

Seeing the Forest for the Trees:

Finance and Managerial Control in the
US Forest Products Industry, 1945-2008

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DEDICATION

This dissertation is dedicated to my family by blood, marriage, friendship, and spirit

This one is for *all* of us

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ABSTRACT

Over the past three decades a significant change has taken place in the ownership structure of industrial timberlands in the United States. The once widely held belief that significant timberland ownership was a necessary ingredient for success in the forest products industry came to an end as millions of acres of productive land were sold from industrial forest products firms to institutional investment organizations, known as Timberland Investment Management Organizations (TIMOs) or Real Estate Investment Trusts (REITs). This dissertation examines this large-scale transfer of timberland ownership through a multi-level analysis of financialization and the rise of shareholder value ideology in corporate management. Part I of the dissertation provides a critical synthesis of these two literatures in order to construct a historical sociological framework for analyzing institutional change in modern corporations. Financialization is defined as a gravitational shift from productive to financial forms of capital accumulation. I then conceptualize the relationship between managers and shareholders as an institutional form of the broader social relation that exists between productive and financial capitalists. The shareholder value conception of managerial control is conceptualized as an ideological manifestation of the shift that took place in the relationship between these two sectors of the capitalist class that motivated and justified managerial decision-making in large non-financial corporations. Part II employs this framework to examine the historical development of the US forest products industry over the course of the second half of the 20th century. This includes an analysis of corporate land ownership strategies during the postwar era of managerial capitalism, the impact of the hostile takeover movement, and the rise of shareholder capitalism in recent decades. I argue that both the decision by managers to sell-off their timberland holdings and the growth of institutional investors seeking to expand their investment portfolios are directly related to the process of financialization. Furthermore, I conclude that the financialization of the US forest product industry led to favorable outcomes for financial interests, but has left the industry with higher levels of concentration, fewer employees, heightened risk, and declining profits.

TABLE OF CONTENTS

CHAPTER I: Introduction	1
The Forest Products Industry: Definition and Overview	4
Data Collection and Sources	8
Methodological Framework and Theoretical Foundations	11
Marxian Dialectics and the General Theory of Accumulation	12
Institutional Neo-Marxism and Periodization.....	17
Critical Realism, Ontology, and Strategic Action Fields.....	23
Dissertation Framework.....	27
 Part I: Towards a Political Economy of Corporate Transformations	33
Chapter II: Finance and Financialization.....	34
Defining Financialization.....	35
Finance and Production in General.....	40
Finance and the Rise of the Giant Corporation.....	46
War and the Resurgence of Production	53
Financialization.....	55
Monopoly-Finance Capital	57
Financialization, Hegemonic Transitions, and Systemic Cycles of Accumulation..	60
Conclusion	65
 Chapter III: Fincialization, Shareholder Value and Corporate Transformations.....	67
Economic Sociology and the Modern Corporation	68
The Managerial Revolution	72
Managerial Conceptions of Control.....	77
The Rise of the Shareholder Value Vonception of Control.....	79
The Role of Institutional Investors	83
Financialization and Non-financial Corporations	86
Critique and Synthesis	92
Conclusion	98
 Part II: Finance and Manaagerial Control in the US Forest Products Industry	101
Chapter IV: Monopoly Capitalism & The US Forest Products Industry.....	102
Early Development of the US Forest Products Industry.....	103
The US Forest Products Industry in the Postwar Era	110
Ownership in the Forest Products Industry during the Post-war era	116
Monopoly Capital and the US Forest Products Industry:	120
The Surplus Disposal Problem.....	120
Mergers and Acquisitions	123

On Oligopoly and Concentration	126
Diversification.....	129
Timberland Ownership	132
Conclusion	141
Chapter V: Contested Management	143
Managerial Response to Stagnation and Crisis.....	146
Managerial Autonomy Under Attack: The Hostile Takeover Movement	149
Organizational Change in the US Forest Products Industry	155
From Dispersed to Concentrated Stock Ownership (1980-2000).....	156
From Fixed-income to Incentive-based Executive Compensation	161
Conclusion	164
Chapter VI: The Financialization of the US Forest Products Industry	166
Financials for the US Forest Products Industry	168
Share Price Appreciation and the US Forest Products Industry	170
Profits and Return on Capital.....	172
Investment, Capacity and Debt	176
From Retain and Reinvest to Downsize and Distribute.....	181
Stock Buybacks and Dividends	182
Mergers & Acquisitions.....	185
Concentration and Oligopoly in the US Forest Products Industry	193
Restructuring, Core Competencies, and Labor	195
Divesting Timberland	203
Conclusion	212
Chapter VII: The Great Financial Crisis and Beyond.....	215
The Great Financial Crisis and the US Forest Products Industry	217
Conclusions and Discussion	224
The Financialization of the US Forest Products Industry	225
Shareholder Value and the US Forest Products Industry.....	231
Future Directions	237
List of References	245
Vita.....	266

LIST OF TABLES

Table 1.1 Economic Characteristics of US Forest Products Industry, 2008.....	8
Table 1.2 Top Ten US Forest Product Firms for Selected Years, by Total Revenue.....	10
Table 4.1 Trends in General Economic Characteristics of the US Forest Products Industry for selected years, 1954-1980.....	113
Table 4.2 Percentage of Sales for Four Largest Firms in Selected Forest Product Industries.....	128
Table 4.3 Area of Commercial Timberland in the United States by Ownership.....	135
Table 5.1: Concentrated Stockholdings in Leading Forest Product Firms, 1980.....	158
Table 5.2: Concentrated Stockholdings in Leading Forest Product Firms, 2005.....	159
Table 5.3: Percentage of Stock Held by Institutional Investors for given Firms, 2010.....	160
Table 5.4 Incentive-based Compensation in the US Forest Products Industry in 1980 and 2005.....	163
Table 6.1. Share of Value of Shipments Accounted for by Top Four Companies for Selected Forest Product Industry Sectors.....	193

LIST OF FIGURES

Figure 4.1 Total After Tax Profits in US Forest Products Industry.....	112
Figure 4.2 Total Capacity in Forest Products industry, 1948-1980.....	115
Figure 4.3 Capacity Utilization in Wood Products and Paper Products Sector, 1948-2008.....	122
Figure 5.1 Investment in Private Equipment and Software by Industry.....	147
Figure 6.1, Change in Share Price for Selected Firms and Dow Jones Industrial Average.....	171
Figure 6.2 Profits After Tax in US Forest Products industry, 1980-2008.....	174
Figure 6.3 Return on Total Capital, US Paper Industry, 1970-2004.....	175
Figure 6.4 Total Investment in Fixed Assets.....	178
Figure 6.5 Total Capacity in Forest Products industry, 1950-2005.....	178
Figure 6.6 Debt to Equity in US Paper Products Sector.....	180
Figure 6.7 Ratio of Total Dividends to Value Added in US Forest Products Industry.....	184
Figure 6.8. Mergers and Acquisitions in excess of \$1 Billion in US Forest Products Industry, 1995-2008.....	187
Figure 6.9 Full-time and Part-time Employees in US Forest Products Industry, 1990-2009.....	202
Figure 6.10 Transfer of Timberland Ownership by Acre and Value.....	208
Figure 6.11 International Paper Timberland Sales, 1997-2006.....	211
Figure 7.1 Annual Housing Starts in the United States.....	218

CHAPTER I

INTRODUCTION: THEORETICAL AND METHODOLOGICAL FOUNDATIONS

Over the past three decades a significant change has taken place in the ownership structure of industrial timberlands in the United States. The once widely held belief that significant timberland ownership was a necessary ingredient for success in the forest products industry came to an end as millions of acres of productive land were sold from industrial forest products firms to institutional investment organizations, known as Timberland Investment Management Organizations (TIMOs) or Real Estate Investment Trusts (REITs). These institutionally owned timberlands are geographically dispersed across the United States, with the most significant concentrations located in the pine plantations of the Southeast, conifer plantations of the Northwest, and mixed softwood and hardwood stands of the Northeast. As of 2009, over 43 million acres of timberland valued at \$39.7 billion changed ownership type, making this one of the most significant transfers of land ownership in recent US history. (Harris 2007; Hickman 2007; Bliss et al. 2009; Rinehart 2010).

The decision to sell off industrial timberland is the latest in a series of “remarkable” changes to take place in the forest products industry in recent decades (Newman 2008). Other notable changes include the gravitational shift in industrial forest production from the Pacific Northwest to the South, the sharp decline in industry access to the federal timber supply, the sustained period of mergers and acquisitions in the late 1990s and early 2000s (Diamond, Chappelle, and Edwards 1999), and the widely publicized loss of US furniture manufacturing capacity to overseas competition (Bumgardner et al. 2004). In explaining these changes, many analysts have pointed to the pressures of neoliberal globalization, which diminished state

protectionist policies and produced a rapid increase in foreign competition (Marchak 1995; Ince et al. 2007).

There is no doubt that the competitive pressures associated with neoliberal globalization are critical drivers of change in the US forest product industry. However, there has been relatively little attention paid to the transformations that took place in the governing logic of American corporations and how these changes affected the management and operation of firms in the forest products industry. If we are to understand change in the US forest products industry, then we must account for the behavior of those individuals that have direct control over the day-to-day operations of the firm. We need to understand how the motivations and priorities of corporate managers were altered in recent decades and how these changes affect various aspects of the firm.

In an article published in the *Forest Products Journal*, Michael and Ray (2008) argue that many of the problems confronting the forest products industry are the product of “self-imposed disasters.” Poor decision-making by senior managers in the industry, they contend, have “caused much of the misfortune that has beset our producers” (Michael and Ray 2008: 6). They list a number of examples of poor managerial decision-making, including managerial tinkering with emissions monitors, failure to capture important emerging markets, and the widespread failure of wood-based companies. In the end, Michael and Ray submit that their solutions to this tendency towards poor decision-making may go unheeded by managers because of “cognitive reasons.” In this dissertation I provide a sociological analysis that may offer clues as to why managers in the forest products industry make the decisions that they do. This analysis goes beyond simply blaming managers for poor decision-making to examine the socio-historical context in which those decisions are made.

The need for a sociological account of managerial decision-making in the industry is particularly pressing for explaining the puzzle of why corporate managers decided to sell-off millions of acres of valuable timberland. What were the motivations that compelled managers to increase their timberland holdings over the course of the 20th century, only to sell them off in rapid succession in recent decades? How was this decision related to other changes in the industry, such the decision to sell-off unrelated product lines in order to focus on “core competencies,” or the decade-long merger wave that continues to increase industry concentration? Furthermore, what are institutional investors and why would they be interested in investing in timberland? Is there a relationship between the growth of institutional investors and the managerial decision to divest their timberland assets?

This dissertation seeks to examine these questions through a multi-layered analysis that focuses on the financialization of the US economy and the rise of shareholder value conceptions of control in corporate governance. The substantial growth of the financial sector in the US and global economy has resulted in a steady increase of academic interest in issues related to finance (Foster and Magdoff 2009; Krippner 2011; Brenner 2006; Dumenil and Levy 2004; 2011; Orhangazi 2008). I argue that many of the transformations that have taken place in the US forest products industry can be traced directly to the increasing influence of financial interests over the management of American corporations. At the same time, I argue that we must go beyond simply describing the effects of financial interests over the firm to understand the logic that propelled the financialization process in the first place. This tracing back enables us to understand both the transformation of timberland ownership in particular and the restructuring of the US forest products industry in general within the context of a broader historical dynamic.

This introduction begins with a brief overview of the US forest products industry, its basic constituent parts and their overall place within the broader US economy. I then provide an overview of the principle data sources that were used in the course of my research. The bulk of the chapter consists of a statement on the methodological framework and theoretical foundations that inform this study. This review of the methodological and theoretical foundations is then used to outline the framework that will be employed to examine how the historical dynamics of capital accumulation were manifested in the decision-making priorities of corporate managers and ultimately led to the transformations of timberland ownership in the United States.

The Forest Products Industry: Definition and Overview

The empirical focus of this dissertation is the US forest products industry. Demarcating this industry is a formidable task in itself: few industries are as complex and multifaceted. Within the US forest products industry there are variety of products and markets, many of which are highly divergent and counter cyclical. The industry also experiences rapid rates of change as firms commonly enter and exit particular markets, engage in mergers and acquisitions, and change their mix of products (Ellefson and Stone 1984). For all of these reasons, there are unavoidable pitfalls in any attempt to discuss the industry as a whole.

In this study, however, I proceed under the assumption that there is enough commonality between the individual firms in the industry to warrant a broader analysis of the effects of financialization and shareholder value. This assumption is buttressed by the fact that the industry shares a common resource base for their raw material needs: the nation's 514 million

acres of productive timberland.¹ It is further supported by the fact that financial analyses of the industry are conducted under the common grouping of the “Paper and Forest Products Industry” and the industry is represented by a common trade association (The American Forest and Paper Association).

The two main sectors of the forest products industry are the wood products and paper products sectors.² Both sectors are highly heterogeneous, consisting of numerous subsectors with their own market dynamics. The wood products sector (North American Industrial Classification System; NAICS 321) consists of those industries engaged in sawing, shaping and assembling wood into a variety of products (U.S. Census Bureau 2007). Included in the wood products sector are a wide array of product markets, including basic sawmills, veneer and plywood, engineered wood products, prefabricated wood products, and the like.

The second primary sector is paper products (NAICS 322). This sector consists of various manufacturers of pulp, paper, and other converted paper products (U.S. Census Bureau 2007). The products developed in this sector are highly diverse and range from the manufacture of newsprint and paperboard to tissue paper and disposable diapers. The pulp and paper sector is considerably more capital intensive than the wood products sector, with economies of scale reaching gargantuan proportions during the late 20th century: the cost of constructing a modern pulp and paper plant is now commonly in excess of one billion dollars, making it one of the most capital-intensive industries in the world (Carrere and Lohmann 1996). In the United States, the largest firms in the industry typically have operations in both sectors, with their relative

¹ The US Forest Service defines productive timberland as those forests that are capable of producing 20 cubic feet per acre of industrial wood annually and not legally reserved from timber harvest (Smith et al. 2010).

² The wood furniture sector is often included in studies of wood-based industries, however, due to the rapid decline of this industry in recent decades and the marginal role that it plays for the large forest product firms under investigation, I do not include it my analysis.

contribution to each firm varying widely and although these two sectors both rely on the same raw material for production; their respective markets fluctuate tremendously and rarely move in concert.

For the purposes of this study, I focus primarily on the large publicly-owned corporations. There remain a considerable number of privately owned forest product firms, but, for the industry as a whole, the corporate form dominates. In the early 1980s, Ellefson and Stone (1984) estimated that roughly 95 percent of forest products establishments with 20 or more employees were corporate in form. Today the vast majority of leading firms in the industry are publicly owned corporations.³ Furthermore, it was the large corporate firms that came to own and manage the millions of acres of timberland that this study is particularly concerned with.

To avoid misunderstandings, I want to clarify my justification for focusing on US-based firms in an industry that is highly integrated on the international level, especially between the United States and Canada. The justification stems from the fact that my primary focus is on the structural and ideological components of corporate actors, both of which are highly sensitive to the national economy and their respective culture of corporate governance. There remains a considerable degree of variance between different nations and the corporate cultures they engender (see Mäntysaari 2005). Nevertheless, many firms included in the analysis have operations in both the United States, Canada, and around the world. For example, Abitibi-Bowater, following the merger of Abitibi-Consolidated (Canadian) and Bowater Inc. (US) is now

³ The most prominent exception to this general rule is Georgia-Pacific, which was purchased then promptly privatized by Koch Industries in 2005. Koch Industries paid a total of \$21 billion to purchase the firm, which included compensating the company's shareholders \$48 per share.

headquartered in Montreal, even though they maintain extensive operations across the United States.⁴

Despite over a decade of downsizing, the forest products industry remains an important component of the US manufacturing economy. As shown in Table 1.1, the value of the industry's 2008 shipments exceeded \$266 billion, which accounts for almost 5 percent of the five trillion dollars of shipment values that took place in the nation's manufacturing sector. Over two-thirds of the total value of shipments (\$178 billion) took place in the paper manufacturing sector alone, making it the 10th largest sector in the US manufacturing. Capital expenditures in the forest products industry totaled \$8.8 billion, or roughly five percent of all capital expenditures in the US manufacturing sector. Again, the capital intensive paper sector accounted for the vast majority of total capital expenditures in the industry.

The forest products industry also continues to be an important source of employment in the US economy. In 2008 the industry employed 864,821 people, which accounted for almost 7 percent of the nation's total manufacturing employment. These employees were split relatively evenly between the two sectors, with the wood products sector accounting for slightly more than the paper products sector. Despite accounting for more employees, the total payroll in the paper products sector surpassed the wood products sector by almost \$5 billion. This most likely reflects the higher degree of education and specialization that is necessary to operate modern pulping mills. In all, total employee payroll in the forest products industry accounts for almost 6 percent of the nation's total manufacturing payroll.

⁴ For information about corporate ties between US and Canadian firms see (Ellefson and Stone 1984: 61-66).

Table 1.1 Economic Characteristics of US Forest Products Industry, 2008

	Wood Products	Paper Products	Total US Forest Products Industry	Total US Manufacturing
Value of Shipments (\$ million)	88,004	178,749	266,753	5,486,266
Capital Expenditures (\$ million)	2,518	6,268	8,786	168,505
Employees	461,621	403,200	864,821	12,781,169
Employee Payroll (\$ million)	15,619	20,546	36,165	607,446

Source: U.S Census Bureau 2008, Annual Survey of Manufacturers

The forest products industry operates in many – though not all – areas of the United States. The most productive region for the forest products industry today is the South. The Southern United States is also the region where institutional land ownership has increased the most. The forest products industry continues to have a large presence in the Pacific Northwest, Midwest, and Northeastern regions of the United States as well, making it one of the most geographically dispersed industries in the US economy today. The fact that the industry is widespread also speaks to its importance as a source of employment and production in the larger US economy.

Data Collection and Sources

Data for this study come from a wide array of sources, including government and private industry databases. For certain measures, aggregate data was available for both the wood products and paper product sectors. These include data collected from both the US Census

Bureau and the Bureau of Economic analysis. Data on capacity and capacity utilization was gathered from the Federal Reserve.

Much of the data necessary for this analysis, however, was not available for the industry as a whole. In these cases, I had to rely on data collected at the level of the firm. This data includes data mined from corporate proxy statements on both shareholder concentration and executive compensation. Much of the financial data, and aggregate data on institutional stock ownership were obtained from Mergent Online. Mergent Online is a wonderful source of information and provides access to data on company's financials, history, ownership, and structure, among others. For practical reasons, I chose not to include every firm in the industry but to focus on the top ten firms in the industry at any given time. Table 1.2 shows the top ten firms in the forest products industry ranked by total revenues for each decade since the 1970s. International Paper held the lead in total revenues for in the industry for most of the 20th century, however, for most firms there was substantial variation in their overall position within the industry. This is a reflection of the turbulence that beset the industry over this time period. When necessary, the top ten firms in the industry will serve as a proxy for the industry as a whole during any given time period.⁵

Much of the historical data was found using Lexus Nexus Academic and ProQuest. These search engines were invaluable for providing concrete examples of the social relations that this dissertation seeks to illuminate. The Standard & Poor's Industrial Surveys, which are published twice a year, also provided a critical source for viewing the evolution of the industry from the perspective of the financial community. These surveys, dating back to the early 1970s,

⁵ This is particularly the case with data collected from corporate proxy statements, such a stock ownership and executive compensation. Due to the time necessary to collect this data from individual proxy statements I did not include data from every firm in the industry.

Table 1.2 Top Ten US Forest Product Firms for Selected Years, by Total Revenue

1970	1980	1990	2000	2009
1. International Paper	1. International Paper	1. International Paper	1. International Paper	1. International Paper
2. Mead Corp.	2. Georgia-Pacific	2. James River	2. Georgia-Pacific	2. MeadWestvaco
3. Crown Zellerbach	3. Weyerhaeuser	3. Kimberly-Clark	3. Weyerhaeuser	3. Smurfit-Stone
4. St. Regis	4. Champion	4. Stone Container	4. Kimberly-Clark	4. Weyerhaeuser
5. Kimberly-Clark	5. Boise Cascade	5. Scott Paper	5. Smurfit-Stone	5. Domtar
6. Scott Paper	6. Kimberly-Clark	6. Georgia-Pacific	6. Boise Cascade	6. AbitibiBowater
7. Westvaco	7. St. Regis	7. Champion	7. Willamette	7. Temple-Inland
8. Great Northern Nekoosa	8. Crown Zellerbach	8. Weyerhaeuser	8. Mead Corp.	8. Greif Inc.
9. Hammermill Paper Co.	9. Scott Paper	9. Boise Cascade	9. Temple-Inland	9. Packaging Corp.
10. Saxon	10. Mead Corp.	10. Union Camp	10. Westvaco	10. Plum Creek

Source: Data compiled from Standard & Poor Industry Survey's

provided invaluable annual overviews of the industry and its incessant fluctuations. And the *International Directory of Company Histories* was a wonderful source of historical information on particular firms in the industry. Additional historical information was mined from the extensive secondary literature on the US forest products industry.

Methodological Framework and Theoretical Foundations

Sociologists have a long history of using comparative historical methods to explain how dynamic processes unfold over time (Mahoney 2004). The methodology employed in this study is most accurately described as a *dialectical* historical sociology. My rationale for adopting this method is due, in large part, to the nature of the questions being pursued: my primary concern is with exploring the relationship between the structural dynamics of financialization, the shareholder value conceptions of control in corporate management, and the transformation of timberland ownership in the United States. It follows that I must adopt a method that privileges process and change over more static interpretations and that is flexible enough to allow me to account for both structural dynamics and historically situated actors. In this section, I provide a broad overview of this method, as well as a discussion of several related methodological approaches. I find that Marx's method, although underdeveloped by Marx himself, remains a fundamental approach for social scientific investigations.

Marxian Dialectics and the General Theory of Accumulation

In employing the concept of dialectic, I refer to the dialectical method as it was utilized by Marx in his economic studies. Although Marx himself never wrote detailed text on his methodology, a number of scholars have begun to outline the basic contours of what may be called a “Marxian methodology” based on a close reading of his voluminous work (Sweezy 1970[1942]; Ollman 1971; 2003, Sayer 1979; 1987, Paolucci 2009[2007]).

The dialectical method is at the heart of this Marxian methodology. Ollman (2003) provides perhaps the clearest exposition of the meaning of dialectics. He begins by explaining what it is not:

[d]ialectics is not a rock-ribbed triad of thesis-antithesis-synthesis that serves as an all-purpose explanation; nor does it provide a formula that enables us to prove or predict anything; nor is it the motor force of history. The dialectic, as such, explains nothing, proves nothing, predicts nothing, and causes nothing to happen (2003: 12).

It is, on the contrary, a method for studying change. If we concede that capitalism is an inherently dynamic social and economic system – as both critics and supporters would readily agree – than it would seem necessary that we adopt a method that can make sense of this ever-changing system as it evolves over time. This is particularly the case with the forest products industry which, as we will see, is notoriously dynamic and cyclical.

A dialectical method achieves this by providing a relational and process oriented perspective for studying change in complex systems. As Ollman (2003: 13) explains, “understanding anything in our everyday experience requires that we know something about how it arose and developed and how it fits into the larger context or system of

which it is a part.” That is to say, a dialectical method usually begins with a conceptualization of the whole, before proceeding to examine its various parts, their functions, and relations to the whole. In doing so, it provides valuable insights into both the complexity of particulars, and a greater understanding of the whole of which they are a part (Ollman 2003).

Dialectics emphasizes how process and change result from the interaction, or conflict, of contradictory forces. Contradiction, in this sense, refers to “the incompatible development of different elements within the same relations, which is to say between elements that are dependent on one another” (Ollman 2003: 17). Marx’s use of the dialectic was strongly influenced by his reading of Hegel. However, whereas Hegel used dialectics to uncover the historical development of ideas, Marx used this method to examine the dynamics of social change as they are rooted in class struggles taking place in the mode of production. Thus he famously charged that in Hegel the dialectic “is standing on its head, and “must be turned right side up again...” (Marx 1967a: 20).

Critical to Marx’s use of the dialectical method was his use of abstractions (Sweezy 1942; Ollman 2003). This method, also known as a method of successive approximations, was used by Marx and other classical thinkers (most notably by Ricardo and Durkheim,) in their effort to understand and analyze complex social processes. It is, in short, a way of narrowing one’s field of view in order to focus on particular features of an object while minimizing the influence of others. In the preface to *Capital*, Marx (1967a: 8) explains that “[i]n the analysis of economic forms...neither microscopes nor chemical reagents are of use. The force of abstraction must replace both.” In practice,

Marx's method of abstraction begins with the world as it presents itself to us (the "real concrete") and then proceeds to break this whole down into workable parts (the "abstraction") so that they can be conceptualized and analyzed in the mind (the "thought concrete"). The method of presentation, however, is often quite different in that it tends to move from the abstract to the concrete, removing simplifying assumptions at successive stages of the investigation in order to highlight complexity and historical circumstance (see Ollman 2003).

In Volume I of *Capital*, Marx begins with an analysis of the commodity, thus using his microscope of abstraction to reveal how the commodity form under capitalism embodied the contradictory social relations of capitalism as a whole. In doing so, he begins the construction of his *general theory of capital accumulation*. Marx's general theory is a dynamic theory of social change that highlights a number of tendencies that derive from a social structure premised on a particular social relation of production. This relation of production – private property and wage labor – gives rise to an economic system that requires ceaseless accumulation in order to survive. Thus Marx's conceptualization of capital was not as a thing, but as a process; a process of self-expanding value. In Volume II of *Capital*, Marx (1967b: 105) explains that

[c]apital as self-expanding value embraces not only class relations, a society of a definite character resting on the existence of labour in the form of wage-labor. It is a movement, a circuit-describing process going through various stages, which itself comprises three different forms of the circuit-describing process. Therefore it can be understood only as a motion, not as a thing at rest.

Once in place, this movement (commonly expressed in Marx's general formula of capitalism: M-C-M') becomes a structural necessity for capitalist economies and compels

them, on the pain of extinction, to pursue ceaseless accumulation. Furthermore, this dynamic becomes a critical (though not the only, of course) engine of social and economic change in capitalist societies.

From this perspective individual actors are dealt with primarily as “personifications of economic categories” and “embodiments of particular class-relations and class-interests” (Marx 1967a: 10). Compelled by both competition in the market, and the accumulation of abstract power (in the form of wealth) in general, capitalists must constantly seek to expand their money capital. In pursuing their own self-interests, capitalists collectively produce a “law of motion,” which in turn reacts back on them, compelling them towards ever greater accumulation. This desire for accumulation cannot be reduced to mere greed – for greed is a human affliction that dates to time immemorial – but as a necessity that arises from this particular mode of production. “[T]hat which in the miser is a mere idiosyncrasy” Marx reminds us, “is, in the capitalist, the effect of the social mechanism...(1967a: 592).”⁶

In conceptualizing capital as a process, Marx is at the same time highlighting the tendency for capitalists to confront various barriers in their efforts to expand. The study of these barriers and their various manifestations is the prelude of Marxian crisis theory, one of the most vigorous areas of Marxian political economy (see Harvey 2006; Shaikh 1978; Howard and King 1988). For our present purposes it is only necessary that we

⁶ It is worth noting that Marx was not alone in his desire to establish central tendencies that derive from the establishment of capitalist markets. Adam Smith’s “invisible hand” was another attempt to deduce various tendencies from the abstract processes of capitalist markets. Although their conclusions are widely divergent, both Marx and Smith’s theories were premised on this idea of a stratified reality that consists of both observable events and structural tendencies.

grasp Marx's general conceptualization of capitalism as a dynamic system that requires growth for survival and at the same time tends to periodically confront barriers to that growth. These barriers arise from contradictions that arise both internally (ie. Marx's theory of the falling rate of profit) and externally (ie. natural limits to growth) to the capitalist system and must resolved if accumulations is to resume (Lebowitz 1982). Capitalism can thus be understood as a system of ever-expanding value that is punctuated by periodic crises. These crises appear as particular "barriers to be overcome" (Marx 1973: 408).

Because it is so often misunderstood, it is necessary to take a brief moment to confront the notion that Marx was an economic reductionist. Marx's method was employed to investigate his particular interest in laying "bare the economic law of motion of modern society" (Marx 1967a: 10) His conclusions are no panacea, but they do provide a theoretically coherent interpretation of capitalism as a particular mode of production based upon a definite social relation, with its own tendencies and dynamics. It is difficult to deny the fundamental role that that economic imperatives play in the shaping of history in modern society. Furthermore, my subject matter warrants a focus on change taking place in the realm of the economy. If this was a study of teen smoking habits, such a launching point might not be necessary; however, this study is concerned with analyzing various transformations taking place within large corporations, surely an institution that is shaped, in large part, by an economic logic. Nevertheless, this study is not an attempt to reduce everything to economic terms, but an affirmation that one cannot understand the shift in timberland ownership, and the concomitant shifts in corporate

structure and ideology *outside* of the development of historical capitalism. In the end, Marx was not trying to reduce everything to economic terms. “He was rather,” as Sweezy (1942: 15) explained “attempting to uncover the true interrelation between the economic and the non-economic factors in the totality of social existence.”

Institutional Neo-Marxism and Periodization

Recognizing the existence of barriers, however, tells us little about the process whereby they are overcome. According to Marx (1973: 410),

[t]he fact that capital posits every such limit as a barrier and hence gets *ideally* beyond it, it does not by any means follow that it has *really* overcome it, and since every such barrier contradicts its character, its production moves in contradictions which are constantly overcome but just as constantly posited (*italics in original*).

The method and manner in which a particular crisis is overcome is the outcome of a various historical contingencies, including class struggle, the given level of technology, and the availability of resources, to name but a few. But the general goal remains the same: in order to overcome crises, capitalism requires a reconfiguration of the institutional and ideological underpinning of society in order to establish the conditions for continued capital accumulation (see Marx 1973; Harvey 2010).

Theorizing the various configurations of historical capitalism lies at the heart of contemporary political economy. These theories seek to embed capitalist social relations within the various social, economic, and political structures that provide the necessary framework for capital accumulation to take place (Polanyi 1957[1944]). Accompanying these various institutions is a host of norms and ideologies that not only serve to

legitimate a given mode of accumulation, but to also provide the regulatory and legal framework necessary for a capital accumulation to take place. Yet these institutions that are at once necessary for capital accumulation can also become so many barriers to continued accumulation.

A prominent example of this approach can be found in the work of theorists associated with Social Structures of Accumulation (SSA). The SSA approach to analyzing historical configurations of capital accumulation is associated with David Gordon and his early work on the institutional and social basis of capital accumulation (Gordon 1978; 1980). Gordon criticized other cyclical theories of capital accumulation for their lack of attention to the relationship between the “purely economic dynamics” of capital accumulation and the “structure and contradictions of the social relations conditioning capital accumulation” (Gordon 1980: 10). Two years later, SSA received its definitive exposition in Gordon, Edwards, and Reich’s *Segmented Work, Divided Workers* (1982), which applied the theory to the capital-labor relations in the US during the twentieth century and began to bring into focus the process of innovation, consolidation, and decay in the construction of various SSA (Kotz, McDonough, and Reich 1994).

In its most basic sense, the concept SSA “refers to the complex of institutions which support the process of capital accumulation” (Kotz, McDonough, and Reich 1994: 12). The basic premise being that capital accumulation requires a whole host of institutions – ranging from the political and economic to the cultural and ideological – in order to establish the necessary conditions for the “existence and reproduction of

capitalist economies.” The SSA perspective draws attention the embedded nature of capital accumulation and emphasizes the social and cultural context in which accumulation takes place. This includes not only domestic institutions such as labor-management relations, industrial organization, and the role of the state, but also international institutions such trade as the World Bank and International Monetary Fund. Yet the need for institutional stability is contradicted by the inherently dynamic nature of capital accumulation; therefore those institutions that are at once necessary for accumulation ultimately serve as barriers to continued accumulation at some indeterminate point. As a result, capitalism proceeds through various periods of stability and crisis, driven constantly by the dynamic interaction of the dual forces of inter-capitalist competition and class struggle (Kotz, McDonough, and Reich 1994).

The basic framework of SSA perspective entails a periodization of capital accumulation that enables a historical and comparative analysis of how particular institutional configurations are established, institutionalized, and, ultimately, disassembled over time. By periodization, I refer to the attempt to divide time into specified blocks, or stages, in order to abstract particular characteristics that distinguish one block of time from another (Haydu 1998). These periods are punctuated by economic crises, which mark the necessity of dissolving or transforming an existing mode of accumulation for another. One may also conceive of a newly established SSA as a critical juncture in a path dependent historical process (Mahoney 2000): once stable conditions for accumulation are in place, these conditions become the “rules of the game” for a time. What is critical to both the SSA perspective and Marx’s is the notion that this

new mode of accumulation will necessarily confront its own barrier at some indeterminate point in the future.

The concept of SSA is sufficiently broad to incorporate a seemingly endless array of institutions and ideologies within its purview, but for our present purposes, we want to bring the modern corporation into focus in order to examine the relationship between changing SSA and corporate organization. Harland Prechel (2000) employed a variant of the SSA framework in his analysis of historical transitions and changing corporate forms. Prechel conceptualizes the corporation as a historical phenomenon that was established under particular historical circumstances, but has continued to evolve and change within the larger dynamic of capitalist development. In doing so, he analyzes corporate behavior within a three-tiered structure consisting of a micro, meso, and macro levels. The micro level consists of corporate managers and other social actors operating within context of a given corporate entity and their interest and behavior is largely shaped within that environment. The meso level brings into focus the corporation in general, its political and economic interests as well as its relationship to other corporations. And finally, the macro level, which consists of the political and economic environment that corporations are embedded in. Prechel then uses this framework to analyze how historical transitions in the development of capitalism have led to recurrent transformations of corporate structures.

This method adopted in this study borrows a number of insights from both the SSA perspective and Prechel's analysis of historical transformations of corporate structures. The first concerns the issue of periodization. The SSA perspective

distinguishes two definite SSAs during the postwar period. The first was the “regulated capitalism of the postwar period. This SSA (also referred to as Fordist, Keynesian, etc) was constructed in the aftermath of the Great Depression and was characterized by the development of the welfare state, active state intervention in the economy (particularly with regard to financial regulation), and a unionized labor force. The postwar SSA experienced a crisis in the early 1970s and was replaced with the neoliberal SSA (also referred to as post-Fordist, neoliberal globalization, and financialization) in the early 1980s. The neoliberal SSA was characterized by a roll-back of the welfare state, laissez faire economics, and an active assault on unions. For our present purposes, we can say that this SSA was in place until the financial crisis of 2008. This gives us two distinct SSAs: one lasting from approximately 1945-1974 and the other from 1975-2008.⁷

These two periods roughly correspond to the periodization that will be employed in this study. However, for theoretical reasons I prefer to adopt the *Monopoly-Finance* perspective of John Bellamy Foster and Fred Magdoff (Foster and Magdoff 2009). This perspective builds off of the theory of *Monopoly Capital* as developed by Baran and Sweezy and views financialization not so much as a distinct period, but as a stage in the development of Monopoly Capitalism itself. There will be more to say about the theory of Monopoly-Finance capital in Chapter 2. For now, it is primarily important that we are able to distinguish between these two periods. In the end, there is no one-size-fits-all

⁷ According to SSA theory, the financial crisis of 2008 should mark the beginning of the dissolution of the neoliberal SSA and the construction of its successor. However, the fact that much of the institutional and ideological apparatus of the neoliberal SSA remains in place calls this this formulation into question. For now we must be contented with that fact that it is probably too soon to know the final outcome of this crisis and the prolonged period of stagnation that the US economy continues to experience.

approach to periodization; it depends most directly upon the questions being pursued and theoretical emphasis employed. And in this dissertation I am interested in explaining institutional change in the US forest products as part of a broader historical development. In Marx (1967a: 371) word's, "[w]e are only concerned here with striking and general characteristics; for epochs in the history of society are no more separated from each other by hard and fast lines of demarcation, than are geological epochs."

A second insight I gain from the SSA literature concerns my own interpretation of the concept of a managerial conception of control (Fligstein 1990; 2001). From my perspective a conception of control can also be interpreted as one of the various ideological structures that come into being in order to enable and legitimate managerial behavior for a particular period of time. In fact, I believe there is substantial area of overlap between these two perspectives that would provide fruitful insights for future researchers.

From Prechel (2000), I borrow his general conceptualization of the corporation as a historical institution that undergoes various transformations over the course of its development. There are many similarities between my own perspective and the one employed by Prechel. A critical difference, however, lies in how we theorize these changes: whereas Prechel examines particular corporate transformations as they occur in response to crisis, I theorize capitalism as a historical system that maintains a historical trajectory that transcends *and* includes its various institutional manifestations – thus while some things changes, others remain the same. An additional difference stems from my own emphasis on financialization and the rise of the shareholder value ideology as the

outcome of a particular crisis of accumulation. While these outcomes were not preordained, they do embody a certain logic in that they were pursued in an effort to overcome a particular barrier to capital accumulation.

Critical Realism, Ontology, and Strategic Action Fields

The methodology adopted in this study also shares a number of parallels with a number of other schools of thought. Although a complete review of these literatures is not possible here, a brief overview of two of the most relevant approaches will help situate this perspective within the broader literature. The first and perhaps most compelling method for contemporary social science can be found in Roy Bhaskar's development of "Critical Realism" (see Bhaskar 1998; Collier 1994). A basic premise of Critical Realism is that we live in a stratified reality that contains both an actually existing empirical reality of observable events and an equally real world of mechanisms, powers, and tendencies. In opposition to strict empiricists, or positivists, critical realists argue that reality is not limited to observable events, but consists of tendencies that derive from relatively enduring patterns of social interaction. Indeed, according to critical realists it is the discovery of these tendencies and their various mechanisms that social science is most directly concerned.

Critical Realism also sheds some light on the confounding relationship between structures and human agency. Bhaskar argues that social structures are both the conditions and outcomes of human agency: both society and individuals are "real" however they occupy different levels in his ontological perspective. Structures, for

Bhaskar, are “conceived as relations between social agents in virtue of their occupancy of social positions (Benton and Craib 2001: 132). These structures arise out of the regular interaction of these social agents and at the same time react back upon them, both enabling and constraining human action. In this sense, human agency is responsible for both reproducing social structure and at the same time contains the possibility of transforming it through both intended and unintended social action.

Critical Realism shares a number of similarities with a Marxian perspective: both are “realist” in the sense that are committed to the belief that there is a real, objective, world that exists and operates independently of our knowledge or beliefs about it; both retain a general view of a stratified reality in which there are both observable events and unobservable social structures; and both maintain a philosophical commitment to the notion that there is a link between science and emancipatory politics (see Ollman 2003; Benton and Craib 2001; Paolucci 2009[2007]). Their primary differences lie in the emphasis they lay on the process of abstraction in explaining how they move between various layers of social reality and in their adoption of a philosophy of internal relations (Ollman 2003, Ch. 10). For our current purposes, however, they should be viewed as complementary in that they both inform the perspective adopted in this study.

An additional perspective that speaks to the general framework of this study can be found in an emerging framework that is being developed in the theory of fields. In an effort to construct a *general* theory of strategic action fields, Fligstein and McAdam (2011), outline a theory that has some striking similarities to the theoretical framework employed in this study. Fligstein and McAdam (2011: 2) base their general theory on “a

view of social life as dominated by a complex web of strategic action fields.” The concept of a strategic action fields is here used to denote any form of collective action between individuals and groups taking place within various meso-level social orders. Fligstein and McAdam’s (2011: 2) argue that a general theory is necessary if we are to integrate disparate theories of collective action within the “overall structure of contemporary society and the forms of action endemic to that structure.”

In outlining their general theory of strategic action, Fligstein and McAdam describe a structure in which each strategic action fields is itself embedded within larger fields. They liken this structure to a Russian Doll, within each strategic action field there are multiple other action fields. So, for example, a university department may be described as its own strategic action field that exists within the larger field of the university. Likewise, various committees within a department could be conceived as fields in themselves. Fligstein and McAdam distinguish the relationships that exist between these fields either in terms of being “distant” or “proximate,” depending on the degree to which they are linked, or as “vertical” and “horizontal” based on the amount of authority that one field might have over another. Theirs is also a dynamic theory in that they describe strategic action fields as only relatively enduring, highlighting how each field consist of “emergence, stability, and transformation” (Fligstein and McAdam 2011: 20).

There are some obvious similarities between Fligstein and McAdam’s general theory of strategic action and Marx’s own ontological underpinnings. However, the critical difference between these two perspectives lies in their use of history. In outlining

their *general* theory of strategic action Fligstein and McAdams abstract strategic action fields beyond the historically specific social relations of capitalism. In other words, theirs is a general theory of social action that applies to all times and places, regardless of context. This may or may not be a rational abstraction, depending on how general of a theory they wish to construct and the question to which it is directed. However, once this theory enters the realm of history it becomes necessary that they specify the historically specific set of social relations that predominate in any given epoch.

A Marxian perspective, on the other hand, is premised on the notion that there is an internal relationship between structure and history. Marx's ontology, as Paolucci (2009: 116) explains, is based on the notion that "all objects of social science have historical features internal to their essence" and "[t]his means that the history included in creating a social phenomenon is as much part of its definition as its structure." Determining how much history is involved in the construction of a particular social phenomenon is dependent on the object under investigation and the questions one is seeking to address. In Marx's case, he was concerned with the dynamics of capitalism as a whole. Therefore, in the language of Fligstein and McAdams, we could say that Marx was making a theoretical argument about the strategic action field that is the capitalist mode of production. Within this strategic action field there are countless others fields, which are each, in varying degrees, constrained and enabled by the processes of capitalism as a whole.

As Fligstein and McAdams note, their general theory of fields bares a strong resemblance and is directly influenced by the work of others. These include new

institutional theory in organizational theory, Anthony Giddens's theory of "structuration," and Bourdieu's concept of habitus. I would add Marx to this list as well. Each of these approaches to social science are concerned with explaining how the underlying structures of social life establish the conditions for both stability and change in modern society. At the same time I would add that Marx's dialectical method and his philosophy of internal relations continues to be one of the most flexible and nuanced approaches to understanding change in dynamics social systems.

Dissertation Framework

In his overview of Marx's method of abstraction, Sweezy (1942: 12) reminds us that "the use of abstractions itself is not a key to accurate knowledge, but merely a means towards organizing one's inquiry. The real difficulty lies in the "manner of its application" and "how to decide what to abstract from and what not to abstract from." Sweezy continues, "[h]ere at least two issues arise: First, what problem is being investigated? And, second, what are the essential elements of the problem?"

In the current study, the primary question to be examined is how are we to understand political-economic dynamics that resulted in the large-scale transformation of timberland ownership in the US from industrial forest product firms to institutional investment organizations? From this premise, one could begin with an analysis of the corporate form and examine how ideological changes associated with the rise of shareholder value were instrumental in transforming managers' belief that owning

substantial timberlands was a necessary ingredient for success in the forest product industry.

Once an investigation into corporations begins, however, two things immediately become apparent. First, the corporation itself is a historical institution that cannot be understood in isolation, but must be contextualized within the historical development of capitalism itself. Marx did not live to see the rise of the modern corporation; however, his theory proved to be a valuable guide for interpreting and analyzing the emergence and evolution of the modern corporations over the course of the 20th century (see Hilferding 1981[1910]; Veblen 1958[1904]; Baran and Sweezy 1966). Second, the rise of institutional investors itself requires explanation, because without this willing buyer, forest product managers would not have been so willing to divest of their timberland holdings. The rise of institutional investors has been highlighted as one of the central pillars of the financialization of the US economy. In recent decades, as institutional investors gained control over large portions of publicly traded stocks, they were able steer managerial priorities towards the interests of the shareholding community. This process reversed the trend towards increasing separation of ownership from control that characterized American capitalism for most of the twentieth century.

From these two observations it becomes immediately apparent that the essential elements to the question of causality in the transfer of timberland ownership cannot be limited to changes within corporations, but must be found in the larger macro-economic transformation of the US capitalism, namely the shift towards financialization.

However, at the same time, a second question of this dissertation is how does financialization occur and to what effect in a specific sector such as the forest product sector? In addressing this question, I argue that financialization could not have occurred without a reorganization of the institutional and ideological underpinnings of corporate America. Here we begin to see how the abstract notion of financialization as a macro-structural phenomenon can be grounded within the concrete instances of managerial decision-making. Thus we reveal the internal relationship that exists between financialization at the structural level and the rise of a shareholder value conception of control among corporate managers. By integrating political-economic perspectives on financialization with economic sociology's focus on managerial orientation, I aim to construct a theoretical framework for analyzing change in the US forest products industry.

Furthermore, in situating the rise of the shareholder value conception of control within the totality of historical capitalism we are better able to appreciate and understand the dynamic processes that both produce and destroy existing managerial orientations. The existence of a discernible ideology among corporate managers has been a topic of study for sociologists for over a half-century (Bendix 1956). In recent years, economic sociologists have come to the conclusion that managerial orientations are ephemeral in nature – they are hegemonic for a definite period time, only to be challenged and replaced by an alternative managerial orientation (Fligstein 1990; 2001; Prechel 2000). The cause(s) of this shift in managerial orientations, their timing and meaning, however, continue to be debated within the literature. In this dissertation I use a theory of

historical capitalism to highlight a critical historical thread that runs through and binds these ever-changing conceptions of managerial control.

The literature on financialization and shareholder value has thus far tended to produce only national generalizations, focusing on various changes in the relationship between states, corporations, and managers. This analysis will provide a much-needed industry-based analysis of financialization and shareholder value, examining how the financialization of the forest product firm was accomplished, in part, through the spread of a shareholder value ideology among top managers.

This dissertation will proceed as follows: Part I, consisting of Chapter 1 and 2, provides an overview and synthesis of the literatures on both financialization and the shareholder value conception of control. Chapter 2 will focus on issues of finance and financialization and their development within historical capitalism. In order to highlight the essential elements of financialization this chapter will necessarily proceed from a fairly high level of abstraction. In Chapter 3 I will lower the level of abstraction in order to examine how the modern corporation emerged within the context of historical capitalism. In doing so, I am able to highlight how changes within corporate institutions have been shaped by, and constitutive of, the development of capitalism as a whole. The goal of Part I is to provide a critical synthesis of these two literatures in order to construct a historical sociological framework for analyzing institutional change in modern corporations.

Part II will use this framework to examine the historical development of the US forest products industry over the course of the second half of the 20th century. This

analysis will include a broad overview of the US forest products industry during three distinct periods. The first period (Chapter 4) will cover the industry during the era of “managerial capitalism.” During this period, which lasted roughly from 1945 to 1980, manager’s operated under a “retain and reinvest” conception of control that compelled them to reinvest their large surpluses into expanded capacity. I examine how this strategy affected various aspects of managerial decision-making, including investments, mergers and acquisitions, and timberland ownership. The second period (Chapter 5), lasting from 1980 to 1990, is a transitional period for managers in the forest products industry. This period is marked by the hostile takeover movement of the 1980s and the protracted struggle that took place between finance (ie. shareholders) and management. The third period (Chapter 6) is the era of shareholder capitalism. This period lasts from the early 1990s until the financial crisis of 2008 and is marked by the ascendancy of finance in the US economy along with a transformation of the relationship that exists between corporate managers and shareholders. I examine how the realignment of managerial interests towards the interests of shareholder changed managerial strategies with regard to the same aspects of the firm listed above, including investment, mergers and acquisitions, and, most importantly, timberland ownership. I argue that both the decision by managers to sell-off their timberland holdings and the growth of institutional investors seeking to expand their investment portfolios are directly related to the process of financialization.

In the end, this dissertation seeks to show how a number of seemingly isolated variables – including the rise of institutional investors, shifting managerial ideologies,

changes in ownership structure of the firm, etc. – were each in their interrelation responsible for the changing structure of timberland ownership in the United States. None of these factors, when understood in isolation, explains the fundamental logic at work that first established manager's desire to increase timberland holdings, only to see them sell them off wholesale over the course of three decades. Furthermore, each of them were driven by developments that were external to the forest products industry and are therefore incapable of theoretical explanation in terms of the logic of the industry's development alone. For these reasons that I argue that these changes are best understood, and theorized, in terms of the logic of the system as a whole.

PART I
TOWARDS A POLITICAL ECONOMY OF
CORPORATE TRANSFORMATIONS

CHAPTER II

FINANCE AND FINANCIALIZATION: A HISTORICAL PERSPECTIVE

This dissertation seeks to examine how the financialization of the US economy and the rise of the shareholder value conception of control led to a number of changes in the US forest products industry, most notably a large-scale transfer of timberland ownership from vertically integrated forest product corporations to financial investment instruments. The primary aim of this chapter is to provide a historical overview of finance and financialization in order to construct a theoretical framework through which to examine such changes in the US forest products industry. Since the financialization process did not emerge within a particular industry, I begin my analysis with an overview of financialization in *general*. This will provide us with a basic understanding of the phenomenon, its principle features and historical origins. It will also allow me to highlight some important questions that stem from the financialization literature that will be important for my analysis of the US forest products industry.

I begin with an examination of how financialization is defined in the literature. Next, I provide a brief sketch of the general and contradictory relationship between financial capital and industrial, or productive, capital sectors. I then examine how financial capital emerged in response to the contradictory forces within historical capitalism's evolution. I also provide an overview of several of the more prominent theoretical interpretations of the financialization phenomenon. This chapter establishes a historical and theoretical context for following chapter, where I lower my level of

abstraction in order to examine how dynamics of capital accumulation were manifested within the modern corporation.

Defining Financialization

As a concept, financialization has been employed to describe an array of phenomena, ranging from the dynamics of international financial institutions (Soederberg 2005) to the political economy of everyday life (Martin 2002). With such a wide array of concerns, the concept is beginning to experience “conceptual stretching” as more and more researchers employ the concept to describe various, seemingly disparate, phenomenon (Sartori 1984). As Orhangazi (2010: 3) notes, the concept is now evolving in a similar manner as “globalization,” which is “a widely used term without a clear, agreed-upon definition.” To avoid this trend, it is imperative that we provide a clear and concise definition of financialization, while at the same time being explicit about the relationship between the concept and the phenomenon it is referring to.

Unfortunately, some analysts have dealt with the complexity of financialization by broadening their definition of the concept. Epstein (2006: 3), for example, defines financialization as “the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies.” This definition, though widely cited in the literature, is pitched so wide that it lacks the specificity needed for facilitating a detailed exposition. This difficulty is apparent in many treatments that attempt to include financialization’s multiple and varied

articulations. For instance, Dore (2002: 116-17), who is interested in analyzing the institutional changes that accompany financialization, defines it as

[T]he increasing dominance of the financial industry in the sum total of economic activity, of financial controllers in the management of corporations, of financial assets among total assets, of marketed securities, and particularly of equities, among financial assets, of the stock market as a market for corporate control in determining corporate strategies, and of fluctuations in the stock market as a determinant of business cycles.

In trying to capture the multifaceted nature of financialization, it is easy to fall into the trap of attempting to explain everything, and thus explaining nothing. Definitions of this sort tend to be ambiguous and often lead to confusion over the subject matter under investigation.

In this study I conceptualize financialization at two levels, corresponding to the two levels of abstraction that I will employ.⁸ The first refers to *financialization in general*. At this broad level of abstraction what is most important is that we retain the central features of the concept that are necessary for its exposition. In keeping with my focus on the process of capital accumulation, I define financialization in general as the gravitational shift in economic activity from the productive to the financial sphere of the economy (Foster and Magdoff 2009). This definition of financialization is fundamentally the same as that employed by Krippner (2005), which she based, in turn, on Arrighi (1994). These authors define financialization as a “pattern of accumulation in which

⁸ This approach was inspired by Orhangazi’s (2010) study on financialization and non-financial corporation. At the general level, Orhangazi defines financialization as “an increase in the size and significance of financial markets, transactions, and institutions.” At a lower level he uses “financialization to designate changes in the relationship between the non-financial corporate sector and financial markets.” In this study I maintain his use of a two-tiered definition of financialization, however my method of analysis and definitions are different.

profit-making occurs increasingly through financial channels rather than through trade and commodity production” (Krippner 2005: 181). A more narrow definition will be employed in the next chapter, when I examine the institutional and ideological transformations that occurred within non-financial corporations.

There are several advantages that stem from this “accumulation-centered” definition of financialization. First of all, the definition is parsimonious and contains a clear reference point. As Krippner (2005: 176) notes, an “accumulation-centered” approach to financialization focuses our attention “on changing patterns of profitability,” which is the “key development in the US economy in recent decades.” Secondly, by situating financialization within the process of capital accumulation there is a direct link to the historical patterns of capital accumulation that preceded it, thereby providing a historically bounded interpretation of the phenomenon. A third and closely related advantage of locating financialization within the process of capital accumulation is that the concept retains a clear theoretical orientation. Marx’s emphasis on the process of accumulation as the engine of capitalist society and all its attendant contradictions contains a systematic theory of social change that continues to provide a coherent and flexible interpretation of the historical evolution of the capitalist system.

Pursuing this multi-level approach to a study of financialization also enables me to highlight the relationships that exist between the structural features of financialization occurring at the macro-economic level and more substantive changes within particular social institutions, namely non-financial corporations. This method of exposition not only provides a more nuanced approach to analyzing financialization, but also encourages us

to examine how financialization is articulated through various social institutions. Thus another benefit of this approach is that it provides the means for establishing common ground between political-economic theories of financialization and more narrowly focused theories of corporate and institutional change, commonly found in economic sociology.⁹

Two additional comments concerning my approach to financialization are necessary at the outset. First, my perspective on financialization will be developed primarily within the context of the US economy. I have chosen to do so for two reasons: first, this dissertation's focus is on the relationship between financialization and the US forest products industry, which makes the development of financialization within the context of the US economy an obvious starting point. Second, and more importantly, I am in agreement with Foster and Magdoff (2009: 21) that "the contradictions of capitalism are still best perceived, as Marx emphasized in the nineteenth century, from the standpoint of the preeminent capitalist economy at a given stage of its development." It is from this vantage point that the dynamics of capital accumulation and class struggle, particularly with regard to the state and regulation, are most clearly articulated. This is not to say that there were important international and world systemic forces at work in the development of financialization (indeed, there certainly were), but only that the key dynamics relating to the US forest products industry were likely taking place within the United States.

⁹ See Krippner (2005) for additional discussion of the advantages of approaching financialization from what she calls an "accumulation centered" view of economic change.

Secondly, I argue that financialization is most fruitfully and accurately understood when situated within a historical perspective that emphasizes the contradictory development of historical capitalism. I contend that while our current era of financialization is a unique development of contemporary capitalism, it is not without historical antecedents. That is to say the dynamics that produced our current bout of financialization are rooted in the development of historical capitalism itself. There will be more to say about this in my discussion of the financialization literature below.

Marx's general conception of capitalism is that of a system that experiences periodic crises because of contradictory relationships that are inherent in its constitution. These contradictions are rooted in the social relations of productions that, for various reasons, tend to produce economic crises. However, as Marx (1973: 408) explained in his economic notebooks (commonly referred to as *The Grundrisse*), "Every limit appears as a barrier to be overcome." Overcoming the barriers to capital accumulation requires novel solutions to the barriers facing capital at any given moment. These solutions are not preordained, but are subject to historical contingencies, including those that are internal to capitalism (ie. class struggle) and those that arise from external conditions (ie. nature). The solution to capitalist crisis is not provided by Marx's theory of capital accumulation, only their *necessity*.

The point here is not to attribute agency to some abstract structural process, but to locate financialization as part and parcel of capitalism and its contradictory development - from its early and relatively competitive past, through the development of the modern corporation, and ultimately to the globalized capitalism of the late twentieth century. In

doing so we can begin to appreciate the logic of an economic system through which finance first arose in order to address problems of concentration and competition in the late 19th century, only to be subsumed under the socio-political restraints that emerged in the wake of the New Deal, and then finally develop into its modern form after three decades of deregulation and technological innovation.

Finance and Production in General

Before addressing the history of finance capital it worth taking some time to discuss the general relationship that exists between the financial and the productive sectors of a capitalist economy. The often remarked upon distinction between the “real” and the “financial” economy comes to us from classical political economy, where the “monetary” or “financial” economy was typically dismissed as a veil that obscures the more fundamental process taking place in the production and sale of commodities. Not merely an ideological omission, this dismissal was premised on the fact that prior to the 1850’s, the production and sale of commodities took place primarily between relatively small firms, or partnerships producing for a relatively competitive market. Under these circumstances finance was relatively insignificant and could justifiably be excluded in most economic analyses (Magdoff and Sweezy 1987). But in the closing decades of the 19th century a series of changes took place in both the structure and operation of American capitalism that would require political-economists to pay increased attention to the role of finance capital.

The division of the economy into a real and financial sector often leads to confusion. As Magdoff and Sweezy (1987: 94) point out,

The trouble with this approach is that there is in fact no separation between the real and the monetary: in a developed capitalist economy practically all transactions are expressed in monetary terms and require the mediation of actual amounts of (cash or credit) money.

A more appropriate distinction, they conclude, “is not between real and monetary (all are both real *and* monetary) but between productive and financial” (Magdoff and Sweezy: 94).¹⁰ This distinction is justified on analytical grounds in that it provides valuable insights into the contradictory relationship that exists between these “two poles of capitalism” (Gowan 1999).

The first pole consists of productive capitalist engaged in the production and sale of commodities. Productive capitalists enter the market with a given sum of money (some, or all of which is often borrowed from the financial capitalist) in order to purchase equipment, raw materials, and labor power. These means of production are then employed in the production of commodities, which are then sold in the market in order to earn a profit. This profit appears in the form of money and contains the surplus value extracted from the laborer in the act of production, minus whatever royalties that may be due to the financier. This is the process highlighted in Marx’s general formula for capital, $M-C-M'$, where money is converted into commodities that are then sold for the original sum plus a profit.

¹⁰ In keeping with the confusion of the discourse, in what follows I will use the terms “real” and “productive” interchangeably.

Financial capitalists, or the second pole of capitalism, have a different perspective on the production process. Financial capitalists start with a sum of money (or more appropriately a line of credit) that they then lend to the capitalist for certain period of time, with the expectation that this sum will be repaid in the future with interest. The financial capitalist is less concerned with what commodity is produced and more concerned with the rate of return on their original investment. In theory, capital invested in financial activities will ultimately, in one way or another, find its way into productive activity. In reality, this is not necessarily the case.¹¹ The shorthand for finance capital, therefore, is an abbreviated form of Marx's equation, M-M', where money begets more money and the production and sale of real, tangible commodities are thus a secondary consideration.

Both of these general formulas of capital accumulation were employed by Marx in keeping with his understanding of capital as a process, not a thing; and by depicting the process of capital accumulation in this manner – as a processes driven by a contradictory polar relationship between two of its key structural functions – a number of critical insights for our understanding of modern capitalism arise (Harvey 2010).

The first concerns their contradictory perspectives on the temporality of capital accumulation. At its core, capitalism is concerned with the ceaseless accumulation of capital. Commodities are not produced as an end in themselves, but are viewed as a necessary intermediary step in the pursuit of capital expansion. For financial capitalists, the time between the employment of capital and the realization of the surplus value from

¹¹ A recent study by Lawrence Mitchell (2008) shows how the public stock market has rarely been a significant factor in financing industrial enterprise.

the sale of commodities represents a period of uncertainty and risk. Therefore, financial capitalists have an inherent desire to see quick returns in order to keep capital in its most liquid and flexible form. That is to say the perspective of financial capitalists is decidedly short-term. Productive capitalists, on the other hand, are resigned to longer-term view of capital accumulation because of their necessary concern with the production and sale of commodities. This contradiction is further heightened by industry's increasing reliance on substantial fixed costs, which only realize their original value over many years (Gowan 1999).

A second insight concerns the contradictory social relation that exists between the productive and financial sector. In his economic studies, Marx was primarily concerned with the social relations of *production*; therefore the primary relation under investigation was between capital and labor, the primary relation in the sphere of production.¹² With the emergence of modern (monopoly) capitalism, however, the sphere of production became more complex and must now account for the role of modern finance capital (Dumenil and Levy 2011).¹³ Finance capital can also be understood as a social relation of production because of the critical role it plays in the hierarchical division of labor in modern capitalism. The key social relation of *finance* capital, however, is that which exists between financial and productive capitalist; and the nature of this relationship is

¹² Following many of his classical predecessors, Marx believed that the ascendant industrial class would eventually subordinate finance capital to its needs (see Hudson 2010).

¹³ Dumenil and Levy (2011) present a model of modern capitalism based on a tripolar class configuration consisting of a capitalist class (ie, finance capital), managerial class, and the popular classes.

embodied in the contradictory relationship that exists between these two poles of capital accumulation.¹⁴

Marx's labor theory of value held that all new value is created by living labor at the point of production. Financial processes, therefore, do not create any new value, but provide various functions for capitalists and receive royalties from these services. Financial capitalists, in other words, derive their income from the portion of surplus capital that was extracted at the point of production, but realized in exchange. Because financial capitalists derive their income from the surplus value that is created in the production of commodities, they are necessarily reliant on productive capitalists. On the basis of this relation, Gowan (1999: 13) argues that the productive sector is *determinant* but the financial sector is *dominant*.

The productive sector is determinant because it produces the stream of value out of which the money-capitalists in the financial sector ultimately gain their royalties, directly or indirectly. On the other hand the financial sector is dominant because it decides *where it will* channel the savings from the past and the new fictitious credit-money – who will get the streams of finance and who will not.¹⁵

The dominance of the financial sector stems from its control over the money supply, which represents general social power under capitalism (Harvey 2006, 2010). However, this general dominance is mediated by two important factors.

¹⁴ To be clear, I am not saying that the relationship between finance and productive capital is now the primary, or even the most important, social relation of capitalism. The fundamental social relation of capitalism continues to be the one that exists between capital and labor. Here I am simply stating that after the development of modern, corporate, capitalism we can now justify the analytical distinction of a social relation between financial and productive capital.

¹⁵ This approach is presumably taken from Grahame Thompson whose definition of finance capital is “an articulated combination of commercial capital, industrial capital and banking capital within which banking capital is dominant but not determinant (Thompson 1977: 247).

The first is the business cycle. During a boom, when productive capitalists are reaping high profits and are flush with capital, they are able to establish a degree of relative independence from finance capital because often they are able to finance their own investments from internal funds. And when productive capitalists do rely on credit from finance, they are in a stronger position to dictate the terms of this line of credit because of the relative decline in credit demand. But in a recession, or during a period of declining profit rates, the power shifts to finance capital because they control the credit that productive capitalists require in order to weather the economic downturn (Gowan 1999; Harvey 2006).

The second mediating factor in the relationship between productive and financial capitalists is the state. The state provides the institutional setting in which financial and productive capitalists operate - a setting that is highly contested and at the root of many political battles. Therefore, the state is not only responsible for mediating antagonisms between classes, but also within them. In this case, the conflict is between fractions of the capitalist class. It is the province of the state to determine what restrictions there may be on banking activities, how corporations are able to conduct business, and the conditions under which a market for corporate securities may exist – all of which are influenced by the existing state of class struggle. In fact, in modern capitalism the interdependence of financial capitalists with the state is so salient that it is difficult to determine where the interests of one stops and the other begins, especially with regard to the policies of the central bank. Therefore, it is most appropriate that we view the relation between finance

capital and the state as one that is “founded upon a contradiction within a unity” (see Harvey 2006: 321-324).

In sum, the general perspective that I have just outlined provides a starting point from which we can begin to understand the dynamics of finance and capital accumulation in modern society – however, this is merely a starting point. To understand the *real* historical development of finance we must descend from the heights of broad abstractions and place finance capital within the historical evolution of capitalism itself. This is the task to which I now turn.

Finance and the Rise of the Giant Corporation

As several commentators have noted, the prominence of finance in contemporary capitalism is not without historical precedent.¹⁶ In the late 19th and early 20th century a series of changes took place in the American economy that would forever change how finance functioned in a capitalist economy. During this era, finance first evolved from its marginal role as a means of circulation within the economy to its modern incarnation hovering above, and often dominating, the “real” economy (Mitchell 2007). This phenomenon turned out to be short-lived, but at the time it was widely interpreted as a permanent transformation of maturing capitalist economies (Veblen 1958[1904]). The resurgence of finance in the late 20th century provoked a debate about the similarities and

¹⁶ Indeed, the development of finance preceded capitalism. However, Marx and many others believed that the ascendant industrial class would eventually subordinate financial interests to their needs (see footnote 5). This has led to a vigorous debate concerning the relationship between finance and capitalism. For example, Braudel and Arrighi privilege finance capital over productive capital and therefore trace the origins of modern capitalism to the city-states of fifteenth century Italy (See Arrighi 1994).

differences of these two periods, and whether our contemporary moment represents a qualitatively different epoch, or merely a repeat of previous patterns.¹⁷

The perspective adopted in this study emphasizes the evolutionary character of capitalism as socio-historical system that develops through relations of both contradiction and contingency. Therefore, setting aside the debate about the similarities and differences between these two “periods” of capitalism, I find it is, at present, most useful to examine the historically specific dynamics that produced these “periods of finance.” In doing so, we begin to develop an appreciation of the various “functions” of finance capital, how it emerged in particular periods in order to address the specific contradictions of capital accumulation, and how it relates to other periods of financial dominance as well as to the contradictory development of historical capitalism as a whole.

Let us begin in the late 19th century with the rise of the Giant Corporation.¹⁸ During this era a number of contradictions were developing within American capitalism; the very contradictions that Marx highlighted in his economic studies. According to Marx (1967), the logic of capitalist competition produced a tendency for capital to accumulate in increasingly larger units. In this discussion Marx draws a distinction between the *concentration* of capital and the *centralization* of capital. The former refers to the increasing scale of individual capitals that necessarily results from the

¹⁷ See Arrighi (1994); Kotz (2011)

¹⁸ To be clear, I am not arguing that finance was invented in the 19th century (it certainly was not), but only that its modern incarnation is directly linked to the rise of the giant corporation during the second half the 19th century. That is to say the emergence of modern corporate capitalism had a profound effect on the *form* that finance capital would take during the 20th century.

accumulation process; the latter, on the other hand, refers to the process of combining these existing capitals into a “single hand” by withdrawing it from the “many individual hands” and thereby bringing it under the control of a single unit. Both the concentration and the centralization of capital would become defining features of the American economy in the closing decades of the 19th century.

The destructive nature of market forces in late 19th century America first compelled capital to centralize under the auspices of finance (Mithchell 2007; Kerbo 1963). In the decades following the Civil War the American economy underwent a dramatic transformation from a largely agrarian economy to one of the world’s foremost industrial powers. Under these circumstances competition became increasingly problematic, due in large part to the nature of industrialized economies and their need for increasingly large sums of capital to finance enormous industrial projects with significant sunk costs.

The railroads, more than any other industry, led the way in exposing this dynamic (see Perelman 2006; Chandler 1977). Railroads require enormous investments up front in order to finance the laying of tracks. Once the tracks have been laid they are “sunk” capital and thus cannot be liquidated or converted into alternative uses. In order to maximize returns on this investment, there is pressure to operate at a high capacity, even if this means cutting prices. In a competitive environment, this results in a vicious cycle in which competing firms continue to cut prices in order to maximize returns, even if these returns are below what is required to make a return on the original investment. This was not only a problem for the railroads, but for other industries operating with enormous

sunk costs and a competitive market, including, as we will see, the forest products industry.

In order to bring stability and order to the anarchy of market competition, industrialists sought protection through various forms of cooperation. Cooperation required a break from the free market orthodoxy that dominated economic and political elites (at least in practice, if not in ideology) and a move towards more collective and cooperative forms of business. Leading the ideological support for this transformation were some of the most prominent economists of the day, including John Bates Clark and Richard Ely (Perelman 2006; Mitchell 2007). According to them, *laissez-faire* was successful in a pre-industrial market environment, but was now wildly impractical. The evolution of American society from its agrarian past to an industrial powerhouse required new economic principles that would stabilize the chaos of market forces. The US economy was no longer characterized by Adam Smith's small producer pursuing his self-interest in a competitive market, but was dominated by large industrial firms, with enormous investments, controlling significant segments of the market. Under these circumstances, cooperation, not competition, would be necessary for continued capital accumulation.

In addition to economists, financiers were growing increasingly impatient with the destructive competition of US markets. As Mitchell (2007: 3) notes:

Destructive competition had been a problem for years. But it was only during the last few years of the nineteenth century that business distress combined with surplus capital searching for investment opportunities, changes in state corporation laws, and the creative greed of private bankers, trust promoters and the newly evolving investment banks created

the perfect storm that shifted the production goals of American industry from goods and services to manufacturing and selling stock.¹⁹

Foremost among the financiers was J.P. Morgan, the father of modern finance and the person who, more than any other, was responsible for the financial takeover of industrial America. Unlike the stalwart defenders of *laissez faire* economics today, J.P. Morgan was able to grasp the nature of destructive competition and considered himself a “sworn foe of free markets.” (Chernow, quoted in Perelman 2006: 116). Morgan took it upon himself to rationalize the chaos of the market. On several occasions, he sat down with leading representative from the railroad industry and promised that no new railroads would be financed if they would agree to stop cutting rates. Yet the tension between cooperation and competition proved extremely difficult to overcome: the directors of the railroads understood that that competition was destructive to the group as a whole, but could not overcome the compulsion to cut rates and squeeze every dime out of their lines. As a result, one-third of all railroads were in receivership by 1893 (Perelman 2006: 116-119).

Morgan was eventually successful in his efforts to consolidate the railroad industry. In doing so, he set the stage for a wave of mergers that washed over the American economy in the closing decade of the 19th century. According to Kerbo (1963), the merger wave was largely unsuccessful in its attempt to control excessive competition; however, it did succeed in enriching a handful of financiers and promoters who made fortunes by issuing watered and overcapitalized securities from the merged

¹⁹ This process is similar to the developments taking place in Germany during the same time period, which formed the backdrop of Hilferding’s classic Marxist study, *Finance Capital* (Hilferding 1981)

companies. But the critical development to emerge from this period was the Giant Corporation itself, an institutional form that would become the hallmark of American Capitalism in the 20th century.

It must be stressed that the modern corporation is itself a financial creature. In its earliest incarnations, the corporation was a legal device that enabled various partners to pool their resources into an enterprise without each of them taking the risk of losing their entire fortune. Yet as opposed to a partnership in which two or more individuals actually own the business and its assets, under the corporate form it is the corporation that owns the assets, while investors own shares that entail them certain legal rights, including the right to vote for directors, income from distributed dividends, etc. For as Magdoff and Sweezy (1987: 101) point out, “The difference between owning real assets and owning a bundle of legal rights may at first sight seem unimportant, but...[i]t is in fact the root of the division of the economy into productive and financial sectors.” The fact that the corporation owns the assets, while shareholders own pieces of paper that grant them access to future revenue streams, means that shareholders can sell their shares on an open market. In doing so, the ownership of corporate securities opens up a level of liquidity to capital formation that was previously impossible. And once this stage was reached, and especially after corporations gained the right to buy stocks in other corporations, the flood gates were open for a virtually unlimited proliferation of holding companies, bond markets, and financial instruments.

And thus through a steady evolution, consisting of much trial and error, American capitalism underwent a qualitative transformation that set the stage for monopoly, or

corporate capitalism, to develop and expand across the globe during the 20th century.²⁰

As Magdoff and Sweezy (1987: 95) put it,

By the end of the nineteenth century, with the spread of larger and larger corporations as the typical form of business enterprise, the composition of the capitalist economy underwent a qualitative transformation. The issuance of many types and quantities of corporate securities brought in its train the development of organized stock and bond markets, brokerage houses, new forms of banking, and a community of what Veblen called captains of finance who soon rose to the top of the capitalist hierarchy of wealth and power.

The foregoing discussion serves to provide a brief overview of the dynamics taking place in late 19th and early 20th century America that resulted in the development of modern finance and, most importantly, the Giant Corporation. I argue, along with Sweezy and his coauthors, that that these historical developments were the necessary precursors to the process of financialization that overtook the US economy in the closing decades of the same century. But the question then becomes: if the necessary elements of a financialized economy were in place by the second decade of the 20th century, then why did it take more than a half century for financialization to become generalized? That is to say, why did a latent financial sector remain subordinate to the industrial sector for over half a century, only to become manifest in the 1970s? The answer, as always, must be found in the historical development of American capitalism and the contingencies of time and space.

²⁰ The developments I have just described were the same events that led Thorstein Veblen to conclude that “Industry is carried on for the sake of business, and not conversely” (Veblen 1958). They were also the central dynamics under investigation in Hilferding’s *Finance Capital* (1981) and Lenin’s *Imperialism* (1966); where the latter concluded that finance capital was synonymous with monopoly and imperialism, the highest stage of capitalism. This is not the place to describe these various theories in detail, but it will suffice to say that each of these observers, as well as many others, were convinced that a qualitative shift had taken place in the historical development of capitalism, a shift that marked the transition from a developing to a *mature* capitalism.

War and the Resurgence of Production

As it turns out, the prominence of finance over industry in the early 20th century was short-lived. A series of circumstances, most importantly the onset of the First World War, tilted the power relation between productive and financial capitalist back in favor of the former. The War brought about a series of market regulations that coordinated the American economy towards the war effort. The war also marked the turning point for the United States from a debtor nation to a creditor nation, and by war's end, the American economy was poised for a decade of substantial growth. Importantly, corporations, flush with cash, were able to finance their own investments instead of relying on credit from the financial community. As a result, the relative power of finance capital continued to diminish throughout the 1920s (Perelman 2006).

The “roaring twenties” came to a screeching halt with the stock market crash of the 1929.²¹ The Great Depression that ensued produced extreme deprivation for millions of workers and a reassessment of economic doctrine on the part of many in the propertied class. It was in this environment that the ideas of John Maynard Keynes found fertile ground. Keynes was extremely critical of financial excesses, calling for the “euthanasia of the rentier” (Keynes 2006[1936]: 345) in order to overcome their propensity to hoard in times of economic uncertainty.

²¹ The fact that it was the stock market crash that triggered the Great Depression led many to place blame primarily on the banks. However, it was the decline in traditional financial services associated with diminishing demand for outside financing that produced the speculative binge of the late 1920s. As Perelman notes, it was industrial capital rather than financial capital that was dominant during the 1920s (Perelman 2006: 149-152).

Keynes' ideas found teeth in the regulatory changes of the New Deal. According to Orhangazi (2008: 29), "[t]he new regulations had two major aims: to ensure the stability of the financial sector and to support the growth and capital accumulation agenda of the era." Perhaps the most important regulation was contained in the Glass-Steagall Act of 1933 which called for a separation of commercial and investment banks. The primary aim of this legislation was to prevent deposit-taking institutions, which were newly guaranteed by the Federal Deposit Insurance Corporations (FDIC), from issuing securities. There were also limits placed on the interest rates that banks were able to charge. In sum, the US government enacted a policy of "financial repression," severely limiting the banking sector's ability to control industry and reorienting the economy towards a productivist agenda.

But once again, the onset of war produced lasting change for the US economy. The Second World War brought the US economy out of depression and set the stage for what came to be called "the Golden Age of capitalism." With all other major industrial powers still smoldering from the devastation of war, the US economy, led by the Giant Corporation, stood alone atop the capitalist world system. Domestically, a series of federal programs in housing and highway construction, along with a glut of saved earnings from the war era, helped spur an unprecedented period of economic prosperity. In addition, a relatively powerful working class led by strong unions forced American corporations to include labor in profit sharing, thus providing increased purchasing power for a rising middle class.

During this period Paul Sweezy (1953: 195) proclaimed that,

[t]he dominance of financial over industrial capital, which for a while was widely interpreted as a more or less permanent state of affairs, is thus seen to have been a temporary stage of capitalist production, a stage which was characterized above all else by the process of forming trusts, combinations, and huge corporations.

Thus the banks and finance capital were resigned to a secondary position in American capitalism. But as Sweezy's comment suggests, nothing is permanent under capitalism. The enormous profits generated by US corporations in the decades following the war would confront their own contradictions. By the late 1960s, creeping stagnation along with increased competition from abroad produced yet another crisis for American capitalism. And out of this crisis came the unprecedented resurgence of finance capital in its current form, a phenomenon that is now commonly referred to as the "financialization" of the American economy.

Financialization

The prominence of finance in contemporary capitalism is now widely acknowledged. The proximate cause of financial ascendancy, however, continues to be a point of debate. The literature on the subject has grown quite large, with some attributing the revolution in finance to changes in technology (Davis 2009), others emphasizing the role of deregulation (Stiglitz 2010), and still others attributing it to the effects of globalization.²² In reality, each of these played their own part in shaping financialization to a degree. None of these, when understood in isolation, provide an explanation of the

²² See Krippner (2005) for a critique of the idea that financialization is simply an effect of globalization.

fundamental logic at work that created the need, or incentive, for finance capital to break free of its post-war chains; nor are they able to integrate their perspective into a more systematic theory of change in modern society. A more appropriate approach, I argue, is to situate financialization within the historical development of capitalism itself, conceived as a contradictory system that develops through the dynamics of capital accumulation and class struggle. In a word, a Marxian perspective.

Like most Marxian analyses of financialization, I trace the origins of financialization to the economic crisis of the early 1970s, and the dismantling of the post-war regime of accumulation. The proximate cause of this crisis and its relationship to financialization continue to be points of vigorous debate.²³ In the following section, I focus primarily on what I believe are two of the more compelling explanations of financialization: The Monthly Review School's theory of *monopoly-finance capital* (Foster and Magdoff 2009) and Giovanni Arrighi's (1994) *systemic cycles of accumulation*. My preference for these theories is based, in part, on the fact that they some of the earliest theorists of financialization and that they built their analysis on a historical framework that revealed finance as a particular solution to a capitalist accumulation crisis.²⁴

²³ See Choonara (2009) for one of the more comprehensive reviews of Marxian interpretations of the financial crisis.

²⁴ Kevin Phillips (1993; 1994) deserves credit for his early recognition and historical analysis of financialization. Phillips is a former Republican strategist turned fierce critic that published a series of books analyzing financialization and the corruption of American power (Phillips 2006; 2008). Phillips' empirical analysis of financialization has striking similarities to both Arrighi and Sweezy, yet his lack of theoretical orientation leave his works open to a wide array of interpretations.

Monopoly-Finance Capital

Paul Sweezy and his co-authors deserve particular credit for drawing early attention to the rapid growth of finance in the American economy in the second half of the 20th century (Baran and Sweezy 1966; Sweezy 1981; Magdoff and Sweezy 1987; Sweezy and Magdoff 1988). In their view, the financial explosion of recent decades is an outgrowth of the stagnation tendencies that are inherent in mature capitalist economies. Sweezy's most elaborate exposition of this argument is developed with Paul Baran in *Monopoly Capital* (1966) where they argue that the development of the Giant Corporation produced a qualitative shift in the functioning of capitalist economies. In short, they argued that the competitive drive of free markets, which was a basic assumption among political economists (including Marx), was no longer an apt characterization of modern (read: monopoly) capitalism. Instead, they argued that under monopoly capitalism the form of competition was fundamentally altered, producing a general law of monopoly capitalism "that the surplus tends to rise both absolutely and relatively as the system develops" (Baran and Sweezy 1966: 72).

The idea that there is a tendency for surplus to rise under monopoly capitalism must be understood in relation to the diminishing investment opportunities in mature capitalist economies. Surpluses can be used in a number of ways, but as capitalists, the majority of these surpluses need to be invested in order to achieve ever greater accumulation. Yet under monopoly conditions the very conditions that give rise to these enormous surpluses also serve as a barrier to their continued expansion. In oligopolistic industries, firms tend to produce just enough commodities to sell at the current market

rate. This often leads to overcapacity, since firms are not willing to run at full tilt, which would flood the market and cause prices to drop. Instead, firms tend to pull back on production in order to maintain price stability. As a result, Baran and Sweezy argue, there is a built in tendency in mature capitalist economies towards stagnation.

The tendency towards stagnation that Baran and Sweezy identified was just that, a tendency. As with any tendency there are countervailing forces that work against it. At the time *Monopoly Capital* was published, Baran and Sweezy identified several factors countering the tendency towards stagnation in the US economy. These included sustained state expenditures in the civilian and military sectors, the sales effort, and the second great wave of auto mobilization and the suburbanization of American cities. Another, prospect, which they only hinted at in *Monopoly Capital*, was the likelihood of surpluses being channeled into the FIRE (Finance, Investment, and Real Estate) sectors of the economy.

In the early 1960s the surplus being invested into the financial sectors was relatively small. Yet in the years following the publication of *Monopoly Capital*, Sweezy, now writing with Harry Magdoff, began to note the rising share of profits taking place in the financial sector. During the late 1970s and early 1980s, as the financial explosion began to take off, Magdoff and Sweezy published a series of articles on how the growth of debt and finance were counteracting the stagnation tendencies of the American economy (Magdoff and Sweezy 1987; Sweezy and Magdoff 1988). They argued that the main solution to the dearth of investment opportunities “was to expand their demand for financial products as a means of maintaining and expanding their money

capital (Foster and Magdoff 2009: 79). The result was a proliferation of financial instruments such as futures, options, derivatives and hedge funds. Magdoff and Sweezy (1977) commonly referred to this process as the “financialization of the capital accumulation process.”

Foster and Magdoff’s recent publication, *The Great Financial Crisis* (2009) applies the theoretical work outlined above to the ongoing process of financialization.²⁵ They refer to financialization in terms of “monopoly-finance capital,” in order to emphasize the “systematic embrace” that exists between the tendency towards stagnation and the financial explosion of recent decades (Foster and Magdoff 2009: 19). In this case, they argue that financialization was functional for US capitalism because it provided a solution to the problems of stagnation under monopoly capitalism. Foster and Magdoff developed their theoretical framework through a series of essays that documented and analyzed the financialization process as it took place. This included their early recognition of the housing bubble and their warnings about an impending financial collapse.

The financialization process was fueled by an explosion of debt in the US financial sector. During the postwar era, banks were primarily involved in loaning funds that had been deposited by the public and banks collected interest from others who were taking on debt. During the financialization period, however, banks and financial institutions themselves became substantial borrowers. Between 1981 and 1988 debt in the financial sector grew from 22 to 42 percent of GDP and by 2005 the financial sector’s

²⁵ This work refers to Fred Magdoff, the son of Harry Magdoff who collaborated with Paul Sweezy in their early analysis of financialization.

debt to GDP ratio had skyrocketed to over 100 percent (Foster and Magdoff 2009: 45-47).

This massive infusion of debt helped fuel a series of financial bubbles in the US economy. The first major bubble inside the US economy occurred in the information technology sector (commonly known as the dot-com bubble), which popped in early 2000 after the Federal Reserve increased interest rates. The bursting of the dot-com bubble flooded the global market with surplus dollars seeking investment. Much of this capital found a home in various financial investments tied to the US real estate market. This process – what financial analyst Stephanie Pomboy described as “The Great Bubble Transfer” (Cited in Foster and Magdoff 2009: 94) – enabled the US economy to quickly rebound from the recession of 2001. However, this massive infusion of capital set the stage for the largest real estate bubble in US history, which popped in 2006 and ultimately led to the Great Financial Crisis of 2008-09. The blowing of financial bubbles is a pronounced feature of a financialized economy and when they pop – as most financial bubbles do – they can have devastating effects on the broader economy (Foster and Magdoff 2009).

Financialization, Hegemonic Transitions, and Systemic Cycles of Accumulation

The analysis of financialization outlined above is focused primarily on the development of capitalism in the United States over the course of the 20th century. Another early treatment, and perhaps the most ambitious, was developed by Giovanni Arrighi in his books *The Long Twentieth Century* (1994) and *Chaos and Governance in*

the Modern World System (1999). Arrighi (1994: 4) argues that the recent transformation in capital accumulation should be investigated “in the light and patterns of recurrence and evolution, which span the entire lifetime of historical capitalism as a world system.” More specifically, he argues that financialization is not unique to our current historical moment, but that it has been a reoccurring phenomenon through four hegemonic transitions in the capitalist world system.

Arrighi constructs his analysis of financialization upon Braudel’s three-tiered conceptualization of capitalism which contains a bottom layer consisting of material life, a middle layer of the market economy, and a top layer consisting of finance, which he insists is the “real home of capitalism” (Arrighi 1994: 10). The point of this model is to draw attention to the “flexibility” of capitalism and its ability to take different concrete forms in various spatial and temporal contexts. He further elaborates on this notion by restating Marx’s general formula of capital: MCM'

Money capital (M) means liquidity, flexibility, freedom of choice. Commodity capital (C) means capital invested in a particular input-output combination in view of a profit....Thus understood, Marx’s formula tell us that capitalist agencies do not invest money in particular input-output combinations...as an end in itself. Rather, they do so as a means towards the end of securing an even greater flexibility and freedom of choice at some future point (Arrighi 1994: 5).

Arrighi uses this framework to analyze four successive hegemonic transitions in the evolution of the capitalist world system. These epochs alternate between periods of material expansion (MC phases of capital accumulation) and periods of financial expansion (CM' phases) and together they constitute what he calls a “systemic cycle of accumulation” (Arrighi 1994: 6). Each systemic cycle of accumulation is conducted

under the leadership of a particular hegemonic state and it is the period of financialization that demarcates an impending hegemonic transition. From this perspective, the current period of financialization marks the decline of hegemonic power for the United States and the end of its systemic cycle of accumulation.

Arrighi's analysis of financialization over the *longue durée* provides a major theoretical contribution to our understanding of the evolution of the capitalist world system. Yet while *The Long Twentieth Century* provides evidence of how financial expansions tend to occur in the later stages of hegemonic development, it does not provide sufficient analysis of the specific crises that produce these financial expansions. In Arrighi's subsequent book, *Chaos and Governance* (1999), he addresses the causes of financial expansions in more detail, arguing that they are the outcome of "two complementary tendencies: an overaccumulation of capital and intense interstate competition for mobile capital" (Arrighi and Silver 1999: 31). Here finance capital serves as the pivot point in a hegemonic transition in the capitalist world system as capital unhinges its ties to one territory and searches for another.

There are important differences between the monopoly-finance capital view of Sweezy and Foster and Arrighi's *longue durée* perspective. Monopoly-finance interprets the current era of financialization as a byproduct of contradictions in the accumulation of capital in mature capitalist economies. Their analysis does not include the possibility that previous hegemonic declines in the capitalist world system would have experienced a similar period of financialization, because their analysis of monopoly capitalism is focused on its development within 20th century American capitalism. Arrighi, on the

other hand, sees financialization as a reoccurring phenomenon that serves the same function for Dutch capital in the 18th century as it does in 20th century America. Another difference between the two perspectives is their take on the functional aspects of financialization. The monopoly-finance perspective interprets financialization as a means to maintain accumulation in a period of declining investment opportunities. Arrighi, on the other hand, argues that financialization is characteristic of capital reverting to its more flexible form in order to escape the bounded territoriality of commodity production within a particular hegemonic state.

With sufficient flexibility, however, it is possible to interpret these seemingly antagonistic interpretations of financialization as different features of the same dynamic and thus not as different as they may seem. For instance, Arrighi's emphasis on the competition for mobile capital provides a key link that is missing from the Sweezy/Magdoff/Foster analysis of financialization, especially with regard to how financial crisis resolve themselves. In this case, a crisis of financialization is resolved when capital takes root in a new territory that provides institutional support and access to resources that are necessary for capital accumulation to resume.²⁶

On the other hand, economic crises can result from multiple factors and by emphasizing the particular form of each crisis we avoid the tendency to obscure important difference with reference to the broader concept of overaccumulation. This applies to the accumulation crisis of the 1970s and the particular way in which finance

²⁶ In Arrighi's *Long Twentieth Century* (1994) he concluded with a discussion of Japan and the likelihood that it would become the next hegemonic state in the capitalist world system. In time, China's rapid development made it the most likely successor to US hegemony. Arrighi's final book, *Adam Smith in Beijing* (2007) discusses this possibility.

was able to provide a solution to the barriers that were then inhibiting capitalist growth. It also allows us to examine how particular institutions were restructured in order to accomplish this task. This is critical for this dissertation because of my particular concern with transformations taking place in the US forest products industry. In the end, both theories trace the rise of financialization back to the accumulation crisis of the early 1970s and are concerned with the role of financialization in sustaining American hegemony in a period of economic instability.

While I believe the two perspectives outlined above to be the most rigorous and historically informed interpretations of our current period of financialization, they are certainly not the only scholars to have taken up the financialization debate. Dumenil and Levi's (2004; 2011) important contributions to our understanding of finance have explored the ties between economic crisis, class struggle, and the rise of a "finance" class in the upper echelons of American class structure. And Greta Krippner's (2011) recent contribution has revealed many of the important political dynamics that provided the necessary opening for the proliferation of the financial sector. Others have focused on the international dimensions of financialization. Gerald Epstein's, *Financialization and the World Economy* (2005), is a collection of essays that analyze how international financial markets have led to crisis in countries across the globe. Susan Soederberg's *The Politics of the New International Financial Architecture* (2005), focuses on the political dimensions of international finance and also argues that the financial interests of those within the G7 have constructed an international regime of finance that preys on developing countries of the global south. Samir Amin, too, has focused on the class basis

of financialization, arguing that the dominant stratum of American capital, or what he calls “oligopoly-finance capital,” has been at center of the economic and political transformation of the neoliberal era (Amin 2008).

Conclusion

The foregoing discussion serves to outline the basic parameters of finance capital and its relationship to both capitalism in general and the historically specific phenomenon of financialization. For our current purposes it is less important that we determine the specific causes of financialization per se, than it is that we conceptualize it as a particular resolution to a specific crisis of historical capitalism. In this case, it was the accumulation crisis of the 1970s that provided the impetus for the transformation of the institutional and ideological components of American society in order to establish and legitimate ongoing capital accumulation. To be clear, I am not arguing that the turn towards finance was a necessary outcome of the crisis of the 1970s, only that, in the end, it did provide a viable means for resuscitating capital accumulation in an era of creeping stagnation.

The literature on financialization is critical in that it provides a historical interpretation of how finance arose in response to a particular crisis of capitalism. However, as Krippner (2011: 13) points out, “there are some important limitations of an analysis that conceptualizes financialization as a response to crisis at the level of the capitalist system as a whole.” The primary limitation is that it is difficult to identify the discrete social actors involved from such a high level of abstraction. This is a common

criticism of structural analysis and one that should not be ignored. Therefore, it is incumbent upon those that tend towards structural analyses to explain how embedded social actors respond to the conditions of economic crisis and how these responses are articulated through various institutions. Furthermore, it is critical that we appreciate how the resolution of a crisis involves a protracted struggle over both what caused a particular crisis and how it should be resolved. These struggles are manifested in the ideological interpretations of crises by embedded social actors that are responding to structural contradictions.

In the following chapter, therefore, I lower my level of abstraction to analyze how the dynamics of capital accumulation that were described above were articulated in the behavior of corporate managers. This analysis will entail a critique and synthesis of the economic sociology literature on managerial conceptions of control in corporate governance. The result will be a critical theory of ideological change in corporate governance that sees the rise of the shareholder value conception of control as one of many articulations of the broader process of financialization.

CHAPTER III

FINANCIALIZATION, SHAREHOLDER VALUE, AND CORPORATE TRANSFORMATIONS

The preceding chapter examined the rise of financialization within the context of historical capitalism, emphasizing how it emerged in response to a particular barrier to accumulation that arose in the early 1970s. Financialization, in this sense, provided a workable solution for maintaining capital accumulation in the face of creeping stagnation. In order to bring the essential elements of this process into relief, it was necessary to present a picture of modern society that was highly abstract. In this chapter, I offer a more narrowly focused level of analysis in order to examine how the financialization process affected change in various aspects of the modern corporation.

As we recall, I conceptualized finance capital as a particular social relation of production that is fundamental to the composition of advanced capitalism. I also explained how finance capital maintained a necessary, yet contradictory, relationship with productive capitalists. The financialization process, in this sense, can be conceived as an increase in the power of finance capital relative to productive capital. In what follows, I examine the relationship between the shareholders and managers of modern corporations as a particular manifestation of this general relationship. In other words, shareholders are generally assumed to embody the interests of finance capital while managers hold the interests of productive capital.²⁷ By situating my discussion of the

²⁷ This is not to say that either group will necessarily engage in behavior that is in line with those interests. Indeed, this is exactly the point. For example, just as an investment banker in the 1950s might believe that the role of finance is to help and support their industrial clients, so might an industrial manager in the 1990s believe that the a manager's primary responsibility is to create shareholder value.

corporation in this manner, I am able to highlight how changes within corporate institutions have been shaped by, and constitutive of, the development of capitalism as a whole.

I begin this chapter with an overview of the economic sociology literature on the modern corporation. Here I argue that there is a bias in the literature on corporate management that tends to emphasize a one-sided cultural view of change while ignoring the material underpinnings of social change. In order to overcome this one-sidedness I attempt to integrate the political-cultural approach to analyzing corporate transformations (Fligstein 1990; 2001) with the historical and structural analysis of political economy (Baran and Sweezy; Foster and Magdoff 2009; Arrighi 1994). This integration also includes a review of the limited existing research on the financialization of non-financial corporations and its various contributions. In order to formalize my integration of these literatures I also introduce the concepts of *organization* and *control* to describe the critical components of corporate change. Questions drawn from this framework will then be used in Part II of the dissertation to examine how the financialization process led to a series of internal transformations in the US forest products industry, and ultimately the transformation of timberland ownership.

Economic Sociology and the Modern Corporation

The corporation has long been a central object of analysis in economic sociology. Beginning with Berle and Means (1933), and their analysis of the corporate revolution of the early 20th century, it has been a central concern of economic sociologists to explain

the relationship between ownership, control, and the structural organization of modern corporations (Fligstein 2001). A common approach taken by sociologists has been to locate and identify a capitalist class and its relative degree of cohesiveness (Zeitlin 1974; Useem 1984). This has led to a protracted debate about “who controls the corporation,” and a number of divergent takes on the social and economic functions of the Giant Corporation (Mintz and Schwartz 1985; Kotz 1978).²⁸

In more recent years, economic sociologists developed more dynamic theories of corporate behavior that seek to ground managerial decision-making within the structure of relations among large corporations and the state. These perspectives build on the notion of the embeddedness (Granovetter 1985) of economic actors and seek to explain corporate behavior in reference to their organizational fields (DiMaggio 1985). Organizational fields produce what Reinhard Bendix (1956) referred to as “managerial ideologies” or a systematic way of viewing the company and its priorities. In more recent years, Neil Fligstein (1990; 2001) developed an analysis of what he calls a “political-cultural approach” that seeks to ground corporate behavior in the relatively stable relations that govern behavior for a period of time. According to Fligstein, these relatively stable relations experience periodic disruptions that force managers to seek out solutions to their collective problems. In recent decades, corporate managers have come under the sway of a shareholder value conception of control that measures corporate

²⁸ The debate over who controls the corporation – whether it be banks, managers, or shareholders is part of a much broader literature on corporate power. See Mizruchi and Bey (2005) for a good overview and synthesis of this literature.

success primarily in terms of increased returns to shareholders, most importantly in terms of share price appreciation (Fligstein 2001; Lazonick and O’Sullivan 2000; Davis 2009).

Economic sociologists have done much to advance our understanding of corporate institutions and managerial behavior. To their credit, they have drawn our attention to the ephemeral nature of corporate structures and managerial orientation, providing valuable insights into the ideological constraints of actors embedded within definite social relations. But, as Fligstein presciently notes, “The theoretical difficulty is deciding what that embeddedness consists of” (Fligstein 2001: 145).

The trouble with Fligstein and other economic sociologists, in my view, is that there is a one-sidedness to their cultural analysis. While elucidating the cultural orientations of managers, their perspective overlooks how the material reproduction of society, driven by the contradictory dynamics of class struggle and capital accumulation, provides both the impetus for changing conceptions of control and some valuable insights into their emergent forms. In contrast, I argue that by situating shifting conceptions of control within the context of material changes in the process of capital accumulation we gain a richer and more powerful understanding of what drives corporate decision-making and institutional change. Furthermore, this perspective enables us to draw the necessary connections between managerial orientation and the broader dynamics of class struggle in contemporary society. In short, my contention is that within any given historical period

there is rough correspondence between the social relations of production in general, and those that exist within corporate institutions.²⁹

Economic sociologists, it should be noted, are not alone in their one-sidedness. Political economists, and theorists of financialization in particular (with a few notable exceptions), often overlook or altogether ignore how ideological shifts accompanied, and made possible, various transformations in the political and economic structures of modern society. That is to say, the tendency to downplay cultural and ideological aspects of change in structural analyses is often just as salient as the tendency for cultural theorists to ignore structural dynamics of modern society.

An alternative to maintaining the polarization of cultural and structural analyses of change is to see them as internally-related aspects of the same phenomenon. They are both necessary components of any meaningful historical change. This is not to say that one may not be more fundamental in explaining a particular historical juncture – this is an empirical question – only that a complete analysis of any socio-historical transformation should account for both. In this sense, I argue that financialization and the rise of shareholder value ideology are internally-related aspects of the same socio-historical process.

²⁹ This idea was incorporated from Samuel Bowles and Herbert Gintis' *Schooling in Capitalist America* (1976). In this work they put forth "the correspondence principle," which asserts that the "social relations of education" normally correspond to the social relations of production in capitalist society (see also, Foster 2011).

The Managerial Revolution

The rise of the giant corporation in the late 19th and early 20th century constitutes one of the seminal transformations in the history of modern capitalism. Arising out of the forces of concentration and centralization in the process of capital accumulation, the corporation proved to be the most viable institution for carrying out the capitalist function in the changing reality of maturing capitalism. No longer was capitalism to be characterized by the aspiring entrepreneur and the small producer operating in a relatively competitive market, as had been widely assumed among classical political economists. The Giant Corporation marked the coming of Monopoly (or Oligopoly) capitalism in which the central economic actor was the Giant Corporations: a vertically integrated institution controlling vast sums of capital, containing multiple divisions, and often employing hundreds of thousands of workers.

The rise of the modern corporation spurred a series of studies seeking to understand the significance of this economic institution. In 1932, Berle and Means published their landmark study, *The Modern Corporation and Private Property*, in which they argued that the separation of management from control had profoundly changed the character of modern capitalism. Their argument was that the rise of the giant corporation resulted in a concentration of power in the hands of managers and a concomitant decrease of power for owners, who had now become diffused among thousands of anonymous stockholders. Berle and Means thought the separation of management from control

represented a monumental shift in the capitalist function, one that would continue into the indefinite future (Berle and Means 1967[1932]).

In years following the publication of Berle and Means study there was broad agreement over their basic insight: the rise of the giant corporation *had* produced a marked change in the relationship between ownership and control in modern capitalism (Chandler 1977; Mizruchi 2004; Herman 1981). The consequences of this change, however, were highly contested (Ryan 2000). Berle and Means' primary concern was with the economic implications that stemmed from the separation of ownership from control. Capitalism had long been justified on the grounds that direct ownership of the means of production provided the entrepreneur with the individual initiative necessary to maximize efficiency, and thus profits. With the rise of the modern corporation, however, it seemed that this foundation had been eroded. Berle and Means argued that the interests of managers were not necessarily in line with the interest of the firm's owners. The owners of the firm, they assumed, were primarily interested with maximizing profits. The managers, on the other hand, were more interested in the long term stability of the firm, and their own ability to rise within its internal hierarchy. In addition, Berle and Means argued, the door was now open for corporate managers to address the concerns of other "stakeholders," such as employees and communities.

Berle and Means were not solely concerned with the economic implications of the separation of ownership from control but also expressed concern over the social and political ramifications of an increasingly powerful managerial class. In Mizruchi's (2004: 581) apt description, Berle and Means "wrote of a small group, sitting at the head

of enormous organizations, with the power to build, and destroy, communities, to generate great productivity and wealth, without regard for those who elected them (the stockholders) or those who depended on them (the larger public).” In the closing lines of their book, Berle and Means warned of the growing economic concentration taking place in the giant corporations and warned that one day they might supersede the state “as the dominant form of social organization” (Berle and Means 1967[1932]: 313). In the eyes of Berle and Means the rise of the modern corporation was not just an economic phenomenon, but constituted a revolutionary transformation of American society that was on par with the Industrial revolution itself.

Others were more sanguine about the broader implications that stemmed from the separation of ownership from control. Sociologists, such as Daniel Bell, Ralf Dahrendorf, and Talcott Parsons, interpreted this development as a move towards increased democracy. Ralf Dahrendorf, for instance, believed that the separation of management from control resulted in a “decomposition of capital,” as widely dispersed shareholders replaced the highly visible capitalist of the 19th century. Others proclaimed the giant corporation was the harbinger of “people’s capitalism” in which publicly owned corporations would cease to be solely concerned with profits and would now consider the needs of both workers and the community. Dahrendorf, in fact, went so far as to proclaim that the rise of the giant corporations represented the transcendence of capitalism itself (Mizruchi and Bey 2005).

As we now know, early predictions about rise of the corporation leading to the “decomposition of capital” and the move towards some type of “post-capitalist” society

were erroneous - the basic social relation of capitalist society, that which exists between capital and wage-labor, remained intact. What had changed was the form and market conditions in which the capitalist function operated. Furthermore, historical evidence has shown that fantastic notions of the “soulful corporation” working towards the common good are more accurately understood in the context of corporate public relations campaigns than they are having anything to do with reality. Nevertheless, these interpretations were widely spread by the corporate media and intellectual class of era (Bakan 2004).

In 1966, Baran and Sweezy published their seminal work on *Monopoly Capitalism*, providing one of the more substantial revisions of Marxian political economy in the 20th century. Baran and Sweezy built their model of Monopoly Capitalism directly from their analysis of the rise of the Giant Corporation and the attendant changes that came with this form of business organization. Although Baran and Sweezy recognized and reaffirmed the basic insight of Berle and Means – that the modern corporation had indeed led to the separation of ownership from control – they were also quick to dismiss some of the more fanciful conclusions that were drawn from this recognition. Perhaps the greatest of these myths was the one which purported that the rise of the managerial class meant that business would no longer be guided solely by their desire to maximize profits. According to this argument, which was widely held at the time, managers had replaced the self-interested entrepreneurs of early capitalism and were now able to address the broader concerns of shareholders, employees, and society in general. In the words of economist Carl Kaysen, “No longer the agent of proprietorship

seeking to maximize return on investment, management sees itself as responsible to stockholders, employees, customers, and the general public, and perhaps most important, the firm itself as an institution” (cited in Baran and Sweezy 1966: 21).

Baran and Sweezy emphatically rejected the notion that profit maximization had ceased to be the guiding principle of corporate managers, arguing that “the economy of large corporations is more, not less dominated by the logic of profit-making than the economy of small entrepreneurs ever was” (Baran and Sweezy 1966: 28). They described the modern manager as an “organization man,” whose interests and behavior were dominated by the interests of the corporation itself. Furthermore, managers were often wealthy themselves, often coming from the upper end of the class structure, and owning substantial shares of their company’s stock. “Far from being a separate class” Baran and Sweezy (1966: 35) conclude, “[managers] constitute in reality the leading echelon of the property-owning class.” The rise of the giant corporation, according to this view, did not result in dissolution of the capitalist function, but on the contrary, marked its institutionalization in modern society.

Over the course of the post-war era, managerial autonomy continued to increase as stock ownership became increasingly dispersed among thousands of shareholders. One study found that by 1974, 82 percent of the country’s largest nonfinancial corporations were under management control, up from 40 percent in 1929 (Herman 1981).³⁰ Stockholders, left powerless in the wake of diluted stockownership, followed

³⁰ There are many different thresholds for establishing managerial control. Berle and Means (1967[1932]) used twenty percent as the minimum necessary for minority ownership to maintain control. See Zeitlin (1974) for an overview and critique of various measures of managerial control.

the “Wall Street Rule” of selling their stock, rather than challenging unresponsive managers (Useem 1993).

The insulation of management from stockholder control was not an inevitable outcome of corporate capitalism, but grew out of the political struggles of the 1930s and populist sentiments against concentrated economic power (Roe 1994). In the eyes of the public, the Great Depression was the result of financial speculation and the greed of the nation’s moneyed elite. In response to public unrest, congress enacted a series of reforms that sought to limit the power of financial institutions. Primarily contained in the securities acts of 1933 and 1934, these regulations prohibited banks and holding companies from owning controlling blocks of stocks and also placed severe restrictions on the portfolios of insurance companies, mutual funds, and pension funds. Congress also passed the Glass-Steegal Act, which separated commercial and investment banking, thereby prohibiting deposit accepting banks from speculating with other people’s money (Roe 1994). In addition to passing regulatory measures reinforcing dispersed shareholder ownership, there were also a series of legal restrictions in place that limited the ability of shareholders to act collectively (Davis and Thompson 1994). Together, these regulatory measures reinforced managerial autonomy by effectively insulating them from shareholder activism.

Managerial Conceptions of Control

The rise of an increasingly powerful managerial class led to the proliferation of sociological studies of managerial capitalism during the postwar era. Sociologists,

including Reinhart Bendix (1956), Talcott Parsons (1960), Daniel Bell (1960) and Ralf Dahrendorf (1959), wrote of the rise of a managerial class, their distinctive ideological disposition, and their growing influence in American society. Each of these theorists premised their analysis of corporate management on the growing separation of ownership from control, a trend which most believed to be a permanent feature of American society.

But in the early 1980s a series of changes began to take place in corporate America that challenged the notion that managers would remain free from stockholder control: A market for corporate control was rapidly developing, forcing corporate managers to pay closer attention to their balance sheet so as to not find themselves the target of a hostile takeover; a merger movement was washing over the nation in the wake of the Reagan administration's efforts to weaken anti-trust laws; and managers, who had once enjoyed a relatively high degree of autonomy, were now coming under increased pressure from institutional investors and a reinvigorated shareholder class that was demanding higher returns on their investments. Collectively, these changes were part of the historical transformation of corporate America that is now commonly associated with the rise of the shareholder value conception of corporate governance (Useem 1993; Davis and Thompson 1994; Fligstein 1990).

Economic sociologists, and other observers of corporate behavior, were quick to provide explanations for the shareholder revolution that was sweeping across corporate America. Neil Fligstein, in particular, developed a theory of corporate control that sought to locate corporate behavior in "the long-term shifts in the conception of how the largest firms should operate to preserve their growth and profitability" (Fligstein 1990: 2).

These conceptions were not based solely on the profit-maximizing and efficiency assumptions that we find in economics, but were constructed by managers that were attempting to find lasting solutions to the various problems they encountered from both within their organization and the organization field in which they were embedded (Fligstein 1990; 2001). According to Fligstein (2001: 115),

[m]anagers and owners in firms search for stable patterns of interaction with their largest competitors. Once stable patterns prove to be both legal and profitable, firms set up organizational field that tend to produce and reproduce those patterns. The principles that guide interaction in those fields can be termed a conception of control.

The notion of a “conception of control” is meant to capture the ideological orientation of managers as they exist for a definite period of time. Once the conditions for a given conception of control are exhausted, a sort of punctuated equilibrium emerges which then sends managers in search of new strategies and novel solutions to the ever-changing market environment. This dynamic theory of corporate control, what Fligstein has called a political-cultural approach, has become a leading theory of corporate governance in the field of economic sociology.

The Rise of the Shareholder Value Conception of Control

The shareholder value conception of control emerged out of the economic crisis of the 1970s, replacing the finance conception of control that had dominated managerial decision making since the late 1960s. The finance conception of control was the product of the postwar period when large corporations diversified into numerous, often unrelated, product markets. Managers of these firms viewed their firm as a bundle of assets, which

were deployed in order to maximize corporate earnings. This “balance sheet” approach to management led managers to evaluate the firm’s various product lines by their profitability and investments were made according to how a particular division would play into the already-existing corporate portfolio, much the same as a financial analyst would manage an investment portfolio. Under the finance conception of control firms became increasingly large and unwieldy, leading many to question whether firms had become too large to be controlled efficiently (Fligstein 1990; 2001). Indeed, it was the size of many US corporations that became a favorite target for critics when the economy began to stagnate in the early 1970s.

The economic crisis of the early 1970s is highlighted as the proximate cause of the breakdown in the finance conception of control. According to Fligstein (2001: 147-148), this crisis was primarily due to growing competition from abroad, particularly from Japan; along with the general economic slowdown coupled with high inflation, or stagflation . In response to these changes in the macro-economic environment, managers sought out solutions to their economic malady. Here, Fligstein (2001: 148) urges us “to consider the role of culture in framing the possibilities for strategic action.” He continues,

For actors to undertake new forms of action, they must decide to rethink their interests, develop a plan to operationalize those interests, and have the power to enforce that view. Culture comes into play to provide actors with a cognitive frame that offers solutions to the problem of strategic action.

Thus Fligstein, as well as others, implores us to think about shifts in managerial orientation as a kind of cultural movement that arises in response to the changing condition in their relevant fields of action (Fligstein 2001; Davis and Thompson 1994).

The cultural movement that arose in response to the breakdown of the finance conception of control was spurred on by ideas imported from agency theory (Jensen and Meckling 1976; Fama and Jensen 1983; Dobbin and Jung 2010). In the language of agency theory, market relations consist of principles and agents, with shareholders being the principles and managers their agents. Under this conception of the corporation, the firm exists primarily to further the interests of the principals (shareholders), and the agents (managers) job is works towards that end. It follows that over the course of the 20th century, as managers enjoyed increasing autonomy from their shareholders, that the principals had lost control over their agents. As Dobbin and Jung (2010: 2) explain,

Executives were serving their own interests rather than those of owners. They had been building large diversified empires that could shield them from downturns in any particular industry, but which maximized corporate size rather than profitability. Profits went to buy new businesses to expand the pyramids executives sat atop.

The remedy for this situation, according to agency theorists, was to enact a series of measures that would bring the interests of managers back in line with shareholders. Their prescription called for a number of changes in corporate governance: first, was the need to alter the incentives of executives, by instituting compensation plans that would work to align the interests of managers to shareholders. This could be accomplished by moving towards performance-based compensation packages consisting of stock options and bonuses (as opposed to fixed salaries), thus giving managers a personal incentive to maximize share prices. Second, was the call for firms to shed unrelated divisions in order to focus on their “core competencies,” leaving portfolio diversification to investors. A third prescription was for corporate managers to use debt, as opposed to issuing new

equity or internal funds, to fund any expansion programs. And finally, was the call for independent board members that would be able to increase their oversight over management. Together these measures would, according to agency theorists, tie the interests of managers more closely to their shareholders and add some much needed vigor to the faltering US economy (Dobbin and Jung 2010; Davis and Stout 1992). In chapters five and six I will use these prescriptions adopted from agency theory to analyze the shift rise of the shareholder value conception of control in the US forest products industry.

In the end, Fligstein and his colleagues reduce the rise of the shareholder value conception of control to a voluntarist argument that simply says that managers confronted an obstacle to growth and that they found the answer in theory coming from then unknown theorist in finance at the University of Rochester.³¹ They concede that the initial push for introducing the shareholder value conception of the firm came from the financial community, particularly institutional investors; and they acknowledge the lax antitrust policies and tax cuts of the Reagan administration as being important as well. Their emphasis, however, is on how managers construct cultural frames that provide solutions for strategic actions (Fligstein 2001; Dobbin and Jung 2010). In doing so, these theorists reduce changing conceptions of corporate control to the problem solving activities of managers and the novel ideas that arise from their collective efforts to address changes in their organizational fields. Dobbin and Jung, in particular, take this argument a step further in commenting on the role of agency theory in introducing the heightened risk in

³¹ Michael Jensen, the financial economist that is credited with formulating many of the ideas that became associated with the shareholder value movement, was a professor at the University of Rochester when he published his work on agency theory. His work on agency theory and shareholder value earned him a prestigious position at Harvard University.

corporate America that ultimately led to the financial crisis of 2008-9: “Chalk one up for Hegel...” they proclaim “...a theory brought down the economy” (Dobbin and Jung 2010).

The Role of Institutional Investors

Underlying these changes in managerial ideologies was a monumental shift in the relationship that exists between shareholders and corporate managers. As discussed above, the rise of the giant corporations produced a marked change in the relationship between ownership and control. The dispersal of ownership among thousands of anonymous shareholders was the necessary precondition for ushering in the era of managerial capitalism, when managers enjoyed a high degree of autonomy from their shareholders.³² Once this precondition was removed, however, the door was now open for a substantial realignment of the relationship between ownership and control in the modern corporation.

The separation between ownership and control continued unabated in the decades following Berle and Means’ initial formulation (see Berle 1967). Stock ownership became increasingly diluted as shares were dispersed among an increasingly large number of shareholders. By the 1970s the managerial revolution had reached its zenith, as most large corporations were firmly under management control (Chandler 1977). In recent decades, however, the “atom of property” – to use Berle and Means’ metaphor –

³² Of course this autonomy was relative in that it was conditioned by their institutional roles within the corporation, but in general, managers of the mid-twentieth century were free from shareholder control.

that exploded with the rise of the modern corporation was, in a sense, re-fused due to a radical change in the ownership patterns of corporate securities (Ryan 2000).

Over the course of 1980s, institutional investors – such as pension funds, banks, mutual funds, and banks – accumulated vast sums of corporate securities. Institutional shareholding had steadily increased during the post-war era, but due to technological changes in the processing of information and the Reagan administration's efforts to relax the rules governing the composition of investment portfolios, there was a rapid increase in the number of stocks held by these institutions. According to one study, the market value of institutional holdings of shares on the New York Stock Exchange rose from \$31 billion in 1955 to \$440 billion in 1980 (Useem 1993: 29). And whereas individual households owned approximately 90 percent of corporate stock in the 1950s, this share had dropped to 68 percent by 1970. By 2000, households owned only 42 percent of public stock, while institutional investors owned 46 percent (Crotty 2002).

By 1990 many of the nation's largest corporations found that the majority of their shares were now held by institutional investors. Useem (1993) found that by 1990 the 1,000 largest publicly traded corporations had, on average, 50 percent of their stocks held by institutional investors. As institutional shareholdings continued to increase, there came a sudden recognition that the Wall Street rule of divesting, rather than challenging management, was no longer feasible. Selling off shares might lead to a fall in prices, which would ultimately harm the seller and, furthermore, for large investors there were limited investment alternatives in an already crowded market (Davis and Thompson 1994; Ryan 2000).

Not only was exit no longer feasible, it was also unnecessary. Through their large institutional holdings, institutional investors had now acquired the means by which they could exert power over managers, and bring them in line with the interests of the shareholding class. This is not to say that investors had total control over managers, only that their influence had grown substantially (Useem 1993). Before this power could be exercised, however, substantial changes to the existing regulatory regime would need to be changed.

The Reagan administration's pro-shareholder orientation provided the political opening that allowed potential investor control to become a reality (Davis and Thompson 1994). The leadership positions in both the Securities and Exchange Commission (SEC) and the Federal Trade Commission (FTC) were filled with followers of the Chicago school's efficient market hypothesis, which viewed unfettered capital markets and property rights (read shareholder rights) as the cornerstones of an efficient market economy. In turn, a number of well-financed shareholder activist organizations formed with the intent of overhauling the regulations that hampered their ability to exert control over management. Over the course of the decade investor activism continued to increase, as institutional investors increased their use of shareholder resolutions to steer management towards the interests of shareholders. By 1990, these efforts succeeded and the chairman of the SEC announced that there would be a major review of the existing proxy rules. Two years later, this review resulted in an overhaul of the proxy rules governing shareholder activism (Davis and Thompson 1994). As a result, institutional

investors were able to bring the age of managerial capitalism to an end and usher in a new era of “institutional” (Useem 1993) or “investor” (Conrad 1988) capitalism.

Financialization and Non-financial Corporations

In the previous chapter I defined financialization as the gravitational shift in economic activity from the productive to the financial sphere of the economy (Foster and Magdoff 2009). For our present purposes, however, I will narrow my focus in order to examine how financialization produced a marked shift in the relationship between financial markets and non-financial corporations (NFC). According to Orhangazi (2008), this change has two fundamental components: first, is the increase in financial incomes and financial investments on the part of NFCs; and second, the increasing pressure placed on managers of NFCs to maximize returns to financial markets in the form of stock appreciation and dividend payments. Together, these two changes constitute the primary means by which NFCs have been “financialized.”

Much of the literature on financialization and NFCs is concerned with detailing the effects of financialization on corporate profit rates and the distribution of those profits. That is to say, their focus is on capital flows – both in terms of savings and investment and the distribution of surpluses. This “accumulation centered” approach to changes in NFCs reveals a number of interesting aspects of corporate change in recent decades. For instance, the financial assets of NFCs have grown considerably, both in absolute terms and as a percentage of tangible assets. Prior to 1980 the ratio of NFC financial assets to tangible assets held constant at roughly 30 percent; by 2000, however,

NFCs' financial assets were equal to their tangible assets. As one would expect, the growth of financial assets produced a rapid rise in the financial incomes of NFCs: both interest and dividend incomes of NFCs increased over the past three decades (Orhangazi 2008).

The data clearly shows that financial profits became increasingly important and eventually integral aspect of corporate America. In fact, the Wall Street Journal reported that by 2000, “[a]lmost 40% of the earnings of the companies in the Standard & Poor’s 500-stock index in 2000 came from lending, trading, venture investments and other financial activity” with corporate giants such as General Motors and General Electric making over half of their profits from financial activities (Found in Davis 2009: 105).

In addition to the direct increase in financial incomes of NFCs was a rapid increase in the outflow of corporate profits (Orhangazi 2008; Grullon et al. 2011). The two primary means of distributing earnings to shareholders are through dividend payments and stock buybacks. In recent decades both of these forms of payout increased, however, the use of stock buybacks increasingly became the preferred option among managers operating under the shareholder value conception of control (Grullon and Michaely 2002).³³ A stock buyback is when a firm purchases its own stock in order to bid up the price of their stock and increase shareholder value. The level of capital outflow taking place in corporate America is astonishing. According to Lazonick (forthcoming: 6),

³³ The preference for stock buybacks is due in large part to the lower tax rate for capital gains in the US (see Grullon and Michaely 2002).

From 2000 through 2009 S&P 500 companies – which account for about 75 percent of the market capitalization of all US publicly-listed corporations – spent more than \$2.5 trillion on stock buybacks, equal to 58 percent of their net income. In addition, these companies distributed dividends equal to 41 percent of net income over the decade, bringing the payout ratio (buybacks plus dividends) to 99 percent.

In other words, almost every dollar of income that was earned in large US corporations was returned to shareholders during the first decade of the 21st century.

This incredible payout rate was supported by the increasing use of debt among NFC. Rising debt is a pronounced feature of a financialized economy (Foster and Magdoff 2009). In the 1970s outstanding debt in the US economy was about one and a half times the size of the country's GDP. By 2005, outstanding debt would rise to become almost three and a half times the size of the nation's GDP. The rise in debt was most pronounced in the financial sector, however, debt rose in all sectors of the economy (private, corporate, and public), becoming the fuel for America's stagnating economy (Foster and Magdoff 2009).

In the context of changes in corporate governance, there has been a long debate about the relative mix of debt and equity in the firm (Jensen and Meckling 1976; Fligstein 2001).³⁴ It is generally assumed that shareholders prefer debt to equity because debt tends to maintain the value of their holdings by not diminishing stock prices or diluting their earnings. Managers, on the other hand, are more inclined to prefer issuing equity because this further diffuses ownership and protects them from ownership control. However, as Fligstein points out, the interests of managers and owners in this regard are not so clear cut, as managers may ultimately lose control of the corporation if they fail to

³⁴ Equity refers to the value of the firm's share price multiplied by the number of shares.

maintain stock prices and healthy dividend payments (Fligstein 2001: 151-153). Nevertheless, as financial corporate managers increasingly relied on debt to fund corporate activities; and as a result, the debt to equity ratio of firms rose substantially.

Another area of research is focused on how the financialization process affects profit rates and investment practices within NFCs. Stockhammer (2004) argues that financialization is the primary reason for declining profit rates in the neoliberal era. Using aggregate time series data from the US, UK, France and Germany, he shows that there is a negative correlation between the rentier income of NFCs and levels of investment. Likewise, Orhangazi (2008) analyzed firm level data and found that there is a negative relationship between financialization and capital accumulation. Orhangazi contends that the higher rates of return in financial markets serve to “crowd out” investments into production. Foster and Magdoff (2009), on the other hand, criticize the notion that investments into financial markets take the place of potential investment into the productive economy. According to Foster and Magdoff (2009: 107), “the idea of the “crowding out” of investment by financial speculation makes little sense...when placed in the present context of an economy characterized by rising excess capacity and vanishing net investment opportunities. In fact, Foster and Magdoff argue the opposite: that financial speculation has served to stimulate growth in an already stagnating economy. This question of whether or not financialization serves to boost an already stagnant economy, or is in fact parasitic of the productive economy, continues to be a point of debate. I will return to this discussion in my analysis of the forest products industry.

It is clear, however, that the financialization of the NFC has been extremely detrimental to labor (Lazonick and O'Sullivan 2000). As in times past, firms searching to maximize profit rates look first to reduce the amount of labor necessary for production. This trend continued, and was accelerated, under the sway of financialization. Firms looking to maximize shareholder returns invested heavily in new technology and spent considerable energy reducing both the size and power of their labor force. As a result, the quantity and quality of employment opportunities offering stable employment and decent pay was rapidly diminished. The manufacturing sector was particularly hard hit, with millions of blue-collar jobs vanishing due to both deindustrialization and the rising productivity of labor (Blueston and Harrison 1982). This trend is further attested by the declining significance of labor unions in the United States. The percentage of the manufacturing labor force that was unionized was 47.4 percent in 1970; by 1983 this number was 27.8 percent and by 1994 it had dropped to 18.2 percent (Lazonick and O'Sullivan 2000). By 2010, the unionization rate in the United States had fallen to 11.4 percent (OECD 2012).

To date, only a handful of studies have examined how particular industries have been affected by the financialization process. Two of these targeted the automobile industry for an industry specific analysis of financialization. Julie Froud (2002) and her various coauthors conducted a financial analysis of the industry that aimed to “add nuance and qualification to existing studies of the financialization process.” Using financial metrics such as stock appreciation and shareholder measures of return on capital employed (ROCE), they found that the financial under-performance produced major

consequences for car assemblers, but these effects varied widely between firms (Froud et al. 2002). Nicole Aschoff conducted an analysis of Delphi Corp., the former in-house parts supplier of General Motors, in which she countered arguments about how high wage, unionized work-force led to the demise of American auto industry. Her research demonstrates instead that the demise was more likely the result of increased pressure from the financial community to maximize shareholder returns (Aschoff 2010). Finally, in research on financialization and clothing retailers in the UK, Gibbon found that increasing pressure from the financial community has indeed occurred; however, he concludes that the relationship between financial institutions' desire for increased shareholder returns and management decision-making is mediated by strategies that are particular to the firm (Gibbon 2002).

To sum up, the literature on financialization and NFCs has shown that the relationship between financial markets and NFCs have indeed undergone a radical transformation over the past three decades. During the postwar era, firms operated under the principle of “retain and reinvest,” which meant that corporate profits were retained by managers in order to be channeled back into expanded production, or used to diversify the corporations existing portfolio. Since the 1980s, however, managers increasingly came under the sway of a reinvigorated shareholder class that demanded higher returns on their capital investments. In their effort to maximize these returns, managers turned away from the principle of “retain and reinvest” and increasingly adopted the maxim of “downsize and distribute” (Lazonick and O’Sullivan 2000). Corporate managers, under pressure from Wall Street, laid off workers in droves, sold off unrelated product lines,

and streamlined their business activities in order to maximize their returns to shareholders. When investments were made they were increasingly financed by debt, leaving NFCs leveraged to the hilt and considerably more vulnerable to external shocks in the economy. As a result, inequality skyrocketed to levels not seen since the 1920s and financial speculation became the principle driver of an American economy mired in stagnation. This period of transformation culminated in the financial crisis of 2008-09, when a speculative bubble in the US housing market produced a “financial tsunami” that spread across the US and global economy.

Critique and Synthesis

It is widely acknowledged that the shareholder value conception of control in corporate governance is a financially inspired ideology that serves the interests of the financial community (Lazonick and O’Sullivan 2000; Fligstein 2001; Davis 2009). To date, however, there have been few attempts to integrate the political-economic perspectives on financialization with the focus of economic sociologists on the shareholder value conception of control. Despite calls for the integration of political economy perspectives and economic sociology (see Mizruchi 2007) these fields remain isolated and rarely engage one another. In this section, I outline one avenue by which these two potentially compatible fields can be made to “speak to one another.” Furthermore, I argue that by integrating these divergent perspectives we gain considerable insight into both the institutional pressures that created the need for a new

conception of corporate control and the highly political process in which this new conception was forged.

In defending his political-cultural approach for constructing a sociology of markets, Fligstein (2001: 145) argues that our “efforts should concentrate on specifying models of the relations between firms that focus on intra- and inter-organizational processes such as the construction of strategic action and the cultural frames by which such a construction makes sense.” Fligstein locates the nexus for emergent conceptions of control in the social relations that exist within firms or between firms in a given market. However, once we concede that emergent conceptions of control tend to affect the majority of firms in generally unrelated markets we must conclude that emergent conceptions of control derive not from managers in a particular organizational field, but from the dominant social relations of society in general.

I argue that this can be accomplished by locating emergent conceptions of control within a political-economic framework that focuses on the essential relations of the broader social structure and the central tendencies that derive therefrom. In doing so, we reveal the relationship that exists between the material processes of production and reproduction in capitalist society and various changes in the ideological orientation of discrete social actors. This is another way of saying that transformations of managerial conceptions of control generally correspond to underlying shifts in the capital accumulation process.

To be clear, I am not proposing that we replace a one-sided focus on cultural understandings with an equally one-sided materialism: the point is to see them as

internally related features of a dynamic historical process. This point harkens back to the long-standing divide in sociology between structural and cultural theories of social change (Dahms 2000). On one side, there are structural theorists who tend to assume that the evolving structures of modern society shape the behavior, ideas, and desires of individual actors; while the other side assumes that social structures are mere expressions of the cultural and ideological underpinnings of social groups. This debate found its early expression in the seemingly divergent explanations of the rise of Capitalism by two of sociology's founding figures: Marx and his materialist explanation of Capitalism as found in the Communist Manifesto and Weber's pointed reply to Marx in his Protestant Ethic. Here we find the roots of a theoretical divide that, despite numerous attempts at reconciling, continues to characterize much of the discipline of sociology. Indeed, it is this division that is on full display in the divergent takes on financialization and the shareholder value conception of control.

Harry Dahms (2000) proposed one possible means of overcoming this theoretical impasse that works well within the current context: as opposed to abandoning structural or cultural analysis all together, one can link them on the level of organization. According to Dahms,

If changes in the mode of production, in the market, in what constitutes the central factor of production, in the role of technological change, etc. do not engender a transformation in the definition of organizational control, the changes may remain superficial. The nature of *decision-making processes* needs to change, along with the kind of *interactions* among business organizations, and between the latter and labor organizations and government. Unless such a change indeed occurred, we have to assume that while the transformation at hand may have affected a specific area of economic action, it may leave unaffected the operation of the economy as a whole. Accordingly, studies that endeavor to demonstrate that major

changes have resulted from a recent trend must be able to show that a change in the production process, the central mode of production, the core factor of production, or the dominant new technology, will bring with it a qualitative transformation that *translates into organizational change* (Dahms 2000: 24-25, italics in original).

Here Dahms is arguing that there is a definite link between changes in the organizational forms of capitalist institutions and the decision-making processes that correspond to and make possible various transformations of capitalism. Dahms proposes that we employ the concepts of *organization* and *control* to highlight the necessary linkages that exists between structural and cultural change.

By integrating organizational shifts in the relations of production to the forms of control we can begin to highlight the internal relation that exists between the macro-structural processes of financialization and the proliferation of the shareholder value conception of control. The concept of organization is sufficiently broad to refer to a number of firm characteristics, however, for the purpose of this study I will focus primarily on those organizational aspects that relate directly to the relationship between managers and shareholders. As we know, the social relation that exists between managers and owners was a critical component of twentieth century capitalism: just as managerial capitalism was premised on the relative autonomy of managers stemming from widely dispersed stock ownership, so was shareholder capitalism premised on the increasing concentration of stock ownership among institutional investors. By locating shifts in the organizational component of large corporations we can identify the mechanisms that underlie and reinforce periodic shifts in managerial control.

Integrating the materialist, or accumulation-centered, perspectives of financialization with those of the shareholder value conception of control produces several advantages for theorizing change in the modern corporation. First of all, it allows us to interpret how changes in the modern corporation relate to broader issues of class struggle and power. The absence of social and political considerations among theorists of shareholder value has been highlighted as one of their principle shortcomings (see Soederberg 2008; Lazonick and O'Sullivan 2000; Seccombe 1999). By embedding the shareholder value conception of control within the broader dynamics of financialization we are better able to answer a series of questions: which social actors were in a position to influence the shift towards shareholder value? What were the mechanisms by which it was enforced? Who ultimately benefits from these changes? And finally, what are the implications of the shareholder value conception of control for American society and its future trajectory? In short, by integrating these perspectives we provide the basis for a *critical* analysis of managerial conceptions of control.

A second advantage of linking these theories is that it helps to clarify some of the paradoxes that have confronted theorists of shareholder value ideology. For instance, the fact that the adoption of shareholder value tactics have not been shown to be effective in producing what is ostensibly its primary goal, increasing profits, has left some puzzled as to why managers would pursue such tactics (see Fligstein and Shin 2007). But it is not just profits and stability that matter in the process of capital accumulation, but exactly how those profits are made and to whom they accrue. Under the shareholder value conception of control, profits were increasingly channeled to the financial community as

part of the broader gravitational shift in the economy from productive to financial profits. Thus we begin to see that the shareholder value conception of control is less concerned with producing profits per se, than it is with increasing the flow of value – in the form share price appreciation – to shareholders (ie. finance).

A third contribution is that by paying heed to the shifting dynamics of capital accumulation, we can begin to appreciate the logic behind emergent forms of managerial conceptions of control. Successive regimes of capital accumulation develop out of the struggles to overcome the barriers to accumulation that arise in a particular crisis. The solution to these crises can take many forms; however, by focusing on the particular manner in which a crisis is resolved we can locate key insights into emergent conceptions of control. In this case, the response to the accumulation crisis of the 1970s took the form of rising debt and increased financial profits in order to overcome stagnation. Thus, we saw a corresponding shift in the dominant conception of control among corporate managers that increasingly privileged the interest of the financial community over others.

Finally, in integrating shareholder value theory and financialization we are able to find a useful avenue for addressing concerns raised about the difficulty of highlighting the role of discrete actors within theories of structural change (see Krippner 2011: 13-14). Political-economic theories of financialization tend to be highly abstract because they are primarily concerned with the structural dynamics of modern capitalism. In this sense, broad abstractions are necessary because they provide insights into fundamental dynamics of historical change; however, they are far from sufficient for explaining the behavior of social actors operating within particular organizational fields. Fligstein's

notion of a shareholder value conception of control fills this void by highlighting how the structural shift towards financialization was articulated within the changing norms of managerial behavior. Integrating these seemingly complementary theories requires that analysts be flexible in their use of abstractions and to acknowledge the limitations of operating within a single level of analysis.

Conclusion

This chapter set out to construct a critical synthesis of the economic sociology literature on shifting conceptions of control in corporate governance and political-economic theories of capitalist transformations. In doing so, I outlined the historical development of the non-financial corporation and the monumental shift that took place in the early twentieth century when the capitalist function was fractured by the separation of management from control. This fracture led to the rise of a managerial class that stood atop and controlled the giant corporations that were so emblematic of 20th century US capitalism. Although their autonomy over decision-making in the firm was relative – bounded as they were by the institutional constraints of market – these managers used their discretion to build large corporate empires with an eye towards maintaining growth and stability over the long term. This period was marked by a “managerial” conception of control in corporate governance.

The economic crisis of the early 1970s, and the protracted period of stagnation that followed, led to a realignment of the US political-economy around the interests of finance capital. This financialization of the US economy included a rapid increase in

financial profits and a concomitant rise in power of financial interests in the political and economic institutions of American society. In non-financial corporations this transformation took on two primary forms: first, there was an increase in the proportion of total profits that came from financial activities; second, there was increased pressure put on corporate managers to maximize the firm's shareholder returns. These two moments can be conceived as the *quantitative* (financial profits) and *qualitative* (shareholder value ideology) components of the financialization process as they were manifested in the firm.

This dissertation is primarily concerned with analyzing the qualitative side of this process as it took place in the US forest products industry.³⁵ The rise of the shareholder value conception of control in corporate management can thus be understood as an ideological and institutional manifestation of the financialization process at work in the realignment of managerial priorities towards maximizing shareholder value.

In addition to this theoretical conceptualization, I provide an avenue for analyzing this relation within various shifts in the organizational component of the modern corporation. In the second part of this study I emphasize two forms of this organizational change that are directly related to the relationship between shareholders and managers. The first is the ownership structure of the firm. As I explained, the diffusion of stock ownership was critical to the rise of managerial capitalism during the postwar era. Likewise, the increasing concentration of stock ownership among institutional investors

³⁵ Due to the difficulty of determining the financial incomes of individual firm's I was unable to include this quantitative component in my analysis of financialization and the US forest products industry. Although there is no reason to believe that firms in the industry followed the larger trend, I cannot speak to the degree to which financial incomes increased or decreased in the US forest products industry.

was a critical development for explaining the shift towards the shareholder value conception of control. This study will therefore include an analysis of stock ownership in the US forest products industry to determine the relative level of ownership concentration, which in turn will be important for establishing the basis for a shift in managerial control. The second critical aspect of organizational change in the relationship between shareholders and managers is executive compensation. The rise of the shareholder value conception of control is directly linked to the rise in incentive-based compensation for corporate executives; therefore I also examine executive pay for a further indication of organizational change associated with the rise of the shareholder value conception of control.

These two organizational components of the US forest products industry will serve to frame and qualify the adoption of the shareholder value conception of control in the US forest products industry. The degree to which managers operated under a particular conception of control will be analyzed using historical data on various managerial activities, including investment practices, debt financing, and merger and acquisition activity. Particular emphasis will be placed on the role of timberland ownership and how strategies concerning timberland ownership reflected the broader conception of managerial control.

PART II
FINANCE AND MANAGERIAL CONTROL
IN THE US FOREST PRODUCTS INDUSTRY

CHAPTER IV

MONOPOLY CAPITALISM & THE US FOREST PRODUCTS INDUSTRY (1945-1975)

“I have no ambition to aid in building up the prestige and authority of Association of Trust and Insurance Companies; do not let us forget that finance is the servant of industry and that industry is not the servant of finance – platitudinous but true.” ~Sir Eric Bowater³⁶

The story of the modern US forest products industry begins in the late 19th century, as the nation underwent its vast transformation from its early agrarian and small manufacturing economy to a full-fledged industrial super power. The forest products industry was on the front lines of this process: as the railroads opened up the continent’s vast interior they provided forest product firms with access to a seemingly endless supply of virgin forests. These forests presented themselves as a valuable bounty for entrepreneurs in this budding industry. In time, the forest products industry proved to be one of the most critical components of the United States’ industrial economy.

This chapter begins with a brief overview of the early development of the US forest products industry. An examination of this early period is necessary because many of the key dynamics of the industry – such as the persistence of cut-throat competition and unstable markets – were critical in shaping the forest products industry of the 20th century. This period can also be understood as the development of the US forest products industry under historical conditions of monopoly capitalism (Baran and Sweezy 1966).

A critical feature of monopoly capitalism was the “managerial revolution” that occurred when the salaried managers replaced the owner-operators of traditional business enterprise

³⁶ Sir Eric Bowater was chairman and managing director of Bowater Corporation from 1927 until his death in 1962. Bowater is cited in Reader (1981: 216).

(Chandler 1977). Over time the separation between ownership and control continued to grow, providing this managerial class with broad discretion over decision making in the firm (Berle and Means 1967[1932]; Mizruchi 2004). In this chapter I provide an overview of the ownership structure of leading firms in the forest products industry during this period in order to establish the basis for my analysis of managerial decision-making under this managerial conception of control.

Operating under the principles of “retain and reinvest” (Lazonick and O’Sullivan 2000), managers in the US forest products industry plowed their surplus profits back into expanded production capacity. The growth in corporate profits further insulated corporate managers from financial influence because it enabled them to finance much of the firm’s activities without relying on financial support. However, as I will show, there were definite limits on the ability of managers to invest their surpluses internally. This gave rise to the so-called *surplus disposal problem*, which refers to the managerial dilemma concerning how to invest surplus profits in the face of limited internal investment opportunities (Baran and Sweezy 1966). Managers overcame these limits by turning to a number of alternative means of expansion, including mergers and acquisitions, diversification, and increased investment into timberland ownership.

Early Development of the US Forest Products Industry

The forests of North America have been critical to the economy for over four centuries. Beginning with the early colonial settlers, the continents abundant forests proved to be an extremely important resource, providing building material, fuel, and raw material for countless everyday uses. Because of their abundance, forest products were not immediately targeted for commercial gain. In fact, more often than not, colonists viewed the forests of the Americas as an

obstacle standing in the way of expanding settlements and agriculture. Longing for the landscape of their homeland, colonists eagerly turned to felling the forests in order to recreate the sprawling agricultural landscapes of fixed fields and open meadows that were characteristic of their native land (Cox 2010).

New England was the site of the nation's first "Lumber Frontier" (Cox 2010; see also Cronon 1983). The region's abundant forests and plentiful rivers with open access to good harbors gave it a natural advantage for early timber production. Maine in particular developed the most extensive lumber industry of the pre-revolutionary Americas. In the South, the industry also developed rapidly, but the South's distance from urban centers of New England and the considerable difficulty of transporting logs across the marshy coasts of the Carolinas slowed the development of commercial forestry. By the time of the Revolution, the colonial population was expanding westward, looking for new settlements and profitable enterprise. The abundant forests quickly turned from an obstacle to a source of profit for early colonists. In time, the forests would become one of the most critical components of the nation's burgeoning industrial economy.

The industrial revolution swept across the nation in the decades following the Civil War and although many think of coal and steel as fueling the revolution, the forest products industry, as much as any other, was at the forefront of this process of industrialization. Many commentators (see Cronon 1983, 1991; Williams 1989) have noted the historical geography of the forest products industry: its early development in New England and the coastal South; the rapid depletion of the forests surrounding the Great Lakes region of the Midwest and then penetrating the rugged mountains of the Southern Appalachia, before moving westward to the seemingly endless forests of the Pacific Northwest. In each case, the industry exploited regional

resources (both land and labor) with reckless abandon, reflecting the optimism of an industry that relied on a natural resource that was seemingly inexhaustible. When the forests of a particular region began to show signs of exhaustion, the lumberman picked up their operations and moved on to exploit the untrammelled forests of the American frontier. This pattern was characteristic of much of the industry's history throughout the 19th and 20th centuries (Williams 1989).

During the late 19th century the forest products industry first developed into a full-fledged industrial operation. Prior to this era most logging operations consisted of small teams of loggers, working in the forests with only mules and their own brawn, making for an extraction process that was painfully slow and extremely difficult. But industrial technology forever changed the timber extraction process as technical innovations in transportation (particularly the railroads), machines for felling timber, and mechanical skidders for dragging logs led to a rapid increase in the productive capacity of the industry. As a consequence, the forest products industry began to suffer from many of the same ailments that plagued industrial capitalism in its nascent, competitive form: chronic overproduction, excessive competition, and a generally unstable market (Robbins 1982; Perelman 2006). As William Robbins (1982: 5) notes, [t]he lumber industry provides key insights into the evolution and expansion of industrial capitalism in the nineteenth and twentieth centuries."

Leaders in the forest products industry, hoping to shield themselves from the anarchy of market competition, sought ways to bring order and stability to their market. Various solutions were attempted, including the development of pools and trusts, ongoing mergers and acquisitions, and eventually the adoption of the modern corporate form. At times (particularly during war) markets would stabilize and create a period of growth for forest product firms; however, most of these were short lived. As *Fortune* magazine commented, "whenever

consumption rises and prices appear relatively stable, the rush to finance expansion begins again...big mills gobble up little mills, and little mills combine to form big mills, and then all of them build in a fine competitive frenzy while the money lasts.” (cited in Gordon 1994: 74). In the end, numerous tactics were employed by industry leaders in an ongoing effort to rationalize the industry and create a stable and predictable environment for ongoing capital accumulation

Finance capital was at the center of this movement towards incorporation, providing investment capital for large firms to incorporate, and making enormous profits by issuing new securities. Although incorporation took place under the auspices of stabilizing markets, the move towards incorporation failed to reduce market gluts and instability. As one commentator noted, “New capacity in the paper industry after 1926 bore less relation to the market than...to the desire of the bankers in control of the industry to float new securities” (Gordon 1994: 74). In this case, the pressure from finance capital exacerbated the problem of overproduction and falling prices by creating incentives for expansion that bore little relation to the reality of market conditions. During this period many of the firms that would come to dominate the forest products industry during the 20th century formed: these include such notables as Union Camp (1874), Kimberly-Clark (1880), Mead (1882), Westvaco (1888), International Paper (1898), Weyerhaeuser (1900), Willamette (1906), Temple Lumber Company (1910), Stone Container (1926), Georgia-Pacific (1927), and Champion International (1929).

The move towards consolidation and incorporation ultimately proved unsuccessful in dealing with the instability of the forest products market. By increasing the scale of industrial production the forest products industry did not alleviate the chaos of market conditions, but merely reproduced them on a greater scale. Investments into larger plants with newer, more efficient technology and greater production capacity often straddled early corporations with

massive amounts of debt. This debt, along with taxes and other carrying charges, often coaxed manager into running their machines at full capacity around the clock, producing a glutted market, falling prices, and an ongoing cycle of boom and bust that quickly became the hallmark of the modern forest products industry (Robbins 1982).

In addition to incorporation, numerous trade associations, both regional and national in scope, were organized in order to provide a forum for industry leaders to establish more cooperative relationships. In the forest products industry, the most prominent trade association of the early 20th century was the National Lumber Manufacturers Association (NLMA). Following reorganization in 1918, the NLMA was led by Wilson Compton, who held this position for the next three decades. During this period Compton became a prominent national figure, providing a unified front for the industry in Washington, and working to decrease the competitive rivalries that plagued the industry. Under his leadership the forest products industry became one of the most important blocks in the nation's power structure (Forest History Society 2012).

When voluntary efforts to control production failed, as they most often did, the industry turned to government for help. Many industry leaders were skeptical of federal intervention into private industry, fearing that any intervention might eventually lead to excessive regulation, or even socialism. However, when voluntary efforts failed to produce the desired results, industry leaders turned to government as the option of last resort. Federal intervention in the forest products industry, like most federal interventions of the Progressive Era, was carried out under the banner of conservation and purported to be in the public's interest.³⁷

³⁷ See Kolko (1963) for an overview of this argument.

William Boyd (2001: 171) summarizes this “rather remarkable example of public-private cooperation” as consisting of three phases: rationalization, regeneration, and intensification. The *rationalization* process included a number of measures aimed at creating a more stable environment for investment in timber growing, such as fire protection and forest management. the establishment of a stable environment. *Regeneration* included federal programs, such as the Clarke-McNary Act of 1924, which promoted the reforestation of cut-over land, particularly in the South. And *intensification* refers to increased research into forest genetics and tree improvement, which often took place in cooperative programs between industry and public universities. Although these federal programs certainly had positive public benefits – such as the promotion of sustainable forest management and the increase in total forest land – their underlying motivations was almost always geared towards preserving the status quo and establishing the conditions for continued corporate profits (Boyd 2001; Robbins 1982).

There is a long history of natural resource-based industries and government collusion in the United States and nowhere is this more evident than the relationship between the forest products industry and the US Forest Service (Robbins 1982; 1985). The US Forest Service was established in the late 19th century, beginning with the Forest Reserve Act of 1891, which authorized the federal government to withdraw land from the public domain as “forest reserves.” For most its history, the Forest Service has served primarily in the interest of industrial forestry, providing valuable research and data on the nation’s forests. As Robbins notes, “whether they worked for the federal government, as private consulting professionals, or in the lumber industry, most professional foresters and others closely associated with the forest products business shared a common ideological vision” (Robbins 1982: 8). Indeed, many professionally trained foresters worked in both the public and private sectors, and their shared ideological commitment to the

economic imperatives of capitalism made this an easy transition. In the language of the day, theirs was a “progressive” vision of capitalism where both the federal government and big business could act in unison to maintain the existing social relations under the auspices of the “public’s interest.”

Despite their best efforts, lumbermen of the late 19th and early 20th centuries were unable to bring stability to their market. According to Robbins (1982: 9),

[t]heir inability to cope with the lumberman’s broader problems does not imply personal incompetence, lack of effort, or insufficient technical expertise. Rather, the chronic and inherent maladjustments that persisted in the lumber industry up to the Second World War reflected the basic contradictions in a system that promoted the idea of a freely competitive economy but was unable to achieve stability under those conditions.

Throughout the first quarter of the 20th century the industry continued to be plagued by market fluctuations that constantly threatened to undermine industrial profits. It was not until the rapid rise in demand for war products that the forest products industry finally began to enjoy a degree of stability.

In the years following the Second World War, a prosperous national economy and a newfound level of cooperation enabled the forest products industry to enjoy a period of stability and prosperity. Price wars, which had plagued the industry for much of its industrial past, were no longer as pervasive as leading firms in the industry were able to exert sufficient control over markets to stabilize prices and usher in a period of stability and growth. According to Robbins (1982: 5),

The increasingly stable lumber economy in the years after 1945 evolved in the midst of dramatically altered competitive conditions, the emergence of larger, more efficient and monopoly like operating groups, and the ability of trade leaders to influence the political world to their advantage.

During this period the modern forest products industry established itself as a seemingly permanent fixture of modern corporate America. In 1956, International Paper, the nation's largest forest product company, became the first in the sector to take a place among the Dow Jones Industrials. This entrance into the Dow Jones Industrial Average (DJIA) signaled the beginning of an era of unprecedented growth and prosperity in the US forest products industry.

The US Forest Products Industry in the Postwar Era

By the 1950s the US forest products industry was firmly established as one of the most profitable and important industries in the nation. Forest product firms played a fundamental role in the prosecution of the Second World War, providing wood products for a wide variety of war-related needs and benefiting greatly from the technological advances that were made along the way.³⁸ According to one study, during the 1950s, the forest products industry experienced “the most rapid advancement in technology in any decade in the United States history,” due in large part to the technological advancements made in the war effort (Panshin et al. 1962: v).

There is no doubt that the industry was crucial to the US economy. Using figures released by the Department of Commerce and the Census Bureau, the same study group found that in 1956 the “wood-using industries” ranked first among all industries in their number of establishments, fifth in number of wage earners, sixth in total wages paid, seventh in expenditures for new structures and additions, third in expenditures for new machinery and equipment, and eighth in value added by manufacture (Panshin et al. 1962). Panshin and his co-authors also estimated that during the post-war period, timber accounted for slightly more than

³⁸ The forest products industry helped fill a number of needs for the US war economy. For example, furniture factories were transformed to build gliders, lumber manufactures built truck bodies, and plywood plants fabricated boats (see Panshin et al. 1962).

one-fourth the value of all industrial material consumed in the US. Clearly the forest products industry was a fundamental component of the postwar US economy.

Throughout this period the US forest products industry enjoyed an unprecedented period of growth and prosperity. As shown in Figure 4.1, total after tax profits in the industry grew from a combined total of approximately \$1 billion in 1950 to almost \$6 billion in 1979. This rapid growth in profits was due to a number of conditions: a growing population was flush with savings from the war economy and enjoying rising wages, causing a steady rise in consumption levels. The working class in the United States, perhaps more than anywhere else, came to identify consumption with personal success and happiness (Resnick and Wolff 2010). This success was often defined by owning one's own house, and in the US, housing has been constructed primarily with forest products. In addition, the US federal government continued to channel money into national development projects, including affordable housing programs and the interstate highway system, which enabled the rapid suburbanization of American cities and a rapid increase in demand for consumer products.

During this period a pattern begins to emerge whereby the performance of the forest products industry showed a strong parallel to the health of the US economy in general. This is due to the fact that the two primary sectors of the industry, wood products and paper products, are directly tied to consumer markets. The primary use of wood products in the US is home construction and one can tie the fate of the industry quite closely to movements in housing starts. The second forest products sector, pulp and paper, is also directly tied to the general health of the nation's economy. This is especially the case with paperboard, which is the sector that accounts for almost half of all paper industry production. Paperboard is widely used for packing and shipping consumer goods, and many goods are also contained in additional packaging for the

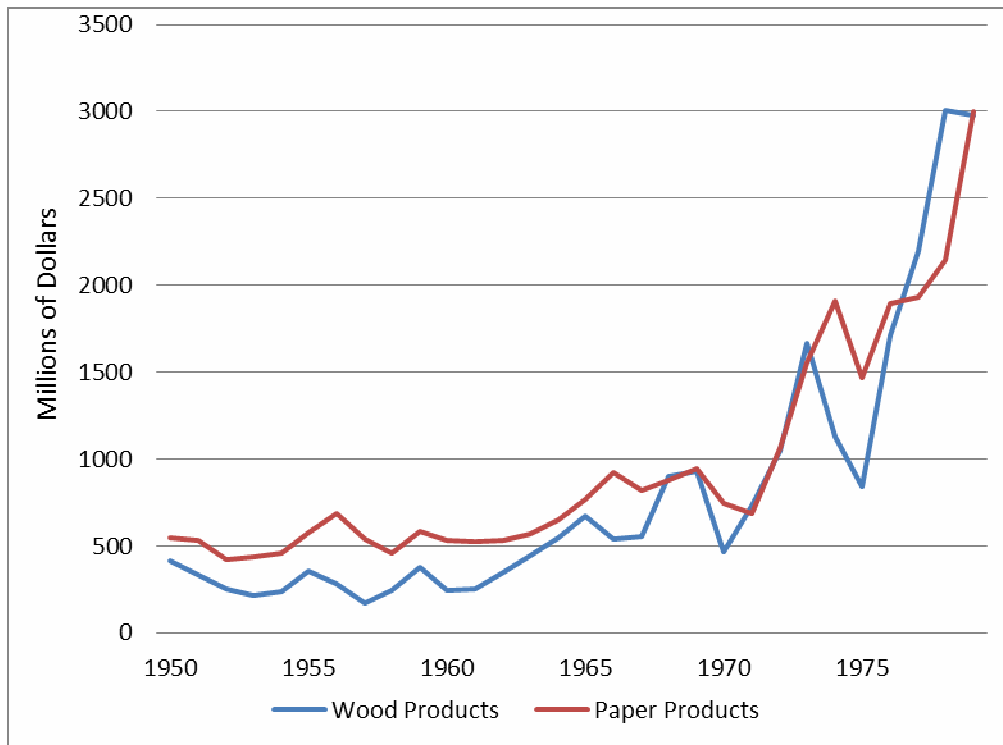


Figure 4.1 Total After Tax Profits in US Forest Products Industry
Source: U.S. Bureau of Economic Analysis, Table 6.19

final purchaser. For example, most of the goods purchased in the grocery store are contained in a cardboard package containing product information and branding images. These packages themselves were shipped in large paperboard packages, which are discarded before the product hits the shelf. The paper industry is clearly tied to the shipment and sales of many of the nation's staple products. Newsprint is another sector of the paper industry that is directly tied to the ups and downs of the economy in general. As one industry analyst noted, "[i]n as much as businesses tend to advertise more in good times than in bad, it follows that the state of the general economy is a prime determinant of newsprint consumption" (S&P 1974: P13).

Table 4.1 highlights some additional economic characteristics of the industry during the postwar era. The industry enjoyed a steady increase in the value of its shipments, which rose from nearly \$26 billion in 1963 to over \$119 billion in 1980. Total value added increased from

Table 4.1 Trends in General Economic Characteristics of the US Forest Products Industry for selected years, 1954-1980³⁹

Item and Year	Wood Products	Paper Products	Total Forest Products Industry
Value of Shipments*			
1963	9,200	16,357	25,557
1967	11,205	20,970	32,175
1972	23,816	28,262	52,078
1977	39,919	52,056	91,975
1980	47,193	72,650	119,843
Value Added by Manufacture*			
1954	3,242	4,630	7,872
1963	4,021	7,396	11,417
1972	10,309	13,064	23,373
1977	16,223	22,171	38,394
1980	18,079	29,688	47,767
New Capital Expenditures*			
1954	217	533	750
1963	395	709	1,104
1972	931	1,335	2,266
1977	1,563	3,295	4,858
1980	2,028	5,226	7,254
Establishments			
1954	41,484	5,004	46,488
1963	36,150	5,713	41,863
1967	36,795	5,890	42,685
1972	33,948	6,038	39,986
1977	37,302	6,545	43,847
Employees in Operating Establishments**			
1954	646	528	1,174
1963	563	588	1,151
1967	554	639	1,193
1972	691	633	1,324
1980	698	645	1,343

³⁹ Data compiled from Ellefson and Stone (1984), Table 2.1 Pp 13-14.

* Million Dollars, **Thousands

\$7.8 billion in 1954 to \$47.7 billion in 1980. This expansionary period included a steady rise in capital expenditures as well, seeing them rise from \$750 million in 1954 to over \$7.2 billion in 1980. This increase in capital expenditures resulted in a decrease in the number establishments in the wood products sector, as larger and more productive saw mills increasingly replaced small-scale lumber yards. In the paper products sector the number of establishments increased from just over five thousand in 1954 to over six and a half thousand by 1977. There was a modest increase in employment as well, rising from 1.1 million employees in 1954 to 1.3 million in 1980.

This period of expansion reflects an industry that was enjoying sustained profits and, furthermore, that these profits were in the hands of production oriented managers with a strong inclination to funnel these surpluses back into expanded reproduction. During decades immediately following the Second World War these managers sought to expand their firm's productive capacity with little regard to rate of return on the money being spent – expansion was the name of the game. This focus on expansion, as opposed to a rate of return, is also an indication of how managers were able to secure a relatively high degree of freedom from financial control.

Figure 4.2 reveals the steady rise in capacity that took place in the industry during the post war era. From the mid-1950s through 1972, capacity for all grades of paper rose at an average annual rate of 3.7 percent (S&P 1973). In addition to capacity expansion, managers also made significant investments into research and design in the hopes of maintaining industry markets that were constantly under threat, especially from plastics.

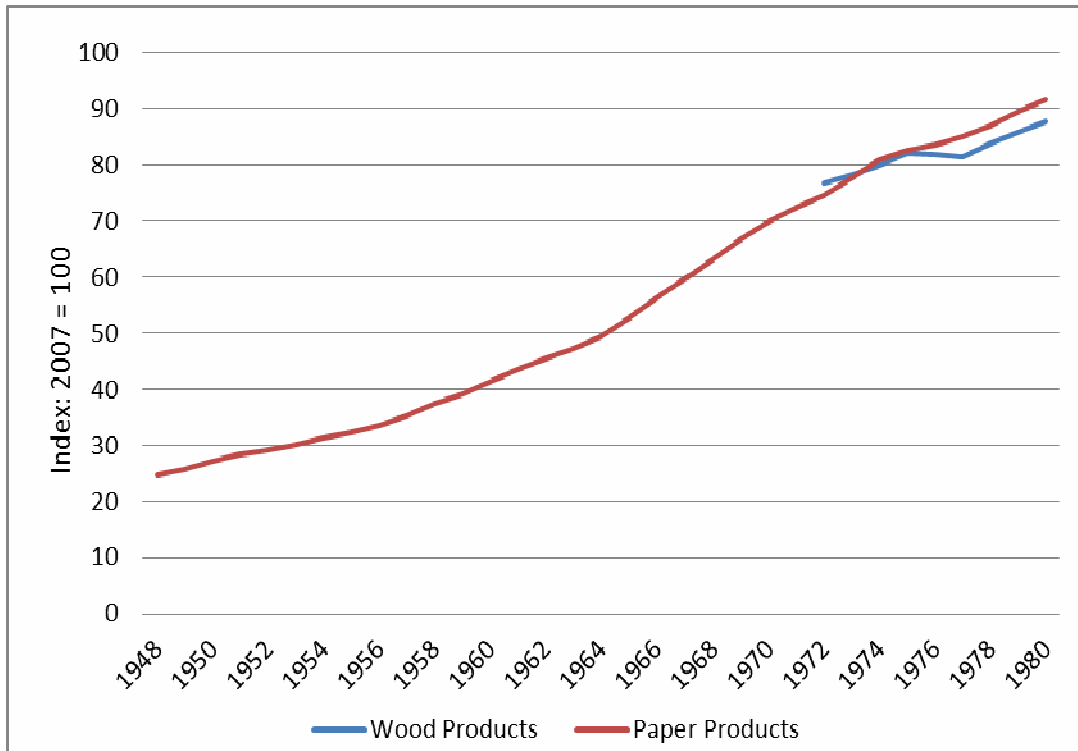


Figure 4.2 Total Capacity in Forest Products industry, 1948-1980

Source: Federal Reserve

By the 1970s, expenditures for pollution control were also becoming significant, as were maintenance costs on existing equipment.

This period of general prosperity for the US forest products industry took place under the leadership of a handful of large corporations. In the following section I examine the ownership structure of leading firms in the industry during this period. Here I will show how the relationship between stockholders and managers was structured in a manner that gave managers a high degree of relative autonomy in their control over the firm.

Ownership in the Forest Products Industry during the Post-war era

As in other sectors of the US economy during the post-war era, the public corporation became the dominant institution in the forest products industry. Other types of ownership structures, such as partnerships or sole proprietorships continued to co-exist, but the bulk of market activity was conducted by large publicly traded corporations. Over time the ownership structure of these firms followed the same trajectory as most corporations as stock ownership became increasingly diffused among thousands of shareholders. This diffusion of ownership provided managers with a considerable amount of discretion in the day-to-day operation of the firm.

The question of how much stock ownership is necessary to exert control and exactly how control is exercised is highly debated. A common benchmark used by researchers is to focus on those who own over 5 percent of a given firm's stock, who are commonly referred to as "blockholders" (Holderiness 2003; Barclay and Holderiness 1991). A higher benchmark of ten percent for corporate disclosure requirements was adopted by the Security and Exchange Commission as part of the Securities and Exchange Act of 1934. In 1970 Congress changed this requirement from 10 to 5 percent in an amendment to the Securities and Exchange Act of 1934, due to arguments that 5 percent had now become a sufficient level for a stockholder to exert substantial leverage over a company. In an earlier report, Congress argued that even 1 or 2 percent of a firm's stock may be significant enough for a stockholder to gain significant influence in the firm (U.S. Congress 1968, cited in Ellefson and Stone 1984: 143-144). The exact nature of

the relationship between concentrated stockownership and control continues to be a subject of debate (Holderness 2003).

Ellefsen and Stone's (1984) study of US "wood-based" industries contains the most extensive study of stock ownership during the postwar era. Examining stock ownership in 1980 they found that "[i]n two-thirds of 26 companies examined, the single largest stockholder controlled less than 10 percent of a company's outstanding stock. Among the top 10 firms in 1980, only five had a single stockholder with more than 5 percent of the company's stock. Based on these numbers Ellefsen and Stone conclude that there is little evidence to suggest that a significant concentration of stock ownership exists for any institution to exercise a significant amount of control over management. Management, in other words, enjoyed a relatively high level of autonomy in the forest product industry.

As Ellefsen and Stone (1984) note in their analysis of stock ownership in the forest products industry, there are five prevalent ownership categories: family interests, foreign owners, wood-based corporations, institutional owners, and thousands of individual stockholders. Large stockholdings among wealthy families is a vestige of 19th century capitalism, often occurring when entrepreneur capitalists, or Robber Barons in the common parlance of the day, bequeathed large sums of wealth, in the form of stock, to their children and grandchildren. The Luke family's interest in Westvaco is a classic example in the forest products sector: founded by William Luke in the late 19th century, Westvaco rapidly became one of the leading producers of paper products in the US. Over the course of the 20th century, five generations of Luke family decedents would go on to

lead the Westvaco Corporation, the latest being John A. Luke Jr. who became CEO in 1992 and continues to lead the company to this day.⁴⁰ Yet, in a pattern that is emblematic of the challenges facing family dominated firms, the Luke family's ownership stake in the company has slowly dwindled. In 1962 the family owned 30 percent of the company's stock; by the early 1980s this share was down to just 2 percent.

This pattern was repeated in several other family-centered firms, including Weyerhaeuser, which did not go public until 1963, and Mead. In other cases, large family stockholdings extended beyond the interests of a single firm; the DuPont family, for example, owned significant shares of both Kimberly-Clark and Louisiana-Pacific. By the early 1980s family ownership of stock in the forest products industry remained significant in many firms, despite their considerable decline over the course of the 20th century (Ellefson and Stone 1984: 133). The question of the family's influence over managerial decision-making, however, is an open question. In fact, the enduring influence of some families, such as the Weyerhaeuser family, might be partially responsible for explaining why the firm later resisted pressure to engage in certain practices, such as selling of timberlands, in order to increase shareholder value.

Foreign ownership was another common feature of stock ownership in the US forest products industry that was highlighted by Ellefson and Stone (1984). In 1980, sixty-eight US forest product firms were identified as having a foreign entity owning ten percent or more of the firm's securities. In some cases, the family form and foreign ownership combined. For example, the British Rothschild family group stood out as one

⁴⁰ Westvaco is now MeadWestvaco following a 2002 merger with Mead.

of the most common owners of stock in US forest product firms, owning stock in at least 26 US firms. Four of these companies, including Boise Cascade, Crown Zellerbach, Georgia-Pacific, and Weyerhaeuser, claimed the Rothschild family among their top ten shareholders. Other examples include the Bronfman family of Canada, who were the number one stockholder of Scott Paper, and James Goldsmith of France, who had acquired over 28 percent of the outstanding stock in Diamond International during the late 1970s (Ellefson and Stone 1984).

Although it was not common for forest product firms to purchase significant interests in other firms in the same industry, by the early 1980s, there were several firms that held significant shares of their own stock. Four firms were identified by Ellefson and Stone (1984) as being among the top three shareholders of their own stock: Kimberly-Clark (third), Georgia-Pacific (first), Masonite (second), and Louisiana-Pacific (third). Companies owning large amounts of their own shares did not become a common phenomenon in the industry for another two decades, after changes in the regulatory regime encouraged firms to increase stock buybacks in order to increase shareholder value.

By the early 1980s, institutional investors were also becoming a major ownership category in the US forest products industry. At the time, however, few institutional investors held large block shares in any particular firm. The tendency at the time was for institutional investors to own small amounts of stock in many different firms. J.P. Morgan Company, for example owned stock in 17 different forest product firms, but few of these holdings exceeded 3 or 4 percent of any single company. In their conclusion,

however, Ellefson and Stone (1984) predicted correctly that forest products industry, following national trends, would see an increase in company stock owned by institutional investors.

Monopoly Capital and the US Forest Products Industry: The Surplus Disposal Problem

Rising profits in the decades following the Second World War left managers in the US forest products industry in control of a significant surplus of capital. In keeping with the managerial conception of control, managers preferred to reinvest their surpluses internally in order to expand capacity and increase efficiencies. This tendency for managers to reinvest their profits in expanded capacity often caused total capacity in the industry to outpace demand. As a result, a glut would emerge in the market and prices would plummet. Maintaining the delicate balance between supply and demand was no easy task, and despite numerous efforts to coordinate output and stabilize profits, it was a constant struggle for managers to bring their own desires for expansion in line with the limitations of the market place. By the mid-1970s, industry analysts were calling for managers to rein in their expansionary inclinations (S&P 1974: P9). However, it was not until the early 1990s that more financially-oriented managers finally were able to rein in capacity expansion.

As shown in figure 4.2, overall capacity in both the wood products and paper products sector rose steadily throughout the post war period. Capacity utilization rates, on the other hand, fluctuated from year to year as managers tried, often unsuccessfully, to limit total supply in order to avoid flooding the market and causing prices to plummet.

Maintaining high utilization rates is critical for capital-intensive industries such as the paper industry. This need is due in large part to the significant debt that often incurred in the process of financing a large pulp and paper mill. In order to meet payments on this debt and to maintain profit rates, managers are compelled to keep utilization rates high.

As one Standard & Poor's analyst explained (S&P 1975:P11),

[h]istorically, paper makers have enjoyed a sellers' market when operating rates are above 94%, at which time prices rise more rapidly than costs...When operating rates are between 92% and 94%, the industry normally has a more balanced posture, with prices and costs moving at the same rate. At 90% to 92%, costs are moving somewhat ahead of prices, and below 90% prices are actually reduced on an average ton.

Figure 4.3 shows the capacity utilization rates for both the wood products and paper products sectors. To the chagrin of these analysts, the paper products sector overall capacity utilization rate fluctuated between 85 and 95 percent in the decades following the Second World War. The need to maintain a high utilization rate meant that there were definite limits to investments into expanded capacity, less they run the risk of overproduction and/or a drop in overall prices. In the wood products sector the utilization rate fluctuates more widely. This is due primarily to the close correlation that exists between the wood products sector and housing starts, which themselves are highly dependent upon federal interest rate policy.

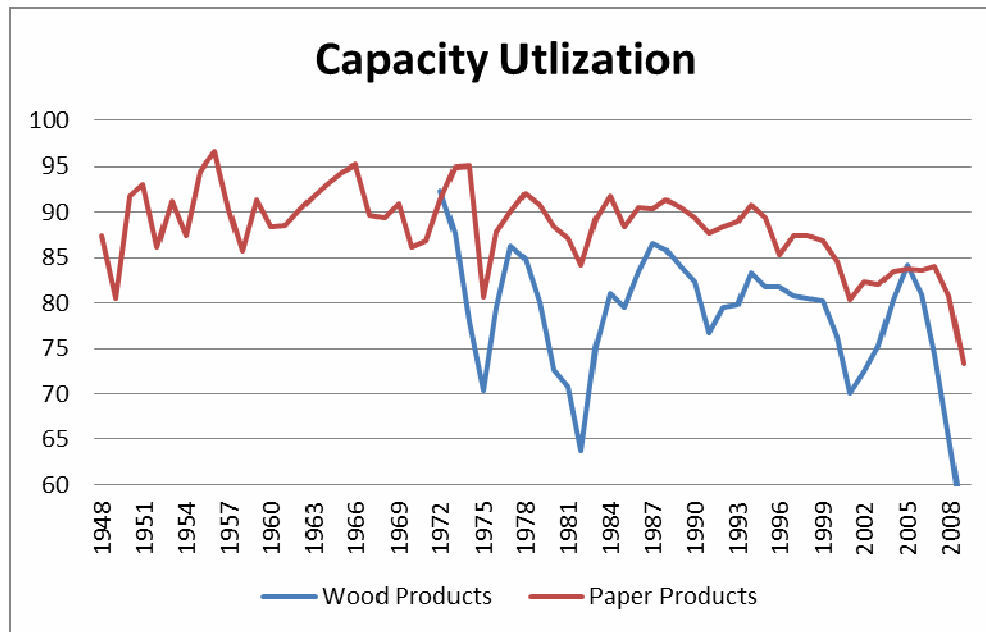


Figure 4.3 Capacity Utilization in Wood Products and Paper Products sector, 1948-2008
Source: Federal Reserve

The need to maintain high utilization rates in the forest products sector coupled with the highly cyclical nature of its markets meant that managers faced tough decisions on when to invest in expanded capacity. The production oriented managers of the post-war period had a strong inclination towards expanding productive capacity; however, as we saw, these inclinations were limited by the reality of overproduction and glutted markets. This gave rise to the surplus disposal problem: how to invest surplus profits and grow the firm without letting supply outstrip demand and cause prices to plummet? In the US forest products industry the response took a number of forms, including ongoing mergers and acquisitions, diversification, and increased investment into timberland ownership.

Mergers and Acquisitions

During the postwar era, mergers and acquisitions became a favorite tactic of managers looking to expand their corporate portfolios. As we recall, the industry was significantly altered by the merger wave that swept across the US at the turn of the 20th century. During this period, mergers and acquisitions were undertaken in the hopes of bringing stability to the industry's notoriously unstable markets. Although these efforts ultimately failed to deliver the stability that industry leaders desired, they did produce the corporate giants that would go on to dominate the US forest products industry during most of the 20th century. And just as the forest products industry mimicked the merger waves of the early 20th century, so it would follow the second merger wave of the 20th century that took place in the late 1960s.⁴¹

Mergers are often characterized as either horizontal or vertical: horizontal refers to mergers of two or more companies that produce the same or similar products in the same market; vertical mergers, on the other hand, refer to mergers that bring together different stages of the production process. For example: a paper company purchasing a packaging company would be a vertical integration of the paper process by linking the two stages of production within the same parent company. There is also a third type of merger, a conglomerate merger, which is when a firm purchases another firm that produces products that are not competitive with each other, but might rely on the same

⁴¹ There were four or five distinct merger waves in the United States during the 20th century: 1887-1904, 1916-1929, 1965-1969, 1984-1989, and the early 1990s to the present. The proximity of the last two lends itself to the argument that there has been an ongoing merger wave in the US since the early 1980s. For a history of merger waves in the United States see Gaughan (2007). For an analysis of the cause of merger waves see Hartford (2005).

raw materials. For instance, it was common for paper manufacturers to purchase sawmills and vice versa. Conglomerate mergers also refer to those mergers that extend a firm's market to different regions. In reality mergers and acquisitions take on a number of different forms, which often defy easy classification (Ellefson and Stone 1984).

During the postwar period, the forest products industry was altered by all three types of mergers. In fact, the forest products industry experienced a greater level of merger activity than the industrial sector in general. According to one study,

In the paper and allied products industry group, the aggregate assets of large corporations absorbed by mergers between 1948 and 1968 were equivalent to 35% of that group's assets in 1965. This was the highest ratio for any of the 21 groups in the mining and manufacturing sectors of the U.S. The comparable ratio for the lumber and wood products industry group was 13% and that for the two groups combined was 28% (Le Master 1977).

The merger wave of the post-war era was largely driven by the leading firms in the industry. LeMaster (1977) found that from 1950 to 1970 there were 424 mergers among the leading forest product firms. The leaders in this group included Georgia-Pacific (85 mergers), Boise Cascade (80 mergers), Mead (57 mergers), St. Regis (52 mergers), and Champion International (46 mergers) (Le Master 1977; Ellefson and Stone 1984: 213).

The rationale for these mergers and acquisitions varied widely; Le Master (1977) identified six general advantages:

1. Advantages associated with increased firm size such as greater control over markets and prices
2. Efficiencies associated with vertical integration through replacement of market transaction control between productive stages with managerial decision making
3. Assurance of timber supply

4. Qualification for tax provisions of section 631 (a) of the Internal Revenue Code
5. Assurance of markets for products
6. Stabilization of profits through diversification

The first and second advantages are common justifications for mergers and acquisitions because larger firms have stronger market positions and are often able to discipline less vertically integrated competitors. Furthermore, managers have a distinct interest in mergers because larger firms generally pay executives more than do smaller firms.

Two advantages display the unique situation of the forest products sector: the need for a steady supply of raw materials and the tax advantages associated with owning timberland. As with all natural resource-based industries, the need to secure an adequate supply of raw materials is critical. The trend towards direct ownership of timberland was supported by a tax structure that greatly benefited firms that owned their own land. Section 631(a) of the tax code allows timber owners to treat the difference between the fair market value of cut timber and its cost as a capital gain when the timber is not sold but merely transferred to another branch of the same corporation. This gave timber owning firms a substantial advantage over those that purchased their timber on the open market. Furthermore, under this tax regulation, firms were allowed to determine the “fair market value” for their timber by themselves. Not surprisingly, this discretionary power often resulted in an exaggerated valuation aimed at decreasing the reported gain and increasing the effective subsidy for timber-owning firms.

The merger wave of the late 1960s had a significant impact on the US forest products industry. The large firms that dominated the industry were able to gobble up smaller competitors, allowing them to gain greater control over prices and mitigate the

effects of cut-throat competition. Merger activity in the industry peaked in 1968 and 1969, with 185 mergers taking place in these two years alone. By this point, federal anti-trust lawsuits were becoming a problem for the industry, prompting firms to increasingly move towards conglomerate mergers aimed at diversifying the firm's portfolio (Le Master 1977; Ellefson and Stone 1984: 197-221).

On Oligopoly and Concentration

The degree of oligopoly in the forest products industry has long been a subject of debate. As early as 1906, a congressionally mandated study by the Bureau of Corporations described monopolistic conditions in the industry. In particular, the study found monopolistic practices derived from high levels of concentration in timberland ownership.⁴² Over the course of the 20th century, the industry continued to consolidate, resulting in larger and larger firms, controlling ever larger segments of market activity. Despite this trend towards consolidation, the debate over the relative degree of monopoly, or oligopoly, continues to this day.

Many observers, particularly economists, argue that the industry is a close approximation of the model of pure competition, in which no individual firm holds disproportionate power over market prices (Zaremba 1963). Others argue that the industry is oligopolistic in character, meaning that a small number of firms are able to

⁴² In an ironic twist, it was the debt incurred from purchasing these timberlands that led some firms to maintain high production levels in the face of declining prices. Unable to pay the carrying costs out of pocket, lumbermen were forced to run their machines at a loss in order to maintain payments on their debt (Steen 2004; Compton 1916).

dominate market activity (Robbins 1982). Still others argue that the industry has an oligopolistic structure, meaning that it is competitive at the output level, but highly concentrated at the input level, leading to various market imperfections (Mead 1966). This debate is confounded by the fact that there are various ways to measure industry concentration and divergent views on what actually constitutes oligopolistic markets.

The most commonly used measurement of industry concentration is the “concentration ratio” which measures the proportion of total industry sales that are collectively attributed to the industry’s largest firms. Concentration ratios are collected by the US Census Bureau and are provided for the top four, eight, twenty and fifty largest firms in any given industry. This measure of concentration is not without fault, as the percent of sales by a number of firms is a poor measure of competition.⁴³ This is particularly the case in industries that have considerable levels of international competition. Nevertheless, these ratios provide a useful starting point.

As shown in table 4.2, the level of concentration varies widely between different sectors, with wood products sectors (SIC code 24) generally having lower levels of concentration than those in the paper products sector (SIC code 26). This pattern is due primarily to the fact the paper products sector is substantially more capital intensive, requiring significant investments into modern pulp and paper plants, and creating a formidable barrier to entry for likely competitors. Logging and sawmills, on the other hand, are relatively cheap and range in size from the industrial mills of the large

⁴³ Concentration measures reflect concentrated market conditions, which are then presumed to reflect the opportunity for the abuse of market power. As Ellefson and Stone (1984: 75) note, “concentration by itself need not imply misuse of corporate position in the market place any more than lack of concentration implies perfect competition and the utopia that supposedly follows.”

corporations, to the “peckerwood mills” that are found in most every small town in the US. Specialty products, such as fine papers and newsprint, tend to have much higher levels of market concentration

Table 4.2 also shows that the levels of concentration in the industry tended to increase over the course of the postwar period. This tendency was most evident in the wood products sector, although it still did not match the concentration levels that were found in the paper products sector. In paper product sectors, the increase was less drastic. As explained above, the merger wave in the industry peaked in the late 1960s, before receding slightly in the 1970s. In this case, the relatively strong anti-trust laws of the era placed definite limits on the level of industry concentration.

But by the 1970s, industry analysts claimed that the US forest products industry was largely saturated and there was relatively little room for new companies to enter the field (S&P 1975: P11). The reason that entry was so difficult is intimately connected to the question of timber supply. Over the course of the 20th century, the most productive timberlands were either placed under the protection of the federal government or were acquired by established firms. Another factor was that the paper industry is capital-

Table 4.2 Percentage of Sales for Four Largest Firms in Selected Forest Product Industries

Industry (SIC Code)	1963	1967	1977	1982
Logging (2411)	11	14	29	30
Sawmills and Planing Mills, General (2421)	11	11	17	17
Special Product Sawmills (2429)	17	21	11	25
Pulp Mills (2611)	48	45	48	45
Fiber Cans, Tubes, Drums, and Similar Products (2655)	57	51	54	61
Sanitary Paper Products (2676)	62	63	65	62

Source: US Census

intensive, making it unlikely that a new entrant would be able to find the kind of financing that would be necessary to finance a modern pulp mill. With anti-trust laws limiting merger and acquisition activity, managers were compelled to seek out alternative means for increasing profits and growing their firm.

Diversification

Although mergers and acquisitions continued to be important in US forest products industry during the post-World War II era, diversification increasingly became the preferred means for managers to expand their corporate portfolios. Diversification serves a number of functions for large corporations operating in mature markets – the most important of which is that it provides a solution for managers facing limited internal investment opportunities. Furthermore, it allowed managers to expand into unrelated product lines, thus providing balance to the firm's portfolio by spreading risk across various market sectors. This was particularly important in cyclical industries such as the forest products industry.

There were a number of different strategies available for managers looking to diversify. First, managers could choose to diversify within the forest products industries. By the late 1960s, most of the leading firms in the industry had multiple divisions related to forest products. Boise Cascade was indicative of a firm that spread itself widely across various sectors of the industry. Under the leadership of their President, Robert Hansberger, Boise Cascade's corporate activities included operations in wood product manufacturing, building materials fabrication and distribution, paper manufacturing, and

packaging and office distributing. Other companies also chose to expand their operations to include non-wood products such as metals, plastics and real estate. In Ellefson and Stone's (1984) study of leading industry firms they found that on average each firm operated in seven different industry segments. Firms such as St. Regis and Georgia-Pacific were operating in as many as 17 different parts of the industry.

A third strategy for diversification was to look outside the industry to completely unrelated markets. In the same study cited above, the authors found that among the 55 studied firms and specifically those that relied on wood-based operations for at least three-quarters of their 1978 revenue, there were 12 firms operating in at least 35 non-wood industries. These included real estate, plastic products, chemicals, machinery, instruments, primary metals, and stone and concrete products. The leaders in this trend were among the largest firms in the industry, including such notables as Union Camp, St. Regis, and Scott Paper Company. By the late 1970s it was now common for industry firms to earn a larger percentage of their revenue from markets unrelated to forest products (Ellefson and Stone 1984; Enk 1975).

Pacific Lumber Company presents an extreme example of this trend towards diversification: although by name the company is most directly engaged in the forest products industry, over seventy percent of the company's 1981 sales originated with the manufacture of cutting and welding products, while only 25 percent originated with forest products. The other five percent consisted of such varied markets as vegetable growing in California and hotel management. Mead was another prominent of example

of this trend: by 1981 less than half of the company's sales originated from wood products.

Diversification strategies often developed directly out of managers' desire to gain control over the everyday expenses of the firm and to reduce costs. For instance, in 1948 Kimberly-Clark decided to establish an airline in order to provide air transportation for company executives and engineers between the company's Neenah, Wisconsin headquarters and their mills. The company airline, then operating under the name of K-C Aviation continued to grow and in 1984 became a regularly scheduled passenger airline under the name of Midwest Express. During Bowater's expansion of the 1950s, their president, Sir Eric Bowater, became frustrated by the excessive rates that his firm had to pay for shipping and decided that Bowater would purchase their own fleet of ships to transport their wood products, thus establishing a subsidiary Bowater Steamship Co. (Reader 1981: 248). This trend towards diversification was not confined to just a few firms: indeed, Ellefson and Stone (1984: 23-32) found that among the top 50 firms in the industry there were 16 whose revenue from forest products operations represented less than 36 percent of their total income.

Forest product firms were also identified by other large corporations during this period as viable targets for their own diversification strategies. During the post war period, giant firms such as Mobil, Time, ITT, and Philip Morris each sought out forest product firms as part of their expanding corporate portfolio. The rationale for diversifying into the forest product industry varied, with some seeking vertical integration for their publishing lines, while others were looking to diversify their holdings in order to

maintain a broader, more diversified corporate conglomerate. A major attraction for potential buyers was the large timberland holdings of major firms, which were often considered an undervalued and potentially profitable investment. The notion that timberland was a profitable investment was also becoming widely known within the industry itself.

Timberland Ownership

Land ownership has long been a significant aspect of the economic and social fabric of American society (Wolf 1981). This is particularly the case with natural resource-based industries, which rely on the land and the products derived therefrom as the principle source of their business enterprise. In the forest products industry, owning and/or gaining access to timberland, is a perennial concern of managers who require an enormous amount of raw materials to keep their mills running. The strategies employed by management to gain access to raw materials tend to change over time as managers adapt to the changing conditions of the market and the availability of timber supply. In what follows, I show how timberland ownership strategies are also highly affected by broader shifts in managerial conceptions of control. That is to say, during the postwar era, timberland ownership was increasingly motivated by the broader strategy of capital accumulation that compelled manager to reinvest surplus profits in order to grow the firm and ensure its long-term survival.

Dating back to the 19th century, land ownership in the US forest products industry was a critical component of success for many firms. In keeping with the general

relationship of coordination between the federal government and industry that I described above, many forest lands were provided as a “free gift” of nature from the state. Indeed, companies such as Weyerhaeuser, Potlatch, and Boise Cascade built their corporate empires on large land holdings that were acquired from federal land grants. In 1864, Congress created the Northern Pacific Railroad Company in order to construct a rail line from Lake Superior to Puget Sound. In order to aid in the construction of this rail line Congress also granted the Northern Pacific nearly 40 million acres of land. Congress intended that this land be open to settlement, but the railroad company sold much of the land to large corporations. Fredrick Weyerhaeuser in particular came to own hundreds of thousands of acres of timberland that was drawn from the public trust in order to promote the development of railroads (Jensen and Draffan 1995).

Over the course of the 20th century managers increasingly came to believe that gaining control over timberland was a necessary component for success in the US forest products industry. This was particularly the case during the postwar era when direct control over timberland became a “prominent concern of corporate managers” (Enk 1975: 41). During this period, population growth and spreading affluence led to increased pressure on the US land base, which in turn led managers to believe that securing control over timberland was critical to their firm’s survival. Commenting on this trend in the early 1960s, Panshin and his colleagues (1962: 4, emphasis added) noted that

[T]he realities of economic forces are pointing to the need for permanency of timber ownership. In times past, it has not always been economically feasible for mill owners to retain ownership of forest lands. Now large segments of the industry realize that permanent ownership and the

management of forest lands on a sustained yield basis offer *the only sure means of survival*.

Gaining access to timber supplies can take a number of forms, including fee simple (i.e., direct) ownership, purchase agreements, public sale contracts, and various other private agreements between private land owners and forest product firms (Ellefson and Stone 1984: 96-97). Enk's (1975) study of land use decision making in the forest products industry found that during the post-war era there was a dramatic increase in both direct ownership and purchase agreements among US forest product firms. He found that between 1961 and 1970 the amount of land controlled by the industry more than doubled to almost seventy-nine million acres. Of the total increase, the majority of this land (71%) was under leasing and cutting agreements, while the remaining land (29%) was purchased outright by the firm. Here we are primarily concerned with the latter category – that of direct fee ownership – because of the critical role that direct ownership played in US forest products industry.⁴⁴

Table 4.3 shows ownership statistics for all commercial timberland in the United States during the postwar era. In 1952, the forest products industry owned over fifty-nine million acres of timberland in the US, which represented 12 percent of all US timberland and 17 percent of the total private timberlands. By 1977, the industry ownership of US timberland had increased to almost sixty-nine million acres, bringing their share of the total privately owned timberlands in the US to 20 percent. This substantial rise in

⁴⁴ The vast majority of the land controlled under leases and purchasing agreements was in Canada, where policy favored the retention of government ownership and the use of control agreements with corporations. In the United States, direct fee ownership was much more common. For a more detailed discussion, see Enk (1975: 40-64).

timberland ownership reflects manager's growing preoccupation with gaining direct control over timberland as part of their broader corporate strategy.

Determining the amount of land that is owned by specific firms is no easy task. However, a number of studies conducted in the 1970s and early 1980s provide us with a good snapshot of which firms were purchasing land, and for what reasons (Enk 1975; O'Laughlin and Ellefson 1982; Ellefson and Stone 1984)⁴⁵. This research clearly shows that the surge in timberland ownership was driven primarily by the industry's largest and most prominent firms. Ellefson and Stone (1984: 109) found that "between 1945 and 1970, 16 companies amassed over 23 million acres of fee-owned timberland (90 percent located in the United States), with the bulk of the increases occurring since 1960." By 1969, International Paper, long the nation's leading forest products firm, held the most timberland with over 6.5 million. Weyerhaeuser was the second leading owner of

Table 4.3 Area of Commercial Timberland in the United States by Ownership (in 1000s of acres)

Year	All- ownerships	Total Public	Total Private	Forest Products Industry	FP percent of total	FP percent of Total Private
1952	499,332	143,721	355,611	59,548	12%	17%
1962	509,380	143,683	365,697	61,558	12%	17%
1970	496,404	141,590	354,815	66,980	13%	19%
1977	482,486	135,722	346,764	68,782	14%	20%

Source: Birch, Lewis, and Kaiser (1982)

⁴⁵ O'Laughlin and Ellefson (1982) liken the accounting of timberland ownership to photographing a moving object with a box camera. Not only does timberland ownership change significantly over time, but it is also obscured by various joint-ventures and subsidiary ownership.

timberland with over 5.5 million acres.⁴⁶ By 1979 the top four firms (consisting of International Paper, Weyerhaeuser, Georgia-Pacific, and St. Regis Paper) collectively owned over 20 million acres, which amounted to 30 percent of all industrially owned timberland. The top 40 largest firms accounted for 84 percent of all industrial owned forest land (Ellefson and Stone 1984: 108-109).

In the early 1980s, International Paper was the largest corporate land owner in the nation, holding more than 7.1 million acres. This would, as Ellefson and Stone (1984: 108) point out, qualify the company as the 42nd largest state in the nation, slightly ahead of Maryland but consisting entirely of valuable timberland. Clearly, such high levels of land ownership gave these firms a substantial amount of wealth and power in the regions that they were located.⁴⁷ Claims that these levels of ownership do not constitute high levels of concentration (see O’Laughlin and Ellefson 1982) ignore the role that regional concentration plays in determining prices and play down the advantage that large firms gain through their access to their own timber supply.⁴⁸ But for now I want to turn our focus to the questions of why managers suddenly sought to purchase all this timberland? What rationale was at play in the decision to purchase timberland and how did the managerial conception of control of the post-war era help shape manager’s perspective on timberland ownership?

⁴⁶ Although Weyerhaeuser owned fewer acres of timberland than International Paper, their high value Western timberland was valued at over twice that of International Paper’s land (O’Laughlin and Ellefson 1982).

⁴⁷ For more on how land ownership is a source of both power and wealth, see Wolf (1981) and Freyfogle (2003).

⁴⁸ See Mead (1966) for an analysis of oligopsony in the Douglas fir market of the Pacific Northwest.

The first and most obvious reason for firms to own their own land was to supply the necessary raw materials for their mills. The enormous size and capacity of a modern mill requires a large land base in order to provide an adequate and steady supply of timber. This need for a constant source of timber supply is particularly critical to the capital-intensive paper industry, which requires the highest possible utilization rates to maintain profitability. In reality, however, even the largest firms rarely provide the majority of their timber supply from company owned lands. In his study of timberland ownership in the US forest products industry, Clephane (1978) found that among the 20 largest forest product firms the average self-sufficiency was 43 percent. Among the largest firms in the industry, Weyerhaeuser was the only one that came close to self-sufficiency, with approximately 88 percent of their supply coming from company owned lands. Several smaller firms had similar ratios, but the majority of firms in the industry relied on the open market for the majority of their timber supply (Clephane 1978).

In fact most large firms used their in-house timber supply primarily as a hedge against short-term price fluctuations in the market. For example, when stumpage prices were on the rise a large firm owning their own timber supply could choose not to purchase on the open market and harvest trees from their own land instead. When prices were low, on the other hand, they could either purchase trees on the open market, or in some instances, sell their own trees. This ability to manipulate the market gave land-owning firms a considerable advantage over firms that did not own land and was certainly an important factor in managerial decisions to purchase timberlands (O'Laughlin and Ellefson 1982). As we will see in Chapter 6, it also proved to be a vital

lifeline for large firms in the early 1990s when environmental concerns led to a precipitous drop in logging contracts on federal lands.

However, a more fundamental reason for the increase in corporate land ownership was described by Gordon Enk in his 1975 study on “Land-Use Decision Making by Large Corporations in the Forest Products Industry.” Quoting an industry executive, Enk found that “...the major change grew from the recognition that (the company’s) essential physical asset was not its trees, but rather its land and the quality of its soils.” That is to say the primary justification for purchasing more land was the value of the underlying asset and its unique characteristics. I argue that this change can be understood in large part as a particular manifestation of the existing managerial conception of control that was in place during this period.

Timberland became a desirable asset to managers for a number of reasons, the greatest perhaps being that it is a low-risk investment that tends to increase in value over time (tree growth is not dependent on the health of the broader economy), thus providing a hedge against inflation. Timberland also provides income tax advantages since cut timber was treated as capital gains under the tax code. A final factor driving the increase in corporate land ownership was the desire of firms to increase their competitive positions vis-à-vis other firms in the industry. O’Laughlin and Ellefson (1982) recall an instance in 1979 in which International Paper purchased a rival company, Bodcaw, for 40 percent over the appraised value of the firm. The primary justification provided for this acquisition was the desire to increase the firm’s timberland holdings and to keep their rival Weyerhaeuser from “intruding into its domain.” Summarizing several studies on

corporate land ownership in the forest products industry, O’Laughlin and Ellefson (1982) concluded that the emerging strategy was moving away from a short-term focus on profits, and giving way “to strategies to use a company’s strength, namely timber resources, to ensure long-term success.”

This emerging awareness among managers that timberland was a valuable asset that could serve to expand corporate profits led to the development of internal corporate divisions whose goal was no longer to manage the lands for timber but “to utilize the company’s land for real estate development and thus increase the return on the investment from the property” (Enk 1975: 59). The first firm to develop such a division was Georgia-Pacific which established the Georgia-Pacific Investment Co. in 1955. During the late 1960s, eleven other companies established their own real estate divisions aimed at maximizing the real estate potential of their land holdings. Enk’s research found that almost all of these companies were actively involved in assessing their land for development opportunities. By 1975, one company, Boise Cascade, had a total of twenty-nine real estate development projects underway involving a total of 125,000 acres of land (Enk 1975).

It was in this environment that the industry began to adopt the real estate norm of “highest and best use” in their management of their timberlands – meaning that parcels of land should be continually reviewed with an eye towards maximizing the financial return on their investment. For most of the timberland this meant continued management for high yield timber product; for others, however, this meant that parcels of land would be separated and used to generate income from non-timber producing means. These

developments included exploration for agriculture, mining, and drilling potential. Other parcels of land were set aside for the development of recreation communities, including several ski resorts.

The industry trend towards in-house real estate divisions was limited, however, by the public backlash that often accompanied these development projects. Boise Cascade's development projects in California produced a wave of negative publicity from the burgeoning ecological movement claiming that the company was causing extensive environmental harm. There was also a series of lawsuits brought against the company by the California attorney general claiming that the company engaged in false advertising in their efforts to sell land. These suits were eventually settled at a cost of \$59 million (Enk 1975; IDCH 2008).

Together these experiences caused other companies to exercise caution in their pursuit of profits from real estate development in order to avoid the negative publicity and risk involved in with such projects. In fact, public pressure on firms caused many companies to develop land use policies that included allowing public access for hunting, camping, and fishing. Several companies established open-access policies for all of their timberland as part of their broader public relations campaign and their desire to appease local stakeholders and build good relationships with communities (Enk 1975).

The trend towards increased ownership of timberland persisted throughout the 1970s as forest product managers continued to operate under the "retain and reinvest" conception of corporate control. These firms used surplus profits and debt to expand their timberland holdings as part of their broader corporate strategy of diversification and

expansion. By the late 1970s it was widely believed that corporate ownership of timberlands was a critical component for success in the US forest products industry (Clephane 1978). Just as this statement was being uttered, however, a series of transformations were occurring in the US political economy that would quickly undermine this industry norm.

Conclusion

In this chapter I analyzed the historical development of the US forest products industry during the postwar era, providing evidence of how managers operated under a “retain and reinvest” conception of control. I argue that this conception of control was directly linked to the industry’s development as a mature sector operating under the historical conditions of monopoly capitalism. This managerial orientation stressed growth and expansion as the ultimate pursuit of the firm. As we recall, the ability to engage in expanded reproduction was limited due to the close relationship between capacity utilization and profit rates. This compelled managers to seek alternative means for investing their surplus capital and expanding corporate profits, including growth through mergers and acquisitions, diversification into unrelated product lines, and increased investment into timberland ownership. Here we see that there is a direct relation between the material realities of capital accumulation under monopoly capitalism and the ideological orientation of managers during the postwar period.

The next chapter will document how a series of transformations in the US political economy associated with the adoption of neoliberal policies and the explosion of

the financial sector would destabilize the corporate empires that managers had constructed over the course of the 20th century. Beginning with the hostile takeover movement of the 1980s, managers in the forest products industry were forced to contend with a reinvigorated shareholder class that demanded more from their capital investment. In response, managers eventually came to adopt a new conception of control aimed at maximizing shareholder value. I argue that this new managerial orientation provided the justification for a series of decisions that would forever change the forest products industry in the United States. Furthermore, I argue that this emerging conception of control was a particular manifestation of the financialization process that then beginning to transform the process of capital accumulation in the United States.

CHAPTER V

CONTESTED MANAGEMENT: ECONOMIC CRISIS AND THE HOSTILE TAKEOVER MOVEMENT (1975-1990)

“Corporations...belong to shareholders, not managements who believe that the business that employs them has become an institution and they are the trustees of that institution.” ~Sir James Goldsmith⁴⁹

Prior to the 1980s, financial capital remained under the regulatory restraints established in response to the Great Depression of the 1930s. This regulatory regime, associated with the New Deal, sought to limit financial speculation and to keep the financial sphere focused on channeling capital towards investment into production. It also established regulatory measures that reinforced the rise of “managerial capitalism” in the decades following the second World War (Chandler 1977). Under managerial capitalism, ownership of large corporations became dispersed among thousands of stockholders while control rested in the hands of an entrenched managerial class with reasonably broad discretion over corporate decision making (Berle and Means 1967[1932]). This trend continued well into the 1970s, with managers of large corporations becoming increasingly insulated from the shareholder community. As we have seen, in the forestry sector this discretion allowed managers to focus on re-investment in expanded capacity, creating its own problems of overcapacity, as well as a range of diversification strategies.

During the 1980s, however, the privileged position of management in corporate America came under attack from the financial community. Both the hostile takeover movement and the sustained period of institutional investor activism that followed sought to undermine the autonomy of managers. These trends were, in turn, motivated by a number of factors - including

⁴⁹ Cited in Fallon (1991: 378).

the easing of credit limits, innovations in financial instruments, and the relaxing of anti-trust enforcement – stemming from the pro-financial orientation of the Reagan administration. The result was the development of a “market for corporate control” (Manne 1965) that would ultimately pressure managers to reorient their priorities in a manner that would favor the interest of the shareholding community (i.e., finance).⁵⁰

The watershed moment for the breakup of the postwar regime of accumulation was the economic crisis of the early 1970s. To reiterate, this crisis was multifaceted and grew out of a number of contradictions emerging from within the political economy of the postwar era. These included, among others, a breakdown in the Bretton Woods monetary regime and the Nixon administration’s decision to abandon the gold standard (Gowan 1999), increasing competition from abroad (Brenner 2006), rising inflation (Krippner 2011), and a stagnating economy (Foster and Magdoff 2009). Together these factors culminated in the accumulation crisis of 1973 and led subsequently to a decade of slow growth and high inflation, or “stagflation.” In response to these changing conditions, capitalists sought the means to overcome their crisis of profitability and usher in a new period of sustained accumulation. The solution, it turned out, was to be found in a turn to financial profits as the primary means to buoy a stagnating economy and an accompanying rise in neoliberal ideology that sought to unleash market forces from the fetters of the state regulation. In the United States, this era began in 1980 with the election of the neoliberal paragon, Ronald Reagan.

The decade that followed was one of dramatic change in corporate America in general and specifically in the forest products sector. Beginning with the Reagan administration’s

⁵⁰ Henry G. Manne (1965) first employed the concept of a “market for corporate control” to describe the role of equity markets in facilitating corporate takeovers. The actual development of this market did not take place until the 1980s, following the deregulatory measure enacted by the Reagan administration.

decision to fire over 11,000 striking air traffic controllers, signaling an open season on union-busting for the private sector, and continuing through efforts to deregulate the rules governing corporate behavior, the administration provided the necessary opening for a resurgence of finance capital. Thus, while it was the crisis of the 1970s that ultimately led to the resurgence of neoliberal ideology, it was not until 1980 and the election of Reagan that a potential financial explosion could become a reality. Similarly, the financialization process and the managerial shift towards a shareholder value conception of control did not occur over night, but were worked out over the course of the decade.

As I will show, managers in the forest products industry were slow to adopt this shareholder value orientation. Throughout the 1980s managers continued to focus on expanding capacity and increasing revenues from their mills. The primary means for achieving these goals was through increased investment into technology and a clamp down on labor. Gaining control over the labor situation was also a pressing concern for management, as unions were quite strong in the industry throughout the 1970s. The first challenge to managerial autonomy in the industry began with the hostile takeover movement of the 1980s, which, as we will see, had a significant impact on management and control in the forest products industry.

But while managers struggled to maintain control over their firms, and to safeguard them from hostile takeover threats, there was a more subtle, underlying change taking place in the ownership structure of US forest product firms. Over the course of the 1980s and 1990s, there was a progressive shift in the stock ownership structure of the forest products industry as institutional investors steadily gained control over the majority of outstanding shares in forest product firms. In addition, the compensation packages for managers were substantially altered in favor of incentive-based compensation, giving managers a very real personal interest in

maintaining a high rate of return to the investment community. I argue that together these two organizational aspects of US forest product firms were fundamentally linked to the shareholder value conception of control that was to wash over the industry in the 1990s.

Managerial Response to Stagnation and Crisis

The 1970s was a decade of economic crisis, rising inflation and slow growth in the US economy (Krippner 2011). The forest product industry responded to these macro-economic conditions by trying to rein in their rate of expansion. During the 1960s the paper products sector experienced a sustained period of expansion; growing at a compound annual rate of 3.8 percent between 1960 and 1969 (S&P 1978). This left many firms with excess capacity in the face of declining demand when the economy began to sputter in the early 1970s. Historically, periods of overcapacity and weak demand would lead to intense price competition in the industry. But by the late 1970s managers more often chose to curtail production rather than slash prices.

During the 1970s the forest products industry continued its historical trend of closely paralleling the overall health of the US economy. In fact, analysts came to expect a close relationship between growth in Gross National Product and total paper consumption, estimating that overall consumption in paper production totaled 53,000-54,000 tons per \$1 billion of real GNP (S&P 1976). Thus when the US economy was growing, the industry grew as well, and likewise when the economy went into recession, the industry usually followed.

The critical factor determining how severe these fluctuations were lies in the ability of managers to control prices; and prices were largely determined by the relationship between production capacity and demand. Maintaining this delicate balance was no easy task: due to the lag-time between the decision to expand capacity and the date at which this new capacity would

come online, the decision to expand production capacity was often made during periods of general prosperity. However this new capacity would often come online just as the market began a cyclical downturn, leaving managers once again with excess capacity. Managers were compelled to exercise caution in any decision aimed at expanding production capacity while the economy continued to be sluggish (S&P 1978).

Over the course of the 1970s and 1980s, the industry invested heavily in technology aimed at increasing productivity and decreasing costs. As shown in figure 5.1, this period was marked by a substantial increase in total investment, particularly in the paper products sector. Investment in the paper products sector skyrocketed from \$1.3 billion in 1970 to \$10.5 billion over the course of two decades. The less capital intense wood products sector rose as well, however in a much less dramatic fashion.

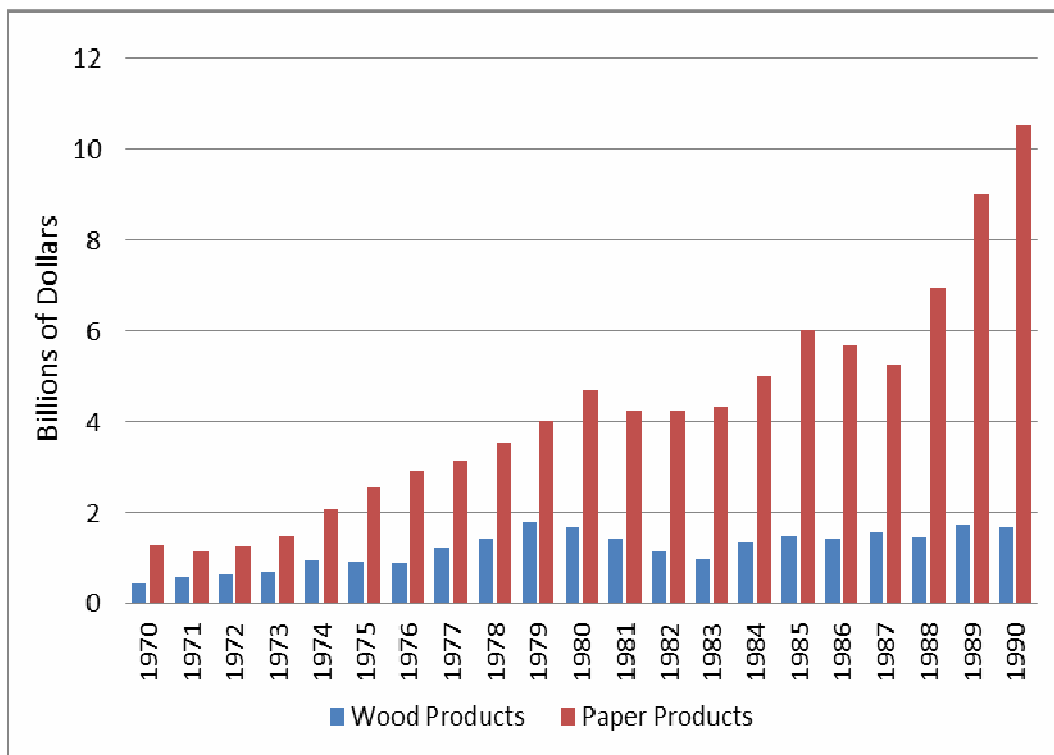


Figure 5.1 Investment in Private Equipment and Software by Industry
Source: U.S. Bureau of Economic Analysis, Table 3.7

These large increases in overall investment led to a number of technological advancements. Innovations were made in all areas of timber production, including genetic research aimed at improving forest productivity and growth rates, improved methods of harvesting timber, and computerizing the milling process. Forest product firms invested heavily in genetic and silviculture aimed at growing trees that were faster, taller, and straighter, with improved resistance to drought and disease. As a result, timberland owned by US forest product firms became the most productive timberland in the world, producing timber yields at a much higher rate than unimproved forests. Mechanical harvesters were developed, which rapidly diminished the number of loggers necessary for cutting timber and whole-tree chipping methods allowed for greater utilization of logging residues that would previously been left unused. Computer technology spurred productivity in the mills as well: a modern saw mill uses lasers to measure each log as it comes into the mill, then computes the optimum sawing plan for each particular log in order to produce boards with the highest possible value (S&P 1977; 1978).

In addition to technological advancements aimed at increasing productivity and curbing the man-hours needed for production, management sought to curtail labor costs by clamping down on unions. Labor is the second largest component of the industry's cost structure (after raw materials), constituting approximately 30 percent of the industry's total costs (S&P 1985). Therefore, bringing labor costs under control was seen as a critical priority for management. However, the industry's high rate of unionization, particularly in the Western region, made this a difficult task. During the 1970s, labor unions were particularly active, demanding higher wages and safer working conditions. In fact, labor costs are often cited as a primary reason for the industry's mass migration from the West to the Southern US during this period (S&P 1983: 85).

Firms that remained in the Northwest followed the Reagan administration's lead and began to clamp down on labor unions. Prior to the 1980s, collective bargaining had been a relatively stable process in the industry, with larger companies often establishing uniform terms with unions that were then extended to other companies. In 1983, Louisiana-Pacific decided to break with this practice when they broke a strike by hiring outside workers. Soon union members were crossing picket lines in order to save their jobs, and by 1985 most of Louisiana's Western mills were established as non-union.

Louisiana-Pacific's success in breaking the strike gave them a cost advantage over their competitors and set a precedent for other firms to follow. In 1985 Potlatch succeeded in demanding wage cuts from its workers and the next year Weyerhaeuser also successfully negotiated wage cuts with their unions. The most significant blow to union bargaining power in the region came in 1986 when the Western States Wood Products Employers Association broke up and announced that companies would bargain individually, often on a mill-by-mill basis (Monthly Labor Review 1986). By the end of the decade, analysts confirmed that the paper companies "have gained the upper hand in an industry once known for its tough labor unions and heavy labor-management confrontations" (S&P 1989: B78).

Managerial Autonomy Under Attack: The Hostile Takeover Movement

Merger and acquisition activity was relatively scant during the 1970s and the overall degree of concentration changed only slightly. By the 1980s, however, the industry began to experience a shakeup due to the hostile merger movement that was then sweeping across the nation. The hostile merger movement arose in the United States due to a number of factors, but a critical factor was the fact that many large corporations contained assets on their balance sheet

that were worth more than the net capital value of their stock. This provided savvy investors with a prime opportunity to purchase a controlling share in firms, only to strip them of their assets and sell them off in pieces. This threat from the investment community was the first in a series of ongoing struggles that would eventually unseat management from their thrones and place shareholders atop the power hierarchy of corporate America.

In the forest products industry, the hostile takeover movement can largely be traced to the machinations of a single man: Sir James Goldsmith. James Goldsmith was an Anglo-French financier who began his career in various food manufacturing industries in the United Kingdom. His business partner described their philosophy succinctly as the belief “that the sum of the parts of most conglomerates was worth a great deal more than the whole” (Fallon 1991: 359). In pursuing this philosophy, he soon became notorious for his methods of purchasing corporations, then selling off non-core assets in order to focus on the firm’s core business activities. By 1980, after years of scandal and public scrutiny, he turned his back on his investments in Britain and France in the hopes of building a new empire in the United States. In a few short years, his name would become synonymous with the corporate takeover wave that swept across the US in the 1980s.

In the United States, Goldsmith was searching for an industry that contained large conglomerates with hard underlying assets that could be used to finance a debt-leveraged takeover (Fallon 1991). In short order he set his sights on the forest products industry which was full of large conglomerates that were in possession of a particularly valuable resource: timberland. After reviewing the portfolios of various firms in the industry, Goldsmith zeroed in on Diamond International.

Established in the late nineteenth century, Diamond had quickly grown into the nation's leading manufacturer of matches. By the 1980s, the company had diversified into a number of unrelated product lines and even though they had sales over \$1 billion per year they were struggling to turn a profit. In pouring over their balance sheets, associates of Goldsmith noticed that Diamond owned 1.6 million acres of land that was carried on the books at an extremely low valuation. Thinking this must be a mistake, Goldsmith asked his financial advisors to double check. It was true; the company had purchased their land prior to 1900 and never revalued it. Goldsmith had found his ideal takeover target. Soon he initiated the process of acquiring Diamond shares on the open market.

After a protracted struggle with Diamond's management, Goldsmith emerged victorious in his first major takeover bid in the United States. He subsequently split the company up and sold its component parts to cover the debt he incurred in the original purchase, while holding on to the timberland assets. By 1983, timber analysts were estimating the value of his timberland at \$723 million, bringing his estimated profits from the deal to approximately \$500 million. Goldsmith was not interested in selling though. Instead, he turned his sights on another forest product firm that was heavily diversified and in possession of a large amount of undervalued timberland.

His next target was St. Regis, another large and heavily diversified forest product firm holding 3.2 million acres of undervalued timberland. Once again, management strongly resisted Goldsmith's takeover bid and searched frantically for a "white knight" to come to the rescue.⁵¹ In this case, Champion International, another paper industry titan, stepped in and saved St. Regis from a hostile takeover from the outside. St. Regis' management, however, fared no better under

⁵¹ A white knight is the term used to describe a "friendly" investor that would come to the rescue of firm's that were under threat of a hostile takeover.

control of Champion: after spending millions more to avoid takeover from an outsider, the management team at St. Regis was subsequently let go.

Goldsmith's disappointment with his unsuccessful bid for St. Regis did not last long and soon he turned his sights on Crown Zellerbach. Crown Zellerbach was a leading firm in the forest products industry and had followed the industry's trend towards diversification during the 1960s and 1970s. By the early 1980s, however, the firm was struggling to turn a profit. Significantly, they were in possession of over 2 million acres of undervalued timberland. The management team at Crown Zellerbach fought vigorously to fight off this unsolicited takeover bid. In their effort to shield the company from an outsider takeover, Crown Zellerbach became the first Fortune 500 firm to adopt the anti-takeover measure that soon became widely known as the "poison pill."

A poison pill, or "shareholder rights plan," is a special dividend issued by the board of directors to existing stockholders in order to prevent a hostile takeover from being successful (Davis 1991). Once triggered, the typical poison pill works by allowing existing shareholder to purchase stock at a deeply discounted rate. The point is to dilute the value of stock and make a takeover prohibitively expensive for the hostile acquirer. In the short run, shareholders are direct benefactors of a hostile takeover bid, because a successful bid typically occurs when a buyer offers to purchase outstanding shares at an inflated price. Therefore, managers that are successful in getting them adopted are implied to already hold substantial discretion in the governing of the corporation (Davis 1991). Although Crown Zellerbach was the first in the industry to adopt a poison pill, soon others would follow, including Owens-Illinois, Boise Cascade, Bowater, Great Northern Nekoosa, International Paper, Southwest Forest Industries, and Union Camp (Dils 1990).

The poison pill and major restructuring effort were not enough to save Crown Zellerbach from Goldsmith, however. By late July 1985 Goldsmith owned more than 50 percent of the company and in heated negotiations with management the decision was made to split the company in two. Goldsmith would maintain control over the forest and oil assets of the firm, while the pulp and paper business would be sold off to James River, another leading firm in the US forest products sector.

Goldsmith was now in possession of over 4 million acres of timberland stretching from Maine to Oregon, which he held under his American holding company, GOSL Acquisition Corporation (Fallon 1991). To manage his holding company, he brought in Al Dunlap, a man who would in time become notorious for his own managerial strategies aimed at maximizing returns to shareholders. Dunlap began his career with Kimberly-Clark, but gained national attention with his turnaround efforts at Lily-Tulip, a disposable cup business. These efforts consisted of cutting the senior staff in half, laying off twenty percent of the workers, and selling off inefficient plants and non-core business assets (Jay 1989). These tactics earned him the monikers of “Chainsaw Al” and “Rambo in pinstripes.” Dunlap employed the same tactics in his effort to restructure the poorly managed properties of Crown Zellerbach. Within a few years the earnings from these properties increased six-fold, making Goldsmith and Dunlap millions in profits (Fallon 1991). Dunlap later was hired to lead Scott Paper, another floundering forest product firm that was failing to make adequate returns to its shareholders.

Other hostile takeover bids were also undertaken over the course of the 1980s. In 1985 the Belzberg Brothers of Vancouver Canada initiated a hostile takeover of Potlatch Corp., which ultimately proved unsuccessful when the company was able to repurchase most of its stock. Also in late 1985 was the hostile takeover of Pacific Lumber Company by Charles Hurwitz and

his Maxxam, Inc. corporation out of Texas. The Pacific Lumber Company was a long-standing family-run corporation based out of the redwoods of Northern California. The company owned a significant amount of timberland in the northern redwoods and was widely recognized as an industry leader in sustainable management practices. Again, it was the value of the timberland assets that made Pacific Lumber Company such an attractive target (Harris 1995: 26). Following his successful takeover bid, Hurwitz replaced the company's sustainable growth policy with a policy of clearcutting in order to increase profits and pay off the debt incurred from the acquisition. After destroying much of the company's land and raiding the worker's pension fund, Hurwitz and his partners drove Pacific Lumber into bankruptcy in 2007 (Cobb 2008).

In 1986, California investor Paul Bilzerian initiated a hostile takeover bid for Hammermill Paper. In this case, the company was saved by a white knight when International Paper stepped in to purchase Hammermill. The next major hostile takeover occurred in 1989, but this time the threat came from inside the industry. In October of 1989, Georgia-Pacific initiated a hostile tender offer for Great Northern Nekoosa that eventually proved successful the following year (Dils 1990).

Analysts at the time were predicting that there would likely be more mergers to follow in the near future, pointing to the fact that there were few sites available that could support the construction of a large new paper mill (S&P 1990: B64). They also noted the prohibitive costs of building new mills and the fact that acquisition was an easier path to growth in a mature forest products industry. As it turns out, the analysts were correct in their prediction: the 1990s were an unprecedented period of mergers and acquisitions in the US forest products industry.

Organizational Change in the US Forest Products Industry

The hostile takeover movement of the 1980s must be understood as the first broadside in an emerging struggle between an increasingly activist-oriented shareholder class and an entrenched managerial class. This conflict had mixed results, with some companies falling victim to corporate raiders and others taking evasive maneuvers to safeguard their company from outside attacks. The impact of the hostile takeover movement, however, was felt by all. Managers could no longer sit comfortably atop their corporate empires but had to pay increased attention to the relationship between their firm's outstanding equity and the value of their assets. That is to say, managers were now conditioned by an active market for corporate control to shift their priorities away from long-term profits and growth, towards the short-term goal of maintaining sufficiently high stock prices.

The shift towards the adoption of what was later identified as a shareholder value conception of control in corporate management, however, remained incomplete. The hostile takeover movement of the 1980s was the most overt and recognizable moment in the shifting power relation between management and shareholders. Yet at the same time a more subtle shift was taking place in the ownership structure of US corporations. The once widely dispersed shareholder class was rapidly concentrating under the leadership of pension funds and other institutional investors. In addition, managers were seeing their compensation packages altered in a manner that would further align their interests with the financial community. Together these two shifts in the organizational structure of corporate America, along with the persistence of a market for corporate control, provided the necessary environment for the widespread adoption of a new paradigm of corporate governance.

From Dispersed to Concentrated Stock Ownership (1980-2000)

The previous chapter examined the ownership patterns that prevailed in the US forest products industry during the postwar period. Relying on data collected from corporate proxy statements and research by Ellefson and Stone (1984), I found that by 1980 stock ownership in the forest products industry was widely dispersed. As shown in Table 5.1, only five of the top ten firms in the industry had a single stockholder with more than 5 percent of the company's stock (also known as "blockholders") and none of these firms had more than one. Two of these blockholders, Weyerhaeuser Family Group and Bronfman Family group, were family trusts that held investments on behalf of wealthy families. Boise Cascade's largest shareholders, Fayes Sarofim & Company, was an investment firm run by the billionaire Fayes Sarofim and the remaining two large blockholders were banks that have since been acquired by larger banks. Based on the ownership patterns that prevailed in 1980, Ellefson and Stone (1984) conclude that there is little evidence to suggest that a significant concentration of stock ownership existed for any institution to exercise a significant amount of control over management in the industry.

Over the course of the next two decades the stock ownership patterns in the US forest products industry underwent a radical transformation. As we know, institutional investors were increasing their share of stock ownership since the early 1960s, but in the 1980s and 1990s their ownership share in corporate America skyrocketed. By 2000, institutional investors became the principle shareholders in most of America's largest corporations.

As shown in Table 5.2, this also was the case for the forest products industry. In 2005 institutional investors held large blocks of stock in each of the top ten forest product firms with the sole exception being Plum Creek, which is structured as a REIT that requires them to have limited manufacturing facilities. On average, blockholders controlled over 30 percent of all

stock in the leading forest product firms. Research shows that there is typically an inverse relationship between firm size and stockholder concentration, meaning that one would expect this level of concentration to increase for smaller firms (Holderness 2009).

In addition to the considerable change in concentrated stockholding among individual institutional investors, there was also a dramatic increase in the percentage of all outstanding stock owned by institutional investors. Table 5.3 lists the percentage of stock held by institutional investors for the ten leading forest product firms in 2010. Remarkably, institutional

Table 5.1: Concentrated Stockholdings in Leading Forest Product Firms, 1980

Company and Principal Stockholder	Percentage of Stock Owned
International Paper	N/A
Georgia-Pacific	N/A
Weyerhaeuser	
Weyerhaeuser Family Group	9.8
Champion International	N/A
Boise Cascade	
Sarofim (Fayez) & Company	6.5
Kimberly-Clark	
National Detroit Corp.	5.1
St. Regis	N/A
Crown Zellerbach	
Bankers Trust New York Corporation	8.2
Scott Paper	
Bronfman Family Interests	20.5
Mead Corporation	N/A

Source: Corporate Proxy Statements (1980).⁵²

⁵² Firms labeled N/A were “not applicable” because there was no single blockholder that owned five percent of the company’s outstanding stock.

Table 5.2: Concentrated Stockholdings in Leading Forest Product Firms, 2005

Company and Principal Stockholder	Percentage of Stock Owned
International Paper	
Capital Research and Management Company	11.9
State Street Bank and Trust Company	6.6
Lord, Abbet & Co.	5.3
Weyerhaeuser	
Capital Research and Management Company	13
Wellington Management Company, LLP	6.3
Smurfit-Stone Container	
AXA	16.6
Wellington Management Company, LLP	12.9
FMR Corp.	12.1
MeadWestvaco	
AXA Financial Inc.	9.4
Capital Research and Management Company	7.7
Temple-Inland	
Capital Research and Management Company	12
Wellington Management Company, LLP	6.5
Bowater	
Massachusetts Financial	10.9
PEA Capital LLC	9.7
Franklin Resources, Inc.	8.9
Wellington Mngmt.	8.1
T. Rowe Price	7.2
Louisiana Pacific	
Barclays Global Investors, N.A.	11.1
Mellon Financial Corporation	5
Greif Brothers	
Michael H. Dempsey	51.4
Robert C. Macauley	9.4
Virginia D. Ragan	5.4
Mary T. McAlpin	5.3
Packaging Corp of America	
Madison Dearborn Partners, LLC	41.1
FMR Corp.	7.7
Iridian Asset Management LLC	5.1

Source: Corporate Proxy Statements

Table 5.3: Percentage of Stock Held by Institutional Investors for given Firms, 2010

Forest Products Firm	Percentage of stock held by Institutional Investors
International paper	81.95
Mead Westvaco	83.7
Smurfit Stone (Rock Tenn)	84.29
Weyerhaeuser	80.52
Domtar	86.54
AbitibiBowater	N/A
Temple-Inland	83.78
Grief Inc.	87.53
Packaging Corp. of America	88.27
Plum Creek	66.15

Source: Mergent Online⁵³

investors had come to control over 80 percent of all outstanding stock in eight of the top ten firms. Given that the interests of institutional investors can be assumed to be generally the same (ie. short term financial gains), it takes no stretch of the imagination to see how this rapid transformation of stock ownership would lead to changes in managerial priorities.

Clearly the dispersed ownership structure that provided the necessary precondition for managerial capitalism in the mid-twentieth century had ceased to exist in the US forest products industry. By the end of the first decade of the twenty-first century, institutional investors had gained a dominant position in most of the leading forest product firms. In doing so, they put themselves into a position that would enable them to steer management's priorities towards the interests of the financial community.

⁵³ Data was not available for AbitibiBowater.

From Fixed-income to Incentive-based Executive Compensation

Changes in the ownership structure of the forest product firms were not, in themselves, sufficient for changing managerial priorities. Additional measures were needed in order to make managers internalize the interests of the financial community as their own. As prescribed by agency theorists, the primary means to align managers with the interests of shareholders was to alter their compensation packages in a way that would tie their own remuneration to how effectively they maximized shareholder value (Jensen and Meckling 1976).

Incentive-based compensation has been a common component of executive pay packages since at least the 1950s (Baran and Sweezy 1966). However, during the era of financialization it grew from a marginal component of executive compensation to become the primary means of executive enrichment. The transition to incentive-based compensation grew steadily throughout the 1980s, but it was not until Clinton administrations tax reforms of 1993 that this movement would really take off (Korzenik 2009). Bill Clinton made the exorbitant salaries of corporate executives a major platform of this 1992 campaign for the presidency. Once in office he ushered in a series of changes to the tax code that would supposedly make good on his promises to curb the executive compensation. The administration's primary means of doing so was to cap the tax-deduction for "non-performance" executive pay (such as salary) at \$1 million. On the surface, this seemed like a well-intentioned effort to reign in executive compensation, but in reality this became the primary justification for corporate boards to turn to incentive-based compensation packages loaded with bonuses and stock options. The result was a dramatic increase in executive compensation that was predicated on shifting managerial priorities towards increasing returns to shareholder. .

In the US forest products industry, the practice of tying executive pay to stock performance began to take off soon after the tax reforms of 1993. In 1994, Scott Paper, a leading firm in the forest product industry, hired Albert Dunlap to help rejuvenate the firm and bring it back from years of lack-luster performance. As we saw above, Dunlap had already earned a reputation as a ruthless corporate manager in his efforts to revamp Crown-Zellerbach and Diamond International. Upon taking the helm at Scott Paper, he introduced the idea of paying directors in shares rather than cash arguing that “it sends a signal that the company values its shareholders” (Hamilton 1997). Following Scott’s lead, other forest product firms began to turn to incentive-based compensation packages in order to tie the interests of managers directly to the well-being of the firm’s shareholders.

Over the course of the past three decades, incentive-based compensation has rapidly increased across the US forest products industry. As shown in Table 5.4, by 1980 managers in the forest products industry were already generating substantial portions of their income from stock options and bonuses. Three of the top firms’ leading executive received over half of their income from incentive based compensation in 1980. The average percentage of incentive based compensation for the top executive in the leading forest product firms was 37 percent. By 2005, however, managers in each of the top ten firms, save one, were receiving the majority of their income from stock options and bonuses and the average percentage of incentive based compensation had risen to 69 percent.

Table 5.4 Incentive-based Compensation in the US Forest Products Industry in 1980 and 2005⁵⁴

1980		2005	
Top 10 Companies	Percentage of incentive-based compensation for top executive		Top 10 Companies
International Paper	57	81	International Paper
Georgia-Pacific	57	75	Weyerhaeuser
Weyerhaeuser	27	55	Smurfit-Stone
Champion	37	69	MeadWestvaco
Boise Cascade	52	83	Temple-Inland
Kimberly-Clark	61	39	Bowater
St. Regis	26	90	Louisiana-Pacific
Crown Zellerback	7	40	Grief Brothers
Scott Paper	12	74	Packaging Corp.
Mead	N/A	85	Plum Creek
Average	37	69	Average

Source: Corporate Proxy Statements

⁵⁴ Incentive-based compensation consists of stock options and bonuses. The total of stock-options plus bonuses was then divided by fixed salary in order to establish the percentage of incentive-based compensation for top managers.

Executive compensation in the forest products clearly underwent a substantial shift over the course of the past three decades. Incentive-based compensation packages, consisting of large bonuses and dramatic increase in stock options, gave managers a personal interest in maximizing share price appreciation. The use of incentive-based compensation was critical for realigning the interests of managers toward those of their shareholders. I would further add that this shift in the relationship between managers and shareholders was part of the broader social transformation of the social relationship between financial and productive capital, or financialization.

Conclusion

This chapter provided an overview of the US forest product industry during the transitional years of the 1970s and 1980s. During this era managers continued to operate under the managerial conception of control that favored growth and long-term stability for the firm. In pursuit of these goals, managers attempted to control their rate of expansion, while at the same time investing heavily into labor-saving technology in order to boost productivity. The opening provided by the Reagan administration encouraged managers in the industry to follow suit and by the mid-1980s, managers in the forest products industry were gaining the upper-hand on labor. These efforts were largely successful and paved the way for relatively prosperous decade.

This era was also marked by the hostile takeover movement of the 1980s. Financiers, led by James Goldsmith, set their sights on the US forest products industry in order to gain control over the undervalued timberland that large firms were carrying on their balance sheets. A series of takeover bids were bitterly resisted by managers in the industry, with variable success. The most important result of the hostile takeover movement was that it placed pressure on managers and increasingly forced them to pay close attention to the value of their firm relative to their

underlying assets. In short, it marked the beginning of a shift in managerial control from the managerial conception of control of the postwar era to the shareholder value conception of control.

This shift did not take place overnight, but was the result of a longer process taking place in the US economy. Over the course of the 1980s, the financialization process was gaining momentum. At one level, this process was marked by an increase in financial profits and growing power of the financial sector. However, at the same time, there were more subtle shifts taking place in the ownership structure of non-financial corporations. Over the course of two decades there was a substantial shift in the ownership structure of US forest product firms, as institutional investors gained control over the majority of stock in leading firms. At the same time the compensation packages of managers in the industry were shifting towards incentive-based compensation that tied the interests of managers directly to the interests of the shareholder (i.e., finance) community. I argue that these two organizational shifts in the relationship between managers and shareholders were fundamental mechanisms in the process that ultimately led to the rise of the shareholder value conception of managerial control in the 1990s.

CHAPTER VI

THE FINANCIALIZATION OF THE US FOREST PRODUCTS INDUSTRY (1990-2008)

“It [is] high time these giant cyclical businesses start focusing on shareholder returns instead of worrying about revenues and market-share growth” ~Peter Correll, CEO Georgia-Pacific⁵⁵

If the 1980s was the decade in which managers sustained their first challenge from shareholders, the 1990s would become the decade in which the shareholder's interests triumphed over managers. More accurately, one could say that during the 1990s the interests of shareholders *became* the interests of managers. It is this cultural transformation that economic sociologists have deployed to explain the change itself. However, as this chapter demonstrates, the structural processes associated with financialization created the conditions for the emergence and proliferation of shareholder value ideology among corporate managers.

As we have seen, the hostile takeover bids of the 1980s were bitterly resisted by the entrenched managers of the US forest products industry. Managers adopted various measures to prevent their firms from takeover by corporate raiders, including the adoption of poison pills and other anti-takeover tactics. When necessary, help was provided by white knights within the industry in a cooperative effort of industry managers against threats from outside. The efficacy of these efforts was uneven, with several firms ultimately succumbing to hostile takeover bids, after which they were split up and sold off in parts. Those that were able to weather the storms of the 1980s did so in part because of their ability to maintain relatively high earnings in the face of turbulent markets.

The effect of the hostile takeover movement, however, was undeniable. Managers could no longer take refuge in the security of their positions atop the corporate hierarchy, but were now

⁵⁵ Cited in Henderson (1999)

confronting a market for corporate control that required them to pay heed to their corporate portfolios, lest they become targets of a reinvigorated financial community. Initially, managers in the forest products industry resisted the pressure to downsize than had swept across US manufacturers over the course of the 1980s. Over the course of the 1990s, however, a number of changes taking place both within the internal structure of the firms and their external environment compelled managers to increasingly adopt a shareholder value conception of the firm. I examined two critical changes in the organizational component of the US forest products industry in Chapter 5. I showed how the relationship between shareholders and managers was transformed through both an increase in the concentrated shareholdings, particularly among institutional investors, and a parallel increase in incentive-based compensation for top executives. I argue that these organizational shifts were critical for realigning the interests of managers towards shareholders, and finance more broadly.

There were also significant changes taking place in the industry's external environment. The first and most important was the rapid increase in international competition stemming from the structural dynamics of neoliberal globalization. Increase competition had a significant impact on the US forest products industry (Ince 2007). The availability of large virgin stands of timber and the faster growing cycles of tropical timber, combined with cheap land and labor, led to a rapid increase of imports into the United States. This increase in competition was compounded by technological changes that were taking place during this period. Information technology and the proliferation of computers led to a decline in paper consumption in the United States (Skog et al. 2012). Although warnings about the "paperless office" have not come to fruition, technological change has led to significant shift in many of the industry's markets, particularly in certain sectors such as newsprint. A third factor was the rapid decrease in timber

supply available to the industry that followed the Spotted Owl controversy of the early 1990s (see Foster 2002, Chapter 10). The industry blamed environmentalists for bringing ruin to timber-dependent communities across the Pacific Northwest. However, as we will see, the decline in federal timber supply led to an increase in timberland prices that greatly benefited the large timber firms during this period and greatly enhanced the appeal of timberland investments among institutional investors.

In this chapter I provide an overview of the US forest products industry during the financialization era. As the shareholder value conception of control proliferated among managers in the industry, the use of financial metrics of success became increasingly prominent. I begin with an analysis of the industry using various measures of financial performance that are common among financial institutions. I then examine how industry managers, under pressure from the financial community, increasingly adopted a shareholder value ideology as can be seen in their tactics, including an increase in shareholder returns in the form of stock buybacks and dividend payments (Westphal and Zajac 2001), increased mergers and acquisitions (Davis and Stout 1992; Fligstein 2001), laying off employees, and a series of restructuring programs aimed at selling off unrelated product lines in order to focus on core competencies. A central component of these restructuring programs was the decision to sell off nearly 50 million acres of valuable timberland to the same financial community that was pushing reform in the industry.

Financials for the US Forest Products Industry

A key aspect of the shareholder value conception of control is that shareholder interests gain prominence over competing interests in the firm. As we saw in the previous chapter, the vast majority of these shareholders were institutional investors and other financial institutions. It

is based on this observation that we can assume that shareholder interests are, in large part, financial interests. In order to examine how financial interests viewed the forest products industry we begin with an overview of the financial performance of the US forest product industry during the era of financialization. By viewing the performance of the industry from this vantage point we can begin to locate periods of instability or decline, which would in turn provide clues as to when the forest products industry began to be viewed unfavorably by the financial community.

The financial community tends to privilege certain metrics of corporate behavior over others. The first and most obvious is the share price of a firm. A firm's share price is a direct gauge of how the market views the value of the firm and its potential for future revenue streams. Other, perhaps more important, measures look at total earnings for a company and their return on capital, which measures how effectively a firm is employing its available resources. A third financial metric that is important for the financial community is the ratio of debt to equity, which signals the extent to which a firm is leveraged against the value of its outstanding shares. Each of these numbers is used by the financial community to examine the relative performance of firms, and performance evaluations are then used to determine investment strategies.

It is also important to note that within any given industry a substantial variation is certain to exist between the financial performances of different firms. In addition, single measures can provide contradictory indications about the relative performance of a firm. In this chapter, I examine multiple measures of financial performance over time so as to include as many different aspects of the industry's financial performance as is possible.

Share Price Appreciation and the US Forest Products Industry

The bull market of the 1990s was an extraordinary period of growth in the US stock markets, with average share prices rising between ten and twenty percent per year. As I explained in chapter 3, share price appreciation was the primary means by which shareholder returns were achieved over the decade, constituting some 80 percent of the total shareholder returns (Froud et al. 2002). Therefore, the quarterly share price of a firm became an important metric for gauging how well the firm was doing relative to other publicly traded firms. Meeting the quarterly expectations of the financial community also became a priority for managers as they increasingly came under a shareholder value conception of the firm (Fligstein 2001; Useem 1993).

Figure 6.1 shows the comparative performance of several leading forest product firms from 1992 through 2008. Comparing the firms to the performance of the Dow Jones is relevant because institutional investors gauged the performance of a given firm relative to the stock market in general and did not limit their comparisons to firms within the same industry (Froud et al. 2002). While the performance of particular firms varied considerably over time, each of the firms listed consistently underperformed when compared to the Dow Jones Industrial Average. In the early 1990s, forest product firms performed relatively well, with several firms (notably, Weyerhaeuser and Kimberly-Clark) coming in consistently above the Dow Jones Average. By the mid-1990s, however, the Dow Jones continued to swell, spurred on by the dot-com bubble, while the forest products industry consistently lagged behind. Clutter and his colleagues (Clutter et al. 2005) found that the ten year rate of return for the industry was 6.2 percent, which was significantly below the S&P 500 (12.1) and Dow Jones Industrial average (13.1).

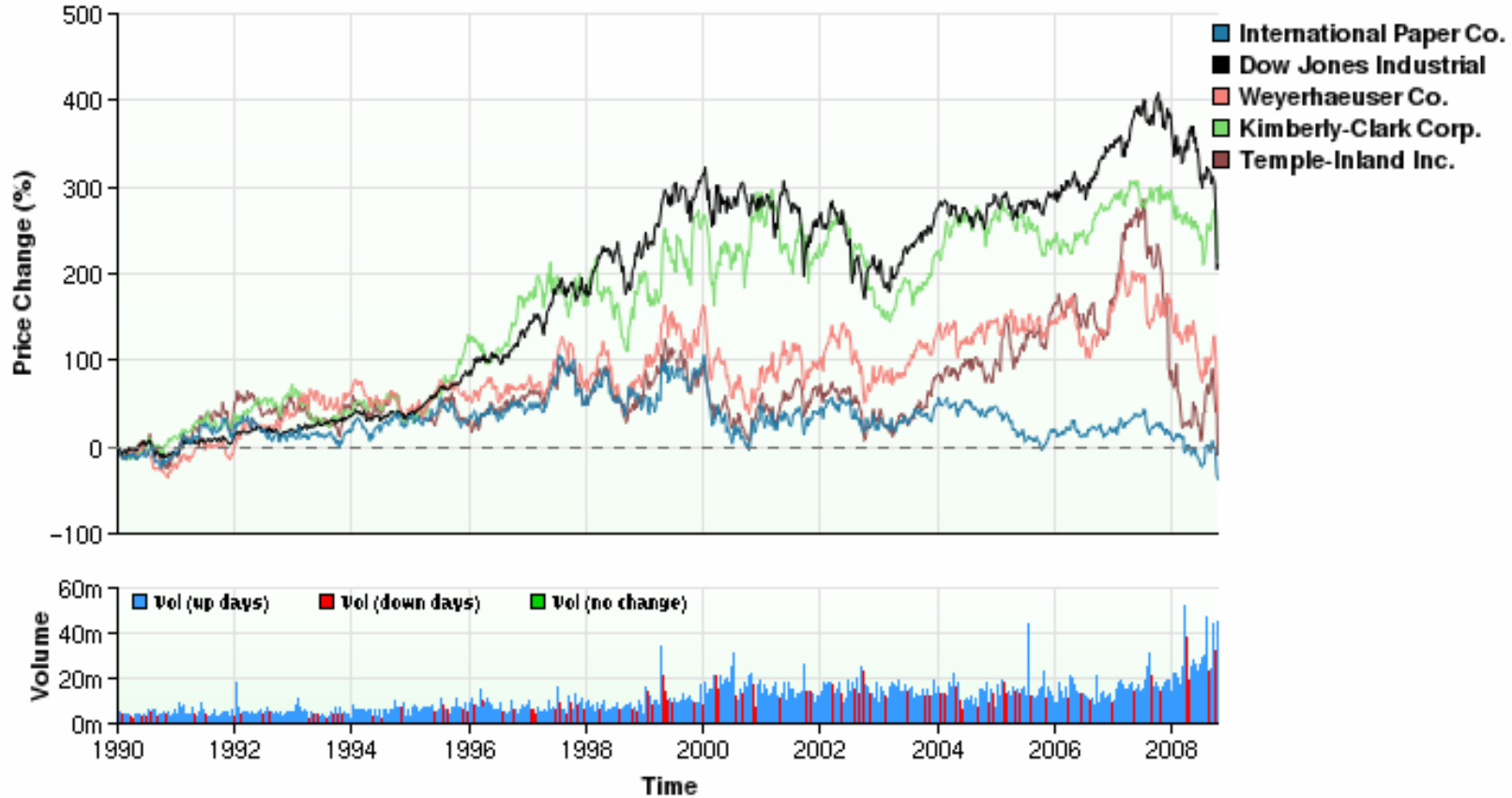


Figure 6.1, Change in Share Price for Selected Firms and Dow Jones Industrial Average.⁵⁶

Source: Merchant Online

⁵⁶ This figure was created in Mergent Online, which limits the number of entries to five. Firms were selected on the basis of their size and availability as a sample of the leading firms in the US forest products industry.

Managers growing preoccupation with share price had a direct impact on their corporate strategies. In fact, certain shareholder value tactics such as mergers and stock buybacks were announced with the explicit hope that they would boost the short-term share price. When managers decided to lay off workers or close mills these actions often boosted share price because Wall Street believed that these measures would produce leaner and more competitive firms. And it did not matter whether these shareholder boosting tactics were quick fixes to more substantial underlying problems, because shareholders were primarily interested in a short-term rate of return. This short-termism is evidenced in Figure 6.1 by the substantial variation in share price that exists from quarter to quarter for many of the leading forest product firms.

The paper industry continued to lag behind the broader US economy for the remainder of the decade. According to an industry publication (Rudder 2002), by 1998 the paper industry represented less than 0.5% of the total market capitalization of the Standard & Poor's 500 index, while Microsoft, the leader of the new information technology industry, alone accounted for 4% of the S&P 500. Furthermore, by the late 1990s, Yahoo! Inc. had a greater market capitalization than the combined total of the industry's top three companies – International Paper, Georgia-Pacific, and Weyerhaeuser. Clearly the American economy had undergone a major transformation by the closing decade of the 20th century. The US forest product industry, which was once a pillar of the US industrial economy, was now unable to maintain earnings on par with the post-industrial US economy.

Profits and Return on Capital

Share price is not always the best measure of a firm's performance because the price of a company's share is determined by a number of market factors that can mask the health of a firm.

Earnings, on the other hand, provide a more accurate gauge of a company's economic position and their ability to generate surpluses, which (indirectly) provide the basis for changes in a company's share price. There are various measures that can be used to gauge earnings in a firm.

The first measure is total after-tax profits. Figure 6.2 shows after-tax profit for the US forest products during the financialization period. Profits in the paper sector varied significantly over this period, but the general trend was downward. The recession of the early 1990s delivered a serious blow to the paper industry and with the exception of the banner year of 1995, the industry suffered from declining profits for most of the decade. In the early 2000s, after tax profits dipped into the negative category. After a series of restructuring programs and massive divestitures, the industry was able to increase profits for a short time before plunging again in 2007.

Profits in the wood products sector fluctuated during this period as well, however in a much less dramatic fashion than the paper sector. The wood products sector is highly correlated with federal interest rates because of its relationship to the housing sector. This relationship benefited the industry greatly when the Federal Reserve lowered interest rates in early 2000. Interest rates remained low throughout the early 2000s, which helped spur the massive housing bubble that eventually exploded in the financial crisis of 2008-09.

But a company's earnings still do not tell us the whole story. Total costs can increase along with profits and lead to an overall reduction in earnings. The return on capital (ROC) is the third measure to be considered. ROC is a ratio measure of a firm's after-tax operating income

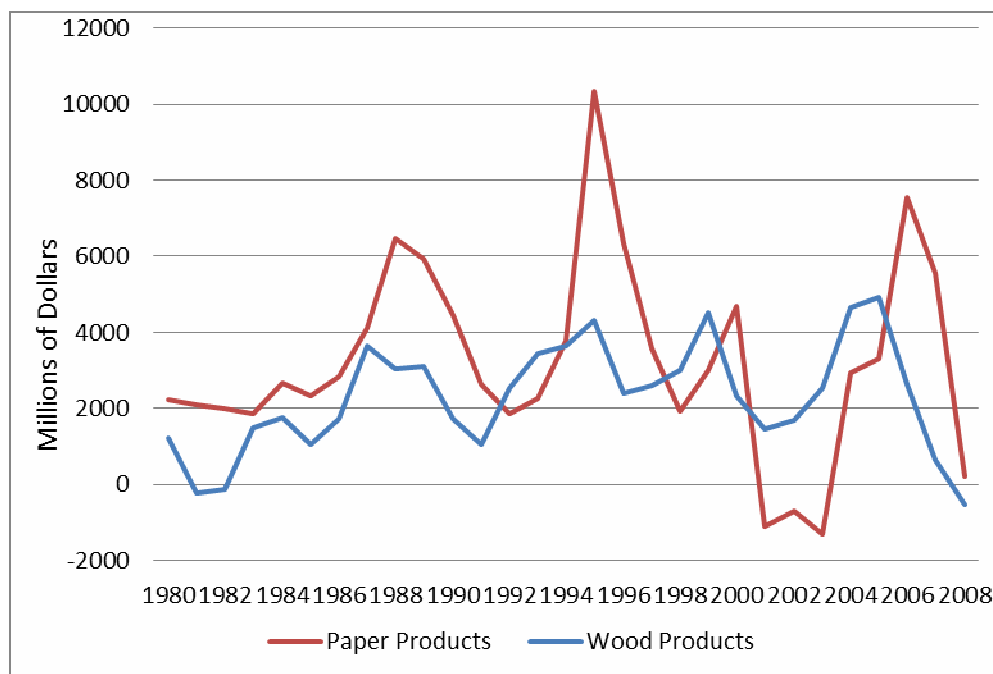


Figure 6.2 Profits After Tax in US Forest Products industry, 1980-2008
Source: U.S. Bureau of Economic Analysis, TABLE 6.9

by the book value of invested capital and is a commonly used metric of earnings that is used by financial analysts.⁵⁷

Figure 6.3 shows the ROC in the US paper industry from 1970 to 2004. The substantial fluctuation in returns reflects the highly cyclical nature of the paper industry and its susceptibility to shifts within the larger economy. The forest products industry maintained a relatively stable level of returns over the course of the 1970s before dipping to 3.7% ROC during the recession of the early 1980s. The industry's earnings steadily increased throughout the 1980s before witnessing a sharp decline in 1991. This decline was exacerbated by the excess capacity that the industry had added in the exuberance of the late 1980s. When the recession began in the summer of 1990, the US paper industry found itself once again with an unfavorable supply/demand

⁵⁷ Return on Equity (ROE) is similar measure, however, whereas ROC measures returns against all capital invested (including loans and bonds), ROE measures returns against the total value of all outstanding shares in the firm. Both measures aim to capture the ability of a firm to generate profits relative to the capital they had to work with. Because these two measures produced similar results in the forest products industry I decided to focus on ROC.

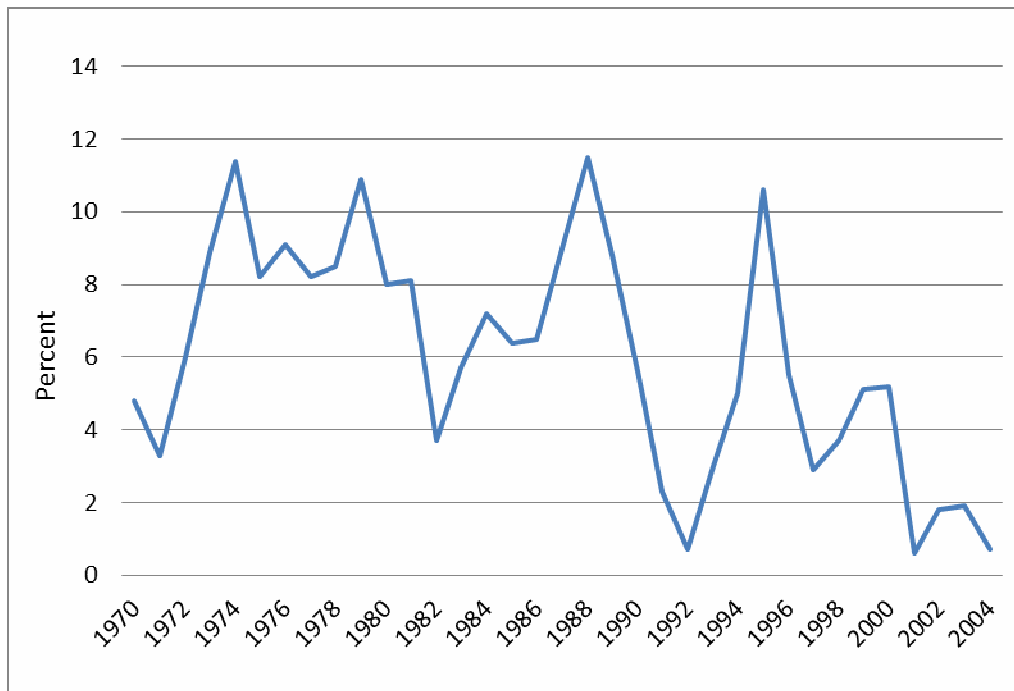


Figure 6.3 Return on Total Capital, US Paper Industry, 1970-2004
Source: Miles (2005)

balance. On average, each decade after 1970 witnessed a lower rate of return on capital than the decade before (Rudder 2002).

Throughout the 1990s the industry continued to suffer from relatively low earnings, with the sole exception being the banner year of 1995 when price hikes in the pulp and paper sector reached record heights. These price hikes were due primarily to two factors: First was the relative shortage of timber on the market following the environmentally motivated federal ban on logging in the Pacific Northwest. This timber shortage had a significant impact on stumpage prices and greatly benefited industry firms that owned substantial timberland holdings. Secondly, was the decrease in capacity expansion undertaken in the industry in the early 1990s, which helped bring supply and demand back into balance (S&P 1996: B82). In early 1996, however, profits began to tumble once again; bringing profit levels back to the lows of the early 1990s and trailing other manufacturing industries in general. The upswing of 1995 turned out to

be the shortest the industry had experienced in recent decades and what followed was a downturn as extreme as any in the industry's long history (Rudder 2002).

Declining returns on capital was becoming a liability for forest product managers. As one industry analyst explained in 2001:

For many years, paper industry CEOs did not pay enough attention to the distinction between "capital" and "assets." Instead, they spent their time managing assets while investors watched the returns on their capital plummet. In other words, companies spent too freely and didn't pay enough attention to what the investments were earning. Currently, the emphasis is shifting, and every paper industry CEO knows that "Return on Capital" is what stockowners are really watching. In fact, most CEOs now watch it closely, too (Connelly 2001).

In hindsight, we know that the 1990s turned out to be a turning point for the US forest products industry. During this period, the historical link between expansion of the nation's GDP and growth in the forest products industry was broken. As explained in the previous chapter, for much of the post war period there was a reliable estimated increase in paper product consumption of between 53,000 and 54,000 tons per \$1 billion of real GDP. In 1996, real GDP increased by about half a trillion dollars to \$7.8 trillion, or 2.5 percent, but the paper industry was no longer able to keep pace (Rudder 2002). As profits fell, so did the value of the industry's shareholdings, and soon managers began looking to the prescriptions coming from the shareholder value movement in order to turn things around.

Investment, Capacity and Debt

The early 1990s was also a watershed moment for total investments in the forest products industry. The spending spree of the late 1980s left the industry with a severe excess capacity problem and a glutted market when the US economy entered into recession in the early 1990s.

The industry's condition was exacerbated by the substantial increase in foreign competition that was taking place during this period. Shareholders were growing impatient with managers in the industry and called on them to rein in spending. Managers responded by bringing an over fifty-year period of expansion to an end.

As shown in figure 6.4, total investments in private equipment and software in the paper industry peaked at \$10.5 billion in 1990 and despite several upticks (1994-1995 and 2004-2006), investment levels never returned to their pre-1990 levels. The wood products sector fared better than the paper sector during these turbulent years, buoyed in large part by low interest rates and a booming housing market. Investment into the wood products sector remained relatively stable throughout the 1990s, before peaking at \$3.7 billion in 2006 on the eve of the housing crash. Firms with higher exposure to the wood product markets, such as Weyerhaeuser, Georgia-Pacific, and Louisiana-Pacific, performed better than those that were tied primarily to paper (S&P 1996).

Declining investments in the industry brought an end to over half a century of steady increases in total capacity. Capacity expansion was the preferred means of investing profits by managers operating under the postwar managerial conception of control. Despite reoccurring bouts of excess capacity and over-production resulting from the industries notoriously cyclical markets, managers continued to expand capacity throughout the 1980s. As shown in Figure 6.5, capacity expansion in both the paper products and wood products sectors leveled off over the course of the 1990s. By the early 2000s, the paper industry was actively reducing capacity in

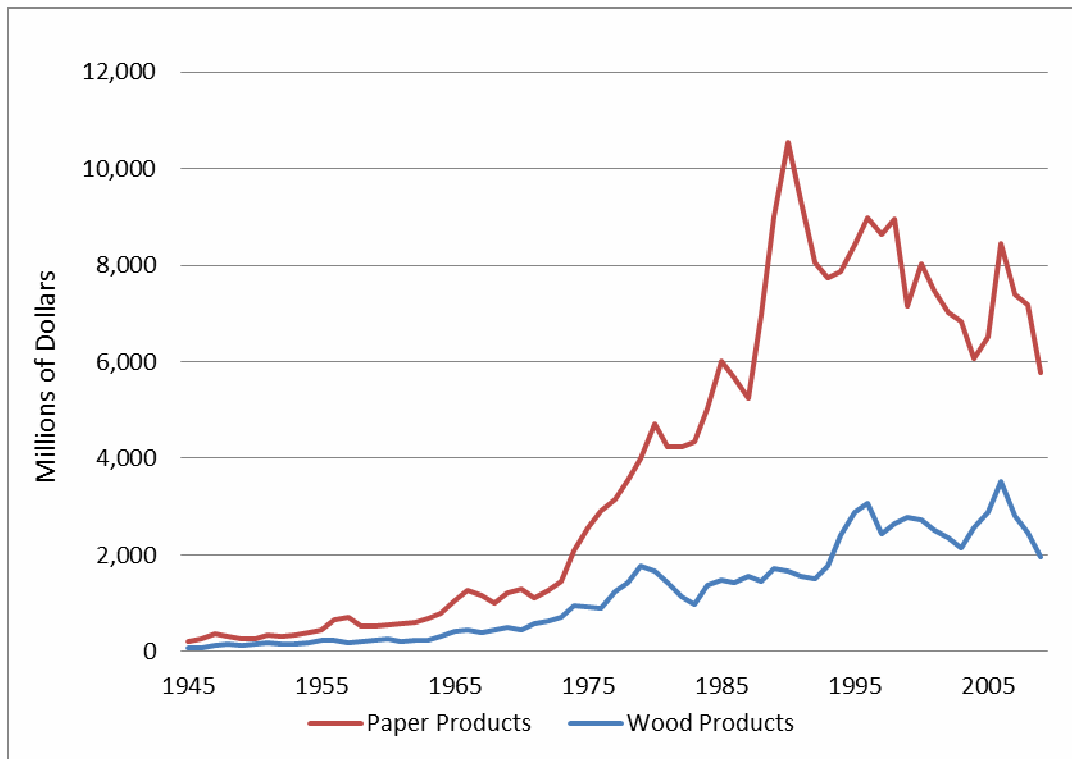


Figure 6.4 Total Investment in Fixed Assets
Source: U.S. Bureau of Economic Analysis, Table 3.73

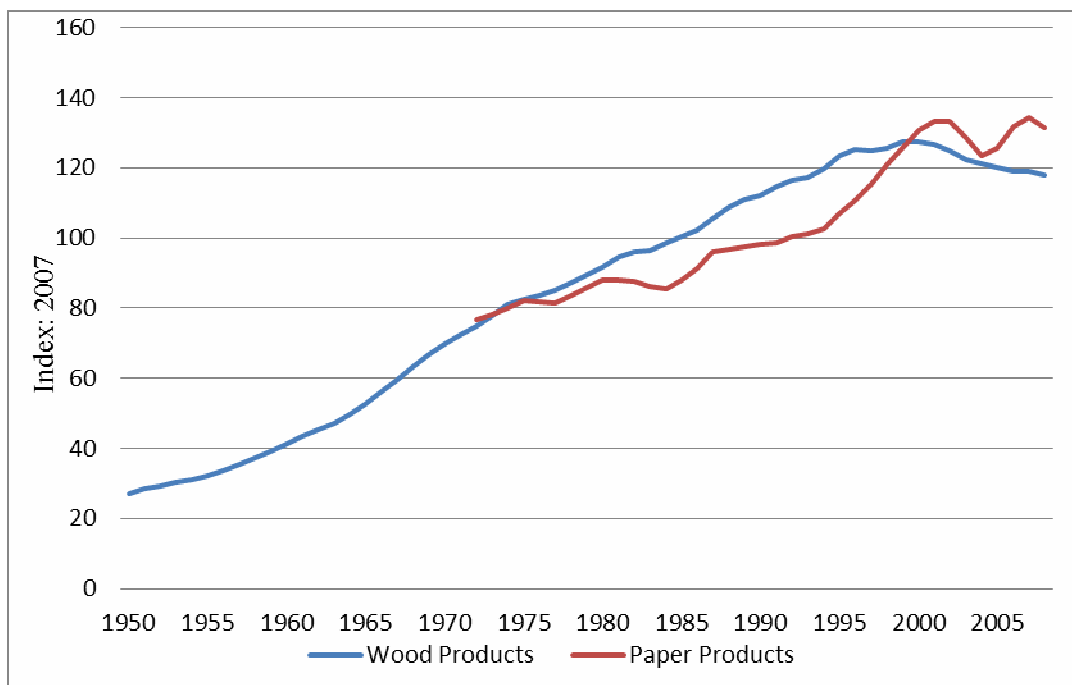


Figure 6.5 Total Capacity in Forest Products industry, 1950-2005
Source: Federal Reserve

order to improve the industry's pricing structure. After reducing capacity in the late 1990s, the wood products sector was able to continue expansion in the early 2000s, thanks in large part to low interest rates and the surge in housing.

This discussion of declining investments and capacity speaks to one of the central questions in the literature on the financialization of nonfinancial corporations. Several studies have argued that the increase in financial investments have “crowded out” investments into production (Orhangazi 2008; Stockhammer 2004). Orhangazi (2008), for instance, argues that the decline in productive investments during the era of financialization diminishes the capital available for investments into expanded productive capacity. Foster and Magdoff (2009), on the other hand, point to the excess of capacity in US manufacturing and the fact that many US industries are already have low and declining utilization rates. They argue that it makes little sense to argue that finance takes the place of productive investment when most industries already suffer from overcapacity.

The evidence from the US forest products industry seems to support the position of Foster and Magdoff (2009). Overcapacity is a reoccurring ailment in the paper products sector and the declining utilization rates accompanying the decline in overall investments does not lend support to the “crowding out” thesis. At the same time, however, managers in the industry have a long history of over investing into expanded capacity and, if nothing else, the increasing influence of finance over management seems to have helped bring this tendency to a halt.

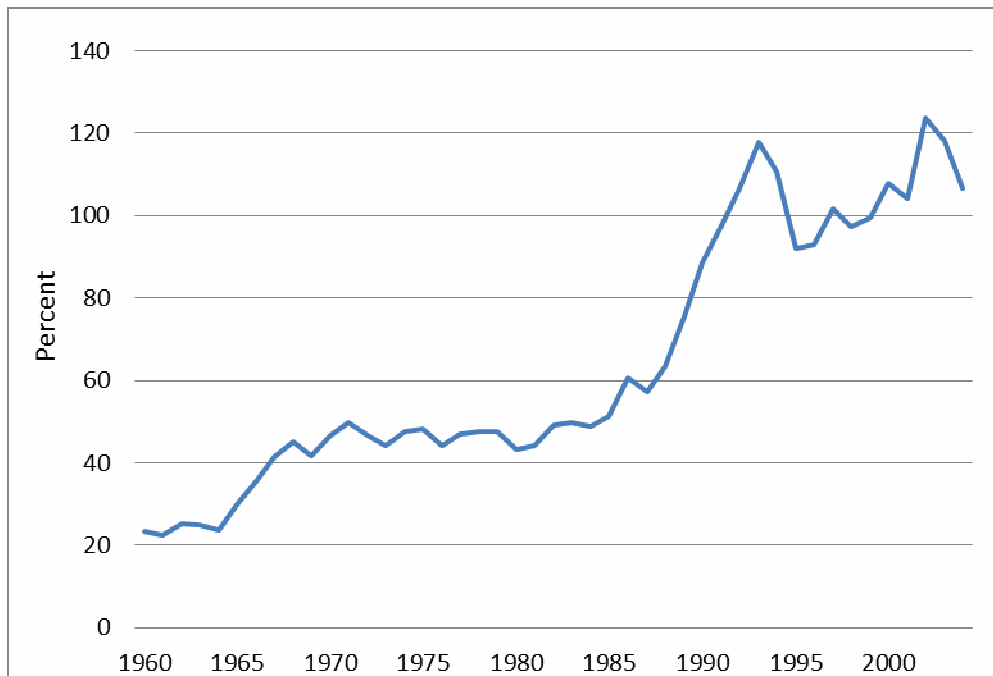


Figure 6.6 Debt to Equity in US Paper Products Sector
Source: Miles (2005)

Furthermore, those who argue that there is a crowding out effect overlook the possibility that increased financial investments were financed, in large part, by debt.⁵⁸

Figure 6.6 reveals the dramatic increase in debt to equity ratio in the leading US forest product firms. By 1990, the average ratio of debt to equity for the leading forest product firm in the industry surpassed one hundred percent, meaning the value of total debt in the leading firms had surpassed their total equity. The industry's debt to equity ratio remained at high levels for the remainder of the decade, before exploding to over 120 percent in 2002, largely as a result of the merger movement that was taking place in the late 1990s and early 2000s. Financial interests tend to prefer the use of debt, as opposed to equity, in financing a firm's operations because issuing equity would further dilute the value of the existing shares of company's stock (Kotz

⁵⁸ Shannon Williams is responsible for pointing out to me the possibility that increased shareholder returns could have been funded in large part by increased debt.

1978; Fligstein 2001). In this sense, the rise in debt to equity is yet another indication that managers were adopting a financially oriented perspective that privileged the interests of their shareholders.

From Retain and Reinvest to Downsize and Distribute

The financial measures provided above provide a backdrop for our discussion of how the shareholder value movement spread across the US forest products industry. Two decades of chronic instability, the persistence of diminishing returns and declining profits ultimately forced managers to search out novel strategies to revive their flailing industry. Research has shown that shareholder value tactics are most likely to be adopted in industries with low profits (Fligstein and Shin 2007). Furthermore, as I have shown, by the late 1990s institutional investors now held a controlling share in most US forest product firms, and managerial compensation was tilted in favor of incentive-based compensation packages that tied manager's incomes directly to the value of the firm's stock.

The shift towards a shareholder value conception of control is evidenced by a number of changes that took place in financial balance sheets of firms in the US forest products industry. In general, these changes can be understood in the context of Lazonick and Williams description of the shareholder value ideology as a shift from "retain and reinvest to downsize and distribute" (Lazonick and Williams 2000). Whereas the conditions of managerial capitalism lent themselves to rising profits and increased investment into expanded capacity and diversification, shareholder capitalism tended towards decreased investments into capacity and an increase in distribution payments to shareholders.

The adoption of the shareholder value conception of control did not take place overnight, nor did it was it adopted uniformly across the forest products industry. In fact the process was a gradual one that spread unevenly across the industry. Nevertheless, by the late 1990s, it was clear that the need to deliver on shareholder value was playing a central role in the reshaping of the forest products industry (Mili 1998).

Stock Buybacks and Dividends

In an era of diminishing profits, managers in the US forest products industry increasingly turned to stock buybacks in order to boost their firms' share price. By purchasing their own shares on the open market, managers reduced the number of shares held by the public and thus increased the value of the firm's share price. This method is favored in industries where there are few opportunities for internal growth and became a preferred means for managers seeking to increase returns to their shareholders (Grullon and Ikenberry 2000). The evidence shows that stock buybacks were the increasingly favored channel for distributing earnings back to shareholders in the forest products industry. In 2001, an analysis of stock buybacks in the US paper industry found that of the 25 US paper companies surveyed, only three lacked a stock repurchasing program whereas a decade ago just a handful of companies had such a program (Connelly 2001).

Stock repurchasing programs often accompanied the more general restructuring programs that spread across the industry in the late 1990s and early 2000s. Mead Corporation announced one of the earliest stock buyback programs in the industry following the announcement of their restructuring program in 1992. Over the next four years Mead repurchased a total of 8.7 million of their own shares valued at \$459 million (IDCH 2006). In 2006, as part of their major

restructuring program, International Paper announced that it intended to purchase \$3 billion worth of its own shares, approximately 20 percent of the company's total outstanding shares. In 2006 and 2007, Weyerhaeuser conducted one of the largest share buybacks in its history, spending \$800 million in a repurchasing program that sent its stock price soaring to a record high of \$86 per share in March of 2007.

Many firms used the cash from large asset sales to finance stock buybacks. For example, in 1994 Kimberly Clark announced that it would use the proceeds from the sale of its Newsprint mills to fund a stock repurchasing program (Dallas Morning News 1994). Other companies, such as Williamette, Boise Cascade, and MeadWestvaco used the proceeds from their sale of timberland to finance large stock buybacks aimed at increasing returns to shareholders. Commenting upon the announcement of a \$400 million stock buyback program following the sale of their timberlands, MeadWestvaco chairman and CEO said, "We are delivering on our commitment to return to shareholders the excellent value we generated from these forestland sales. We expect to continue to drive shareholder value by generating sustainable earnings and cash flow growth" (MWV 8-K, 2007). With limited investment opportunities available, managers found stock buybacks to be one of the few options available for buoying their firm's share price.

Stock buybacks were not the only means by which managers channeled capital back to shareholders; dividend payments also remained as an important channel for funneling capital back to the financial community. Over the course of the financialization period stock buybacks increasingly replaced dividend payments as the preferred means of increasing returns to shareholders (Grullon and Michaely 2002). In the forest product industry, however, dividends continued to play an important role. Figure 6.7 shows the total dividends as a percentage of

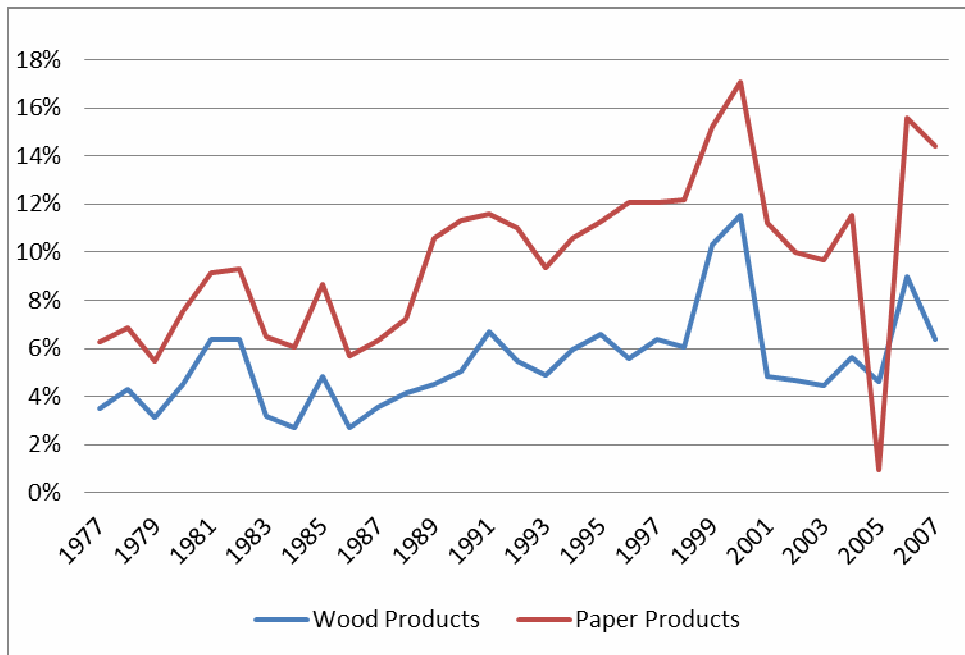


Figure 6.7 Ratio of Total Dividends to Value Added in US Forest Products Industry
Source: U.S. Bureau of Economic Analysis, Table 6.20

value added in both the wood and paper product sectors.⁵⁹ The rate of dividend payments in both the wood and paper products sectors grew over the course of the last several decades. In the paper sector, the ratio of dividends to value added remained below 10 percent for most of the 1980s, but by 1990, when the forest products industry began to stagnate, the payout ratio continued to climb, staying above 10 percent for the remainder of the decade.

The substantial increase in both stock buybacks and dividend payments reveal a management in the forest products industry that is increasingly preoccupied with maintaining high returns to shareholders. Critically, these increased returns to shareholders took place in the face of declining returns and rising debt, suggesting that any increase in shareholder returns were most likely financed by debt and may have had little relation to the financial health of the firm.

⁵⁹ Value added is a measure of the gross output of an industry less its intermediate inputs (BEA), and thus provides an objective baseline measurement for viewing how profits in the industry are being distributed (see Orhangazi 2008).

That is to say, the evidence provided above suggests that managers in the US forest products industry loaded their firms down with debt in order to maintain increased returns to shareholders.

Mergers & Acquisitions

In the previous chapters I detailed two other waves of mergers and acquisitions that took place in the post war era. The first was the merger wave of the late 1960s, when US firms engaged in a frenzy of acquisitions aimed at diversifying and broadening their corporate empires. During this period, mergers in the forest products industry were not “substituted for internal growth strategies in general,” but were more often “of the conglomerate product-extension type” (Ellefson and Stone 1984). In other words, mergers did not replace investments into expanded production capacity, but accompanied them in an ongoing effort to expand corporate portfolios.

The second wave of mergers and acquisitions came in the 1980s as a result of the hostile takeover movement. This movement was spurred on by the cheap credit and relaxed antitrust enforcement of the Reagan administration. Critically, the hostile takeover movement came from outside corporate boardrooms, from corporate raiders that used junk bonds and debt to finance corporate takeover with the intention of breaking up the conglomerates and selling off their assets for a quick profit.

The merger movement of the late 1990-2000s was distinct from both of the previous waves in two important ways: first, whereas during the 1980s, most hostile takeovers came from corporate raiders outside the industry, during the 1990-2000s they predominately came from within the industry; and second, during the late 1990-2000s mergers became the principle means for firms to grow, as investment into expanded productive capacity all but ceased in the industry.

Growth in the industry now came through increasing the firm's market share and market power by merging with one's major competitor. In the face of declining returns, chronic overcapacity, and a glutted market, the US forest products industry turned to consolidation and the reshuffling of existing assets in order to reestablish growth in their stagnating industry. Taking over existing mills became the preferred means of capacity expansion because while it did increase the capacity of a firm involved, it did not add to overall capacity in the industry. The result, as shown in Figure 6.8, was an unprecedented period of mergers and acquisitions that utterly transformed the US forest products industry, bringing an end to many of the industry's mainstays for the past century (Diamond, Chappelle, and Edwards 1999; Miles 2005; Mei and Sun 2008a).

The first hostile takeover bid from inside the industry came in late 1989 when Georgia-Pacific initiated a hostile takeover bid of Great Northern Nekoosa Corp. This was a turning point for an industry that had long been known for a high level of cooperation between competing firms. A report in the New York Times described Georgia-Pacific's takeover bid as "a stunning development" in an industry "which has long been dominated by a dozen major companies that generally dealt with one another on a friendly, almost gentlemanly basis" (Berg 1989). The battle for Great Northern raged on for several months with law suits and slander coming from both sides. In February of 1990, after twice increasing the offering price – from \$58 a share to \$63, and then to \$65.75 – Georgia-Pacific succeeded in their takeover of Great Northern, acquiring the firm for a \$5 billion cash buyout, the largest merger of its kind in the history of the US forest products industry. With this acquisition, Georgia-Pacific became the world's largest forest product firm, briefly surpassing International Paper, with estimated revenues of over \$14 billion dollars.

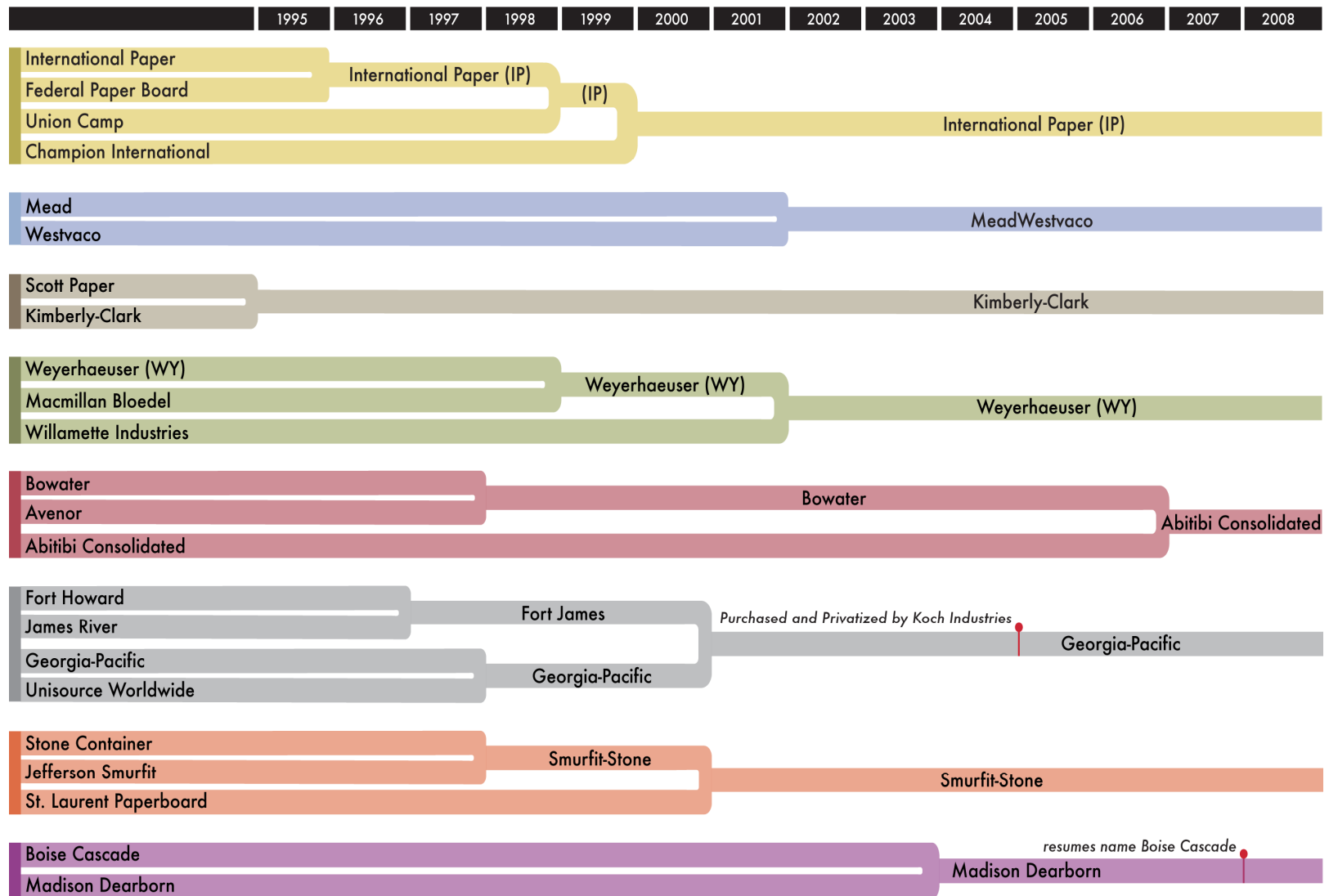


Figure 6.8. Mergers and Acquisitions in excess of \$1 Billion in US Forest Products Industry, 1995-2008
Source: Rudder (2002) and Miles (2005).

Industry analysts predicted that there would be an industry-wide wave of consolidation following Georgia-Pacific's acquisition of Great Northern (Hoffman 1991); however, the recession of 1991 undermined any potential deals for a time. In fact, sagging prices and a high debt overhang forced Georgia-Pacific to sell over 80 percent of the mills they acquired to Bowater just 18 months after they were acquired.

The merger wave of the 1990s really began to explode in the years after the industry's rebound in 1995 and continued unabated for the next 10-15 years. Between 1995 and 1997 mergers and acquisition increased from 26.0 to 36.9 percent based on annual dollar increases (Diamond, Chappelle, and Edwards 1999). In 1995, many firms in the industry found themselves with a surplus of cash due to the record profits of that year, and with the lessons of the late 1980s excesses still fresh in their mind, they turned to purchasing existing machines instead of building new capacity. Consolidated Papers, Appleton Papers, Chesapeake, and Kimberly-Clark all purchased existing papermaking facilities over the course of the year. Kimberly-Clark's purchase of Scott Paper for \$9.4 billion was the largest merger of the year. This merger raised a number of anti-trust concerns within the Justice Department, ultimately forcing Kimberly-Clark to sell off their facial tissues and baby wipes businesses in order for the merger to go through (Bloomberg 1995). In addition, Madison Dearborn Partners, a private equity firm that specializes in leveraged buyouts, began its long foray into the US forest products industry when it purchased a mill in Hyde Park, Massachusetts from the bankrupt Patriot Paper Corp (Rudder 2002).

After a brief respite in 1996, the industry experienced two significant mergers the following year, both of which were friendly mergers aimed at increasing the market share and reducing competition. The first involved a \$5.8 billion merger between Fort Howard Corp. and James River Corp., forming a single company under the name of Fort James Corp. Fort Howard entered the deal after employing advisors from Morgan Stanley to devise a way to “maximize value” for shareholders (Bagli 1997). After the merger, Fort James Corp. was now the second largest tissue producer in the world (behind Kimberly-Clark) and one of the top 10 consumer product companies (Rudder 2002). Less than two weeks later, another major merger occurred when Wausau Paper and Mosinee Paper joined to form Wausau-Mosinee Paper Corp., making it the nation’s largest producer of specialty papers. Commenting on this merger, an industry analyst remarked that “both stocks have tread water lately and this is a way to increase shareholder value” (Reuters 1997).

The move towards consolidation continued in 1998 when Stone Container merged with Jefferson Smurfit to form Smurfit Stone Container Corp., then the world’s largest manufacturer of paperboard and paper-based packaging. Another “mega-merger” occurred when Bowater acquired Montreal based newsprint and market pulp producer Avenor for \$2.5 billion, outbidding Bowater’s primary competitor Abitibi-Consolidated (Rudder 2002). Less notable deals continued to take place as firms shuffled around their existing production facilities in order to “extract merger-related cost savings and synergies” (Banham 1999).

International Paper began its move towards consolidation in 1999 when it merged with Union Camp in a stock-for-stock deal worth an estimated \$7.9 billion. Industry analysts were clear on the motivations behind the merger: the need to increase shareholder value (Banham 1999). The following year, International Paper made another large purchase when they acquired Champion International for \$9.6 billion, solidifying their leadership in the printing/writing paper and market pulp sectors. International Paper also served as a white knight when it stepped in to purchase Shorewood Packaging for \$600 million after a prolonged bidding war with Chesapeake Corp. These acquisitions secured International Paper's position as the world's largest forest product company.

The decade came to an end with one final mega-merger when Georgia-Pacific agreed to purchase Fort James Corp for \$7.5 billion, plus \$3.5 billion of debt (Rudder 2002). Fort James had been struggling since its inception three years earlier and Miles Marsh, the CEO of Fort James, said that this merger represented a "fine opportunity" for the company's shareholders (The Ottawa Citizen 2000). This merger established Georgia-Pacific as the world's leading tissue producer, surpassing their rival Kimberly-Clark.

The shakeup in the US forest products industry continued to surge in the early years of the new millennium. Two of the nation's longstanding firms, Mead and Westvaco, merged in early 2002 in what was described as a "merger between equals" (Pidgeon 2001). The new company, MeadWestvaco, became the nation's fourth largest paper company with about \$8 billion in annual sales. Commenting on the merger, John A. Luke, Jr. President and CEO of Westvaco added, "[w]ith this combination and the

powerful business it creates, we are well positioned to deliver higher returns to shareholders” (Pidgeon 2001).

Weyerhaeuser made its foray into the merger movement in early 2002 when it initiated a hostile takeover of their rival, Willamette Industries. Weyerhaeuser’s first bid consisted of a public offer of \$48 per share, which was roundly rejected by Willamette’s management. Weyerhaeuser’s final bid of \$55.50 per share plus the assumption of \$1.7 billion in debt proved successful. The total takeover, valued at \$7.8 billion was the largest transaction in the industry since Georgia-Pacific’s merger with Fort James in 2000. This acquisition placed Weyerhaeuser as North America’s second largest forest products company (Rudder 2002).

In 2005 the largest acquisition in the history of the industry took place when Georgia-Pacific was purchased and subsequently privatized by Koch Industries for \$21 billion including debt. Under the terms of the deal, Koch paid \$48 per share to Georgia-Pacific’s shareholders, a 39 percent premium on their current value. This acquisition was the largest purchase to date by the family owned conglomerate and made Koch Industries the nation’s largest privately held company by revenue. Interestingly, Koch Industries decision to purchase and privatize Georgia-Pacific was carried out because of their belief that highly cyclical, commodity-dependent industries such as forest products were “better suited as private companies than in the public markets because they face less pressure to hit quarterly targets” (Whiteman 2005).

During this period there was an emerging trend towards financial investors becoming key buyers of large forest product firms. Madison Dearborn Partners was the

leading firm in this regard, having “consummated approximately \$15.5 billion of management buyout transactions since 1993, several of which are now public companies, including Packaging Corp. of America and Buckeye Technologies” (Miles 2005). In 2004, Madison Dearborn also purchased the paper and forest products sectors of Boise Cascade, after the latter rebranded itself as OfficeMax following its purchase of the office retailer a year earlier. Cerberus Capital was another financial firm that purchased mills from existing companies in order to sell off assets and establish new firms. In 2005, Cerberus Capital purchased mills from Mead Westvaco and Consolidated Papers and they formed a new company under the name of New Page.

Mergers and acquisitions continued to pick up pace between 2005 and 2008. In late 2007, the Canadian based Abitibi-Consolidated merged with Bowater in what was described, like MeadWestvaco, as a “merger between equals.” The new company, called AbitibiBowater, controls about 55 percent of North American newsprint capacity and 17 percent of the global newsprint market. Early the next year, Weyerhaeuser announced that it was selling its containerboard, packaging and recycling businesses to International Paper for \$6 billion in cash, which would more than double International Paper’s containerboard capacity and make it the world’s largest producer of containerboard. This announcement by Weyerhaeuser was preceded by another large transaction in which the company sold off its printing papers business in a deal with Domtar (S&P 2008).

To sum up, the mergers and acquisitions of the late 1990s and early 2000s, radically altered the landscape of the US forest products industry. Industry titans dating back to the 19th century were swallowed up and/or merged with competitors in an

unprecedented reshuffling of ownership. At least half of the top ten firms in 1990 were merged under new names and/or acquired by a competing firm by 2008. These mergers produced substantial increase in the market valuation of firms and were therefore successful in achieving their principle aim of increasing shareholder value (Mei and Sun 2008b).

Concentration and Oligopoly in the US Forest Products Industry

As a result of this historic merger wave, the levels of concentration reached record heights in an industry that has long been characterized as oligopolistic. Table 6.1 shows the relative concentration ratios for the top four firms in selected industries based on their value of shipments. In the paper industry as a whole, the concentration level for the top four firms rose from 18.5 percent in 1997 to 24 percent in 2007. This increase in concentration has produced a rapid growth in oligopoly market power in the paper

Table 6.1. Share of Value of Shipments Accounted for by Top Four Companies for Selected Forest Product Industry Sectors

Industry (SIC Code)	1997	2002	2007
Paper Manufacturing (322)	18.5	25.8	24
Pulp mills (322110)	58.6	61.1	53.9
Newsprint Mills (322122)	43.9	53.9	58.1
Sanitary paper (322291)	63.1	56.3	62.2
Wood product manufacturing (321)	10.5	10	9.1
Sawmills (321113)	16.8	17.5	14.6
Hardwood veneer and plywood (321211)	30.5	33.1	30.4

Source U.S. Census Bureau (2007)

products sector, providing industry leaders with greater control over production and prices in the industry (Mei and Sun 2008a).

This concentration is particularly evident within specialized sectors of the industry because large firms have divested various divisions in order to focus on their “core competencies.” In the pulp mills sector, the share of value added accounted for by the top four firms increased to 61.1 percent in 2002, before sliding back to 53.9 percent in 2007. Newspaper is now one of the more concentrated sectors of the US forest products industry. By 2007, the top four firms in the newsprint sector accounted for over 58 percent of market activity. These levels increased substantially in 2007 following the merger of Abitibi-Consolidated and Bowater, which left the newly formed Abitibi-Bowater in control of over half of the total newsprint market (CBC News 2007).

The merger wave does not seem to have led to similar levels of concentration in the wood products sector. In the sector as a whole, the value of shipments accounted for by the top four firms actually decreased slightly over this period from 10.5 percent in 1997 to 9.1 percent in 2007. This continues to reflect the less capital-intensive nature of wood products manufacturing and the fact that small mills continue to account for a substantial portion of market activity. For the forest products industry as a whole, however, the merger wave of the 1990s and 2000s led to a substantial increase in overall concentration.

Restructuring, Core Competencies, and Labor

The mergers and acquisitions that took place between 1995 and 2005 were symptomatic of the rising influence of the shareholder value conception of control in the management of US forest product firms. Once completed these mergers were often followed by a series of restructuring programs aimed at increasing efficiencies and streamlining production processes. Translated, this meant that underperforming mills would be shut down or sold-off, while employees would be laid off by the thousands. These restructuring efforts were undertaken by managers at various times, depending on the circumstances of particular firms within the industry. Most often they occurred after a prolonged period of declining profits or immediately following a merger or acquisition. In fact, many large firms explicitly hired financial analysts at some of the nation's largest financial institutions for advice on how best to "maximize shareholder value" (Farley 1997)

Perhaps the first major restructuring effort undertaken with the explicit intention of increasing returns to shareholders occurred in 1992 when Steven Mason took the helm of Mead Corporation. Mead had been suffering from several years of declining returns and Mason was charged with turning the company around. Mason immediately announced a three-year performance improvement which included the immediate dismissal of about 1,000 employees aimed at increasing productivity. Mason also announced that Mead would be selling off several of its non-core product lines, including its imaging and insurance business. The largest divestment occurred in 1994 when the

company sold Mead Data Central unit, which included the LexisNexus information service, to the Anglo-Dutch publishing giant Reed Elsevier for \$1.5 billion. Commenting on this sale, Mason declared that “we’re interested in shareholder value” (Bloomberg 1994). The proceeds from this sale were used to pay down debt and make stock repurchases (IDCH 1998).

The most symbolic restructuring of a US forest product firm along the dictates of the shareholder value conception of control occurred in 1994 when the board of Scott Paper decided to hire Al Dunlap to take over management of their floundering company. As we recall, “Chainsaw Al” gained notoriety during the 1980s for his ruthless approach to corporate management of several US forest product firms, most notably when James Goldsmith hired him to manage Crown Zellerbach after his successful takeover bid. Dunlap embodied the shareholder value ideology, with his emphasis on streamlining corporate management and focusing on core competencies of the firm. His management tenure at Scott Paper set a precedent for the industry that many would soon follow.

In 1994 Scott Paper was a century-old \$5 billion “stumbling giant” of the US forest products industry (Perkins 1999). Like many in the industry, Scott had embarked upon a flurry of expansion during the late 1980s, leaving the firm with an excess of capacity, coupled with stagnating sales and declining market share. Scott’s CEO, Phillip Lippencott, attempted a number of strategies aimed at turning the ailing company around, but each proved unsuccessful. In a moment of desperation, the board of Scott Paper turned to Al Dunlap to revitalize their failing company.

Dunlap immediately set out to institutionalize his shareholder value ideology of corporate management. His plan consisted of four parts: first he fired the existing management team and brought in a team of trusted associates from his days with Crown Zellerbach. Second, he began a series of asset sales aimed at refocusing the firm on their core strength in the paper products sector. These included selling off the firm's coated paper division, a power plant in Alabama, and its health and food services unit. In order to change the corporate culture, he also decided to sell off the corporate jet and the company's 55 acre headquarters camp in Philadelphia, moving the headquarters into a leased office building in Florida (Rudder 2002; Perkins 1999).

Next, he oversaw the "largest proportionate restructuring" of a US corporation to date. Sam Perkins (1999: 5) described these efforts in a report on Dunlap and corporate restructuring:

More than 11,000 employees were eliminated from Scott's payroll. The headquarters staff was reduced by 71%, salaried management by 50%, and hourly employees by 20%. Many functions, such as Washington lobbyists, real estate, HR and IT were either eliminated entirely or outsourced. Additional cost reductions came from ending the use of most outside consultants (\$30 million) and putting services such as auditing out to bid (\$1.5 million annual savings). Further, Dunlap ended a tradition of Scott contributing \$3 to \$4 million a year to community organizations, terminated the practice of matching employee contributions to United Way and reportedly canceled the last \$50,000 of a long-term commitment to the Philadelphia Museum of Fine Arts.

Scott Paper's CFO Basil Anderson later commented on the restructuring, noting that "the focus on shareholder value allows you to make better judgments on those kinds of expenses" (Perkins 1999: 5). The final step in Dunlap's four part plan included a number

of investments in strategic sectors and a reinvigorated marketing campaign aimed at improving Scott's market share.

In the year after Dunlap was hired, his efforts at restructuring Scott Paper seemed to have been a success, at least when measured in terms of shareholder value. Operating income increased substantially and, most importantly, the price of Scott Paper's shares rose from \$38 when Dunlap took over, to \$60 at the end of 2004 and then to \$90 the following year. Wall Street cheered his management style and lauded him as a "turn-around champion." Former employees, of course, had a different view of his accomplishments, but for Dunlap's financial constituency, his efforts were a resounding success. In the summer of 2005, Dunlap sold what was left of Scott Paper to Kimberly-Clark for a \$47.7 billion stock swap and Dunlap himself walked away from the deal with a \$100 million compensation package for his efforts.

Dunlap was essentially the ideal-typical manager operating under the shareholder value conception of control. He had a strong disdain for incompetent managers of corporate America, referring to them as "America's Aristocracy" and denouncing them for their lavish abuses of corporate power. Shareholders were the only constituency that mattered for Dunlap and he strived to instill this belief in those around him. He also began the practice of compensating board members solely with stock, becoming at the time only the second company in the US to do so. If there ever was a personification of a

manager operating under a shareholder value conception of control, it was “chainsaw” Al Dunlap.⁶⁰

Restructuring efforts in other firms may have been less drastic – they were certainly not carried out by such a charismatic figure as Dunlap – but they were similar in many regards. Georgia-Pacific began a restructuring program under the leadership of A.D. “Pete” Correll in the mid-1990s. Correll was seen as a leader in the shareholder value movement and was quoted as saying “it was high time these giant cyclical businesses start focusing on shareholder returns instead of worrying about revenues and market-share growth” (Henderson 1999). Correll’s efforts began in 1994 when he launched a number of initiatives aimed at making Georgia-Pacific “the most cost-efficient company in the industry.” This restructuring program led to the closing of almost half of the company’s distribution centers and a “Mill Improvement Program” that cut costs and increased efficiency at the firm’s 14 large pulp and paper mills. In 1996, Correll announced a hiring freeze and an early retirement program for salaried employees while he continued to close down under-performing plants and began the process of selling-off timberland assets. The next year Georgia-Pacific announced that timberland assets would be spun off into a separate operating group with its own common stock under the title of the “Timber Company.”

⁶⁰ Dunlap celebratory status on Wall Street was later ruined when he was fired and subsequently found guilty of committing accounting fraud as the chief executive of Sunbeam. This also led investigators to investigate irregularities during his tenure with Scott Paper. Dunlap settled these charges with the SEC for an agreement to pay a \$500,000 fine and a lifetime ban from serving as an officer or director of any public company (see Norris 2002; 2005).

Correll's efforts to restructure Georgia-Pacific took a contrary turn in the late 1990s when it was decided that the company would make a number of large purchases. These included the purchase of Unisource, a leading distributing company based out of Indianapolis. This purchase enraged shareholders who would "have rather have them return money to shareholders than put it into distribution," and as a result, the firm's stock plummeted (Fineman 1999). However, Correll soon after announced that Georgia-Pacific would be exiting the timberland market for good when he announced a \$4 billion dollar sale of their remaining timberlands to the timberland investment firm, Plum Creek. Soon after Georgia-Pacific acquired Fort James Corp. and announced that it would be selling its newly acquired Unisource at a loss in order to cover some of the debt incurred in this large acquisition (Cassidy 2002).

Other firms across the industry continued to cut non-essential operations and reduce employees. In 1998, Willamette announced that it would be selling-off its timberland holdings in order to reduce debt and resume its \$25 million stock repurchasing program (Bloomberg 1998a). Following its mergers, Smurfit-Stone announced the closures of a number of plants and cutting of 3,600 jobs, or 10 percent of its work force (Bloomberg 1998b). Weyerhaeuser also consolidated its core business in the late 1990s when they ended their services in mortgage banking, personal care products, financial services, and information systems consulting. The investment community typically greeted the announcement of these restructuring programs with a spike in investment, sending a signal to other managers that "shrinking to grow" was the mantra of the day (Verespej 1997).

International paper announced its major restructuring program in 2002 aimed at exiting non-core businesses and selling or closing existing assets. During this year, the company sold both its OSB facilities and its decorative products division. In 2005, International Paper announced a new three part restructuring plan aimed at “improving the company’s returns, strengthening its balance sheet, and returning cash to shareholders” (S&P 2006). This plan included selling off its coated papers, beverage packaging, kraft papers, wood products, and virtually all of its 6.8 million acres of US timberland. Together, these divisions accounted for approximately 30 percent of the company’s sales in 2004 and nearly 40 percent of its profits. International Paper would now concentrate solely on its uncoated papers and consumer packaging lines. On the day International Paper announced this restructuring plan their shares rose \$1.56 or 5.1 percent to \$32.22 on trading of 22.8 million, the highest volume in the company’s history (The Globe and Mail 2005). Clearly, the investment community’s desire to invest in companies with well-defined and focused strategies was pressuring managers to conform to the dictates of the shareholder value ideology.

By 2005, the US forest product industry had undergone a thorough reconfiguration as firms bought and sold various assets and product lines in order to solidify their own positions within particular market segments. International Paper’s purchase of Union Camp extended its leadership in the uncoated-free sheet area and brought it up to second in the containerboard sector. In the newsprint sector, the merger between Abitibi and Bowater gave them over half of all newsprint capacity in North America. Weyerhaeuser held the leading position in the wood products sector, while the

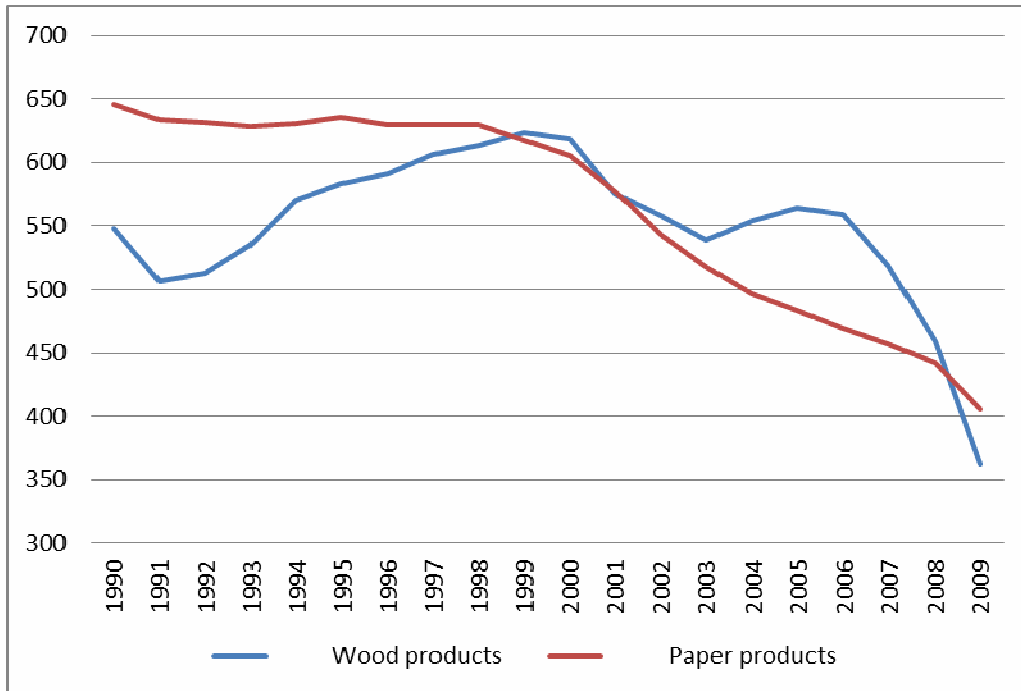


Figure 6.9 Full-time and Part-time Employees in US Forest Products Industry (Thousands), 1990-2009

Source: U.S. Bureau of Economic Analysis, Table 6.5

paperboard and packaging sector is dominated by MeadWestvaco and Smurfit-Stone. Georgia-Pacific, which was now a private company operating within Koch industries, held on to its position as the world's leading tissue manufacturer while continuing to have significant operations in pulp and wood products sectors.

The effect of the shareholder value ideology was devastating for labor in the US forest products industry. Most restructuring plans were accompanied with mass layoffs, often affecting thousands of employees at a time. Figure 6.9 shows the dramatic decrease in employee for both forest products sectors. Over a third of all employees in both sectors lost their jobs between 1990 and 2009. In both sectors, the layoffs rose dramatically in the years following 1999, corresponding to the merger wave and restructuring that took place in the late 1990s and early 2000s. The pressure to maximize

shareholder value left employees increasingly vulnerable as mass layoffs and mill closures became a central tactic in manager's desire to increase the shareholder value of their firm.

Divesting Timberland

In the previous chapter I explained how the managerial decision to acquire vast timberland holdings was driven not merely by the need for greater quantities of raw materials, but grew directly out of manager's desire to diversify and expand their corporate empires – a rationale that is directly associated with managers operating under the retain and reinvest conception of control of the post war era. Likewise, the managerial decision to sell-off corporate timberlands can be seen directly in line with the structural dynamics of financialization and the proliferation of the shareholder value conception of corporate control. Whereas existing research has tended to explain this transfer of ownership in piecemeal fashion, citing a litany of causes and influences (see Binkley, Raper, and Washburn 1996; Clutter et al 2005; Hickman 2007), I argue that the transfer is best understood as part of the broader structural context of financialization.

As we saw in Chapter 5, the financial community began to show interest in timberlands in the early 1980s. During this period financial actors, led by James Goldsmith, targeted forest product firms in order to gain control of these undervalued

assets.⁶¹ Managers resisted this intrusion by corporate raiders and adopted a number of measures aimed at reducing the likelihood that they would become a takeover target. They did, however, begin to reevaluate the strategic role of their timberland holdings. (Binkley, Raper, and Washburn 1996).

Disposing of these timber holdings was not as easy it might seem. First of all, selling to a rival firm was not an option because it would put the selling firm at a competitive disadvantage and most likely prevent access to timber supply in the future. Secondly, firms require that their timber supply come from land that is relatively close to their existing mills because transporting it over long distances is not cost effective. And finally, other firms in the industry were under the same pressures and were no longer looking to expand their timberland assets. What they needed, therefore, was a buyer with a large amount of investment capital that could own and manage the land while continuing to provide the market with ample timber supply.

The passage of the federal Employee Retirement Income Security Act (ERISA) in 1974, along with other state level regulations, relaxed the rules governing the investment practices of many public pension plans. As a result, institutional investors began to diversify away from their traditional reliance on low-risk, fixed-income securities such as government and corporate bonds. Initially institutional investors were investing heavily in the stock market, but before long they turned to commercial real estate and other assets

⁶¹ Actually, financial institutions had been noticing the investment potential of timberland since the 1970s, when several firms began issuing agricultural loans to American farmers while using the farm's timber as part of the collateral base of the farm (Binkley 2007).

in order to diversify their rapidly expanding portfolios (Binkley, Raper, and Washburn 1996).

Timberland became an attractive investment class to investors for a number of reasons. First was the fact that investments in timberland seemed to offer fairly high returns when compared to other investment options. Second, investors believed that timberland investments could help spread risk in large portfolios because they had low correlations with other assets classes such as stocks and bonds. And third, timberland returns tended to be highly correlated with the rate of inflation, which provides investors with a hedge against inflation (Hickman 2007). As the realization of the investment potential of timberland began to spread, two institutions emerged in order to accommodate the financial community's growing demand for timber assets.

The first was the Timberland Investment Management Organization (TIMO), which is an institution that buys and manages timberland on behalf of various clients, such as insurance companies, pension funds, endowments, and foundations (Hickman 2007). Thus, TIMOs do not actually own the land, but buy and manage it for these various financial intuitions. TIMOs typically purchase timberland for a short time period, usually between 10 and 20 years, and unless there is a specified option to extend, the timberland will be sold at the end of this period (Hickman 2007).

As with the financialization process in general, the role of debt appears to have been critical in the purchasing of many of these timberlands. Binkley (2007) recalls a case in which, a new TIMO, Timberstar, purchased a significant amount of timberland from International Paper and raised 72 percent of the capital through a public bond. This

means that the company only had to invest 28 percent of the total equity, while 72 percent was raised in debt markets. The use of debt in this case does not appear to be an exception; on the contrary, there has been a substantial increase in the amount of debt in most large timberland acquisitions (Clutter et al. 2005).

The second institution was the Real Estate Investment Trust (REIT), which own and manage real estate related assets (timberland in this case) on behalf of private investors (Hickman 2007). REIT's are corporations whose special tax designation allows them to invest in real estate while receiving a vastly lower tax rate than typical corporations. As part of the rules of this designation, they are required to distribute 90 percent of their income directly back to investors. REITs had been in existence since the early 1960s, but it was not until the passage of the Real Estate Investment Trust Simplification ACT (REITSA) of 1997 that timber-REITs were established. The REITSA of 1997 changed the rules governing the conversion from a vertically integrated timber company to REITs and allowed for institutional funders to invest directly in REITs. Today there are several REITs, including Plum Creek, Potlatch, Rayonier, and Weyerhaeuser that are traded on the NY Stock Exchange, thus allowing investors to purchase directly in timberland.

The timberland holdings of TIMOs and REITs are spread across the United States, but the largest concentrations occur in the regions where the forest products industry is most prominent, such as the pine plantations of the Southeast, the conifer plantations in the Pacific Northwest, and the mixed hardwoods in the Northeast (Hickman 2007). There is also a growing interest in international timberland

investments, particularly in South America, where significant investments continue to be made (Mendell 2006).

In the United States, the demand for timberland investments coming from TIMOs and REITS needs to be understood within the context of forest product managers who were beginning to rethink the role of timberland ownership in their corporate strategies. Although managers initially resisted the idea of divesting their timberland in the 1980s, by the early 1990s, the adoption of the shareholder value conception of corporate control was beginning to spread across the industry. Years of relatively weak financial performance had caused the industry to fall out of favor with the financial community (Yin et al. 1998). As the balance of power – in both corporate boardrooms and the nation more broadly – shifted towards the financial community, managers came under increased pressure to sell off non-core assets. Other reasons cited in the decision of managers to sell-off timberland include the higher tax-rate for corporate timberlands and the need to reduce debt that was acquired during the merger movement of the period (Hickman 2007).

Figure 6.10 shows the net acres and value of this transfer of timberland ownership. Here we see that the transfer of timberland began to occur in the 1980s and accelerated slightly over the course of the 1990s. Investors that got into timberland investment early were unexpectedly rewarded when the Forest Service sharply cut back timber harvesting from federal lands in the aftermath of the Spotted Owl controversy (Rinehart 2010). The removal of federal forests decreased the total timber supply by half in the Western United States and led to a sharp increase in timberland prices, even in

non-Western timber producing regions. Rinehart (2010) estimates that this spike in timberland prices resulted in a cumulative rate of return of 26.75 percent for early investors.

The sharp increase in timberland prices and their impressive rate of return for early investors made timberland even more attractive to potential investors. Over the course of the 1990s, managers that were coming under the sway of the shareholder value ideology began to notice the rising value of these timberlands as well. The real explosion of timberland sell-offs, however, occurred during the 2000s, when managers acting under “marching orders from Wall Street” decided to sell off their timberland assets (Rinehart 2010: 13).

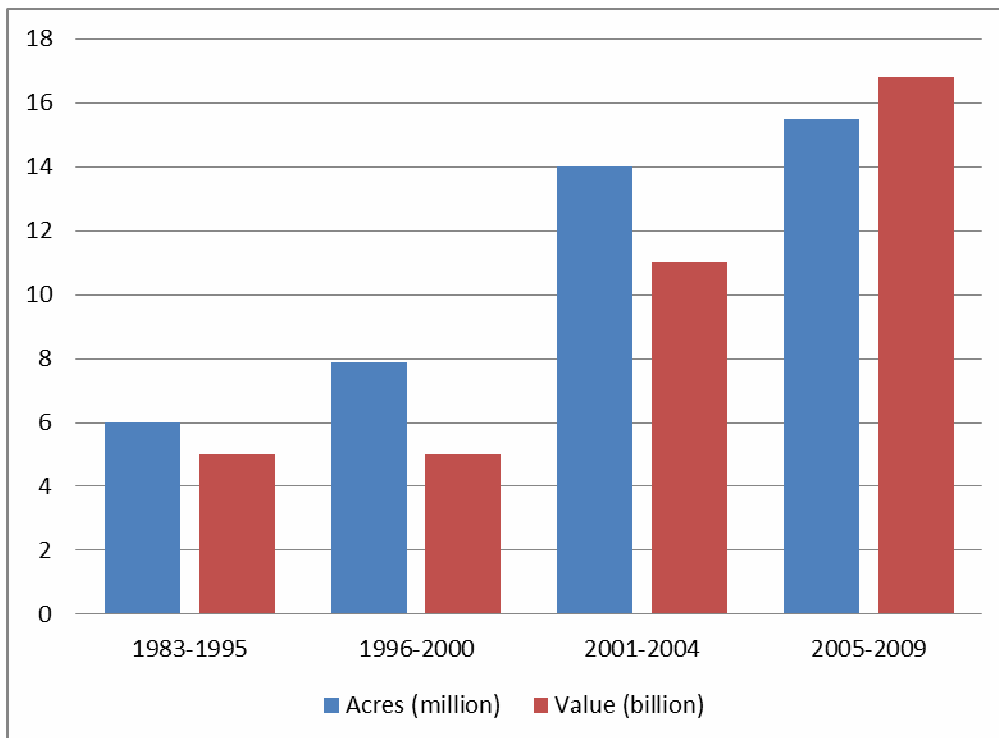


Figure 6.10 Transfer of Timberland Ownership by Acre and Value
Source Rinehart (2010)

The timing of the decision to sell-off timberland within particular firms can be traced directly to the corporate restructuring plans that I described above. Corporate managers looking to increase returns to shareholders in a struggling industry found that they could accomplish this by selling off non-core assets. For example, Peter Correll, the CEO and shareholder value champion of Georgia-Pacific, first spun-off the company's timberland assets into a separate unit in 2007 before deciding to sell-off their timberland assets wholesale to Plum Creek two years later in a deal valued at \$3.8 billion (Johnson 2000). Another example is Boise Cascade, which sold all of its timberland holdings to the private equity group Madison Dearborn as part of its transformation to Office Max in 2004. The markets usually rewarded the sell-off of timberland with a sharp increase in their share price. When Temple Inland announced their decision to sell of their timberland in 2007, their shares rose by \$8 (Rinehart 2010).

In 1980, International Paper was the largest private landowner in the United States with approximately 7.1 million acres of timberland. By 2008, the nation's largest private land owners was Plum Creek, a REIT that now owns over 7 million acres of timberland spread across 19 states. Plum Creek got its start in 1989 as a limited public partnership that was formed in order to buy 1.4 million acres of timberland from Burlington Resources, land that was again originally part of the late 19th century railroad land grants (Jensen and Draffan 1995). In 1999, Plum Creek became the first wood products company to transform themselves into a REIT in what one commentator labeled as "one of the greatest business coups in history" (Skinner 2009). This militaristic language presumably refers to the tax savings that firms enjoy once they convert to a

REIT. Whereas traditional subchapter C corporations are taxed at federal income rate of 40 percent, REITs enjoy a special tax status that allows them to be taxed at only 15 percent. In return, REITs are not allowed to have more than 20 percent of their assets in manufacturing.

Plum Creek's conversion to a REIT was followed immediately by their purchase of Georgia-Pacific's Timber Company and their 4.7 million acres of timberland. In the weeks prior to this purchase the IRS had issued a ruling that allowed companies to spin off real estate to REITs tax-free (Sikora 2001). Therefore, Georgia-Pacific was able to sell their timberlands to Plum Creek for \$3.8 billion while paying zero taxes on these profits.

Interestingly, the transfer of timberland ownership did not take place under the leadership of the industry's largest firms. International Paper, the leading firm in the industry with the largest timberland holdings did not sell the majority of their timberland until 2006. As shown in Figure 6.11, International Paper began selling off timberland as early as 1997. They continued to sell off parcels of land for most of the next decade; however, the majority of their timberland (5.8 million acres) was sold in 2006 following their announcement of their major restructuring program. Weyerhaeuser became the last major firm to restructure when it announced its decision to convert to a REIT in early 2010 (Chasan 2010). The managers at Weyerhaeuser actively resisted the pressure to sell off their timberland. In 2008, they successfully lobbied the federal government and received a \$182 million tax break that was tucked inside a larger farm bill (Blumenthal 2008). This federal handout helped Weyerhaeuser avoid restructuring at the time;

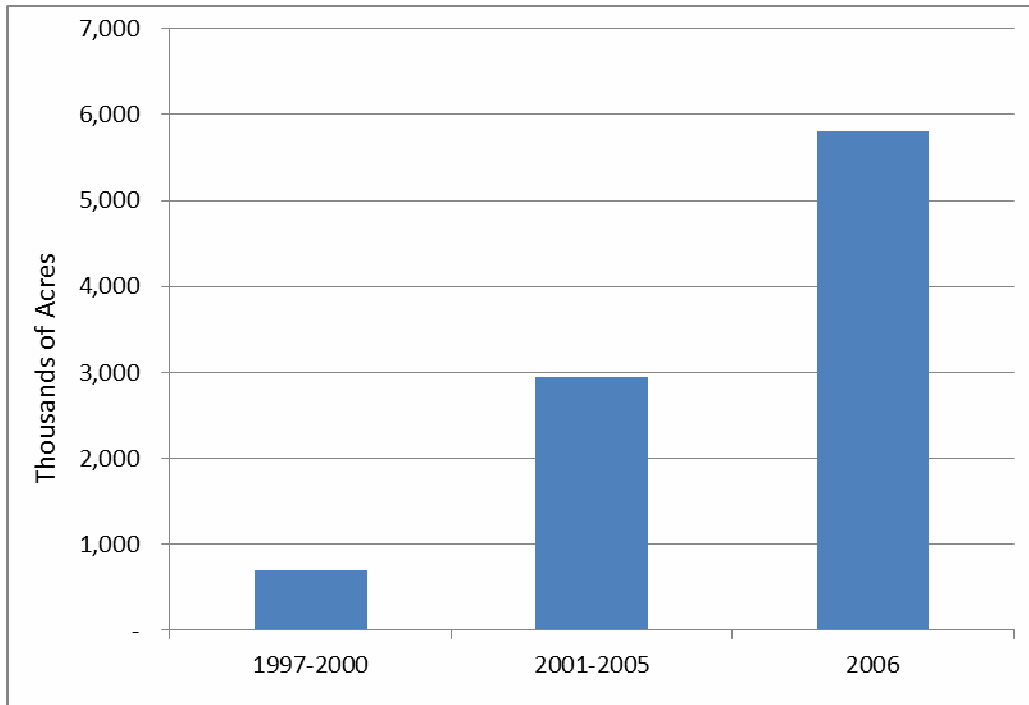


Figure 6.11 International Paper Timberland Sales, 1997-2006

Source: Rinehart Timberlands Transaction Database⁶²

however, it did not help the 1,500 employees that were laid off less than two months later (Chasan 2010).

It is difficult to know exactly why larger firms were more reluctant to sell off their timberland. Perhaps it was because they were the firms that owned the most timberland and reaped the greatest benefits from continued ownership. Or it could have been the relative degree of shareholder influence within these firms and/or their respective corporate cultures. Weyerhaeuser, for instance, built its corporate empire upon the large land holdings that they acquired from federal land grants in the late 19th century (Jensen and Draffan 1995). Over the course of the 20th century Weyerhaeuser came to own 6.4

⁶² Jim Rinehart is an expert in timberland investment that was among the first to predict the large-scale transfer of timberland ownership (See Rinehart 1985). The data on International Paper was taken from Rinehart's timberland transaction database that he has maintained since 1989 and was kind enough to share with me.

million acres of land, consisting of some of the most valuable timberland in the nation. In the end, however, even managers in Weyerhaeuser could not withstand the mounting pressure from shareholders. Upon making their conversion to a REIT, Weyerhaeuser transferred approximately \$5.6 billion to their shareholders in a special dividend (Donville 2010).

Weyerhaeuser's restructuring as a REIT marks the culmination of one of the more pronounced periods of land ownership restructuring in recent US history. Prior to Weyerhaeuser's restructuring, Rinehart (2010) estimated that over 43 million acres of timberland valued at \$39.7 billion has changed ownership type between 1983 and 2009. With the addition of Weyerhaeuser's timberland to these figures in 2010, we are dealing with a land transformation in the range of 50 million acres. As Rinehart (2010: 17) notes, "[t]his represents a stunning transfer of assets and wealth, especially considering that much of it occurred in a single decade."

Conclusion

The foregoing discussion reveals that managers in the US forest products industry increasingly adopted a shareholder value conception of control and that this ideology was used to motivate and justify corporate decision-making in recent decades. At first, managers in the industry resisted the challenge from shareholders; however, by the mid-1990s the shift in stock ownership and executive compensation, coupled with years of stagnant growth produced the necessary conditions for the shift in managerial strategies.

In this chapter, I showed that during the 1990s the forest products industry consistently underperformed in several important financial measures of corporate success, causing the industry to grow out of favor with Wall Street. Managers responded by pulling back investments and ending an over half-century of capacity expansion. Yet in the face of falling profits, managers were still able to maintain increased payments to shareholders in the form of stock buybacks and rising dividend payments. These payments were presumably funded in part by debt, which rose substantially during recent decades.

This period was also marked by one of the industry's most substantial merger waves. This merger wave completely reshaped the industry and led to the disappearance or merger of many of the industry's long-standing firms and an increase in overall concentration. Following these mergers, managers often engaged in a series of restructuring programs aimed explicitly at increasing shareholder value. These restructuring programs included divesting non-core assets and a further increase in concentration as firms consolidated their position within particular subsectors of the market. The period also witnessed a massive layoff of employees in the industry as part of ongoing managerial efforts to reduce costs.

A critical component of the industry's restructuring during this period was management's decision to sell-off nearly 50 million acres of timberland that they had acquired over the course of the 20th century. These timberlands are now owned and controlled by financial institutions, known as TIMOs and REITS, which manage them directly and with a focused strategy of maximizing financial returns. Although this

transfer is stunning in and of itself, I argue that the transfer of timberland ownership is a concrete example of the financialization of the US political economy. The financialization process entailed a substantial realignment of the relationship between financial and productive sectors of the capitalist class. Within the firm, this transformation included a restructuring of the material relationship that exists between shareholders and managers, and the proliferation of shareholder value ideology among corporate managers. Outside the firm, this process included a dramatic increase in institutional investors controlling vast sums of capital and seeking out profitable investments. Together, these two internally-related processes produced one of the largest transformations of land ownership in U.S. history.

CHAPTER VII

THE GREAT FINANCIAL CRISIS AND BEYOND: CONCLUSIONS AND DISCUSSION

“Intensive study of a particular sector of the economy first led to the isolation of what appeared to be the main active forces in determining the organization of producers. It was then a natural step to attempt to observe the action of those forces in the economic process as a whole.”⁶³

In this dissertation, I began with the vast transformation of timberland ownership and asked what compelled managers to increase their timberland holdings over the course of the 20th century, only to sell them off in rapid succession in recent decades? In the course of investigating this puzzle I soon realized that the various factors cited in the literature – rising timberland values, pressure from shareholders to increase returns, the need to reduce debt in the forest products industry, tax advantages associated with financial ownership of timberland, etc. – were each related to broader transformations associated with the financialization of the US economy. I also recognized that there was an under-theorized relationship between the proliferation of the shareholder value conception of control in corporate governance and financialization. From these initial observations, I soon became convinced that the transfer of timberland ownership was best understood, and theorized, in terms of the logic of the system as a whole.

As the quote from Paul Sweezy suggests, it was a seemingly natural progression for me to make the move from my observation of changing timberland ownership to an examination of managerial changes in the modern corporations and then from that point to examine these dynamics within the economic process as a whole. What is remarkable

⁶³⁶³ Sweezy (1938: 150).

is that so few make the journey from the particular to the general in our analysis of contemporary society. The failure to do so often results in a one-sided analysis of contemporary society that ignores the historical specificity of capitalist social relations and the unique dynamics that spring therefrom.

In this concluding chapter I review and discuss the general conclusions of this study. The conclusions are organized according to the two primary vantage points that were employed in this analysis: financialization and the shareholder value conception of control. Before addressing these vantage points, however, I believe it is vital to pause and examine the effects of the Great Financial Crisis of 2008-2009 on the ongoing development of the US forest products industry.

Because the effects of the Great Financial Crisis are so significant – on both the US economy and the forest product sector – I chose to end the analysis in this dissertation in 2008. This decision is further supported by the critical role that economic crises play in my periodization of US capitalism. However, in this conclusion I want to provide an overview of what has happened to the industry in the years since the crisis and examine how the crisis continues to affect the forest products sector up to the final moments of revising this dissertation (and beyond). This updating is also critical because one cannot adequately address the effects of financialization on the US forest products industry without taking into account the consequences that ultimately stem from this form of capitalist development.

The Great Financial Crisis and the US Forest Products Industry

During the summer and fall of 2008 the bottom fell out on billions of dollars' worth of mortgage backed securities. These mortgage-backed securities, combined with historically-low interest rates, had helped fuel the largest housing bubble in United States history. When the housing bubble popped in 2006 it left the financial sector holding billions of dollars of overvalued assets. Panic began in the summer of 2008, when Bear Stearns announced that it required a bailout because of losses coming from the \$10 billion it held in "sub-prime mortgages." The panic continued to build over the course of the summer, culminating in the fall of Lehman Brothers in early September 2008 and the government bailout of the financial sector that followed. The Great Recession that followed the financial crisis officially ended in June of 2009, however today, in early 2012, the US economy continues to suffer from high unemployment and a general condition of stagnation.

As I have explained in earlier chapters, the US forest products industry is highly sensitive to the health of the broader US economy. It should come as no surprise then to learn that the Great Recession has had a severely negative impact on the industry. The downturn was particularly severe for the wood products sector. A recent study of the wood products industry claims that the collapse of the housing market and the recession that followed produced "the worst housing and wood products market since the Great Depression" (Woodall et al. forthcoming). Figure 7.1 shows the total annual housing starts in the United States from 1990-2011. Here we see that total housing starts plummeted from a high of 2,068,000 in 2005 to a low of 554,000 in 2009, their lowest in

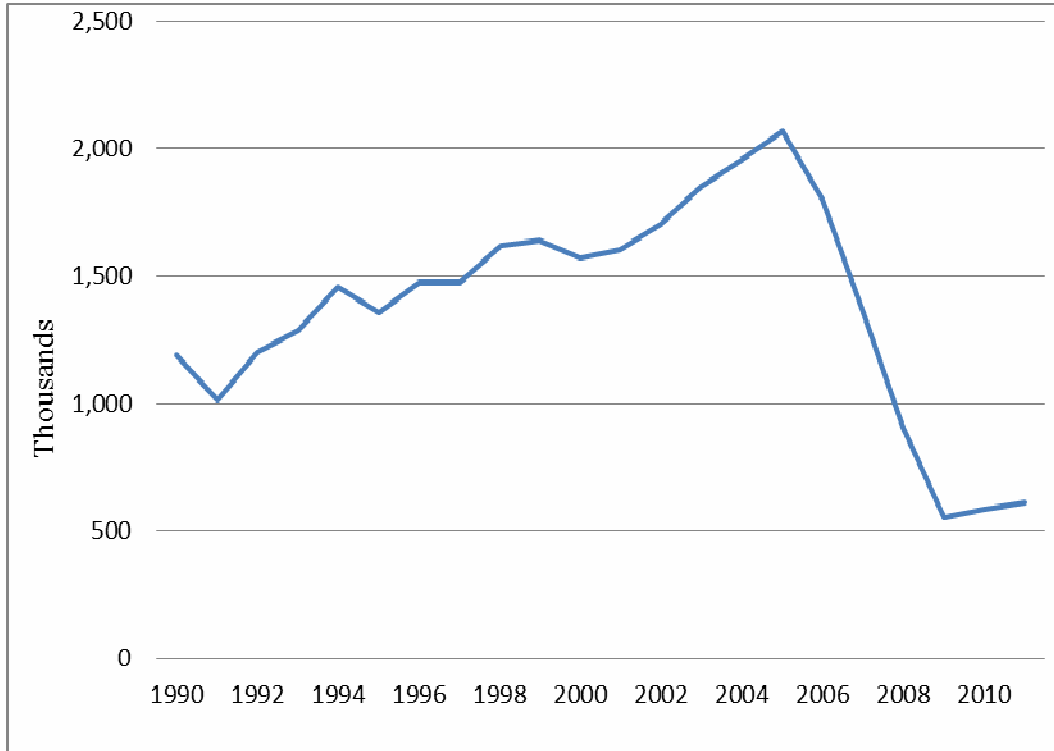


Figure 7.1 Annual Housing Starts in the United States
Source: US Census Bureau 2012

over 50 years. Although industry analysts continue to see signs of recovery right around the corner, housing starts remain sluggish and full recovery is nowhere in sight.⁶⁴ This is difficult news for an industry that relies on residential construction for nearly half of its total lumber output (S&P 2009).

The report by Woodall (forthcoming) and his coauthors goes on to show that in the wake of the financial crisis, production output in the softwood lumber market has dropped to levels not seen since the late 1940s. They also highlight the significant

⁶⁴ In a report filed in response to the release of the February housing starts data, financial analysts concluded that a recovery in the housing sector will be “long and slow” (see Russolillo 2012).

impact that the downturn has had on labor, finding that between 2005 and 2009, over 1.1 million jobs were lost in the six sectors that are most directly related to the US forest products industry. This includes 218,677 and 89,507 jobs for the wood products and paper products respectively. In a stunning contrast, Woodall and his authors point out that in the US auto manufacturing sector – which received significant media attention and a government bailout to the tune of \$80 billion – total employment declined by 24 percent, or 444,000 workers, over the same period. The fact that these forest industry jobs are spread across almost every region of the United States makes these figures even more startling (Woodall et al. forthcoming).

Although the paper products sector fared better than wood products, they also continue to be plagued by the ongoing stagnation in the US economy. Since 1999, overall paper consumption in the United States has continued to decline (Skog 2012). The industry has responded by continuing to reduce overall capacity. For example, In October 2009, International paper announced that it would be permanently shutting down eight paper machines in four different locations, totaling 13 percent of the company's North American paper capacity (S&P 2010). Other leading firms, such as Sunoco and MeadWestvaco also announced capacity reductions during this period (Goldstein 2009). These capacity reductions have benefited the paper sector and enabled them to increase prices, despite decreases in demand (S&P 2010).

Nevertheless, several firms in the industry ultimately declared bankruptcy in the years following the financial crisis. Smurfit-Stone filed for Chapter 11 bankruptcy in early 2009 in what *Pulp and Paper Week* declared as the “largest bankruptcy filing in the

history of the North American paper and forest products industry” (cited in S&P 2010). The company cited weak demand and tighter lending standards as the principle factors in their decision to file. Their condition was exacerbated by high debt, which rose to \$5.6 billion by late 2008. Smurfit-stone emerged from bankruptcy protection in July, 2010 after agreeing to a restructuring plan that included a guarantee that all existing lenders would be paid in full and the issuance of \$1.2 billion in new debt (Whiteman 2011).

The newly formed AbitibiBowater also filed for Chapter 11 bankruptcy in 2009 less than two years after its inception, following the merger of Bowater and Abitibi-Consolidated. This merger created the world’s largest newsprint producer with a nearly fifty percent market share in the newspaper sector. However, as an industry insider described it to me, this was equivalent to “attempting to rescue two drowning ships by tying them together.” In the face of declining newsprint demand and an extremely high debt burden of \$8.8 billion, the company declared bankruptcy in April of 2009. Abitibowater emerged from bankruptcy in December of 2010 after a restructuring program that included a reduction of their debt to nearly \$1 billion, largely by allowing creditors to exchange their claims for equity in the firm. This restructuring program also included the closure of a number of mills – reducing the firm’s total number of mills from 18 to 34 – and the “slashing” of jobs in the firm (Austen 2010).

In the face of protracted economic stagnation, the industry continues to consolidate through ongoing mergers and acquisitions. In March of 2008, Weyerhaeuser sold its containerboard, packaging, and recycling business to International Paper for \$6 billion in cash in a transaction that affected 14,300 employees. The Weyerhaeuser

acquisitions more than doubled International Paper's North American containerboard capacity and made it the world's largest producer of containerboard with a market share of approximately 30 percent.⁶⁵ By early 2009, Seattle Times was reporting that that "Weyerhaeuser is in a financial crisis so deep that the largest U.S. lumber producers turn down the heat in its offices to save money" (Robinson and Donville 2009). Despite restructuring efforts, in late 2009 Moody's rated Weyerhaeuser's proposed new notes at Ba1, a rating on par with junk bonds.⁶⁶

In the summer of 2011, International Paper continued to fortify its dominance over the industry when they offered to purchase their rival, Temple-Inland. The managers at Temple-Inland resisted the offer and took a number of steps to prevent a takeover, including adopting a poison-pill. John Faraci, the chief executive at International Paper responded by taking the bid hostile and appealing directly it to Temple-Inland's shareholders. After a several rounds of negotiations, International Paper eventually clinched the deal by raising its offer 5% to a total of \$3.7 billion and assuming \$600 in Temple-Inland debt (DeLaMerced and Cane 2011; S&P 2012).

A second major acquisition took place in 2011 when Rock-Tenn Co. completed its purchase of Smurfit-Stone, which had been free from bankruptcy protection for less than a year. In this case, a group of shareholders were vocal in expressing dismay over the initial offer, believing that it undervalued the assets of the firm. These shareholders lamented the fact that Smurfit-Stone CEO, Patrick Moore, would receive a bonus totaling

⁶⁵ Smurfit-Stone, the second largest producer of containerboard, held a 19 percent market share, giving these two firms control over nearly half of the global containerboard market (S&P 2010).

⁶⁶ Information on Moody's rating of Weyerhaeuser was originally found at Weyerhaeuser's Wikipedia page (Wikipedia 2012). For Moody's announcement see Moody's (2009).

\$19 million if the deal took place. In a letter they said it is “not hard to imagine the incentives that pushed Mr. Moore, and possibly the board, towards accepting this transaction with an eager buyer” (Whiteman 2011). Despite resistance from some shareholders, managers agreed to sell the firm for \$3.5 billion. Within days of completing this acquisition, managers at Rock-Tenn announced the closure of three Smurfit-Stone mills and promised there would be more to come (Johnson 2011). The purchase of Smurfit-Stone gave Rock-Tenn an estimated 20 percent share in the North American linerboard market. This put them in second in the linerboard market behind International Paper, which dominated the market with a 40 percent share following their takeover of Temple-Inland (S&P 2012).

As a result of this ongoing trend towards consolidation, the US forest products industry now has an unprecedented level of concentration.⁶⁷ In the most recent survey of the industry by Standard & Poor’s (S&P 2012) they summarized the current levels of concentration, citing a report from *Pulp & Paper Week*:

[t]he top four containerboard producers in 2007 accounted for 57% of total capacity. With the acquisition of Temple-Inland by IP, the top four producers would now have 73% of total capacity. As of year-end 2010, the most concentrated sector was coated recycled board, where the top four producers had an 87% share, while they had 72% and 69% shares, respectively, in the uncoated free sheet sector and the tissue market. However, according to *Pulp & Paper Week*, the containerboard industry, with a capacity of about 38 million tons per year, is much larger than these other categories, with uncoated free sheet the next largest at about 12 million tons per year.

⁶⁷ At the time of writing, in March, 2012, AbitibiBowater (now operating as Resolute Forest Products following a name change) has begun a hostile-takeover bid of Fibrek Inc., a firm that specializes in pulp. The board of directors at Fibrek unanimously rejected the unsolicited offer and has adopted a poison pill order to fend off a possible takeover (S&P 2012).

As the industry continues its trend towards increased consolidation and oligopoly, there has also been an ongoing transformation in the two organizational components of the firm that I highlighted in this study. The first is an ongoing increase in the level of stock ownership concentration in the US forest products industry. By 2010 the level of concentrated stock ownership in the US forest products industry was reaching new heights. Control over large shares of the industry came under the control of a single institution: Blackrock Inc. Founded in 1988, Blackrock grew quickly through a series of acquisitions to become the world's largest and most powerful institutional investor, controlling over \$3.5 trillion in assets in 2010. Included in Blackrock's vast portfolio is a sizable ownership share in seven of the top ten of the US forest product firms: International Paper (8.6), Mead Westvaco (15.4), Weyerhaeuser (5.9), Domtar (7), Temple-Inland (10), Packaging Corp of America (7.7), and Plum Creek (6.3).⁶⁸ The ability of a single institution to gain such overwhelming control over an industry is a striking example of how the ownership structure of corporate America has changed in recent decades. It also suggests that this trend has not decreased in the years following the financial crisis of 2008-09.

There is also evidence that compensation packages for managers in the US forest products are continuing to rise. In 2010, International Paper's CEO, John Faraci, was featured in The Institute for Policy Studies *Executive Excess* report, which examines the intersection between extravagant CEO pay and corporate tax dodging (IPS 2011). In 2010, Faraci received a 75 percent pay increase, bringing his total compensation to \$12.3

⁶⁸ Ownership data compiled from 2010 corporate proxy statements filed by firms with the SEC.

million for the year. In that same year International Paper received a \$249 million dollar refund from the federal government, due in large part to their exploitation of a loophole that allows them to earn tax refunds for their use of a timber byproduct known as “black liquor” for fuel.⁶⁹

In reality the financial crisis and the Great Stagnation that followed only added insult to injury in an industry that was already floundering on the eve of the financial crisis. Ironically, it was the housing bubble itself that supported the forest products industry in the years leading up to the crisis (at least for firms that maintained strong positions in the wood products sector). But when the bubble popped – as bubbles always do – it sent the industry into a spiral that continues to wreak havoc on the industry.

Conclusions and Discussion

The analysis of the US forest products industry in this dissertation speaks to several of the fundamental questions that continue to be debated in the literatures on financialization and the shareholder value conception of control. This analysis also contains important insights for the US forest products industry and its ongoing development. Many of these questions were highlighted in Part I of the dissertation and

⁶⁹ As part of a 2005 highway bill, the US congress created a tax credit to incentivize the use of alternative fuels. Following a revision of this tax credit in 2007, the forest products industry was able to include their use of “black liquor” for tax credits. Black liquor is a byproduct of the kraft process used to produce pulp that contains a substantial amount of the energy contained in wood. The industry has long used black liquor as fuel to generate steam and produce electricity for their mills. However, following the modification of the highway bill in 2007, the industry began to use this loophole to receive billions of dollars in federal tax returns (S&P 2009). This practice has led some to criticize the industry because of the fact that the use of this alternative fuel tax credit has actually led to an increase in of carbon-emitting fossil fuels consumption in the industry (Dead Tree Edition 2009).

were mentioned in passing during my analysis of the industry in Part II. Here I discuss the relationship between financialization and the US forest products in greater detail.

The Financialization of the US Forest Products Industry

Because financialization is a condition that stems from the dynamics of the economy as a whole, it does not necessarily follow that those same affects will take place in a particular sector. A word of caution is therefore necessary in interpreting conclusions found in this study as saying anything about the conditions of financialization in general. As Ollman (2003: 87) notes, “[h]ow a particular branch of industry...appears and functions involves a set of conditions that fall substantially short of applying to the entire capitalist epoch.”⁷⁰ The financialization process did not emerge from within the US forest products sector, but was a product of the general development of US capitalism. Nevertheless, we can observe the degree to which various claims made about financialization in general were present in the US forest products and make some preliminary conclusions from them.

Within the financialization literature we are confronted by two primary questions: the first relates the question of whether financialization is the cause or consequence of economic stagnation in the US economy. This debate revolves around those who view financialization as an outgrowth of the tendency towards stagnation that serves to compensate for a dearth of profitable investment opportunities in production (Foster and

⁷⁰ This quote comes from Ollman’s analysis of Marx’s abstractions of generality (see Ollman 2003: 86-99). The notion that we should not confuse general characteristics with particulars is similar to the ecological fallacy of inferring details about individuals from the study of a group to which they belong.

Magdoff 2009) and those who believe that financial investments “crowd out” investments that otherwise would have been put to more productive uses (Orhangazi 2008; Stockhammer 2004).

In the US forest products industry the evidence shows that investments did in fact decline during the period of financialization. Did this curtailment of investment occur because managers could invest more profitably in the financial sector than they could in their own industry? I was unable to include an analysis of financial profits in the forest products industry for this study, so I am unable to show definitively that capital – that otherwise would have been invested into production – has been diverted to finance. However, in light of the industry’s protracted struggle with overcapacity, it makes little sense to argue that capital was diverted towards finance that otherwise would have been invested into production. The surge of investment into expanded capacity in the closing years of the 1980s served as a final wake-up call to the industry. During the 1990s, managers largely refrained from making investments into expanded capacity and instead focused on increasing efficiencies and returns to shareholders. There is no convincing reason to believe that the money distributed to shareholders would have otherwise been invested into expanded production capacity when the industry was already suffering from excess capacity and declining utilization rates. To the contrary, the evidence shows that pressure from the financial community and the spread of shareholder value ideology convinced managers to finally overcome their propensity to over-invest. In this sense, the experience of the US forest products industry provides supports – at the sectoral level – to the argument of Foster and Magdoff (2009) that financialization served to boost

economic activity in a mature sector that was already plagued by chronic overcapacity and glutted markets.⁷¹

This brings us to a second and closely related question of the real source of the increase in shareholder returns. During the financialization period, a rise in total returns to shareholders occurred at the same time as there was a decrease in overall profits. Some of these profits continued to be invested into production in order to increase efficiencies and otherwise contribute to further profits. However, the rapid rise in debt suggests that shareholder returns were also financed to a significant degree by taking on ever greater levels of debt. Therefore, in keeping with financialization as a whole, there was a tendency in the US forest products sector to use debt as a lever to boost economic activity.

These two conclusions – financialization did not channel investments away from production and rising debt enabled managers to increase returns to shareholders – might lead one to the further conclusion that financialization was, in fact, functional for the US forest product industry. In other words, it could be argued that financialization enabled managers to avoid overcapacity and increase capital flows to the firm's shareholders. This argument that financialization was functional for maintaining profits in a stagnating sector is further supported when we consider the broader effects of the housing bubble. Low interest rates and the growing demand for investments into subprime mortgages helped fuel one of the largest residential construction booms in modern history. This

⁷¹ Foster and Magdoff's analysis is based on the US economy as a whole. See Foster and Magdoff (2009: 128-134) for their analysis of declining capacity utilization in the US over the course of the financialization period.

surge greatly benefited the wood products sector and enabled to maintain healthy earnings during this period. In this sense, financialization did in fact provide a direct boost, albeit a temporary one, to the forest product industry with the increased demand for wood products needed for housing construction.

A final and particularly important question related to financialization that stems from this dissertation is the question of whether the transfer of timberland ownership has produced a bubble in timberland prices. Because debt-fueled financial bubbles are a pronounced feature of a financialized economy (Foster and Magdoff 2009), the rapid increase in timberland prices in recent decades has led some observers to suggest that there is a bubble in US timberland. For instance, in August of 2009, Andrew Bary (2009), a financial analyst writing for *Barron's*, suggested that “US timberland may be one of the world’s most overvalued asset classes.” Bary supports his claim by pointing out the glaring discrepancy between the rapid increase in timberland prices in recent decades and the accompanying drop in the stumpage price for logs and other forest products. Bary claims that in the event of this bubble bursting, timberland owners may see the value of their timberland decline by as much as 50 percent!

Other analysts have also warned that timberland might be experiencing its own “irrational exuberance” (Washburn 2001, cited in Rinehart 2010). Jim Rinehart (2010), a leading expert in timberland investment, took up this topic in a recent publication, “US Timberland post-recession: Is it the same asset?” Rinehart shows that the removal of federal timberlands as a source of supply following the listing of the Spotted Owl on the Endangered Species list led to a rapid increase in timberland prices, allowing early

investors to reap giant windfalls in the range of 26 percent cumulative return between 1986 and 1992. These gains bolstered the attractiveness of timberland as an investment within the financial community and led to increased interest in timberland investments throughout the 1990s, despite falling revenues in the forest products industry. This trend increased after the bursting of the dot-com bubble in early 2000, which sent institutional investors desperately in search of alternative investment outlets (Rinehart 2010). In sum, over the course of the 2000s, timberland prices took on the form of a classic real estate bubble: low interest rates produced a surplus of capital that increased demand for investment and sent prices sky-rocketing. At the same time stumpage prices continued to decline in a mature industry that was suffering from poor market conditions.

In the wake of the financial crisis, therefore, Rinehart predicted a decline in timberland portfolio values in the range of 20 percent. Other timberland analysts generally agree and predict a decline of 10 to 20 percent, with one TIMO executive predicting closer to 30 percent. But at the time of writing, Rinehart says that the drop was smaller than predicted, somewhere in the 5 percent range. Rinehart (2010) concludes his analysis of post-recession timberlands with the prediction that in the face of ongoing economic hardship in the US forest products industry we can expect a further decline of 10 to 15 percent.⁷² This decline, according to Rinehart (2010) will bring an end to the abnormally high returns that characterized early investments and bring returns

⁷² Rinehart argues that much of the decline has failed to reveal itself because timberland valuations are based on appraisals that tend to be “sticky” on the high side (see Rinehart 2010: 3). Due to the slowdown of timberland transactions in the wake of the financial crisis it is difficult to know the true value of these timberlands and how the market will react when these timberland investments reach maturity in coming years.

back to more modest level of 6 to 10 percent – nowhere near the 50 percent drop in prices predicted by Bary (2009).

The decline in timberland returns raises a number of questions about the future of US timberlands as an investment class. As Rinehart (2010: 44) notes, “much of the immediate development value of timberland has already been monetized,” meaning that valuable parcels were spun-off by investors seeking the “highest and best use” of their land. This leaves the forest products industry and alternative timberland uses – such as biofuels, carbon credits and income derived from ecosystem services – as the primary sources of demand for timberland in the future. Today it is difficult to tell which of these potential markets might enable timberland investments to continue to deliver returns because each of these developments is speculative and contingent on a number of external developments. But in the end, if an emerging markets fails to develop, this could potentially leave certain timberland investors holding a “hot potato” of overvalued timberland.

In sum, this dissertation provides support to several claims that are made in the literature on financialization. First, there is no convincing evidence to show that financialization led to a decline in overall investment in the US forest products industry. Although investment did decline in this sector, it was more likely due to the fact that the industry was suffering from excess capacity and declining demand. Secondly, the financial returns that did take place in the US forest products sector were made possible by a rapid increase in debt. This supports the conclusion that debt was a powerful tool for boosting economic activity in a sector that was suffering from declining returns. And

finally, it appears that the transfer of timberland ownership resulted in a bubble in timberland prices as a result of the rapid growth in investment demand coming from institutional investors looking to expand their investment portfolios.

Shareholder Value and the US Forest Products Industry

In this dissertation I integrated the shareholder value conception of managerial control within the broader structural transformations of financialization in order to highlight the interrelation between these two processes. I also argued that the cultural one-sidedness of much of the economic sociology literature tended to ignore how material dynamics of capital accumulation create both the need for a new conception of control and help shape its emergent form. In this conclusion I want to first discuss the effects of the shareholder value conception of control on the US forest products industry. I will then explain why my integration of the shareholder value literature within the context of financialization reveals a number of insights that are obscured by a one-sided focus on culture.

In chapter 6 I demonstrated how the shareholder value ideology spread across the US forest products industry over the course of the 1990s and became firmly established as the dominant conception of managerial control by the early 2000s. I also showed how this cultural transformation was undergirded by organizational shifts in the relationship between managers and shareholders – including increased concentration of share ownership among institutional investors and increases in incentive-based compensation for managers – that shifted the power relation in US forest products industry decisively in

favor of shareholder interests. As a result, managers became increasingly preoccupied with maintaining shareholder returns and turned to a number of shareholder-favored tactics in order to increase those returns. These tactics included a historic merger wave that substantially altered the landscape of the industry and brought concentration levels to historic highs. Following these mergers, managers often instituted vast restructuring plans with the explicit intention of increasing shareholder returns.

In many ways, these restructuring programs were devastating for the US forest products industry. They included divesting “non-core” assets, particularly timberlands, and a reshuffling of industry assets that further increased oligopoly in various market subsectors. The result has been a massive downsizing in the labor force, as one in three employees in the industry was laid off between 1990 and 2009. The spread of shareholder value also increased the risk and vulnerability of US forest product firms by reducing the diversity of income sources in this inherently cyclical industry and increasing the indebtedness of firms. This vulnerability came to a head in the 2008 when the financial crisis exerted an enormous shock upon the forest products industry, causing widespread losses for most and bankruptcy for some.⁷³ Based on these considerations, we can conclude that the shareholder value conception of control is, on the whole, harmful to the US forest products industry.

⁷³ It is interesting to recall the rationale that was offered in the 2005 purchase and privatization of Georgia-Pacific by Koch Industries. A source close to the deal commented that “Koch believes such commodity-dependent, cyclical businesses such as Georgia-Pacific are better suited as private companies than in the public markets because they face less pressure to hit quarterly targets” (Whiteman 2005). This statement suggests that the forest products industry – as well as other natural resource-based industries – are inherently risky and therefore ought not to be operated with an eye towards short-term returns to stockholders.

A full consideration of the effects of shareholder value, however, should also include a measure of the success of the movement on its own terms. As Fligstein and Shin (2007: 421) note, from the perspective of agency theory, shareholder value tactics were a success in that they “pushed managers in poorly performing industries to rationalize their production, lay off redundant workers, make technology investments, and thereby take advantage of whatever opportunities their industry had.” As we saw, each of these goals was accomplished by managers in the US forest products industry.

However, as Fligstein and Shin (2007) show us, the shareholder value conception of control did *not* succeed in returning failing industries to profit. This failure was also the case in the US forest products industry, where earnings continued to stagnate over the course of this period. Fligstein and Shin (2007: 420) wonder “why firms pursue mergers and layoffs if they not subsequently help profits?” Their unsatisfying conclusion is that these practices might just be “ritualistic and imitative and do not produce efficient outcomes.”

The cultural perspective thereby turns a blind eye on the material realities of financialization. Recall that in this dissertation I conceptualized financialization as a shift in the relationship between the financial and productive sectors of the capitalist class that was defined by the gravitational shift towards financial profits in the economy. From this perspective the shareholder value conception of control is not simply a means to increase corporate profits, but is most directly concerned with the enrichment of a particular sector of the capitalist class. To this end, managers engaged in a series of activities aimed at increasing returns to shareholders. Furthermore, these returns were not necessarily drawn

from profits, but were most likely the result of share price inflation driven by financial maneuvers and rising debt. In short, financialization and shareholder value are not about *making* things, but *taking* them.

I would further argue that a one-sided cultural perspective on shareholder value tends to obscure another reality that underlies the shareholder value conception of control. An emphasis on “shareholders” lends itself to democratic connotations, especially in the US where over half of the population now owns stocks.⁷⁴ But when we realize that the majority of these shareholdings are controlled by institutional investors and large financial institutions we begin to reveal the real interests that lie behind the shareholder value conception of control. Even renowned Marxist, David Harvey, has fallen victim to this misrepresentation: in commenting on the power of CEOs, Harvey (2005: 33) claims that “[t]he power of the actual owners of capital, the stockholders, has...been somewhat diminished.” He goes on to point out that “[s]hareholders have on occasion been bilked of millions by the operation of the CEOs and their financial advisors.” There is no doubt that some shareholders end up on the losing end of these processes. However, the shareholder value conception of control is not an ideology of the average investor, but is the byproduct of a financial sector that has become obsessed with short-term financial gains. In the US forest products industry, managers pursued shareholder value by selling off assets and loading their firms down with debt. As a result, firms have become far less stable than they once were and some became unable to

⁷⁴ Fifty-four percent of the US population had stock market investments in 2011 (Jacobe 2011). The vast majority of these stocks are controlled by institutional investors in the form of mutual funds and other retirement funds.

survive when hit by the financial crisis. In this sense, some shareholders lost big as a result of manager's pursuit of shareholder value.

Another immediate benefit of this synthesis of financialization and shareholder value is that we can begin to draw some lessons about the underlying causes of the shareholder value revolution and perhaps some insight into their future development. The shareholder value conception of control emerged in response to the economic crisis of the early 1970s. Just as financialization was the solution to the barriers to accumulation in general, so was the shareholder value a solution to the problems confronting managers in large corporations. In this sense, I argue that there is a general correspondence between the dominant social relations of production in modern capitalism – conceived as a tripolar class relation between financial capitalists, managerial (productive) capitalists, and working class – and those that exist within corporate institutions.

The importance of situating the shareholder value conception of control within this framework is highlighted by considering some recent criticisms of this ideology. William Lazonick (forthcoming), a longtime critic of shareholder value ideology, argues that “shareholder value is destroying the US economy.” After presenting a devastating case on the effects of the shareholder value ideology on the US economy, Lazonick puts forth several mild policy prescriptions such as banning stock buybacks, and indexing employee stock options to other measures of success besides stock-price movements. In my opinion, such suggestions serve primarily to legitimate the one-sidedness of cultural perspectives by locating the problem confronting the US economy as primarily one of

distorted incentives among managers. What Lazonick and others overlook are the contradictions that first created the need for a new conception of control, and then helped shape its emergence. That is to say, this cultural emphasis downplays the class dynamics that underlie the shareholder value ideology. In doing so, they also obscure what would be necessary to alter it. Because shareholder value works to promote the interests of a powerful financial sector, any changes to alter it will be bitterly resisted. In the absence of a struggle of sorts by the working class or some other section of the popular classes there is no reason to believe that these policies could even be adopted, let alone the questions of whether they would address the fundamental problems. Perhaps certain shareholders might join this struggle in order to create a more just and stable approach to corporate governance. The exact manner that such a transformation would take cannot be determined in advance, however, the take home point here is that any lasting solution will entail a power struggle in society between those who do and do not benefit from the shareholder value conception of control.

In the end, however, even in lieu of a popular backlash to the dominance of shareholder value in publicly held corporations, we can be relatively certain that shareholder value will someday be replaced. Capitalism has shown itself to be a system of contradictions that develops through periods of stability and crisis. These crises emerge in response to particular barriers to accumulation that capitalism confronts over the course of its historical development. Overcoming these barriers requires a transformation of the material and ideological structures of society in order to establish stable conditions for continued capital accumulation. “The bourgeoisie,” Marx and

Engels (1978[1848]: 476) tell us, “cannot exist without constantly revolutionizing the instruments of production, and thereby the relations of production, and with them the whole relations of society.”

The financial crisis of 2008-09, could have been the signal crisis of the shareholder value conception of control. Marxian theory tells us that it is during crisis that capitalist social relations are most likely to be transformed, because it under these conditions that struggles over how the crisis is to be resolved are most acute. For now it may be too soon to tell what is to become of the shareholder value conception of control. In the forest products industry, and elsewhere, there are signs that some shareholders are growing weary of manager’s pursuit of short-term gains.⁷⁵ However, it seems to this author that in the wake of the financial crisis the financial sector has dug in its heels and is doing everything in its capacity to maintain its grip on the institutional levers of the US political economy. This can only mean that the *real* signal crisis of financialization and the shareholder value conception of control is yet to come.

Future Directions

The conclusions in this dissertation point in the direction of a number of potential avenues for future research. These questions fall under two broad categories. The first are theoretical questions that stem from my synthesis of financialization and the shareholder value conception of control. The second line of questions relate specifically

⁷⁵ A web group claiming to represent the interests of individual shareholders was recently formed under the web address www.shareholdersfightback.com

to the transfer of timberland ownership and the implications that stem from this change. In this final section I survey a number of unanswered questions from both of these categories in order to provide a glimpse at the potential research opportunities that lie ahead, for both myself and the research community more broadly.

Towards a Political Economy of Corporate Transformations

In this dissertation I constructed a framework for integrating political economic theories of capitalist transformations with economic sociology's emphasis on shifting conceptions of managerial control. The course I pursued provides one means of accomplishing this goal by conceptualizing the relationship between shareholders and managers as a particular manifestation of the broader social relations that predominate in any given historical period. There may be other ways of conceptualizing and organizing this subject matter that prove more fruitful. However, the task that this framework sought to accomplish remains an important subject of social scientific inquiry. If we are to understand the dynamics of historical change in the modern corporation then we need to be able to account for the both the material and ideological aspects of corporate transformations. In fact, according to Dahms (2000: 25, italics added), "the definitive criteria for determining whether there has been a qualitative change in capitalism is whether it has brought with it a qualitative transformation of the dominant form of economic organization, *and* the prevailing definition of organizational control." Future research should strive to incorporate these two interrelated aspects of socio-historical change.

I would also add that future research would benefit by theorizing corporate transformations within a framework that explicitly addresses the historical dynamics of capitalism. This is important for several reasons: first, the modern corporation itself is a product of the historical capitalism. That is to say, the corporation emerged in a particular historical period in response to particular contradictions that were emerging in a nascent industrial capitalism. To paraphrase Ollman (2003: 13), understanding the historical development of the corporation requires that we know something about how it arose and developed and how it fits into the larger system of which it is a part.

Secondly, corporate transformations are clearly linked to the periodic crises that confront historical capitalism and should therefore be specifically situated in those historically-specific conditions that create the impetus for shifting conceptions of managerial control. Capitalist crises emerge when the process of accumulation confronts a particular barrier to its ongoing quest for ceaseless accumulation. The particular manner in which this barrier is overcome will provide important clues for scholars of corporate transformations. By paying attention to these shifts in the process of capital accumulation – and the social relations they reflect – we gain valuable insights into emergent conceptions of control. We also benefit from an understanding of who benefits from these changes.

Future research should continue the process of developing and refining this political economic theory of corporate transformations. One way this can be accomplished is through intensive study of additional sectors of the economy. The differences and similarities that may exist between various sectors of the economy are

extremely important for understanding of a particular corporate transformation. How have the processes of financialization and shareholder value affected other areas of the economy? Are there important differences between mature industry like the forest products industry and emergent industries such as those related to information technology? Another distinction that may also be important is the difference between natural resource-based industries and non-resource-based industries. I began this study with the intention of developing a theory of socio-ecological transformations that were rooted in the development of historical capitalism. For various reasons, I was not able to fully develop this line of thought in this dissertation. In the future, this will provide an important line of research.

The Consequences of the Transformation of Timberland Ownership

A second area of future research concerns the consequences and fate of the millions of acres of timberland that changed ownership type as a result of the financialization process. A number of concerns have been raised by foresters, academics and policy analysts about the possible economic, social, and environmental implications of this transfer of timberland ownership (Bliss et al. 2009; Fernholz 2007; Little 2006; Gunnoe and Gellert 2011).

Many of these concerns are related to the relatively short investment horizon that accompanies these timberland investments, which typically range from 10 to 15 years. Central in this regard is the increased use of “highest and best use” management strategies that seek to maximize the financial return of the timberland asset (Bliss et al.

2009). Since TIMO managers are not primarily concerned with supplying local mills, they may seek out alternative land uses, such as real estate development, in order to maximize returns on their investment. This may increase forest fragmentation, a leading threat to forest biodiversity, and present numerous challenges for forest managers and local communities. Future research is needed to document the extent to which these developments are actually taking place.

Another major concern is the effect that these new timberland owners will have on small landowners and local communities. The industrial timberlands that this dissertation focused on represent just a fraction of the over 423 million acres of total private timberland in the United States. To be sure, these are among the most productive and valuable timberlands, however, there continue to be millions of small land owners, particularly in the South, that may be impacted by this changing land ownership structure. Assessing exactly how these small land owners are being affected and what can be done to promote the interests of small landowners is an urgent task. In addition, local communities often have strong cultural relationships to these industrial timberlands and there is increasing evidence that many of the new institutional land owners are restricting public access to these timberlands. As a result, communities have begun to fight back, engaging in various acts of protest and vandalism aimed at these new institutional landowners.

Finally, there is growing anxiety about the question of what will become of the forest products industry and the countless communities that depend on it if these timberlands are no longer valued for their ability to produce raw materials for mills. A

diminished forest product industry would spell disaster for communities that currently rely on the industry for employment. Despite massive layoffs in recent decades, the industry continues to provide employment for nearly 736,000 people across the United States, or roughly 6 percent of total employment in US manufacturing (BEA 2010). The industry's importance for employment, along with the fact that timber is a *potentially* renewable resource that, if managed properly, can continue to play an important role in the US economy, indicate that forest products should remain an important industry in the future. The question of whether the industry will remain, and in what form, is open, but it is important to ask questions about what kind of forest products industry would most directly benefit American society and what must be done to make this a sustainable industry that works for the American people, not the other way around.

Many in the forestry sector see the structural developments affecting the industry as inevitable outcomes of a seemingly naturalized historical development (see, for example, Ince et al. 2007). As a result they are primarily concerned with overcoming the barriers to capital accumulation by expanding the realm of value creation from timberland.⁷⁶ These alternatives include various land uses, ranging from payments for maintaining forests as a carbon offset, the development of biofuels, or payments for various types of ecosystem services (see Rinehart 2010). Some of these potential alternatives (such as Biofuels) may provide employment opportunities, but none seem to be capable of providing the level of employment that has historically been provided by

⁷⁶ See McMichael (2009) for a broader critique of how such attempts to overcoming barriers to accumulation by extending the realm of value creation serve to intensify the contradictions of capitalism. Also see Correia (2010) for a critique of this practice as it relates to forest certification practices in the US forest products industry.

the forest products sector.⁷⁷ Instead of proposing defense measures that merely react to the changing conditions of US capitalism, industry analysts might take a minute to question the very dynamics that are destroying the industry they promote. These are not inevitable processes that are inscribed by some law of nature, but are specifically linked to the contradictory development of capitalism itself. Addressing the more deleterious aspects of these historical transformations requires that we take the time to ask questions about exactly why these structural transformations are taking place, and, even more importantly, *whose* interests they serve.

In the opening pages of this dissertation I commented on an article published in *The Forest Products Journal* blaming poor managerial decision-making for causing many of the ailments that have beset the forest products industry (Michael and Ray 2008). In this light, it is worth asking whether the decision by manager to sell-off millions of acres of valuable timberland constitutes another poor decision. The analysis presented here requires that we ask a poor decision for whom? The evidence provided in this dissertation indicates that this transfer of timberland was harmful to the industry because it removed yet another support beam that was a source of profit and stability in an industry that is inherently cyclical. Future research may also show that this decision was bad for the employees and communities that rely on the land for a source of their economic and spiritual livelihood. This research might also show that the transfer of timberland has negative environmental outcomes as well if timberland is parcelized and developed. However, in the end, the managerial decision to sell-off industrial

⁷⁷ See Bailey, Dyer, and Teeter (2011) for an analysis of the potential economic benefits that a biofuels industry may hold for the logging sector and rural regions in Alabama.

timberlands does seem to have been a good decision for both the managers that sold them and the financial institutions that were able to secure and monetize the value of this timberland through a debt-financed acquisition process that sent timberland prices skyrocketing.

The future of these timberlands and the US forest products more generally remains uncertain. The short-term prospects of a protracted stagnation and high unemployment do not bode well for an industry that is highly dependent on the health of the broader US economy. In the short-term, industry analysts and promoters will continue to seek out alternative means of extracting value from these lands in order to maintain the imperatives of capitalist markets. In the long-term, however, it would behoove all those that care about the industry, its workers, and the land to pause and consider some more fundamental questions about the logic and desirability of a social system that is driven, on the pain of extinction, to pursue ceaseless accumulation as an end in itself.

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VITA

Andrew Gunnoe was born in Dayton, OH on September 8, 1979. He graduated from Centerville High School in 1998 and subsequently moved to Knoxville, TN to attend college at the University of Tennessee. He graduated from the University of Tennessee in 2002 with a Bachelor of Arts degree in Political Science. After taking a year off he decided to return to the University of Tennessee to pursue a Master's degree. In 2005 he completed his Master's degree in Political Science with a minor Environmental Policy. During the final semester of his Master's studies he was fortunate to have his first encounter with the discipline of sociology, which reignited his intellectual curiosity and convinced him to pursue a doctorate degree. As a doctorate student in sociology, he gravitated towards the field of political economy.

In early 2012 he accepted a post-doctorate position at Auburn University. He defended this dissertation in April of the same year and graduated from the University of Tennessee with a Doctorate of Philosophy a month later. Although his career is taking him elsewhere (for now), his heart and soul will always be with the people and places of the Southern Appalachian Mountains.