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## Conflicts of Interests in the US Brokerage Industry

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### Introduction

In this chapter, I will be focusing on the role that conflicts of interest have played in the brokerage industry during the recent corporate scandals in the United States. My reason for choosing this particular topic and this particular period has to do with the fact that a number of interesting cases involving conflicts of interest in the brokerage industry came to light during 2001–2. New important legislation on conflicts of interest was also introduced around this time, namely the Sarbanes–Oxley Act. Of particular interest, I argue, are two major cases of conflicts of interest, in which the Attorney General of New York State, Eliot Spitzer, was active: the fining of Merrill Lynch in 2002, and the ‘global solution’ with all the major brokerage houses on Wall Street that was finalized later the same year.

A few introductory words need to be said about the concept of conflict of interest. This concept has its origin in legal thought and is usually defined as a situation in which a private interest threatens to overtake a general interest. According to the most recent edition of *Black’s Law Dictionary*, a conflict of interest is present when there is ‘a real or seeming incompatibility between one’s private and one’s public or fiduciary duties’ (Garner 1999: 295).<sup>1</sup> Conflict-of-interest legislation is basically prophylactic in nature and what matters, to cite a Supreme Court decision from 1961, is not so much what ‘actually happened’ as what ‘might have happened’ (*U.S. v. Mississippi Valley Generating Company*; see Stark 2000: 4). The notion of conflict of interest has gradually been expanded in US legislation, from the area of politics to the economy itself. In 1789, for example, an act was passed during the first Congress in the United States according to which the holder of the newly instituted office of Secretary of the Treasury could not invest in government securities (Association of the Bar of the City of New York 1960: 4, 27–8). During the twentieth century it became common that various forms of conflicts of interests were singled out and regulated in the professions, including the financial professions (e.g. Twentieth Century Fund 1980; Davis and Stark 2001).

We shall now return to the conflicts of interest that took place on Wall Street in 2001–2, especially in the brokerage industry. The usual explanation

of these events in the media is that they had been caused by *greed*. The boom of the 1990s on the stock exchange, the argument goes, had wetted the appetite of many individuals, who now set aside the general interest that it was their duty to guard. Accountants, who were supposed to give honest accounts of the corporations that they audited, now began to rubber stamp dubious audits; and business analysts, who were supposed to give disinterested advice to investors about which shares to buy, now began to push for certain shares according to their employers' wishes. While the power of material interests as a source of motivation should not be underestimated, especially in a country with such a strong commercial culture as the United States, this explanation is nonetheless too simplistic and fails to address many of the key issues. What is seen as the general interest, for example, has varied quite a bit over time and is not to be seen as something given. As to the importance of greed as an explanatory factor, there is also the fact that money-making involves social interaction, and that the psychology of greed only goes so far in explaining actions that also involve social structures and institutions.

Sociologists, I argue in this chapter, can add to the conventional interpretation of why conflicts of interest take place during the corporate scandals of 2001–2, primarily by relying on the following two propositions: (1) *interests are always socially defined or constructed* and (2) *interests can only be realized through social relations* (e.g. Bourdieu 1990; Coleman 1990; Bourdieu and Wacquant 1992; Swedberg 2003). I will try to show this in two steps, after a brief introduction about the brokerage industry in the 1990s. First, I will give an account for what happened in the case of Merrill Lynch and how various attempts have been made to solve the conflicts of interest in the brokerage industry, including Spitzer's 'global settlement'. I will then suggest a sociological interpretation of the increase in conflicts of interest during the 1990s that draws on the two sociological propositions about interest, just cited.

### **Conflicts of Interest in the Brokerage Industry in the 1990s**

The main type of conflicts of interest that came to light during the corporate scandals of 2001–2 typically involved the relationship of business analysts to investment banking. Why this was the case had much to do with two important institutional changes on Wall Street: the deregulation of commissions in 1975 and the *de facto* repeal of the Glass–Steagall Act from the late 1980s onward (e.g. Demski 2003). The former made it much more profitable for Wall Street firms to do business with banks and institutional investors than with small investors; and the latter greatly increased the competition for big customers, since commercial banks were now allowed to buy and sell shares on behalf of their clients. Analysts, according to one experienced observer, now 'grafted themselves onto the investment banking team' (Levitt 2002b: 66). Small investors from now onward became much less interesting to brokerage

firms, and were often treated with contempt. Buy and sell orders from this type of individual were, for example, referred to as 'dumb order flow' by NASDAQ market makers since they had so little information that it was always easy to make money out of them (Craig 2002: C3).

During the 1990s the relationship between business analysts and investment banks intensified. Business analysts now assumed the role of 'an adjunct of investment banking', and their pay was often directly dependent on how much business they could drum up (e.g. Levitt 2002b: 70). The financial firms publicly denied that any conflicts of interest existed and referred to 'the Chinese Wall' that has to exist between investment banking and research. Business analysts were nonetheless very useful in helping out with Initial Public Offerings (IPOs), which were a major source of profit for investment bankers during this period; they also assisted conventional brokerage. The analysts helped to attract business through overly optimistic analyses; and these overly optimistic analyses also helped to sell the IPOs. According to a study in the late 1990s, the long-run performance of IPO stocks which were recommended by analysts who worked for firms that lead the underwriting of these stocks, did significantly *worse* than stocks which were recommended by non-underwriting analysts. According to the authors of this study, 'it is not the difference in analysts' ability to value firms that drives our results, but a bias directly related to whether the recommender is the underwriter of the stock' (Michaely and Womack 1999: 683; similarly Hayward and Boeker 1998).

Many CEOs also leaked information about future earnings to analysts, in order to forewarn the market of what was to come. Uncooperative analysts got little information and were sometimes ostracized. According to a famous internal memo from Morgan Stanley and Co (which was quickly disowned when it became public), 'our objective is to adopt a policy, fully understood by the entire Firm, *including the Research Department*, that we do not make negative or controversial comments about our clients as a matter of sound business practice' (Hayward and Boeker 1998: 6; emphasis added).

Some business analysts now became superstars and could directly affect the market through their recommendations (e.g. StarMine, as cited in Der Hovanesian 2002). They appeared on television shows and wrote financial columns which reached a mass audience of small investors. The best analysts earned between \$10 and 15 million a year, including bonuses, and the most famous of them all, Jack Grubman of Salomon Smith Barney, made \$20 million. Grubman, who was an expert on the telecom industry, involved himself intimately with the corporations he analyzed, and helped them out with strategy, mergers, and sometimes even attended board meetings. In a much quoted interview from 2000 he said: 'What used to be a conflict [of interest] is now a synergy. Someone like me who is bank-intensive, would have been looked at disdainfully by the buy side 15 years ago. Now, they know that I'm in the flow of what's going on' (Rosenbush et al. 2002: 34).

This development toward a symbiotic relationship between business analysts and investment banking meant that the interest of the small investors was set aside. Business analysts sometimes said one thing in private, to the initiated few, and another in public. Grubman et al. issued practically no sell recommendations during the 1990s and often recommended investors to buy shares in corporations till these were close to bankruptcy. Grubman, for example, did not stop recommending WorldCom till April 2002, when its shares had lost 90% of their value.

By the end of the 1990s, it was apparent to many observers that business analysts were getting careless and irresponsible in their analyses (e.g. Sernovitz 2002). The big players fiercely opposed any intervention by the Securities Exchange Commission (SEC), including its efforts to stop CEOs from leaking information to analysts whom they were close to. Nonetheless, in late 2000, SEC succeeded in getting through a very important piece of legislation called 'Regulation Fair Disclosure' (RFD). The main point of RFD is that relevant economic information must be made available to *everyone*—not just a select few. This regulation has made immensely more information available to small investors. The attempt by SEC to get business analysts to behave more responsibly on public television, on the other hand, failed, largely because of the resistance of the television companies.

### The Case of Merrill Lynch

During 2002, a number of investigations were started that tried to establish that serious cases of conflicts of interest existed in a number of securities firms; and the US media has followed these with great interest. Many of these investigations were initiated at the state level since SEC, now under the Levitt's successor, Harvey Pitt, was reluctant to take action. The pioneer among these investigations, and also the most spectacular, was the one that involved Merrill Lynch in the state of New York (e.g. Scheiber 2002). On April 8, 2002 Attorney General Eliot Spitzer announced publicly that he had issued a court order requiring immediate reforms in Merrill Lynch, the largest brokerage firm in the United States. What was at issue, according to Spitzer, 'was a shocking betrayal of trust by one of Wall Street's most trusted names' (Office of New York State Attorney 2002: i).

Spitzer's charges against Merrill Lynch were based on a piece of state legislation known as The Martin Act of 1921. This law has two important advantages over SEC legislation and federal law. For one thing, it allows the attorney general to bring criminal charges; and in the case of Merrill Lynch a criminal conviction would have meant its death sentence. And second, the Martin Act, as opposed to federal law, allows you to proceed without establishing intent, which is typically hard to do. At the time when the case against Merrill Lynch was presented, Spitzer also announced that several other firms

were under Martin Act subpoena to produce evidence about possible conflicts of interest between investment banking and research activities.

The evidence presented by Spitzer to the media on April 8 was based on a ten-month long investigation of Merrill Lynch, which involved some 30,000 documents and thousands of e-mails. The basic charge against Merrill Lynch was that its research had been presented to the general public as objective, while in reality it was biased by the fact that it had been produced in close association with investment banking. While noting that 'tension between various departments in a single (brokerage) firm is nothing new', and that 'this tension is usually addressed by the establishment of a "Chinese Wall"', it was also emphasized that this arrangement had failed in this particular case' (office of the New York State Attorney 2002: p. 14). According to the affidavit, Merrill Lynch had on a regular basis misled investors in the following ways:

(1) the ratings in many cases did not reflect the analysts' true opinions of the companies; (2) as a matter of undisclosed, internal policy, no reduce or sell recommendations were issued, thereby converting a published five-point rating scale into a *de facto* three-point system; (3) Merrill Lynch failed to disclose to the public that Merrill Lynch's ratings were tarnished by an undisclosed conflict of interest: the research analysts were acting as quasi-investment bankers for the companies at issue, often initiating, continuing, and/or manipulating research coverage for the purpose of attracting and keeping investment banking clients, thereby producing misleading ratings that were neither objective nor independent, as they purported to be. (Office of the New York State Attorney 2002: p. 3)

The main focus of Spitzer's investigations was directed at Merrill Lynch's so-called Internet Research Group, led by well-known analyst Henry Blodget. E-mails that were made available to the media revealed, among other things, that stocks that were publicly said to represent a sound investment (a '2'), were in private emails described as a 'piece of shit' and a 'piece of crap' (see Table 9.1). Blodget wanted the analysts to devote 50% of their time to research and 50% to banking; and he described his own work as '85% banking, 15% research' (p. 15).

Blodget and his staff were well aware that their involvement with investment banking would lead to biased research. According to one e-mail from a person on his staff, 'we bend backwards to accommodate banking', and according to another, 'the whole idea that we are independent of banking is a big lie' (p. 17). At one point Blodget noted that going against the wishes of Merrill's banking clients in the analysis would lead to 'temper-tantrums, threats, and/or relationship damage' (p. 19). This, however, did not prevent him from publicly pretending that the research produced by the Internet Research Group was objective. It was also noted in the affidavit that during 1999–2000 Blodget had made more than 120 appearances on public television, such as CNN and CNBC.

On May 21, 2002, after several weeks of discussions, a settlement was reached between Merrill Lynch and Spitzer. What exactly went on during these negotiations was not reported in the media and is currently not known.

TABLE 9.1. The Disparity between Private and Public Ratings of Analysts at Merrill Lynch, 1999–2001— Selected Cases

Company	Date	Contemporaneous analyst comments in e-mails	Published ratings
Aether System (AETH)	03/15/01	Might have announced next week ... which could pop stick ... but fundamental horrible (ML82578)	3–1
Excite @home (ATHM)	12/27/99 12/29/99	We are neutral on the stock Six months outlook is flat, without any real catalysts for improvement seen (ML37899; ML37956)	2–1
Excite @home (ATHM)	06/03/00	Such a piece of crap (ML51453)	2–1
GoTo.Com (GOTO)	01/11/01	Nothing interesting about company except banking fees (ML03806)	3–1
InfoSpace (INSP)	07/13/00	This stock is a powder keg, given how aggressive we were on it earlier this year and given the bad smell comments that so many institutions are bringing up (ML06413)	1–1
InfoSpace (INSP)	10/20/00	Piece of junk (ML06578)	1–1
Internet Capital Group Inc. (ICGE)	10/05/00	Going to 5 (closed at \$12.38) (ML63901)	2–1
Internet Capital Group Inc. (ICGE)	10/06/00	No hopeful news to relate ... we see nothing that will turn around near-term. The company needs to restructure its operations and raise additional cash, and until it does that, there is nothing positive to say (ML64077)	2–1
Lifeminders (LFMN)	12/04/00	Piece of shit (ML60903)	2–1
24/7 Media (TFSM)	10/10/00	Piece of shit (ML64372)	2–2

Source: Office of New York State Attorney General (2002: 13).

*Comment:* This table comes from the affidavit of Attorney General of New York State Eliot Spitzer on April 8, 2002, against Merrill Lynch; and it shows the disparity between what Merrill's Internet Research Group said in public about certain stocks and what it said in private. E-mails, according to a 1997 decision, have to be retained for three years in the security industry.

The published ratings (in the right-hand column) are based on Merrill's 5-point system, with 1 meaning 'Buy'; 2, 'Accumulate'; 3, 'Neutral'; 4, 'Reduce'; and 5, 'Sell'. Further differentiation was accomplished in the following way: 2–1 would, for example, mean 'Accumulate [in the short run]/Buy [in the long run]'; 2–2, 'Accumulate [in the short run]/Accumulate [in the long run]'; and so on. One of the charges of the Office of the Attorney General was that the analysts at Merrill Lynch never used a 4 or a 5; when stocks dropped too low, they were simply not rated at all.

Nonetheless, since some 30% of the revenue of Merrill Lynch comes from retail investors and the firm has become known as 'a symbol of middle-class investing', it is often suggested that the firm may have been very sensitive to accusations that it had mistreated small investors (e.g. Scheiber 2002: 18). According to the press, Spitzer also threatened to indict Merrill Lynch, which would have meant the end of the company (McGeehan 2002: B6). Spitzer later noted that, 'we could have indicted, convicted, and destroyed Merrill [but] that would have been insane' (Rosenbush et al. 2002: 43). Some observers also feel that the quick drop in the stock of Merrill Lynch, as a result of Spitzer's investigation, was a further reason why Merrill Lynch chose to settle.

Without denying or admitting guilt, Merrill Lynch agreed to pay \$100 million in fines (Levitt 2002*b*: 82–83). Much more importantly than the fine, however, was that Merrill Lynch now also had to introduce a number of structural changes into its ways of doing business, as dictated by Spitzer, to prevent conflicts of interest in the future. It was, for example, decided that an independent committee should be established at the firm to monitor the communications between the investment bankers and the analysts. The investment bankers would also have no say in issues pertaining to the compensation of the analysts; and the analysts would exclusively get paid on the basis of how well the stocks that they picked performed.

### **Attempts to Solve the Conflicts of Interest in the Brokerage Industry**

A large number of proposals for how to solve the conflicts of interest involving business analysis have been made in response to the corporate scandals of 2001–2, along the lines of Merrill Lynch. The most important piece of legislation that has been used to deal with these issues is the Sarbanes–Oxley Act, which was signed into law in July 2002. Much attention has also been devoted in the media to Eliot Spitzer's 'global solution' that was initiated in the fall of 2002 and completed by the end of December. More generally, it can be said that the decision has been made to maintain 'Chinese Walls', as opposed to the strategy of demanding that different functions are placed in different firms. A compromise has also been struck between using law to accomplish this, as opposed to self-regulation (see Table 9.2).

Under the impact of new scandals that kept happening one after the other during the spring and the summer of 2002, the Bush administration decided to take measures. The signing into law of the Sarbanes–Oxley Act on July 30 was the major result of this resolve. According to Bush, this law represented 'the most far-reaching reforms of American business practices since the time of Franklin Delano Roosevelt' (Bush 2002*b*).

From the Sarbanes–Oxley Act and various speeches by Bush it is clear that the US government's perception of the crisis of 2001–2 was primarily in terms of individual responsibility (e.g. Bush 2002*b*). According to the new

TABLE 9.2. Different Ways of Handling Conflicts of Interest in the Brokerage Industry

	'Chinese Wall'	Different functions in different firms
Law	1	2
Self-regulation	3	4

*Comment:* Conflicts of interest in the brokerage can either be handled through legislation or self-regulation; and the two activities can either be allowed to coexist in the same firm ('Chinese Wall') or be assigned to different firms.

The Sarbanes-Oxley Act of 2002 contains legislation about Chinese Walls and allows for many forms of consulting and accounting (1). A few suggestions for radically separating the two activities were made in Congress early in 2002, as well as by people such as Eliot Spitzer and Arthur Levitt (2). Before the Sarbanes-Oxley Act most conflicts of interest of brokerage firms on Wall Street were handled through self-regulation, typically in the form of a Chinese Wall (3). Self-regulation in combination with assigning different functions to different firms was suggested by Paul Volcker in the spring of 2002 for the accounting industry, using Andersen as his model (4).

law, CEOs must vouch for the annual financial statements of their firms. The penalty for white-collar crimes, which have been committed by those in charge of a corporation, was dramatically increased to a maximum of twenty years. From around July, it also became increasingly common in the US media to see prominent businessmen being led away in handcuffs—another indication that the Bush administration wanted to let the public know that it had gotten tough with those who were engaged in 'corporate corruption' (Bush 2002b). This tendency continued through the fall of 2002, and throughout 2003 Bush often lashed out at 'corporate criminals' (e.g. Bush 2003).

But even if the Sarbanes-Oxley Act to a large extent has been shaped by the need for what Bush and his administration termed 'a new ethic of personal responsibility in the business community', it also contains several paragraphs expressly devoted to more structural issues such as conflicts of interest in business analysis (Bush 2002a). Bush was well aware that many average Americans owned shares and had been badly hurt by the meltdown of corporations such as Enron and WorldCom in 2001–2. 'More than 80 million Americans own stock, and many of them are new to the market', as the President noted in a major speech in early July of 2002 (Bush 2002a).

According to the new law, business analysts cannot be forced to submit their analyses for clearance, before publication. The power of brokers and investment bankers to decide salaries for business analysts, and in general supervise their work, has also been limited. The goal of the legislation, when it comes to business conflicts of interest, is as follows: '(to) improve the objectivity of research and provide investors with more useful and reliable



information' (US Congress 2002: 47). The authority in charge of this task, as well as of other rules for business analysts, will be the SEC.

While the passing of the Sarbanes–Oxley Act may have given the general public the impression that a stern law now existed, with which to fight corporate misbehavior and corruption, it was soon pointed out in the press that its paragraphs on conflicts of interest were very flexible and could be interpreted in many different ways—either leniently or harshly. It may also have been the failure of the Bush administration to handle the conflicts of interest in a more decisive manner that made Eliot Spitzer, the attorney general of New York State, to act on his own. In any case, during the fall of 2002 Spitzer decided to push through a general or 'global solution' to the various wrongdoings in the whole brokerage industry on Wall Street. Instead of going after the major brokerage firms one by one, Spitzer wanted to get them all together in one room and negotiate a general settlement. SEC soon supported Spitzer's plan.

According to the press, Spitzer initially tried to get SEC to agree to a clear separation between investment banking and business analysis. This, however, was not accepted by SEC, and it was instead agreed that the existing 'Chinese Walls' inside brokerage firms should be strengthened, beyond the provisions in the Sarbanes–Oxley Act. The firms were also to be fined for their wrongdoings. The most innovative part of the plan, however, had to do with the attempt to get the firms to finance independent business analysis. One early version of this effort was to have the brokerage firms finance a board that was to buy research from some twenty already existing independent analyst firms, such as Value Line. This plan, however, was rejected by the brokerage firms.

Spitzer tried very hard to push through an agreement before the national elections in early November 2002. This did not succeed, and the fact that also the Senate now passed into republican hands encouraged the security firms to lobby Congress for support against Spitzer's plan, especially his innovative idea of having a panel dispense money for independent research. On December 20, it was nonetheless announced that an agreement had been reached, probably due to Spitzer's threat that he would otherwise proceed with criminal charges (e.g. McGeehan 2002; Morgenson and McGeehan 2002). The thrust of the agreement was a strengthening of the 'Chinese Wall', in relation to the Sarbanes–Oxley Act. The major brokerage firms on Wall Street also agreed to pay \$900 million in fines and an additional amount of \$535 million over five years to finance independent stock research (\$450 million) and educate investors (\$85 million). For these years, the agreement states, each firm has to buy independent research from at least three sources that do not have any ties to an investment bank, and it must also make this research available to its customers. According to a statement by Spitzer, when the settlement was announced, 'the objective throughout this investigation has been to protect small investors by ensuring integrity in the marketplace' (Morgenson and McGeehan 2002: C5).

### A Sociological Approach to the Conflicts of Interest

The two sociological propositions about interests that were mentioned at the outset of this chapter—that these are (1) *socially defined or constructed* and (2) *can only be realized through social relations*—can be illustrated by looking at the changes that the notion of the public or general interest of investors was going through in the 1990s. This way we can also get a better understanding of why the traditional measure of having ‘Chinese Walls’ did not succeed in containing the conflicts of interest during the 1990s. A public interest is by definition what is of interest to a large group of people, as opposed to the interests of these as single individuals. What constitutes a general interest is, however, not something that is given by nature. There always exist different public interests in a group of people, and it is a useless exercise, as Schumpeter (among others) has made clear, to try to define the one and only general interest. Schumpeter writes in *Capitalism, Socialism and Democracy* that ‘there is ... no such thing as a uniquely determined common good that people could agree on [since] to different individuals and groups the common good is bound to mean different things’ (Schumpeter 1975 [1942]: 250 ff.). A general interest, in other words, always has to be *constructed*. As part of this process, a general interest typically also needs to be recognized as *legitimate*.

Similarly, and closely related, general interests need to be rooted in social relations in order to survive and triumph. General interests that are embedded in durable social relations—in institutions, in brief—are extra well protected and also tough to challenge. What adds to their general strength is also the fact that these typically also are legitimate. General interests that are less firmly anchored are easier to fight and to uproot, even if it usually is hard to totally eliminate an interest.

Schumpeter’s point about the multiplicity of potential general or public interests can add to our understanding of what went on in the 1990s and led to the corporate scandals of 2001–2. That there exist objective business analyses is in the general interest of the investors—but the structure of the investor public changed quite a bit during the 1990s, and so did the equivalent general interest. The number of small investors grew strongly, and these had typically no inside information about Wall Street but were instead exclusively dependent on public information of the type that can be found in accounting reports and reports from business analysts.

The more legitimate a general interest is, the stronger it will naturally tend to be. The problem for the increasing number of small investors, however, was that their general interest was not much acknowledged in the 1990s; it was not yet seen as the general interest of investors, and it was not protected in legislation. There was also an obvious collective action problem involved in this type of situation; until this had been solved, various people and institution felt that they had to step in and represent small investors. This is

what Arthur Levitt tried to do during his chairmanship at SEC in the 1990s (1998; 2002a); and this is also what Eliot Spitzer was trying to do in 2002: 'I've got a job, and it's to protect small investors' (Traub 2002: 41).

When one switches from a general reasoning about the small investors and their general interest to an examination of empirical data about them, in order to better handle this interest, it quickly becomes clear that there is much less information about them than one would wish. This reflects the fact that there is a general lack of data in the United States on wealth, which in its turn appears to be related to the fact that American authorities collect very little information of this type because of the way that taxes are structured. According to one of the few sociologists who has studied this issue, the only time when the authorities need to find out exactly how much an individual is worth is when he or she dies, since in this case detailed estate tax returns have to be filled out (Keister 2000: 27; Spilerman 2000).

Whatever the reason may be for the lack of empirical data on wealth and the small investors in the United States, the most comprehensive and widely used type of information that does exist comes from the triennial surveys which are administered by the Federal Reserve Board, the so-called Surveys of Consumer Finance (SCF).<sup>2</sup> According to these, a little more than half of all American families (51.9%) owned stocks in 2001—that is individual stocks, mutual funds, retirements accounts, and what is known as 'other managed assets'. This figure can be compared to the one from 1989 which was 31.6% (Kennickell, Starr-McCluer, and Surette 2000: 15).<sup>3</sup> Together, these stocks accounted for nearly three-fourths (72.8%) of the financial assets of these families in 2001, up from one half (48.4%) in 1989. The median value of stocks for families in 2001 was \$34,300, as opposed to \$13,000 in 1992. It should also be noted that it was considerably more common to own stocks as part of one's retirement account than to own them as part of their savings. All in all, it is clear that stock ownership, measured in several complementary ways, increased sharply in the United States during the 1990s—but also that someone like Paul Volcker was wrong in his assertion that all Americans are shareholders ('a nation of shareholders'; see Volcker 2002).

But even if it is granted that about half of all American families do own stock, all of these families do not belong in the category of 'small investors'. A first step in addressing this issue may be to draw a line between what we may term the elite and the rest of the population, with the former being defined (in SCF categories) as families in the 90–100 percentile of income, and the latter as all other families (or in the less than 20, and in the 20–89.9 percentile). According to this way of reasoning, 'the small investor' would be defined as a residual (and abstract) category. Among 'elite families', the data show that 60.6% owned individual stocks in 2001, while the equivalent figure for the rest of the shareholding population of families ('small investors') ranged from 37% in the 80–89.9 percentile to 3.8% in the less than 20 percentile. The median value of the former's stock holdings was \$50,000,

TABLE 9.3. Direct and Indirect Family Holding of Stock, by Selected Characteristics of Families, According to the Consumer Finance Surveys of 1992, 1995, 1998, and 2001 (%)

Family characteristics	Families having stock, direct or indirect <sup>a</sup>				Median value among families with stock holdings (thousands of 2001 dollars)			
	1992	1995	1998	2001	1992	1995	1998	2001
All families	36.7	40.4	48.9	51.9	13.0	16.9	27.2	34.3
<i>Percentile of income</i>								
< 20	7.3	6.5	10.0	12.4	9.9	4.3	5.4	7.0
20–39.91	20.2	24.7	30.8	33.5	4.9	7.3	10.9	7.5
40–59.9	33.6	41.5	50.2	52.1	6.2	7.2	13.1	15.0
60–79.9	51.1	54.3	69.3	75.7	10.1	14.6	20.4	28.5
80–89.9	65.7	69.7	77.9	82.0	17.3	28.9	49.0	64.6
90–100	77.0	80.0	90.4	89.6	58.8	69.3	146.5	247.7

<sup>a</sup> Indirect holdings are those in mutual funds, retirement accounts, and other managed assets.

Note: In providing data on income and assets respondents were asked to base their answers on the calendar year preceding the interview.

Source: Aizcorbe, Kennickell, and Moore (2003: 16).

and that of the latter between \$20,000 in the 80–89.9 percentile and \$7,500 in the less than 30 percentile. If we include ownership of stocks to also include mutual funds and retirement accounts, the differences are in the same direction (see Table 9.3).

But even if our way of drawing a line between the elite and ‘the small investor’ is accepted, it is still an open question what the general interest of the latter would be. One factor that reminds us of this dilemma is the fact that there also exists a clear ethnic division in the investor community. According to the survey for 2001, it is, for example, twice as common for ‘white non-Hispanic families’ to own individual stocks (24.5%), than for ‘non-white or Hispanic families’ (11.0%). The median value of the former’s holding was US\$22,000 and that of the latter US\$8,000. If we extend ownership of stock to also mean mutual funds and retirement accounts, the differences are roughly the same (see Table 9.4). In other words, what the general interest of ‘the small investor’ is, does not in some natural way emerge from social reality, as it might if small investors constituted a homogenous group. It very definitely has to be *constructed*.

Before leaving the issue of how many investors there are in the United States, there is one further issue that needs to be addressed. This has to do with the fact that the rapid growth in the number of shareholders in the 1990s took place during a period when overall wealth of Americans remained dramatically unequal (and when wealth inequality even slightly increased. In 1998 the top 20% of the population controlled 83.4% of all wealth, the next

TABLE 9.4. Family Holdings of Stocks, According to the 2001 Survey of Consumer Finances

Family characteristics	Stocks	Mutual funds <sup>a</sup>	Retirement accounts <sup>b</sup>	Other managed assets <sup>c</sup>
<i>Percentage of families holding assets</i>				
All families	21.3	17.7	52.2	6.6
<i>Percentile of income</i>				
<20	3.8	3.6	13.2	2.2
20–39.91	11.2	9.5	33.3	3.3
40–59.9	16.4	15.7	52.8	5.4
60–79.9	26.2	20.6	75.7	8.5
80–89.9	37.0	29.0	83.7	10.7
90–100	60.6	48.8	88.3	16.7
<i>Race or ethnicity of respondents</i>				
White nonHispanic	24.5	20.9	56.9	8.2
Nonwhite or Hispanic	11.0	7.2	37.3	1.8
<i>Median value of holdings for families holding assets (thousands of 2001 dollars)</i>				
All families	20.0	35.0	29.0	70.0
<i>Percentile of income</i>				
< 20	7.5	21.0	4.5	24.2
20–39.91	10.0	24.0	8.0	36.0
40–59.9	7.0	24.0	13.6	70.0
60–79.9	17.0	30.0	30.0	60.0
80–89.9	20.0	28.0	55.0	70.0
90–100	50.0	87.5	130.0	112.0
<i>Race or ethnicity of respondents</i>				
White nonHispanic	22.0	40.0	35.0	70.0
Nonwhite or Hispanic	8.0	17.5	10.0	45.0

<sup>a</sup> Excluding money market funds and funds held through retirement accounts; can be held in stocks or bonds.

<sup>b</sup> These may be invested in virtually any asset, including stocks, bonds, mutual funds, real estate, and other options.

<sup>c</sup> These include assets such as annuities and trusts with an equity interest and managed investment accounts.

Source: Aizcorbe, Kennickell, and Moore (2003: 13).

two-fifths 16.4%, and the remaining two-fifths 0.2% (Wolff 2000: 16). While the number of investors increased during the 1990s, there was no equivalent shift in ownership—only a change in what *type* of wealth people owned. If we use ‘ideology’ in its original Marxist sense of a set of ideas that conceal

the nature of the economic 'base', then it is fair to say that the notion of 'the small investor', as it was understood in the 1990s, falls into this category.<sup>4</sup>

### Concluding Discussion

The attention given to conflicts of interests in the corporate scandals of 2001–2 represents a good opportunity for sociologists to turn to a topic that they have not paid much attention to (see, however, Shapiro 2001). Sociologists who follow in the footsteps of Bourdieu and Coleman, I argue, are nonetheless well equipped for an effort of this type since both of these assign an important role to interests in social life and also suggest various ways how these can be introduced into a sociological analysis. The latter, to recall, is basically to be done by following two propositions: (1) interests have to be socially constructed; and (2) interests are embedded in social relations.

These propositions have been applied to one of the major conflicts of interest that have received the most political and media attention in 2001–2, namely conflicts of interest in the brokerage industry. What happened in this case, according to the public discourse, is that self-interest got out of hand during the boom in the stock market in the 1990s. The general interest was set aside, and the scandals were a fact. In contrast to this type of analysis, which is fundamentally psychological in nature with its strong emphasis on the greed of the individual actor, I tried to show that social relations and institutions did indeed play a key role in channeling and directing various interests into conflict with one another. The way that the actors with their various interests were situated in the social structure is also of crucial importance in order to understand how they tried to realize their interests during the boom of the 1990s. I finally also argue that one of the reasons why the public or general interest of the investors was vulnerable during this period was that it was being redefined, as a result of the rapid growth in the number of small investors. These latter were especially vulnerable to various wrongdoings since they had little access to alternative information.

By looking at interests in this manner, the analysis in this chapter not only differs from the greed-centered analysis that can be found in the public discourse, it also goes counter to quite a bit of contemporary economic sociology in that it explicitly assigns a central role to *interests*. My argument on this particular point is that interests have to be part of the sociological analysis, and this is something they tend *not* to be, since the focus is often exclusively on social relations. The main reason for taking this stance in favor of including interests in the sociological analysis is that interests drive human behavior, in the sense that they constitute the basic forces of motivation of the actor. Or to cite a line from Max Weber's famous passage about the so-called switchmen of history: '*action is pushed by the dynamic of interest*' (Weber 1946: 182; emphasis added). Simmel, Marx, and many other early sociologists, it can be

added, basically agree with Weber on this point, and it is first in modern sociology that we find a tendency to leave interests out of the analysis.

### Notes

1. A second definition (of less interest here) is also given: 'A real or seeming incompatibility between the interests of two of a lawyer's clients, such that the lawyer is disqualified from representing both clients if the dual representation adversely affects either client or if the clients do not consent'.
2. For a general introduction to the Survey of Consumer Finance, see, for example, Fries, Starr-McCluer, and Sundén 1998 and Keister 2000: 24–7; for a discussion of similarities and differences between this and other surveys of wealth in the United States in the 1990s, see Wolff 2000: 11–3. It should also be noted that the longest historical time series on stock ownership in the United States has been published by the New York Stock Exchange (NYSE). Drawing on this latter type of data, as well as some other sources, James Burk (1988) has attempted to estimate the number of individual shareholders between 1927–80. In 1927, there were 4–6 million shareholders or 3.4–5.0% of the population (Burk 1988: 260–7), and in 1985 47.0 million or 20.2%.
3. The figures that are cited in this and other passages that come from SCF (apart from 1989) can be found in tables 3 and 4 in the appendix, 'Data from the Surveys of Consumer Finance about Stockholders in the 1990s'. On the assumption that each of the two adults in a family (or the only adult) does own shares, this means that something like 55% of the (adult) US population were shareholders in 2001 (cf. the calculation based on the 1998 figures in Poterba 2001: 1–2, 11).
4. Another issue that deserves to be mentioned in this context has to do with the fact that political power in the United States is built on voting—a fact that makes it important to know how many of the voters are also shareholders. I have not been able to find any reliable information on this point. One figure that circulates in the press, however, often together with the correct assessment that half of the American population owns shares, is that two-thirds of the voters own stock (e.g. Scheiber 2002: 16; Stevenson 2003: A1). People who are shareholders, in other words, have more say in the appointment of politicians than their mere number would indicate.

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