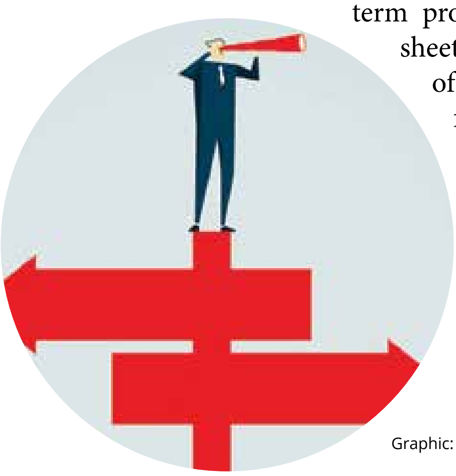
Graphic: The Economist

FINANCIAL SHORT-TERMISM:

the impact on workers and the fight back

Food workers and their unions face the relentless pressure of permanent restructuring driven by short-term financial imperatives. Unions have found it difficult to mount an effective defense against the endless cycle of attacks on employment and working conditions. The environment in which workers organize, negotiate and struggle has changed fundamentally, undermining many of the assumptions which have traditionally guided collective bargaining.

In the long post-war boom which ran through the 1970s, the companies driving the processed food sector built their dominant positions on slow, patient investment. Growth was financed through reinvested profits, or by issuing new equity (shares of stock). Companies nurtured an increase in physical assets and employees, and their success in doing so was reflected in their market share, their credit rating and their share price. Returns were modest but dependably steady – even in a downturn, consumers needed food on their table. Share ownership in the largest companies was a long-term project; debt on a balance sheet was seen as a symptom of financial weakness. The food industry like banking, was said to be 'boring'. Workers braced for layoffs in a downturn, unions consolidated and strengthened their gains when the business cycle turned around.



Graphic: WSJ

Today, short-term movements in share prices rather than patient investment dictate corporate strategy, as companies compete in financial markets to offer the highest rates of return (and executive compensation). Where job cuts once signalled an uncertain future and were reflected in a declining share price, companies now announce massive job cuts precisely in order to attract investors, with no thought given to the operational impact. Asset reduction through closures and sales, rather than investment in plant, equipment and innovation, is now a standard route to boosting returns. For large companies, the stock market has become a source of *disinvestment*, as companies compete to buy back their own shares in order to boost earnings per share, diverting cash flow from productive investment. Large scale mergers and acquisitions are driven by financial engineering rather than industrial logic. Companies investing in assets and people are punished on the markets, driving a rush to outsource production, employment and even research and development and marketing. With research and innovation largely outsourced, the larger companies prowl for start-ups, often financing their acquisition through internal hedge funds.

Food workers struggle to understand why their employer has diverted billions of cash to fund share buybacks when their company is losing market share and struggling to squeeze the last drop from aging equipment; or why a successful financial report comes accompanied with an announcement of tens of thousands of layoffs; or why successful brands are sold off to investment funds rather than being supported through investment. They are grappling with the impact of *financialization* and one of its key drivers, *financial short-termism*.

Mergers and acquisitions...are the quickest, most direct route to profit in contrast to 'patient' investment in a company's long-term future.

The key components and driving forces defining financialization were identified by the IUF in a 2006 paper published by the ILO, **Financialization: New Routes to Profit, New Challenges for Trade Unions**. Financialization emerged in the 1970s, triggered by a squeeze on profits and the emergence of new, mobile pools of capital, frequently parked in unregulated offshore accounts. It has steadily gathered pace, bringing with it a massive increase in global financial assets relative to manufacturing and services output. Relatively little of this – some 15% – finds its way into productive, non-financial investment; the rest is simply recycled within the bloated financial sector. Finance, insurance and real estate take a growing share of profits and increasingly set the benchmark rate of return for all investors. The increase in the relative size and weight of finance amplifies and intensifies the volatility of the business cycle, rendering downturns more severe and inhibiting recovery. Non-financial companies (services and manufacturing) increasingly manage their real assets as a disposable basket of purely financial assets, to be shuffled, reshuffled and sold off in the quest for short-term returns. Physical assets – plants, equipment and workers – once seen as a source of strength, are now treated as liabilities. Mergers and acquisitions, frequently financed through large quantities of debt, are the quickest, most direct route to profit in contrast to 'patient' investment in a company's long-term future. Manufacturing gives way to the search for income streams generated through intellectual property, rents derived from ownership of brands, patents and trademarks.

Finance-driven capitalism severs the link between wages and productivity; workers in many parts of the world have seen their wages stagnate for decades, and in many countries the share of wages in the national income is at its lowest point since the Great Depression. While wages stagnate and casualization dissolves the employment relationship which has been the foundation of collective bargaining, workers are increasingly integrated into global financial circuits. Consumer, housing and student debt make workers even more vulnerable while providing the financial sector with new sources of enrichment.

This is the 'macro' world of financialized global capitalism, whose dynamic differs fundamentally from the post-war decades in which collective bargaining (at least in the developed world) captured wage gains from productivity increases and these gains financed the welfare state. But it is at the workplace where workers directly experience the impact of financial short-termism. In what follows below, we look at the impact of financial short-termism at three leading food companies.

3G Capital/Kraft Heinz and leveraged buyouts

Leveraged buyouts, which rely on extreme levels of financial engineering to generate short-term profits, are a concentrated expression of the forces unleashed by financialization. The classic leveraged buyout uses substantial amounts of debt (Leverage) to buy all public shares of a company and 'take it private'. The new owners then strip out the cash and dispose of the investment by returning the company as quickly as possible to public markets. Reliance on debt minimizes the private equity fund's own equity stake; the bulk of the financial risk is born by the fund's investors. The fund realizes a handsome return on equity if the operation succeeds in returning the company to public markets at a price greater than the cost of taking it private. In the interval between buying the shares and returning the company to the stock market, the investment funds charge large management fees and pay themselves special dividends. The real cost of the operation, however, is born by the workers, because the debt used to fund the acquisition, along with the special dividends, goes directly onto the acquired company's balance sheet. In a leveraged buyout, companies pay the cost of their own acquisition, and have to aggressively pillage the cash flow to manage the interest and other payments.

In 2013, the Brazil-based private equity fund 3G Capital teamed up with Warren Buffett's Berkshire Hathaway to take Heinz private in a heavily debt-financed buyout. Heinz had been steadily raising its dividends yearly and even quarterly since the 2008 financial meltdown, while regularly celebrating increased profits with new layoffs and more outsourcing. The buyout ratcheted up the pressure on the workforce. The new owners stripped out costs to fund the interest on debt by laying off thousands of workers and closing facilities before the company went public again, merging with Kraft in 2015. To fund the merger, and to generate increased profits and returns to shareholders, Kraft Heinz laid off 3,000 workers and closed more facilities.

On paper, the operation was successful. The company's operating margin, a key profitability metric, grew from 14.39% in fiscal 2015 to 25.82% in fiscal 2017. Other food and consumer goods companies took notice, and scrambled to demonstrate to investors that they could produce comparable margins.

But the limits of the model – borrow, acquire, strip out costs and borrow again to fund a new acquisition and renew the looting cycle – have become apparent even to financial analysts who not long ago cheered the company's extraordinary margins. The company's drive for short-term financial gain has choked off long-term growth prospects. In early 2019, 3G/Kraft Heinz wrote down 15.4 billion dollars in goodwill – an accounting fiction which inflated the value of its brands – in an acknowledgement that the brands haven't performed and the business is in trouble. Following the write-down and a reluctant dividend cut, Kraft Heinz shares dropped by 28%. The 3G model has, at least for the moment, lost its financial allure.

Financializing Nestlé

Nestlé, the world's largest food company, launched its first-ever share buybacks in 2005-2006. In 2009, the company spent USD 9.46 billion buying its own shares while boosting the dividend payout (the ratio of dividends to earnings) to 51%. The financial rewards to investors and top management were accompanied by a massive restructuring as part of a fundamental change in corporate strategy. Internal corporate financial flows (particularly royalties accrued by the separate entity that owns Nestlé brands and Nestlé's internal foreign exchange hedge fund) were given priority over sales revenue. The GLOBE program was introduced to cut costs and increase levels of outsourcing and casualization.

To further boost returns by hiving off assets to generate low-tax royalties, in 2016 Nestlé created an ice cream joint venture with private equity fund PAI Partners, Froneri. Rather than investing to innovate in a saturated market, Froneri launched a cost-cutting drive targeting factory, salesforce and office workers across Europe.

Investors, however, are still not appeased. US hedge fund investor Third Point is pushing Nestlé to sell off and reorganize more divisions and buy back more shares in order to boost returns.

Mondelēz, debt and share buybacks

The 2012 Kraft/Mondelēz split was marketed as a move which would create dividends at Kraft and growth at Mondelēz. Kraft promised to double its dividend payments, while Mondelēz, which assumed the debt run up by Kraft's acquisition binge, would become a "global snacks powerhouse." To pay down the debt, Mondelēz aggressively cut costs but also took on new debt to fund share buy backs and dividends. The focus on buybacks and dividends diverted cash flow from investment in workers, capital expenditures and innovation. From 2015 to 2017, capital expenditure (investment in plants, property and equipment) dropped from 5.11% of net sales in fiscal 2015 to 3.92%, while dividends were consistently increased. Financial short-termism between 2015 and 2017 meant 16,000 workers no longer work for Mondelēz.

Dirk Van de Put became CEO of Mondelēz in November 2017 against a background of growing scepticism over the company's narrow cost-cutting strategy and disappointing growth. He announced a new company strategy prioritizing sales growth over cost-cutting. The impact on job destruction at Mondelēz is not yet clear; the job losses continue, although at a slower pace. The path to global growth is encumbered by debt and a legacy of cost-cutting and outsourcing at the expense of needed investment.

Fighting back

While the harsh impact of financial short-termism on food workers and their unions is clear, workers struggle to find an adequate response. Financialization has undermined the link between profits, productivity and wages – a link which unions have struggled for over a century to establish – but solidarity remains a powerful tool.

Acting together, unions can take coordinated action to raise the costs and limit the damage of financial short-termism. By organizing to contest plant closures and layoffs and raising the costs to the company, they can reduce the pressure and gain breathing space in which to organize opposition as well as mitigate the damage.

Large scale mergers and acquisitions are driven by financial engineering rather than industrial logic.

Most recently, for example, in 2018, with support from the IUF the German foodworkers' NGG organized solidarity and resistance to Nestlé's restructuring plans, leading to a comprehensive restructuring agreement. International solidarity with strikes organized by the FNV in the Netherlands in 2018 beat back efforts by private-equity owned Jacobs Douwe Egberts (JDE) to impose a discriminatory two-tier wage system.

As we wrote in the 2007 **Workers' Guide to Private Equity Buyouts**, unions can contest the impact of short-term financial imperatives by organizing to strengthen "company and sector-wide bargaining agreements to reduce disparities in collective agreements and consolidate bargaining power." Through the collective bargaining process, unions can also challenge "the financial arrangements which dictate [these short-termist] management strategies and negotiate their impact on employment and working conditions."

International organizing to ensure respect for basic trade union rights remains a fundamental pillar of resistance. IUF agreements with food transnationals on union rights and recognition have been an indispensable instrument for ensuring our members' rights to organize, to mobilize and to bargain. These agreements, as well as more recent agreements with Unilever and Danone on restricting and reversing casual employment, have also assisted in resisting the pressure of financially-driven casualization, transforming precarious into permanent jobs, boosting union membership and bargaining power. The IUF Food Processing Division can build on these foundations, and on the existing union solidarity networks within many transnational food processing companies.

Now that the gloss is off the 3G model and private equity buyouts have generated a new wave of bankruptcies, unions can build tactical alliances with investment advisors and pension fund trustees to help wean investors from their addiction to instant financial gratification. The rush to meet ESG criteria – Environmental, Social and Governance – can be reconfigured to agitate for long-term investment as a key sustainability metric. There is fruitful ground for building broader alliances with NGOs with related concerns.

Political mobilization

Markets are not the natural state of affairs promoted in mainstream economics textbooks, but political constructions. Corporations and their lobbyists understand this, and have consciously organized to create a regulatory and fiscal environment which favors short-term financial gain over long-term investment and the defense of rights and livelihoods. Share buybacks were until recently illegal in most countries. Specific changes to laws and security regulations were required to create a legal and fiscal regime which subsidizes debt over equity, paving the way for the emergence of mega-buyout funds. The credit default swaps and other financial instruments which sunk the global economy in 2007-2008 are recent, politically enabled inventions.

Corporations understood that another world was possible, and organized to build it. The specific changes to laws and regulations they fought for can be reversed through political action. Unions need to mobilize politically to build a regulatory environment that promotes productive investment based on:

- the long-term interests of working people
- employment creation based on a decent work agenda
- comprehensive protection of trade union rights.

Political action, alongside union organizing at national and international level, is a fundamental component of the fight to roll back financial short-termism, and unions have an essential role to play in building the political alliances to power it.

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The IUF's Financialization: **New Routes to Profit, New Challenges for Trade Unions** published by the ILO outlines the driving forces and consequences of financial short-termism on food processing workers as well as other IUF sectors. **A Workers' Guide to Private Equity Buyouts** explains the mechanism of the most extreme expression of short-termism, the leveraged buyout, with many examples affecting IUF members. More information, including the impact of the buyouts on public companies and the emergence of hybrid forms of the leveraged buyout, is available on the **IUF's Private Equity Buyout Watch** site (site is in English only, all other publications in all IUF languages). The IUF publication **Trade Deals That Threaten Democracy** explains how international agreements misleadingly presented as 'trade' deals advance the scope of investment regimes designed to promote financial short-termism.