Case Study: Monopoly Finance

Warren Buffett, America's wealthiest financial investor and the world's fifth richest person, is quite clear about the secret of his riches: he invests in businesses with little competition. He is a monopolist.

"The most important thing [is] trying to find a business with a wide and long-lasting moat around it," he said, "protecting a terrific economic castle with an honest lord in charge of the castle."[1]

Monopoly power, or 'lordism' – though there's nothing honest about it – has spread widely across the world economy. After decades of corporate mergers and acquisitions, barely opposed by our regulators, we now find ourselves in a world of Big Tech, Big AI, Big Pharma, giant energy firms, dominant ride-sharing or hotel-booking platforms, global commodity traders, giant supermarket chains, the Big Three music labels, or the Big Four grain traders. And of course, Big Finance.

But in the monopoly story, finance plays a special role, in three ways:

- First, is it heavily monopolised in its own right – with 'too big to fail' banks leading the charge.
- Second, less well known, is the financial sector's role in pushing the non-financial economy towards monopolisation.
- Third, finance and "financialisation" are corrupting competitive processes in ways that tip markets and our economies towards ever bigger and more dominant firms.

All these trends are worsened by the fact that the financial sector as a whole has grown dramatically as a share of economic activity. Credit to the private sector has nearly tripled as a share of global GDP since 1960, to nearly 150 percent. The value of global debt is now worth over $300 trillion, equivalent to three times global GDP, while the notional value of financial derivatives is worth twice that.

The sheer size of finance has, of course, translated into political power and political 'capture', another hallmark of monopoly.

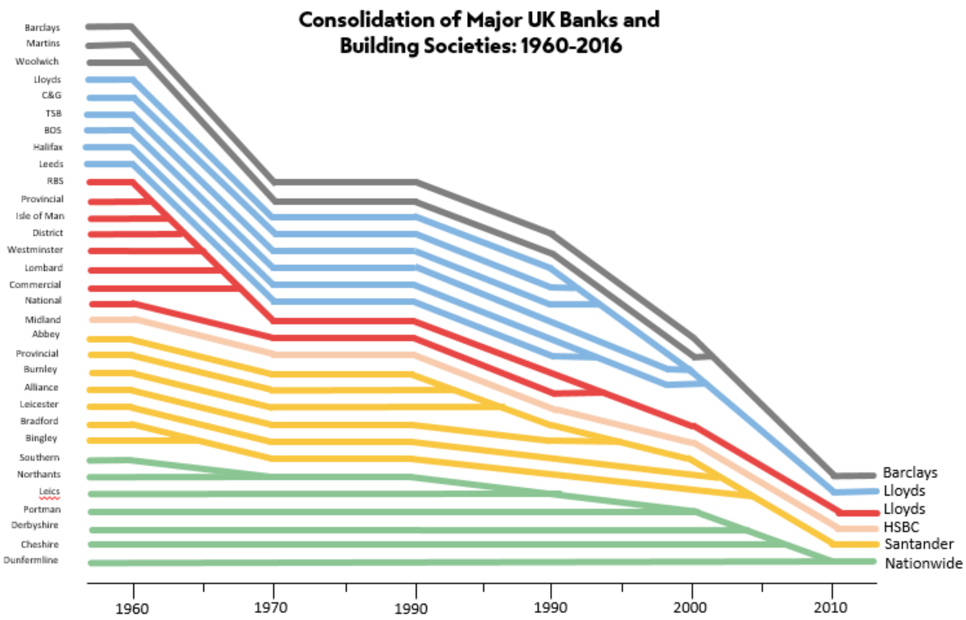
1. Monopolised Finance

When the last global financial crisis erupted 15 years ago, people were reminded of a problem nearly as old as finance: some banks turned out to be "too big to fail." (There is an official list of these giants: 29 currently considered globally systemically important.)

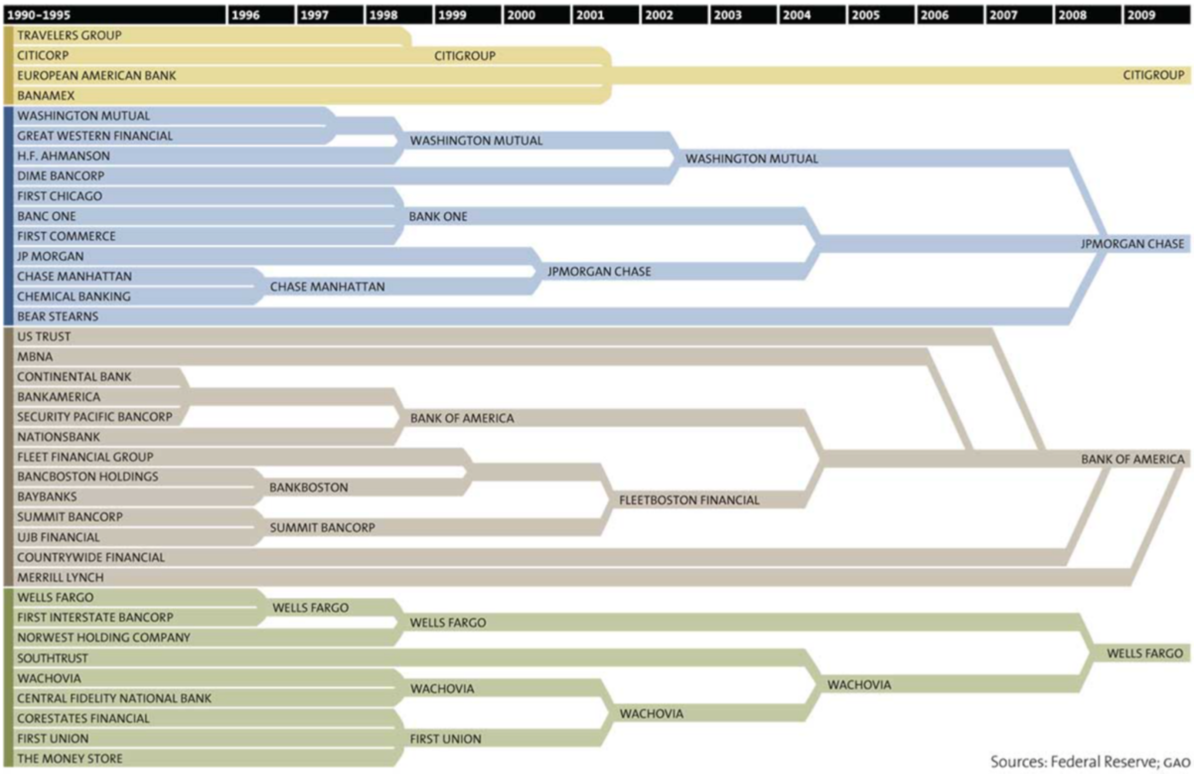
Ahead of the crisis, giant banks had made large speculative bets on mortgages, derivatives and other financial instruments – knowing that if those bets turned sour, governments would be forced to bail them out, to avoid wider economic collapse. That word 'forced' is key – it is an important component of the political and economic power of the financial sector.

The more powerful and systemically connected the financial institution, the greater, and more dangerous, the "moral hazard" – the ability of finance to enjoy the winnings from their speculative activities, while shifting the losses onto the shoulders of taxpayers and others.

Finance has grown as a share of economic activity, under tremendous financial deregulation since the 1970s. But a lesser-known counterpart of this is the dramatic growth in size and power of individual financial institutions, under a set of ideological changes that ushered in enormous bank consolidation, in the name of 'efficiency'[2].



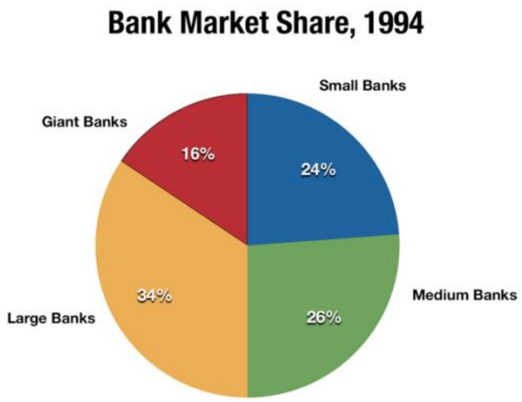
Source: Cascade, 2016 and The Myth of Capitalism, Denise Hearn and Jonathan Tepper, Wiley, 2018.

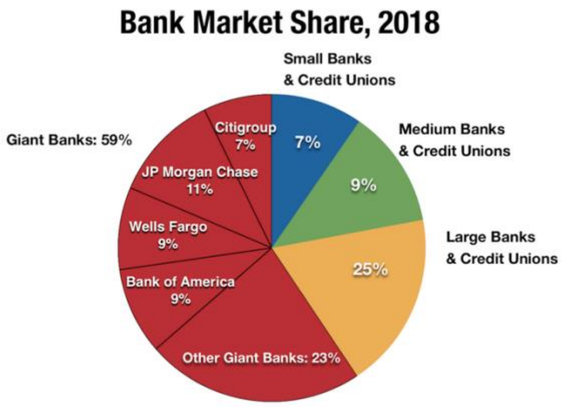


Source: [*https://www.visualcapitalist.com/the-banking-oligopoly-in-one-chart/#google_vignette*](https://www.visualcapitalist.com/the-banking-oligopoly-in-one-chart/#google_vignette)

In the United States, this consolidation was spurred especially under the Clinton administration. One key change was legislation that effectively repealed the Glass-Steagall Act of 1933, which had separated speculative investment banking activity from deposit-taking activity. The repeal let banks bring these activities back together, so banks could now take their customers' deposits to the Wall Street casino.

Another piece of legislation allowed national or global banks to buy up local ones: the number of licensed U.S. banks [fell]() from around 14,000 in 1990 to just over 4,000 today. As the Institute for Local Self Reliance (ILSR) has shown, this consolidation has changed the character of the banking sector, towards larger institutions more interested in financial returns than in local banks, which tend to understand and support local businesses.





Source: *Bank Market Share by Size of Institution, 1994 – 2018, ILSR, 2019*

The result has been to convert finance's role feeding local circulatory systems for wealth into one of extracting wealth and shipping it out to rich money centres, overseas and offshore. As this has happened, inequality, polarisation, and anger has grown.

Many other finance institutions beyond banks enjoy excessive and harmful market power. For example, the two largest ESG index providers have a 68 percent market share between them, and conflicts of interest foster "greenwashing" instead of channelling investment to climate-friendly activities.[3] The Big Four accounting firms, which audit companies but also sell them consulting and advisory services, have similar conflicts: they have incentives to go easy on audits, to win consulting business.

The most definitive and durable solution here is to break these giant firms up along the lines of these conflicts of interest[4].

2. How finance monopolised everything else

There's an old saying that a banker is someone who will lend you an umbrella when it's sunny, but wants it back when it rains. Finance will lend freely and cheaply to those who are doing well but if your prospects are poor they will charge high interest rates, or not lend at all.

As a venture capital investor, Paul Arnold, put it:

"I will meet yet another founder who wants to disrupt Microsoft's LinkedIn. They will have a clever plan to build a better professional social network. I always pass on the investment. It is nearly impossible to overcome the monopoly LinkedIn enjoys. It is but one example of an innovation kill zone.[5]"

While monopolists get cheap and easy finance, smaller businesses trapped in their gravitational fields are barely able to eke out a profit, lost in so-called "finance valleys of death" or "kill zones" where they can't get off the ground.

Nobody encapsulates this tendency - to throw cheap capital at monopolists, while starving their competitors – better than the avuncular Warren Buffett, whose annual meetings (dubbed "Woodstock for Capitalists) attract tens of thousands of followers.

Special focus: Warren Buffett, arch-monopolist

In the aftermath of the last global financial crisis, a government enquiry described the Big Three ratings agencies, Moody's, Fitch and Standard & Poors, which controlled 95 percent of the market, as "key enablers of the financial meltdown."[6] Plagued by conflicts of interest, the agencies had given Triple-A ratings to tens of thousands of financial instruments that eventually imploded. Those ratings encouraged investors around the globe to pile into these dangerous instruments, spreading the crisis worldwide.

The Commission asked Warren Buffett, the controller of the Berkshire Hathaway investment firm and the largest shareholder in Moody's, if he was happy with Moody's management controls ahead of the crisis. He admitted:

"I had no idea. I'd never been at Moody's, I don't know where they are located." He invested, he said, because ratings were "a natural duopoly," which gave it "incredible" pricing power—and "the single-most important decision in evaluating a business is pricing power."

"If you've got a good enough business, if you have a monopoly newspaper or if you have a network television station," Buffett said, "your idiot nephew could run it."

The castle analogy is apt, for it accurately describes how business ecosystems often operate today, with a dominant firm like a lord in a castle, and competitors, suppliers, and even customers in subservient, serf-like relationships.

"[W]e think in terms of that moat and the ability to keep its width and its impossibility of being crossed," Buffett told the annual Berkshire Hathaway meeting in 2000. "We tell our managers we want the moat widened every year."

He holds stock in endless giant corporations with impressive moats: Amazon, American Express, Apple, Activision Blizzard – and that is just those beginning with the letter 'A'[7].

In the words of David Dayen, a journalist who has explored Buffett's wealth in his book Monopolized, "America's favorite investor loves monopoly, not free markets."[8]

Predatory pricing and killer acquisitions

Sometimes monopolists use their superior access to cheap finance to offer excessively cheap or below-cost products and services, losing money in the short term to drive smaller rivals out of a market – after which they can raise prices again and recoup their losses.

For example, when Freddie Laker, a pioneer of low-cost airlines, set up the Skytrain service from London to New York in 1977, rival airlines colluded to offer cheap and below-cost flights: Laker could not match their deep financial resources and access to finance, and went bankrupt. He later won tens of millions in damages for predatory pricing.

Sometimes, the finance-monopoly driver is even more deliberate, as financiers actively assemble monopolies by joining them together, like Lego bricks.

Dealmakers and the M&A gravy train

Journalists often laud the "dealmakers" in the Mergers and Acquisitions (M&A) departments of large investment banks in heroic terms: as 'rainmakers' who 'unlock value' bringing together companies – especially large companies – to build even larger and more profitable ones, earning huge fees.

Here's a list of the top banks advising on M&A last year:

1) Overview | 2) Deal Breakdown | 3) Capital Flow | 4) League Table | 5) Deal List | 6) Buyer List | 7) Time Series

Filter by Adviser <Enter an adviser name> Adviser Type Financial Legal

Adviser	Rank (Total Deal Value)	Market Share (%)	Total Deal Value (M)	Average Deal Value (M)	Deal Count
101) Goldman Sachs	1	26.5317	875,640.08	3,009.07	291
102) JP Morgan	2	20.3604	671,966.90	2,687.87	250
103) Morgan Stanley	3	19.8519	655,182.76	3,119.92	210
104) BofA Securities	4	13.1834	435,099.45	2,636.97	165
105) Citi	5	12.5843	415,326.01	3,146.41	132
106) Barclays	6	9.7705	322,462.81	2,424.53	133
107) Credit Suisse	7	8.2605	272,624.90	3,245.53	84
108) Wells Fargo	8	5.4128	178,641.16	3,572.82	50
109) BNP Paribas	9	4.7885	158,036.84	1,755.96	90
110) Lazard Ltd	10	4.6562	153,669.71	878.11	175
111) Allen & Co	11	4.5252	149,346.20	13,576.93	11
112) Jefferies	12	4.3388	143,195.64	813.61	176
113) UBS	13	4.3385	143,186.21	1,403.79	102
114) Evercore Partners Inc	14	3.8836	128,173.78	1,086.22	118

Note: market shares add up to over 100%, as some deals involve more than one bank

Unspurprisingly in light of these fees, M&A dealmakers aren't just passive facilitators of mergers: they scan the horizon for potential tie-ups, then actively encourage them[9]. One M&A focused website notes, for instance:

> In **broad buy-side deals**, you show a company dozens or hundreds of potential acquisition targets and try to find something that interests them; in **broad sell-side deals**, you run an "auction" where you pitch the company to (potentially) dozens of buyers.

Research shows this trend increasing in the past 20 years.[10]

But it isn't just investment bankers and M&A departments that assemble companies. Other kinds of financial investors do too, often with smaller, more local horizons.

Private equity, rolling up the competition.

Private equity firms take money from investors (say, rich people or sovereign wealth funds) then use that money to buy up companies. They then get those companies to borrow more and apply other kinds of financial engineering to try and juice up profits – and take hefty fees from their investors.

One part of the private equity playbook involves "roll-ups." Here, they buy up competitors in a market (often a small, local market niche): for example, buying up all three veterinary practices, or dentist's surgeries, in a medium-sized town. This way, they can raise prices for clients, and impose costs on other stakeholders, like trained vets or dentists.[11]

“They are very clever” a British vet told us: “"In a single area, there might be six vets with different names, all owned by the same corporate . . . the things people compare prices on, like vaccinations, or consultations, are cheap, but everything else is very expensive. A friend of mine said ‘I had to make an estimate for a treatment for a broken leg, and I am cringing.’ "[12]

One private equity firm, IVC Evidensia, has recently bought over 2,200 veterinary practices in at least 20 European countries: the Financial Times called it “a giant acquisition machine.”[13] The amassing of market power is a key part of its success.

Finance, corrupting competition

Finance does not only reduce competition by removing competitors: it also in many cases corrupts competitive processes in ways that ‘tip’ markets towards bigger firms. This is linked with ‘financialisation’ – the increased role of financial techniques, benchmarks, and institutions in the operations of the non-financial economy.

Take children’s social care, which is provided by governments or private companies. In 2022 the Balanced Economy Project published a study of the Children’s social care ‘market’ in the UK, and discovered that the largest care companies were making “excess” profits of around £22,000 per child per year[14].

The report also found ‘competitive contagion’ where companies that use extractive financial techniques show higher profits and are therefore able to put in higher bids for care contracts with the government, and can also offer higher acquisition prices for other ‘targets’ in the children’s social care sector than companies that are not so driven by financial returns – such as companies whose core mandates are to care for children, rather than make profits.

Companies that do not use these financial techniques cannot compete, so they either go bankrupt or adopt similar, more extractive strategies to stay in the race.

The market will thus tend to 'tip' further towards more financialised, and bigger firms[15].

Asset-manager capitalism

Asset-manager capitalism is a term coined by the German academic Ben Braun, to refer to the rise of gigantic asset managers. People invest in passive "exchange traded funds" (ETFs) set up by these firms, which buy shares in companies all across the economy.

Investors have piled in so much that the three largest asset managers — BlackRock, Vanguard Group, and State Street — collectively own nearly a quarter of the average S&P 500 company in the United States, up from 13.5 percent in 2008. They have significant ownership of and control over firms that are supposed to be competing with each other – creating incentives for collusion. The extent to which this happens is still being worked out, but profit margins for asset managers are very large: often 30 percent or more. [16]

The finance-monopoly ideology

The finance-monopoly train has a rich, if deeply misguided, ideological foundation. Three thinkers, all American men, helped construct this: Robert Bork, Michael Jensen, and Michael Porter.

Robert Bork helped legitimise monopoly power, arguing from the 1970s that regulators should ignore stakeholders such as workers, citizens or taxpayers, ignore the public interest, and ignore power – and narrow their focus down to two things: consumers (and prices), and the internal 'efficiency' of corporations. (Our main report provides more detail.) This was a recipe for bigness, and it opened the floodgates for M&As worldwide.

Bork's ideas influenced regulators; **Michael Porter**'s ideas, by contrast, influenced businesses. His famous "five forces" analysis steered businesses to acquire market power and avoid competition wherever possible, and to use finance as the handmaiden in ushering in the changes[17].

As the antitrust brakes came off and the merger train began rolling, the ideas of **Michael Jensen** began to channel the trends, to the benefit of finance.[18]

Jensen took the ideas of Milton Friedman (who had famously argued that the only responsibility of business was to its shareholders (and not to workers, its community, or anyone else), and put them on steroids.

Jensen saw big corporations as sprawling bureaucracies whose bosses stuffed boards with cronies, and organised firms based on whims, friendships, and "the attractiveness of the office staff." They needed proper incentives, and finance offered three.

The first task, Jensen argued, was to tackle the "principal-agent problem" where managers weren't accountable enough to owners. So: sharpen managers' incentives by tying their remuneration to the share price, with performance-related pay.

Second, ramp up bosses' anxiety by getting their companies to borrow a lot more, to juice up both returns and also the price of failure.

The third was grander:

> "To relax laws to allow for the development of a full-blooded "market for corporate control," where financial players would buy and sell companies across the global economy as if they were cartons of orange juice. The free market, thus unleashed from above onto the corporate landscape, would magically dismantle and rearrange the corporate world in a blur of dealmaking to deliver a great surge of efficiency to the economy."

"Dealmaking," of course, typically meant mergers and acquisitions (M&A) - and once Robert Bork's ideas had defenestrated antitrust, there was no limit to which smaller companies could be assembled together into bigger dominant ones. And who would be running this "market for corporate control?" Why, financiers.

Merger mania spread like an explosion, radiating outwards first across the United States, across the world. By 1999, according to United Nations data, a stunning 95 percent of Foreign Direct Investment (FDI) purchases were cross-border M&A deals[19] (as opposed to "greenfield" FDI, such as building a new factory from scratch). Just in the last three years, over 100,000 M&A deals worth more than US$6 trillion were executed.

Conclusion

In many countries, such as Britain and the United States and most of the world's tax havens, the purpose of finance has shifted fundamentally since the 1980s: from being a utility supporting the rest of the economy, towards bringing its master, able to extract money from activities in the non-financial economy.

In line with these changes, finance has both become monopolised in its own right, but it has also been a monopoliser too: spreading monopoly power widely outside into the non-financial economy.

Author

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Layout and design: Christian Guthier

Endnotes

1. Warren Buffett believes this is 'the most important thing' to find in a business, Tae Kim, CNBC, May 7, 2018.

2. The key legislative changes were in the United States, notably the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, which opened the floodgates to cross-state banking acquisitions, the Financial Services Modernization Act of 1999, which effectively repealed the 1933 Glass-Steagall Act that had sought to keep banks' deposit-taking arms separate from their speculative investment banking activities and the Commodity Futures Modernization Act of 2000 that deregulated derivatives. Richard Parsons, former chair of Citigroup, said in 2012 "to some extent, what we saw in the 2007-2008 crash was the result of the throwing off of Glass-Steagall." Banking interests have sought to downplay the role of consolidation and the 'too big to fail' problem but scholars have laid out extensive evidence why it played a central role in the crisis. Other legislative changes in other jurisdictions especially in the UK also deregulated finance, leading to extensive growth both in the size of financial institutions and also in the the financial sector relative to the rest of the economy.

3. Some of the most important conflicts revolve around companies that provide public-service outputs such as auditing, ESG ratings or financial stability ratings, also selling consultancy and advisory services to the same firms.

4. Ref. the breakups paper again

5. Investigation of Competition in Digital Markets: Majority Staff Report and Recommendations, Jerrold Nadler, David Ciciline, Subcommittee on antitrust, commercial and administrative law of the committee on the judiciary, 2020, p48.

6. Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States, Official U.S. Government Edition, Feb 25, 2011, especially pp206-207. On the 95 percent share, see The Great Escape: How Credit Raters Ducked Reform, Sid Verma, Bloomberg, Aug 2, 2017.

7. Berkshire Hathaway, Form 13F Information table, Securities and Exchange Commission, Aug 2023. Key shares in Activision Blizzard were bought in July 2023, just after the UK's Competition and Markets Authority (CMA) had intervened to try and block a takeover by Microsoft but before the CMA partly foldedm under intense political pressure, allowing the deal to go ahead under certain conditions. During the tussle, Activision shares jumped from $83 to $93 a share between July 10 and July 17th, according to Yahoo! Finance, as the CMA on July 14th signaled a change of heart.

8. Special Investigation: The Dirty Secret Behind Warren Buffett's Billions, David Dayen, March 12, 2018

9. How finance Drives Monopoly Power Part 3: the finance-monopoly freight train, The Counterbalance, Dec 16, 2022

10. For example, research by Florian Ederer and Bruno Pellegrino finds that the 'market for corporate control' is concentrating power. "Dominant companies that are disproportionately active in the corporate control market for startups have become more insulated from the pressures of product market competition . . . consistent with the hypothesis that startup acquisitions have contributed to rising oligopoly power." It shows a 'secular shift' from Initial Public Offerings (IPOs) towards acquisitions: IPOs used to greatly outnumber acquisitions until the early 1990s; now the ratio is closer to 9:1 in favour of acquisitions. See The Great Startup Sellout and the Rise of Oligopoly, Florian Ederer, Bruno Pellegrino, March 2, 2023.

11. See How Finance Drives Monopoly Part 1; Private Equity, The Counterbalance, Nov 19, 2021, and

12. See How finance drives monopoly Part 1: Private Equity, The Counterbalance, Nov 19, 2021.

13. See How Finance Drives Monopoly, Part 1: Private Equity, The Counterbalance, Nov 19, 2021. The company owns veterinary practices in Austria, Belgium, Denmark, England & Wales, Estonia, Finland, France, Germany, Ireland, Isle of Man, Latvia, Netherlands, Northern Ireland, Norway, Poland, Portugal, Scotland, Sweden, and Switzerland (data updated with annual report for IVC Acqusitions Pikco Ltd, year-end Sept 30, 2022.) The UK Competition and Markets Authority launched a review into the veterinary sector in September 2023.

14. Large firms making excessive profits in children's social care; CMA ducks the challenge, Balanced Economy Project, March 10, 2022, and Children's social care generates excessive profits – report, BBC March 10, 2022.

15. See, for example, the Balanced Economy Project's forensic analysis of children's social care in the UK, and our detailed submission to the UK's Competition and Markets Authority (CMA,) showing how superior access to finance allowed private equity and other large firms to out-compete smaller and often more accountable care providers, on factors that had nothing to do with superior quality of service, and everything to do with having better access to finance, and especially a greater willingness to use debt to juice up returns. We estimated that these firms were making excess profits of some £22,000 a year per child

16. On control, see e.g. Exit, Control, and Politics: Structural Power and Corporate Governance under Asset Manager Capitalism, Benjamin Braun, Politics & Society,

Oct 18th, 2022. On profit margins, one study estimated that median profit margin for a group of 26 north American and European asset management companies was 29-35% in 2019-2020: see Asset Managers Ended 2020 With Record Revenues, Institutional Investor, March 2, 2021; also see the UK Financial Conduct Authority (FCA)'s study of asset managers, estimating that average profit margins for 2010-2015 averaged 35 percent annually (Asset Management Market Study, Financial Conduct Authority, 2017, p.34.)

17. See The Five Forces, Institute for Strategy & Competitiveness, Harvard Business School, undated (accessed Oct 10, 2023.)

18. Jensen delivered the goods in three short pieces in the Harvard Business Review: the Theory of the Firm, in 1976, then 'Eclipse of the Public Corporation' in 1989, and then in 1990 'CEO Incentives: It's not How Much You Pay, but How', a rousing defence of performance-based executive pay. Jensen later recanted most of his ideas (see On the Birth of the Economist Class and the Untaming of Corporations, Nicholas Shaxson, Literary Hub, Jan 15, 2020). We should also note the role of Harvard's Michael Porter, a business strategy guru whose "Five Forces" analysis urged business leaders to acquire buyer power, supplier power, and to avoid competition where possible. See also Competition is Killing Us, Michelle Meagher, Penguin Business, 2020, p40.

19. See UNCTAD, World Investment Report 2000, Figure 1.5, and associated text