke the extraordinary levels of income and wealth inequality the country has seen in the last 30 years, and particularly since the Great Recession. (Milani and Tung are careful not to draw a causal relationship between stagnant worker pay and rising buybacks, but other analysts have.)

Both by increasing inequality and reducing corporate investment, and thus productivity gains, buybacks might be bad for the overall economy, too. A high-inequality economy is one with less consumer spending and demand across the board, thus one with a lower GDP. A low-investment economy is a more sclerotic and less innovative one, and thus one with a lower GDP.

The growth of buybacks and growing research on the perils they pose has increased interest in regulatory or legal action to bar or limit them. Tung and Milani argue that companies should be required, as they were before the 1982 rule change, to provide dividends rather than purchase shares with their cash. "Issuing cash dividends (regular or special) has a less predictable and manipulative impact on a company's stock price—and thus is less prone to gaming by executives or activist investors for their own gain," they write. "Dividends also do not have the same potential as buybacks to mask the market and balance sheet impacts of increasing executives' stock-based compensation."

Democratic Senators Elizabeth Warren of Massachusetts, Tammy Baldwin of Wisconsin, Cory Booker of New Jersey, and Chris Van Hollen of Maryland, among other legislators, have also put forward legislation targeting the practice, raising the prospect that the rules could change if and when Democrats take back power. "The surge in corporate buybacks is driving wealth inequality and wage stagnation in our country by hurting long-term economic growth and shared prosperity for workers," Baldwin said in a release. "We need to rewrite the rules of our economy so it works better for workers and not just those at the top."

In the meantime, corporate boards are poised to spend hundreds of billions more on their own shares, benefiting executives along with the mostly wealthy Americans who own stock. Just this week, Caterpillar, for instance, said it plans to spend $1 billion buying back shares in the latter half of this year, before kicking off a new $10 billion round on buybacks starting in January. It is also in the midst of laying off hundreds of workers.

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