"HOLD-UP" IN FINANCE: THE CONDITIONS OF POSSIBILITY FOR HIGH BONUSES IN THE FINANCIAL INDUSTRY

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ABSTRACT

Pay in the financial industry can be very high, and understanding how it gets determined is a key to understanding the wage labor nexus. The fact that some employees acquire "hold-up" power is more relevant in explaining this phenomenon than the idea of optimal effort incentives. To better understand the mechanism, an exemplary case of hold-up is studied: two heads of a trading room in a major French bank were granted bonuses of €10 million and €7 million respectively for the year 2000 by credibly threatening to leave for a rival bank with their entire teams. The hold-up mechanism can be outlined on the basis of this case: having control over transferable assets makes it possible for employees to threaten to inflict damage on a company if it refuses to accept a contract renegotiation favorable to the employee. The hold-up mechanism is particularly likely to operate if protections against it are weak or ineffective. This leads to viewing the financial industry job market differently, less as a market of persons and personal skills than a market for company assets produced and carried by persons who organize their transfer.

Due to their extreme nature, financial markets constitute a good laboratory for studying social relations; they have therefore elicited much social science research in recent years (Baker, 1984; Abolafia, 1996; *Politix,* 2000; *Actes de la Recherche en Sciences Sociales,* 2003; *Réseaux,* 2003). As laboratories of globalization (Leyshon and Thrift, 1997), marketization (Muniesa, 2000) or rationalization (Godechot, 2001; MacKenzie, 2003), financial markets also seem a good site for observing wage relations. Certain high salaries, but above all the annual bonuses paid to certain employees on the basis of evaluation by their superiors of their importance and contribution over the year –in 2000 some individual bonuses went above €10 m– are surprising (Godechot and Fleury, 2005). Reviews of the literature (Stearns and Mizruchi, 2005; De Goede, 2005) show that, with the exception a few sporadic incursions (Burt, 1997), there are few studies of pay in the financial industry. Pay in that world is more likely to be thought of as a feature of a context that facilitates opportunism and illegality (Abolafia, 1996; Sauviat, 2003) than analyzed in and for itself. Variability, correlation with financial results, the undeniable fact that pay works as an incentive –these features would seem to align pay in finance with the optimal incentive model (Elton, 1991; Ahn *et al.,*

2002). Such an interpretation is incomplete, if not false. It can account for pay variability perhaps, but is powerless to account for the size of the sums (Godechot, 2004).

Critically questioning this simple, intuitive interpretation of pay in the financial industry involves constructing a robust alternative explanation. The explanation proposed here centers on the effects of accumulation by certain employees of what almost amounts to property rights over the company's collective assets, implicit property rights that under certain conditions legitimize pay demands and allow the development of a balance of power likely to make it impossible to refuse those demands (Godechot, 2004). While analysis of wage relations –and, here, relations among employees– should, like kinship studies, take account of the dual reality of those relations –i.e.,they are at once symbolic relations of legitimation and economic power relations (Bourdieu, 1972)– my main focus here, in the interests of analytic clarity, is the strictly economic dimension of the balance of power.

Certain employees' appropriation of key assets allows them in some instances to conduct negotiations that both the actors themselves and post-Williamsonian economists call "hold-up" (Malcomson, 1997). According to Williamson (1985), investment in a specific asset(1) –i.e., an asset dependent on a relation of collaboration with other actors and that loses part of its value if that collaboration is broken off– puts the asset holder in a weak, dependent position in relation to the persons he is trading with. The value of his asset is preserved only if the exchange relation in which that asset assumes value is perpetuated. The holder is therefore dependent on the opposite party and risks falling victim to opportunism from that side after the contract is signed –i.e., getting "held up": the other party threatens to end the relationship, leaving him with his devalued asset heavy on his hands. That party, then, can indeed demand a renegotiation of the contract on exchange terms that are not favorable to the asset holder. In the financial industry, the power that some employees such as trading room heads wield over pay is rooted in the dual differential of specificity and redeployability. On the one hand, the assets they control are fairly independent of those controlled by their collaborators, whereas the collaborators' assets are much more dependent; this allows the employees to threaten to break off the relationship with the asset holders to their own advantage. On the other hand, their assets can readily be transferred, with low associated value loss, making threats to break off the relationship that much more frequent, credible and effective.

(1) The expression "specific asset" can be confusing if we do not pay careful attention to what the specificity applies to. It does not apply to the person who possesses the asset –having a monopoly over a scarce good would be more likely to strengthen the holder than weaken him– but rather to the relation between asset-holder and other economic actors, the latter relation being required in order for the asset to have value. What is specific is the production relation; it is this that can put one of the parties at the mercy of a threat to break off the relationship. If "specific asset" were not the standard expression, it would perhaps be more appropriate and explicit to use "dependent asset". Salais and Storper (1993) speak of *dedicated products* (and therefore *assets*), but they are referring mainly to the relation between buyers and sellers at the inter-firm level.

Whereas the economic literature aims to show how economic actors avoid getting into this type of relational dependence and the alternatives they find –which can be summed up as either adopting a hierarchical organization (Williamson's solution) or designing more sophisticated contracts (see Malcomson among others)– I show how such situations, which occur frequently and are highly plausible, actually play a structuring role. In the first section I present an emblematic case of hold-up: a renegotiated contract in which two bank trading room supervisors obtained between them €17 million. In the second section, I present approaches to generalizing the hold-up mechanism used by those protagonists. On the basis of this stylization, I then show why the financial industry job market should be seen less as a market for individual skills than a market for interfirm asset transfer.

A case of hold-up

In June 2001, the financial press gave significant coverage to a scandal at Bank A: the bank's head of derivatives had just been paid a €10-million bonus and his deputy a €7-million one for 2000. The sums, revealed by a *Confédération Générale du Travail* unionist, threw the people of the bank into turmoil, including at the highest level. How had it happened that such sums got paid out? Though there are no statements from the two beneficiaries, who refused to be interviewed, several bank employees –specifically, the former superior of the trading room head, his rival head in fixed income and exchange, and his former back-office boss– enabled me to reconstruct the situation fairly thoroughly.(2)

During the 1990s at Bank A, the derivatives head and his deputy had received high bonuses compared to those of ordinary operators but moderate compared to those for other equity derivative products heads. The bonuses were distributed following a classic discretionary procedure. The head of the market department suggested a sum, to be ratified by Bank A's CEO. The highest bonus sum for the period was €1.5 million. As the fixed income head noted, "[The equities head] and his deputy thought that they'd been done down for several years and that they'd been getting lower bonuses than what they should have been getting."

On the eve of a major corporate action likely to affect the future of Bank A, the head of derivatives resigned with his second, giving Bank A 48 hours to hire them back on the conditions a competitor was offering them. The two

(2) The following reconstitution is particularly reliable given that at the time of the interviews, those three persons had left Bank A, the first for reasons unconnected with the affair, the other two after the ascension of the equity derivatives head. These former employees were thus no longer bound by the obligation to keep mum, an obligation particularly strict in this milieu. I also met with the union leader who had revealed the affair and two of his colleagues, as well as a human resources manager, an equities risk controller and two fixed income traders.

heads announced they were leaving "for a German bank operating in London", and they explained as follows: "'That's it, we're leaving. We've got a contract.' The name of the bank was whited out with typex, but the contract in its entirety was sent to [Bank A]." The implicit threat was that they would take the whole team with them. According to the head of fixed income, who did not partake in the negotiations, they said, "We're leaving together, and naturally we're taking the team with us. But we like [Bank A], so we're giving you 48 hours to align" –i.e., to offer them the same contract as the one the German bank was offering. That contract included a mechanical bonus-fixing clause: the derivatives head was to get 8.5% of the bonus pool reserved for derivatives products (or 30% of profit [before taxes and bonuses]) and his colleague 6% of the sum –14.5% of the bonus pool for the two alone, or 4.5% of department profit (before taxes and bonuses). The contract did not require paying out any exceptional bonuses for the year 1999. That year the equity head had gotten €1.7 million and his deputy 1.2 million. In 2000 the financial bubble swelled and burst, generating extremely intense action on derivatives and extremely high takings. Bank A had also benefited from this favorable context: profits before taxes and after bonuses came to €230 million, according to the head of fixed income.(3) The mechanical application of the formula –which had not been revised between 1999 and 2000– enabled the two heads to get the two major bonuses mentioned, sums that contrasted sharply with the history of the bank's pay practices.

The head of fixed income acknowledges that given the way things proceeded, the two had "pulled it off really well". All features of the negotiation, whether chosen by them or not, proved judicious and favorable to them.

First, the *timing*. The fact that they resigned in the middle of a corporate action put the company in an extremely delicate situation and would have made their departure highly costly. Because of the corporate action, the bank directors were taken up with contacting and meeting investors and had little time to think about alternative solutions (such as calling in head hunters), especially since they were given so little time to think altogether. Moreover, letting the two heads leave and taking the risk of having the whole unit follow would have given a negative signal to the financial community. The danger of having the bank's most profitable unit vanish –even if, at the scale of the group, the unit's importance was fairly modest– might have indicated low asset durability and strongly compromised the corporate action. Lastly, the two were taking advantage of a vacancy at the top management level: the bank's second highest executive was leaving for a high political office in the European Union. Executive management, caught up in preparing the "road shows", ultimately granted the financial market department head full latitude

(3) On the basis of the bonus formulas, the bonus pool for equity derivatives can be estimated at €119 million (17/14.5%) and profits before taxes and bonuses at €400 million (119/30%). To arrive at the €230 million figure, we have to subtract bonuses and employer contributions on bonuses. The fixed income head noted that given the €230-million profit figure and the fact that the equity derivatives room was "consuming" €115 million in share capital, its ROE (Return On Equity) was 200%!

for the negotiation, with the result that Bank A simply accepted all the heads' conditions for staying on.

Second, *resigning together.* The fact that this was a resignation and not a threat to resign made their determination much more credible. By taking a much greater risk, the two were explicitly signaling that they were not willing to return to their former employer unless their conditions were met. As Thomas Schelling remarked (1960), it is sometimes by willingly surrendering a degree of freedom (here "We've left" and not "We may leave") –"burning one's ships" when one has one's "back to the wall"– that one can send the most effective signal of determination and thereby obtain the best bargaining conditions.

The collective character of the resignation bolstered the signal of determination sent by the act of resigning before the negotiation. Were the equity head and his deputy particularly close friends? It was sometimes said that the second was the first's "pal". The fact is that whether they were friends –which I am ready to believe– or not –which is also possible, leaving together was a crucial feature of their power move. As the derivatives head's former superior explains:

> – If he'd been the only one to resign we could have managed. But as soon as it became the whole team, it wasn't so doable. He alone would have been perfectly manageable –we would have appointed [his deputy]. [...] But the two heads– that would have caused major damage to the team. And they would've pulled them along with them.
> – You couldn't have promoted the people under the deputy?
> – No. There was a really gifted guy below [the deputy], he was in Hong Kong at the time and I knew him well. But he didn't have the managerial caliber to take on the international line. He was 29. Both of them –it was impossible. One of them, ok, we could've handled it. But the two of them, no. And since they were leaving for a European bank, the team would have gone with them six months later.

Replacing the two with an external equity derivatives head would have been relatively risky. First, Bank A would have had to attract one, and this would have been highly costly in terms of bonus guarantees; second, the trading teams would have been wary of the newcomer and therefore just as tempted to leave for their former bosses' new situation.

Resigning together thus made the threat to bring about the collective departure of the equity derivatives unit much more credible. Most of their crucial collaborators, from desk heads all the way down to subordinates, would very soon have joined them. By aiming to bring all their teams to the competitor's, the two heads were actually organizing a full-fledged business transfer. At the rival bank, the equities head and his deputy would soon have had virtually intact production capacity at their disposal. At Bank A, meanwhile, the better part of the years' worth of investments –development of technical, practical know-how, market share acquisition, client loyalty, etc.– was likely to be seriously damaged if not annihilated by the transfer. By virtue of their social capital –here, the ability to bring their teams with them– the two heads had company assets at their disposal, assets which for them were eminently transferable, whereas for the company (particularly the group of employees in charge of support functions), those assets were eminently specific.

Next, the *choice of rival bank*. The equity head's whole game was to give enough information for his purposes about the bank that was ready to hire them without revealing its name. The two let it be known that it was a European bank operating in London that had chosen to set up a derivatives products unit. This information signaled that the resignation of the two heads and their threat to take the entire team with them were very real. The two heads would not have to take over and manage an activity that was already in operation but rather to create one from scratch. Clearly the quickest way to realize this was to suggest that their usual collaborators join them. At the same time, keeping the competitor's name a secret prevented Bank A from trying to negotiate in secret with that bank to get it to withdraw its offer.(4) By leaning on common business and financial interests and possibly personal relations, Bank A might (this is only a supposition) have worked to develop a credible retaliation move against its rival that would have put an end to the threat from its two rebel heads.

Next, *the percentage*. By setting bonus level by contract, the two were protecting themselves from discretionary intervention by the head of marketing or the head office and were thereby able to profit fully from the soaring increase in these activities in the late 1990s. The rise in share value in 1999 and the profitability of equity derivatives products was leading banks to invest in this lucrative sector, and in so doing they were willing to raise risk limits and increase funds and team size. Fixing bonus distribution made it possible both to profit from these increases (greater risk, more funds, etc.) and keep their bonuses from being whittled away by the high number of newly hired personnel all laying claim to one. Moreover, the negotiation actors demanded that their bonuses be determined by a *rate*, whereas the sums on which that rate was to be applied were very likely to be different. Keeping in mind that the equities head and his deputy would have had to reconstruct their activity at the rival bank, bring along all their former subordinates, and above all get themselves allotted the necessary funds and human support (back office and computer equipment), they probably would not have been able to generate the same level of activity immediately for that bank and would therefore not have obtained the same bonus levels in 1999 and 2000, even using the exact same formula. We can therefore hypothesize that for Bank A, accepting the rival bank's formula without a discount from par meant paying much more to keep the two heads than the rival bank was ready to give them for leaving.

But though the two made sure they would get a very sizeable chunk of the profits by fixing the percentages in advance, they were clever enough to present things in such a way as to keep the agreement acceptable for their former bank. The percentage of the bonus pool they would get was to be levied from a single base, bonuses for equity derivative products, that had not been modified by the spring 1999 bargaining. As the fixed income head

(4) Ten years earlier, when the department head hired the man who would later became head of the equity derivatives trading room, she came under serious pressure from the director general of Bank B, the new hiree's former employer.

remarked, the only problem this raised for the bank at time *t* was distribution: "It didn't cost the bank anything, because in any case it was inside the 30%. The problem was distributing the 30%, but the bank always pays out the 30. In fact, the bank couldn't care less whether it pays it out to *x* or *y*. Cynical! So up against this problem, the CEO balked, but he signed". Top bank executives as a company component are often likely to reason in terms of overall cost, thinking of distribution as simply a problem to be resolved between managers and subordinates.(5) But this will not prevent the bank from judging the difference unacceptable when it shifts from budget reasoning to reasoning in terms of persons.

Lastly, *the overall context*. 1999 was a good year for the stockmarket and the derivatives industry. The near-continuous rise in share value, on the order of 50%, and the even greater rise in volumes, both in underlying assets and derivative products, was attracting a high number of financial institutions; they wanted to pull in some of the rents being generated by this type of business. These *last movers*, late and handicapped because of it, could hardly hope to catch up with the leaders by reconstructing a business from scratch. This meant that their main means of getting into the equity derivatives market and profiting from the fallout of the financial market bubble was to buy teams –by poaching trading room heads, for example. Moved by concern not to let a great opportunity pass them by, these institutions were ready to offer extremely high prices –in terms of bonus guarantees, fixed salaries or, as here, profit ceding– to acquire teams. This configuration offered the unit heads an excellent position from which to renegotiate conditions for staying at Bank A. What's more, in this kind of economic context, the degree of realism implied in that position was more likely to be over– rather than underestimated (especially since the top management was not familiar with the markets). Though one never knows beforehand what day or hour the bubble will burst and the market turn down, it seemed clear in 1999 that it was highly probable that the happy day would have come to an end by the time the productive teams had been brought together at the competitor's. By instead renegotiating at very high prices their conditions for staying with the bank, the two heads were making sure they would profit as much as possible from the peaks of euphoria in the stock market while remaining in the already productive structure they were working in.

Though we do not know the explicit reasoning and strategies of the two equity derivatives heads, this reconstruction of the bargaining conditions –representing a full-fledged hold-up of Bank A– shows that they had a real sense of how to position themselves, a knowledge of *kairos*, the tactical moment that, according to the Greeks, decisively determines the success or failure of an action –in sum, as French stockmarket traders themselves would put it [using the English terms], a "feeling" for the "timing" of an operation.

(5) Though I do not have full information on this, it is possible that this new distribution program would not have satisfied the rest of the team, leading to departures, hurting group productivity, and over the medium term leading the two superiors to demand a pay increase for the whole team.

The hold-up model

The case just described is both spectacular and exemplary of transactions on this job market. How is it that we can designate this freely agreed, non-violent transaction as a hold-up? In addition to cleverly exploiting the economic context, the two heads used the rival bank's offer as leverage for credibly threatening the other party (i.e., the bank) with disaster (i.e., the departure of its equity derivatives activity) if it refused to do what they were demanding (i.e., renegotiate their contract).(6) By bringing along a firmly united team, the two employees were in a position to take a significant segment of the bank's activity to a rival bank.

The hold-up mechanism exemplarily used here operates at a smaller scale in other jobs and at other hierarchical levels in the financial industry. A fixed income trader in the same bank got himself a raise twice by threatening –competitor's contract in hand– to leave and practice his art in a rival bank. Through the leverage effect, renegotiation allows for obtaining much more than a mere individual contribution to the whole would (assuming that that contribution can actually be measured). In fact, the two heads could also capture part of the trading room value by threatening to redeploy the whole unit. Similarly, by threatening to leave, the fixed income trader was able to capture part of the trading know-how he had been allowed to accumulate by having been given access to assets that required learning, allowed to share in collective knowledge, and paid a salary to accumulate that knowledge.

I first present the hold-up mechanism, then discuss possible ways of protecting against hold-up and reducing hold-up risk –and the limitations of these protections.

The hold-up mechanism in finance

According to Malcomson's review of the literature (1997), the hold-up idea, while already present in such authors as Williamson (1985) and Klein, Crawford and Alchian (1978), was first modeled by Grout (1984).(7) Following Grout, hold-up models have generally been most concerned with the fact that a company's anticipating of hold-ups that would be costly for it leads it to invest at a lower than optimal level. I am interested in these models not because of the conclusion they reach (i.e., company underinvestment) but

(6) In a hold-up, the leverage is the firearm, the disaster is death and the demand is for the content of the safe.

(7) Grout's model is in line not with studies of transaction costs inspired by Williamson (his article does not cite representatives of that first tradition) but with collective bargaining studies. Grout compares two systems of union relations, the American one, where unions commit to not renegotiating an agreement before a certain date, and the British one, where an employer cannot sue a union that does renegotiate. If the company's investment is specific, the union may capture part of the investment profit. This is an incentive to the company to underinvest.

rather because they make it possible to bring to light the fact that employees can capture very high rents relative to the market wage rate prevailing when there is no hold-up situation. If we modify the models at the margins only, enough to adapt them to wage relations in the financial industry, we readily understand the profit-capturing power that financial operators acquire.(8)

The general hold-up idea in connection with redeployable assets is the following: If the company's investment in financial activity can be entirely or partially redeployed by an employee in a competing company, the employee who threatens to go to work for the competitor will be able to renegotiate his salary, demand and get another value distribution, and obtain collective investment profits. It should be noted here that the "company" should be seen as a collective entity representing all the parties: shareholders, of course, but also and above all employees. In the case just analyzed, the two heads' subordinates were, without knowing it, direct short-term victims of the less egalitarian distribution imposed by their bosses.(9)

How hold-up occurs can be clarified by analyzing the trajectory of a novice broker or novice salesman in a bank. The work contracts that companies sign with such novice employees are fairly standard –standard here meaning fundamentally incomplete in that there are few clauses in them specifying how the exchange terms (wage, conditions for breaking the contract) will evolve in response to modifications in either external environment or internal organization. In many cases, the job itself is not defined by the contract but assigned gradually as employees become integrated into the work group. That integration is what determines whether the hiree is to trade, sell or join back-office management. The contract is incomplete first of all because of the uncertainty attaching to the external environment and internal organization. Not only is the financial world constantly shifting, but there is no pre-existing, stabilized nomenclature for the set of the employee's future states at the time the contract is signed. Even for the most readily measured dimensions of the future, and therefore the most probabilizable, establishing the indicators to index contract clauses on can be a complex matter, and it can be even more complex to get these indicators verified by a third party.

Let's assume that our junior professional has become a financial products salesman. To get him to perform well, the company has to invest in training him; it also has to put him in a position to attract customers. Fairly frequently, sellers of sophisticated products can only realize their first financial transactions after several months of work finding clients. The company's investment exceeds the first months' salary (which in this case it pays out without a return). It is much greater than that, and it is both continuous and multiform, involving "wining and dining" clients, marketing new financial products and instructing clients about them, investing in the trading and back-office teams

(8) For a simple formalized model of the mechanism, see an earlier version of this study (Godechot, 2005).

(9) Shareholders are *indirectly* harmed by the destabilizing nature of the new distributions and the risk of having to increase the budget line that funds this activity.

so that financial product arbitrage and transaction payment and delivery, etc. can go forward. Investment in the person, based as it is on general investment in the financial segment of the company, is difficult to isolate as such, and it is hard to imagine contract clauses that would be *a priori* conditional on the total of that investment. In contrast to general (or ongoing) training, investment of this sort cannot be handled by the employee alone outside of any financial structure. It is consubstantial with integration into financial activity, and the company cannot call in any external training structure that the employee himself would pay for.

While the simplest formal models emphasize investment by one of the parties –here, the company– it is more accurate to assume, as in more sophisticated models (Hart and Moore, 1988; Rajan and Zinagales, 1998, 2001), that both parties are investing in production, i.e., both the company and the employee. Though the employee is being funded, he is also making an effort to get specialized in wielding the assets he is in charge of, an effort, that is, to get trained and to attract customers, and he will do this particularly intensely if he intends later on to appropriate part of the yield on total investment for himself. Even on the most standard financial products, the way sales succeed is by making this dual –i.e., collective and individual– investment of attracting clients (usually financial institution portfolio managers) by producing highly idiosyncratic information. Because of their monopoly on the external environment (i.e., clients), these "marginal secants" of the organization (Crozier and Friedberg, 1977) bring in clients (thereby actually detaching them from the company) by learning to provide them every day on the telephone with the type of information most likely to attract and hold their attention. This ranges from technical information on market prices all the way to jokes, and includes subjects of conversation on extra-occupational interest areas such as sports and film. When portfolio managers engaged in daily transactions involving big sums of money have a choice between fifteen phone salesmen offering identical products at virtually identical prices, they tend to favor those who they most enjoy talking to and with whom they have the greatest number of affinities, both professional (same way of conceiving the market, same way of selecting relevant financial information) or extra-occupational (conversations on sports and cultural activities).(10)

After some time (two to three years), the salesman, no longer a novice, starts to observe the effect of economic tides on his financial niche and, if not collective investment, at least on the financial activity, transactions and trading flows that pass through his own hands. He begins to think that this financial activity could not take place if he were not there to mediate it, and in many cases becomes convinced that he is the only truly legitimate owner of the profit obtained (Godechot, 2004) –especially if he underestimates or forgets the collective dimension of the investment. He may therefore demand that the collective give him a cut of the profits, and threaten to deploy his activity elsewhere if his new wage conditions are not met. Hold-up here

(10) Horacio Ortiz (2005) emphasizes client attraction modes constructed on similarity of professional and extra-professional dispositions.

operates on the basis of two mechanisms: the *specificity* of assets for the company (Williamson, 1985; Klein, Crawford and Alchian, 1978) and the *transferability* of assets for the employee (Rajan and Zingales, 2001). If the employee left, he would cause the company to lose value. Even if he left for another sector or quit working altogether, the company would have to bear high disorganization costs. The classic problem of specificity here is compounded by a *transferability* problem: in leaving to work for a competitor, the salesman takes not only his person but also a certain quantity of the company assets, here some of its clients.(11) If the company's anticipated loss is higher than the profit cut the employee is claiming in the form of a bonus, it will be in the company's interest to accept the renegotiation conditions. Belief plays a major role in power struggles where the threat to resign is the main argument. Financial operators getting ready to leave work to strengthen their position by dramatizing the impact of their departure on the company.

Pure power struggles of similar intensity to the one imposed by the two heads do not occur very often if we consider total annual employee wage transactions in the financial industry. Still, the resignation threat functions as a kind of regulating horizon. By gradually increasing bonuses (trying to "keep people happy", as the expression goes) at the different hierarchy levels in an investment bank, superiors try to avoid reaching this dually critical point. Though it is more a matter of abrupt mood changes than sophisticated renegotiation plans, every year at bonus negotiation and distribution time, a significant number of financial operators (traders and sales) express dissatisfaction with their bonus, explaining to their superiors that "If that's how it is, I'm resigning!"

The fact that employees go so far as to threaten to deprive a finance company of major financial flows if they are not given a part of them, or that the company, anticipating the hold-up, yields them a part, favors soaring wages. The first effect of the hold-up mechanism, the one we are most directly concerned with here and that I have studied in this particular professional context, is that it explains how financial operators constitute a micro-labor market, a market whose level is disconnected from that of other job markets.(12) This is a market not only of persons but also asset transfers,

(11) Many hold-up models concentrate exclusively on the problem of specificity: the employee's power resides primarily in his ability to put an end to a value relation and thereby depreciate it. But the mere threat to end the relation is not entirely effective, because his departure option in itself will not get him anything. By concentrating solely on the specificity dimension, neglecting transferability, Malcomson (1997) concludes that certain work contract features –particularly the fact that in American labor law ("employment at will") continuing in the job is the equivalent of accepting the wage– function effectively to keep hold-up risk at bay as long as the specific investment is made by a single party only and each party correctly assesses the other party's external options. If the company knows that the employee's external option will not bring him any more than if he continued to work with it in accordance with its contract, it will not be in its interest to give in to his threat –even if it has made specific investments.

(12) The second effect of the hold-up model, the one that generally elicits the most attention, is suboptimal investment levels (Hart and Moore, 1988) and in some cases suboptimal employment rates (Cahuc and Zylberberg, 1996, pp. 332-333).

captured by financial operators but generated by group investment. Here I have modeled that group as "the company", but in addition to the president and the shareholders, it encompasses all employees besides the ones doing the hold-up.

Protection limitations

Can the company protect itself against the transfer and negotiation power the employee is likely to acquire as he acquires control over certain key assets? What happens if the company tries to thwart its employee's hold-up power beforehand? Two sorts of contract protection are here envisioned: at the beginning of the period the company can try to exchange the employee's potential power on terms favorable to itself, and at the end of the period it can try to lower the risk of defection by means of non-competition clauses.

Exchanging negotiation power

One point left in suspense until now is fixing the novice employee's starting wage. If the company knows that the newly hired employee is going to acquire strong internal bargaining power, it could move –on a non-regulated job market– to introduce this future bargaining power into the terms of the present exchange, either by selling the employee the position as a concession or demanding that he pay a deposit on his position, which he will recover at the end of the period if he is still with the company but lose if he leaves the company prematurely.(13) In this last event, he would lose his bargaining power and only be paid the market wage for professionals, without any bonus.

The first difficulty in a world of radical uncertainty is to define the initial amount the employee would pay. If it is below the amount he could capture by leaving, it will of course be in the employee's interest to impose renegotiation by brandishing the threat of leaving. Conversely, if it is above that amount, the company could come out ahead by renegotiating the work contract in its own favor or not applying changes in wider professional market wages. It is not necessarily a simple matter to get the employee to agree to pay such a sum, potentially very high, a sum that would put him in an extremely vulnerable position in relation to the company, as he would be paying in advance for an uncertain investment to which it is impossible to commit by contract (because it is too difficult to describe the contract and the set of states-of-the-world in which it would assume value).If the investment in kind and in monetary terms is not the one anticipated, his bargaining power would be severely weakened. How could he be gotten to pay to become a French convertible

(13) Economists speak of "deposit models" (Cahuc and Zylberberg, 1999). In labor economics there is a similar debate on the role of severance pay. Certain neoclassical authors consider severance pay "neutral" because the employee can always be made to pay a deposit at the beginning of the wage relation which can be used as severance pay later on.

bond salesman when the company cannot commit on the kind of investment it will make? First, will it invest or won't it? Second, will it invest a significant amount in the *process*, in the quality of execution and payment-and-delivery –this would diminish salesman's overall bargaining power– or in attracting clients (cases of wine, soccer tickets, restaurant meals), which, on the contrary, would increase employee's overall bargaining power? The company's opportunism is also relevant: a desk or trading room head sometimes promises hirees "developments" that he or she cannot realize, leaving the employee with a sense of bitterness (even if he or she did not have to buy the position).(14)

To commit to such a contract and keep it from being broken opportunistically by the company, the employee has to be sure of getting back the deposit if the company lays him off before term. But the borderline between being fired and resigning, and therefore between a salary renegotiation initiated by the employee and one initiated by the company, is hard to draw. A cautious employee will try to protect himself from all the techniques the company may have for forcing him to resign (being assigned to a closet job, moral harassment, transfer, deteriorated working conditions); he will try to recover the deposit for any breach of contract whatever its cause. But then the deposit would no longer work as incentive against the employee committing a hold-up. Without exactly applying the deposit technique, some Anglo-Saxon banks pay out bonuses in the form of shares or stock options that the employee can only cash in after several years, providing, of course, that he has not resigned. This means of protection moves some financial operators desiring to leave to try to get fired (to get the shares) rather than resign outright. An equity derivatives trader with a credible threat coming from his father, head of one of the biggest law firms in Paris, obtained the right to be fired and thereby recover the two million dollars in accumulated shares and stock options due to this "non-voluntary" departure. He then set up a hedge fund in direct competition with his former bank.

Even in a highly deregulated world, then, there are major obstacles preventing an employee from signing a work contract that would force him to pay or put down a deposit for the investment he could possibly capture by way of a future position in the organization.(15) Moreover, a generally inefficient economic world could make it impossible to fund such deposits. Employees have to deal with credit rationing: banks seldom lend big sums of money without requiring a deposit. Existing labor legislation on work

(14) A currency broker recounts how he followed a "pal" to another brokerage firm and ultimately let himself get "mystified" on the matter of advancement prospects. "I left for less than what I was getting (fixed plus a percentage) with the idea that since they were going to develop the department, my percentage was going to soar. [...] I left because I let them talk me into believing there were real development possibilities –that's true. That was what I wanted to hear. I'm really naive!" His contribution to the investment that was never made was modest: a slight fall in wages (partially compensated for by his "best year" two years later).

(15) On this point see also Hart and Moore's demonstration that dual specific investment can lead to suboptimal contract relations (1988).

contracts means that employers cannot make employees pay for their job, and it requires them to pay their employees higher first-period wages than the minimum wage for the industry sector. Other contract forms, such as franchises or sales, can be requalified by the courts as work contracts if it is proved that the financial operator is subordinate to the company.

Lastly, if we take into account the limited rationality of ordinary economic actors and the intellectual and economic costs of finding solutions at the contract level –and in a changing economic world –we see that little energy is ultimately devoted to improving the initial contracts of novice employees in the world of finance. In Bank B, when a junior executive coming out of a *grande école* [elite French training institution] was hired, the human resources head scanned the salary range for hirees and applied the indicated rates,(16) regardless of whether the employee had applied for a position in the back office, middle office, front office, as a financial engineer, risk control officer, etc. and despite the fact that redeployment risk was very different for the various jobs. It is true that to get one's first job on the financial markets one had to have done a training period, sometimes a *CSNE*,(17) and in a few cases to have worked as a temp in a trading room. The training periods vary from one to two months full-time to a year half-time and are done while pursuing the last year of study in elite French schools.(18) In the *Compagnie Universelle* trading room, by my count, 10% of the personnel were students in training (Godechot, 2001); their work capacity was being used to the full, generally in exchange for half the wage they could lay claim to for their first job. Still, according to *ENSAE* students, the companies that paid their placement students the highest wages were banks and financial institutions. Also, despite the fact that the training period as a first stage in employment is more common there than in other sectors, lasts longer and may generate greater work intensity, employees themselves pay for very little of the investment being made in them, an investment they will be able to capture later on.

Containing defections

If at the start of the period the employee cannot be made to pay the price of the bargaining power he will acquire in the job, it would perhaps be possible to have him pay for it at the end of the period. For example, a non-competition clause can be used to get him to pay for breach of contract. As protection,

(16) In June and July 2000, human resources managers each had a small file containing the papers sent in by the centers and dated June 1, 2000, on which had been noted the following salary ranges for newcomers by elite business training institution or group thereof: *Polytechnique*: 225-250K FF; elite business schools like *ESCP, HEC, ESSEC*: 215-235K FF, etc. Personnel managers complained that the document was not up to date and that they had to go higher than the indicated ranges.

(17) Army service in a company (before abolition of compulsory French military duty in 2001).

(18) At the *ENSAE* [*École Nationale de la Statistique et de l'Administration Économique]* in the late 1990s it was very common for students to work half-time in their third year. The study program was explicitly designed to allow for this kind of alternating work/study training.

this applies more directly to the company's asset transfer risk than its specificity problem (loss of value if the relation is broken off). Non-competition clauses will only be effective for the company if transgressing the clause would be sufficiently costly in moral, judicial or financial terms for the employee. It the clause specifies a fixed fine only in case of early departure for another company, that fine has to be higher than or equal to the maximum gain the employee could expect from threatening to quit the company. If this is not the case, the company will have to reserve itself the right to sue the employee for anticipated damages to the business.(19) In certain non-competition clause models, a lump sum is combined with reparation for damages inflicted by breach of contract.

Having the employee sign this type of contract at the outset of the period would effectively protect the company against hold-up, and it would not have to pay employees any more than market wage. But work contracts with non-competition clauses are few and far between in the financial industry. This has to do with the history of the sector (inertia of contract practices that do not use non-competition clauses) and above all the difficulty of making these clauses legally viable.

In liberal economy societies, the legitimacy and legality of non-competition clauses are likely to be problematic. They highlight the conflict between one of the foundations of labor law –i.e., the freedom to work– and a fundamental civil right: the freedom to contract. In some American states, e.g., California, such clauses are legally nul and void (Casper, 1999, p. 19). Other states tolerate them but strictly regulate the scope of their application and subordinate contract freedom to principles of public order such as freedom to work, often deemed a fundamental human right in itself. If these clauses cover too much ground, they can put the ill-informed, uncritical employee who signs them in a situation close to slavery.

In France, non-competition clauses have to be shown to be indispensable to the protection of the company's legitimate interests; they have to be limited in time and space, take into account the specificity of employee's job (i.e., the clause has to allow him to exercise his profession) and, since the July 10, 2002 ruling of the *Cour de Cassation*, they can only be imposed on the employee if he is paid something in return (Vatinet, 2002a). The legislation itself offers no more than very general guiding principles. In practice, space is counted as *départements* and time in months (24 months is the most likely, a few go longer; they can also be for 6 or 12 months). It is up to the judge to examine clause proportionality and the fit between real specifications and the general principles. Companies that make their employees sign a non-competition clause therefore have to anticipate legal costs. Though the time criterion may be appropriate for protecting company assets against hold-up (two years is long enough for the unused assets to be almost entirely devalued), there are

(19) See, for example, Edlin and Reichelstein (1996) on the efficiency of contracts that allow the company to bill for the amount of anticipated damages to its business.

two limitations to this type of clause that can make it impossible to activate them in the financial industry: job specificity protection and spatial limitation.

First, an employee cannot be prohibited from practicing his profession, doing his job.(20) Everything depends on the way that profession or job is defined. In the financial industry, a job is defined not only by the activity but also by the products that activity bears on. A convertible bond trader is not a bond trader or an equity trader. A convertible bond trader might even be able to contend that he was being prevented from doing his job even if the clause were restricted to French convertible bonds. Moreover, when the restriction bears on certain products and clients only, it is not easy to check whether it has been complied with.

The space limitation is becoming harder and harder to apply in a world where financial activities are on the cutting edge of globalization. In general, this limitation means that the competition clause cannot apply beyond the national territory. In Europe, most financial activities can be carried out in one of the following locations: Paris, London, Frankfurt, Amsterdam. A small part of activities is carried out in American (or Japanese) offices, but here the problem of different time zones arises. In order to be truly effective, a non-competition clause should not include a spatial restriction. But in the framework of current French legislation, this type of clause would then be difficult to apply legally. A big team operating in London at a major French commercial bank specialized in structured operations and subject to a non-competition clause collectively resigned in 2001 to set up a competing financial company in Dublin, where such clauses of course no longer applied.

In the English-speaking world, non-competition clauses are very seldom used (Casper, 1999, p. 19). Employees' freedom to work is seen as the counterpart of employers' freedom to lay off. In continental Europe, non-competition clauses seem more likely to be used. They are not very readily encountered in the financial industry, though they do exist. A head-hunter I interviewed said she hardly ever encountered them. A human resources manager at Bank B said that up until 2001 the bank never included such clauses for two reasons: trading room heads expressed no need for them and the bank's legal services advised against them because the risk of their being invalidated by the French labor courts was too great. One possible reason for trading room overseers' lack of interest in this kind of contract clause (in addition to the lack of historical precedent) may have to do with their ambivalent relation to them. First, the company could impose such clauses on the managers as well as their subordinates. Second, imposing them only on subordinates would not necessarily be to managers' own advantage. They would of course be protecting themselves against subordinates' leaving, but they would

(20) The *Cour de Cassation* ruling of September 18, 2002, states that a judge can reduce the scope of a non-competition clause if it prevents "an employee from practicing an activity consistent with his training and occupational experience by limiting application of that activity in limiting its effect in time, space or other modes" (Vatinet, 2002b).

also considerably limit their own bargaining power, which consists as explained in threatening to leave with those same subordinates.

According to the same human resources manager, contacted in late 2003, the head of the equity derivatives products department began imposing non-competition clauses when the crisis began. After several tries, the clauses were instituted at the end of November for all new *cadre*-level employees hired by the investment bank: traders, sales, financial engineers, computer experts, support function managers. The bank's legal experts –"pusillanimous", in the eye of the human resources manager– deliberately restricted the scope of the limitations: the time limit was six months and the space restriction was the Île-de-France region. The clauses were not applied to persons hired before November 2002. Up until now –and despite the fact that there have been some resignations– the bank has never activated these clauses. Given financial operators' ability to turn to the courts or even the unions to defend their interests, and given the interests at stake for head-hunting firms, it is unlikely that non-competition clauses could put an end to the hold-up phenomenon and the disconnection between the financial industry labor market and other markets. At most it might slow development of the phenomenon, lengthen circulation paths: Paris-Paris transfers would simply become Paris-London-Paris ones.

Clearly, then, though the two types of protection in question –having employees pay a deposit and non-competition clauses– can have real effects (effects that the banks have only recently begun to realize and test), they also have limitations, and they do not seem capable of ensuring the total protection of a company's assets or preventing the financial operators in charge of those assets from appropriating rent from them. The individuation process under way in financial work and accounting is surely a significant obstacle to determining effective protection measures. There is an increasing tendency to forget the fact that key assets are continually being ceded to employees, and though the balance of power that they are in a position to create may elicit indignation, employees are also credited with success when it occurs. "He earned it, he deserves it!" exclaimed the head of the back-office at Bank A, referring to the head of equity derivatives in the above-cited case, even though the speaker himself was one of the first victims of the derivative head's power move. The symbolic hierarchy of what is understood as individual merit simultaneously confirms and veils the economic foundations of this domination. And even if the truth of this unequal economic exchange were to become fully evident, it would be difficult for the concerned actors to protect themselves from its effects.

The job market as asset transfer

In the mechanism described above, I simplified matters by taking for granted the renegotiation outcome. That outcome is very often the real one, and it is not seen as a mark of disloyalty. Head-hunters know that such

practices are common in the financial industry and that a much advanced hiring process can be scuttled by last-minute renegotiation with the former employer.(21) A head-hunting firm director specialized in finance mentioned as a rough figure that one employee in ten renegotiates with his former employer rather than going to work for the new one he has got lined up. The renegotiation possibility plays a structuring role in this job market. However, it is not systematic. It can happen that two companies estimate differently the value implied in the transfer and, in this case the company the employee is leaving or threatening to leave makes no move to hang on to its operator. Generally, the resigning employee refuses to put himself on the auction block, preferring to leave straightforwardly rather than engage in a bargaining process that even in the world of finance may feel degrading (transformation of personal relations into market relations). Renegotiation, when it does take place, is usually on the company's initiative; that is, the initiative of employee's former superiors. For all these reasons, the job market in this sector is very active and transfers are frequent. In *Les Traders*, I estimated that 56% of former employees were no longer in the trading room after two and half years (but some may have been working for the same company abroad). On the basis of Bank D data, it can be estimated that 16% to 17% of traders and salesmen left that bank some time in 1999, an expansion year characterized by major hiring. In sum, we can estimate that after three or four years, half of financial operators change employers.(22) The flourishing activity on this market hardly makes it the incarnation of a perfect job market, however.

Operators do not leave alone. When they resign, they take their body with them, a repository of assets that give those operators great value on the job market. They leave with information, knowledge, know-how. They leave with clients. They leave with teams. This job market is therefore fundamentally dual: a market of persons and a market for what those persons carry away. What accounts for the value of a transfer lies more in the assets transferred than in the intrinsic skills of the persons who bear those assets.

Former CEO of the Bankers' Trust Charles Sanford, assessing his experience of the transformation of the bank into an investment bank, makes a very similar observation:

> The problem with having innovation and ideas at the center of your business as opposed to, say, automobiles, is that your capital is made up of people rather than physical inventory. Your assets walk out the door at the end of every day. And there is no copyright or patent

(21) In case of failure, the hiring process is usually picked up where it was left off without extra funding (in the case of the most classic contracts). The phenomenon of hiring manager opportunism should also be noted: the hiring interview is a means of extracting information and knowledge about what competitors are doing, and it may be organized to this sole end rather than to offer any real job.

(22) This can be compared with what happens in French society at large: in the five years from 1988 to 1993, 35.4% of men and 33.6% of women changed jobs (Chapoulie, 2000). The *FQP* [*Formation et Qualification Professionnelle*] survey the study is based on unfortunately does not allow for determining what proportion of these changes were "voluntary" and what proportion "non" (i.e., occurring after respondent was laid off or due to spouse's mobility). Among financial operators, the great majority of job changes are voluntary.

> protection available to ensure that employees cannot take their ideas and talents to another firm and start competing with you. This is especially easy on Wall Street because changing jobs often doesn't mean uprooting your family and leaving your friends. It simply means walking across the street (Sanford, 1996).

To understand how the financial industry job market is first and foremost a market for assets produced by group investment –and thereby explain why it is not correlated with surrounding job markets– I first detail the different ways an individual carries around those assets. We then see how the job market itself is a means of making advantageous take-over bids.

Extensions of the body

Financial knowledge amounts to what are probably the most fully incorporated financial production goods. Attention to skills or human capital in scientific literature over the last two decades has moved researchers to seek out the individual foundations of social orders. We do have to analyze all the implications of individual mediation –mediation that generates individuation, of course, as well as belief in the individual origin of profit, mediation that leads to legitimating the demand for profit and profit capture. Still, it is important not to forget the collective origin that this individuated knowledge develops out of: that knowledge is acquired through on-the-job training in a collective environment. To judge the effectiveness of pay policies based on individuated knowledge, it is necessary to ask whether the constituting of that knowledge was actually paid for by the persons who become productive thanks to that process.

In *Les Traders* (2001), I described the "space" of "winning strategies" in which financial operators move. The winning strategies amount for the most part to practical knowledge (some may be highly formalized, of course, such as mathematical arbitrage, though this does not prevent development of the practical knowledge required for using those mathematical models). In the non-partitioned trading room, in the noisy environment, in the absence of privacy, knowledge circulates. Indeed, all of these conditions are precisely the ones required for the emergence of such knowledge. The "morning meeting" favors knowledge sedimentation. But the trading room is hardly an ideal communication society where knowledge is fully shared. Two antithetical types of behavior play a role in constituting knowledge: withholding knowledge and divulging it distinctively. As in many highly competitive contexts, knowing what others don't know yet is an advantage. But revealing that knowledge to someone may also be a means of establishing one's authority over him, and aquiring all sorts of "distinction" profits –i.e., strengthening one's position within the trading room's symbolic hierarchy. While financial operators may balk at sharing knowledge or information with colleagues from other desks, collective constitution of that knowledge is facilitated by rivalry among senior operators in their attempt to acquire authority (during the morning meeting "jousts" for example); also by friendship among operators, above all friendship between mentor and novice –a desk senior showing a

junior the ropes of the job in exchange for affection and loyalty (Lewis, 1989, pp. 204-217).

The decidedly collective constitution of this knowledge is particularly valuable for an individual who has access to it if it is linked to a monopolistic form of power and if rents are associated with this lasting monopoly. To have an idea of the relation between capture of collective knowledge and individual profit, we can take the borderline example of diffusion of a valuable secret. In simplified terms, financial strategies can be seen as so many small secrets (of unequal quality) for generating money: arbitrage techniques, designing and mastering a new financial product, developing a statistical arbitrage formula, etc. But these productive secrets, the ideal-type of which is the statistical arbitrage model, cannot be protected by a system of patents and intellectual property rights as in the pharmaceutical industry. Exploiting the secret is a delicate matter and it can hardly go on for long. Any employee in on the secret, whatever his contribution to discovering it or productivity in using it, can sell it to a competitor at its marginal value and thus weaken its productivity (Zabojnik, 2001).When a trader working on statistical arbitrage discovers a recurrent anomaly in market prices (a correlation between the stock prices of two companies in the same sector), this of course enables him to predict with greater certainty. But he can only earn money with his "thing" as long as it remains a secret. Diffusing it would lead, through a simple arbitrage effect, to eliminating the opportunity for arbitrage.(23) By leaving to work for the competition, a member of his team could sell this lucrative knowledge to the outside, increase exploitation of it –and thereby accelerate its disappearance. Moreover, competition on the job market is highly effective in diffusing knowledge about arbitrage opportunities and thereby causing them to disappear: "If I didn't have any competitors, the model I developed two years ago would still be working; it would still be making incredible profits today !" exclaimed a trader specialized in statistical arbitrage.

Mastering an innovative financial product is a kind of knowledge similar to knowing the "open sesame" that will open the thieves' cave. When a sophisticated new financial product such as an exotic option or a structured product is launched on the market and the team in charge of it makes the effort required for mastering the mathematical price-setting formulas and the relevant dedicated software while learning how the product behaves in practical terms and what its commercial value is, that team acquires a monopoly power that one of its members could in turn sell on the outside. Mastering strategic assets becomes more important to the exchange than the asset bearer's intrinsic competence. A head-hunter I interviewed remembers how a client of hers who wanted to hire a trader in a particular product would only settle for "a person from Bank B"; "beyond that, he didn't care whether it was *x* or *y*". Bank B

(23) The difficulties of long-term capital management (LTCM) began when many financial institutions, learning of the fund's success, started imitating its arbitrage strategy (MacKenzie, 2003).

dominated the market for that type of product, and the best way its competitor could think of to get a foothold in the market was to hire a Bank B operator.

The transfer of incorporated assets such as knowledge, techniques, know-how is often extended by the transfer of more clearly external assets. In 2002 a trader specialized in convertible bonds brought with him a laptop computer containing price-setting software and programs for handling derivatives products –a set of computer routines that he then made available to his new desk. Financial operators bring with them a whole range of assets, from practical to technical knowledge, from organizational to computer routines, from pricing software to client data bases, from collaborators to clients. While traders move around with a whole set of disparate types of market knowledge and organizational and computer routines, salesmen are reputed for transferring their address books. Analysts, particularly star analysts, whose fame is the complex dual product of the press and the financial community, bring with them clients and fame, the latter being virtual clients, and "good rankings" from clients –such rankings are having an increasing impact on orientation of brokerage flows. When we move from financial operators (traders, sales) –i.e., employees who control detachable assets that could almost be sold in themselves on the outside– to financial engineers, quants, and above all risk controllers and back-office managers, we find people who, though certainly knowledgeable, control less of the collective assets. They may have control over a market share or a client, and assets such as computer programs, mathematical models, pay-and-delivery systems –i.e., the gears of a greater organizational whole that exceeds them, assets that are not readily transferable.

Conceiving of the job market as an assets market thus enables us to understand the hierarchy of financial jobs and why, within the financial operator hierarchy, job value fluctuates if not with market prices at least with the activity reigning in the micro-markets that these operators are specialized in.

Collective departure, or how to engage in profitable take-over bids

Job market transfers do not always take the simple, paradigmatic form of selling knowledge of where the treasure trove is hidden. Since the secret of rents is complex and based on highly disparate elements (clients, organization, knowledge, know-how, etc.), a transfer through mere displacement of the person is highly unlikely to be complete and will tend to involve some loss of the total initial asset. Leaving as a group, an existing team, is a means of endowing the transfer with greater value and containing that loss. Taken together, the components are worth more than they would be as a sum of separate parts.

This characteristic works to give social relations –particularly work relations– strategic importance. The financial industry is sometimes presented as a jungle where everyone is permanently at war with everyone else, or as the noisy juxtaposition of individual solitudes –a motif often developed in Jean-Manuel Rozan's novel (1999). The alternative vision, of a world of personal

relations, tips and pals, a vision regularly used to denounce the "mafias" of the finance world, may also be a caricature but it more accurately depicts the reality of that world.

Though the cult of friendship is not made an explicit theme, what comes through consistently loud and clear in the interviews is the presence and importance of professional friendships, particularly (and perhaps more than elsewhere) the effect of friendship on how the job market functions.(24) Even among financial operators who say they make a point of distancing themselves from their professional world, refusing to be assimilated with their colleagues and the mercantile, opportunistic, mundane world of money, we find market-related friendships that play a combined social, affective and economic role:

> And we were really making money, and the ECU really took off, it was astounding. […] Then we were approached by another company. Somebody I knew before, somebody came out to me and said [...] "Come to our place and do ECU"! So there were the four of us, there was the guy called Burny, there was Dave, my best friend in the market, and Angus. […] We had lunch together, we discussed. Because that doubled our wages. It gives us really nice cars, like blablabla, and a chance of a tour to Europe. So yeah, we took it in the end, and the four of us went, you know. And at that time, I was like seventeen or eighteen thousand pounds a year. […] And they offered me like forty thousand pounds to get in, like four hundred thousand francs to get in. (Steve, ECU salesman in London in the 1980s) (Godechot, 2001, pp. 147-148).

The way social relations operate on the finance job market is particularly complex. "Weak ties", whose importance was stressed by Mark Granovetter (1973), do of course play an important role. They work to circulate singular, original information that strong ties, often involving redundant contact, are less likely to circulate. Relations with superiors in finance are not always warm (though often they are). In these professions where the hierarchy is relatively flat (the links in the chain are operators, team heads and trading room heads), superiors and subordinates are potentially in competition with each other. Subordinates are waiting for their superiors to resign or move up while superiors may dread subordinates' master strokes or resignation moves. Financial operators' straight talk and crude language have been pointed out; they dress each other down in rough terms that would shock in any other sector. Still, while this behavior is visible and striking to any observer used to the more univocal circulation of discontent found in large organization hierarchies, it is counterbalanced by the importance of "attention to the forms". A operator who has decided to resign knows that his former superior and especially his colleagues, with whom he has never had particularly warm relations, will remain his market partners in financial transactions –they will continue to furnish products, clients, exchanges– and that they will also remain his partners on the job market. They are sometimes used by headhunting firms as "sources" on that market, to certify a former colleague's results and performance or give an opinion on his personality. And they are highly likely to run into each other again on this ultimately tight-knit job market, likely to follow each other and end up together again one, two or

(24) Friendship plays a similar professional role in law firms (Lazega, 1992).

three years later in the same work structure. The importance of weak ties is preserved on this job market as a vector of information circulation.

However, strong ties too are extremely important, particular those made on the job. This is because of their productive efficiency.(25) Friendly financial coproduction relations within a team are economic modes of productive "matching". Familiarity, common knowledge, common experience of organization modes, knowledge of the implicit limits of each person's domain, trust, cooperative goodwill and the limiting of competition allow the team as a group to be more productive and thus give it much greater power to move and sell itself as a team on the job market.(26)

There are many accounts of collective team departures, group resignations, scaled regroupings, buying back teams –group moves, either successful or not. Well before pulling over to Bank G in London, the aforementioned convertible bonds trader made an attempt to leave his brokerage firm with a colleague-friend and negotiate a collective hire using a head-hunter in a bank that had no convertible bond business and wanted to acquire one. "Setting up a desk –that's the dream" of every financial operator, he explained. To get out from under the desk head, whom they did not really trust, and create the whole thing from scratch themselves on virgin territory –an exciting intellectual experience in that it breaks with the repetition of financial transactions and kindles the hope of major gains if the activity takes off and multiplies– they saw themselves becoming team heads, room heads, department heads: internal entrepreneurs with a financial mushroom pushing up beneath them. For the trader in question, the negotiation failed. Surprised that his head-hunter was not calling, he found out that the bank in question had acquired a team from Bank C instead, and he and his friend from the brokerage firm only managed to find positions in London separately in existing convertible bond teams, one in a major American bank, the other in a hedge fund. Close financial coproduction relations are a strong asset not only when it comes to leaving as an existing team but also for setting up full-fledged financial enterprises, particularly hedge funds. The extremely high bonuses distributed in the late 1990s, together with favorable financial organization, encouraged the formation of hedge funds, organizations in which financial operators can become even more autonomous, and that allow them to independently valorize the assets they have captured in the financial organization. The equity derivatives trader mentioned above, who in spring 2002 maneuvered to get

(25) Network sociology has explored organizational contexts in which certain forms of ties afford advantages. When the point is to acquire information resources, weak ties and porous network structures are preferable, whereas strong, cohesive ties are important when it comes to cooperating and constructing a collective identity (Podolny and Baron, 1997).

(26) This phenomenon also appears in law firms. Emmanuel Lazega writes: "As many managing partners in law firms know, the importance of constraint at the group level is not necessarily an encouragement for management to create dense and permanent workgroups in collegial organizations. The existence of such groups is risky for the firm. They can threaten the firm with disintegration when entire teams consider themselves exploited [...] decide to defect, and take away with them part of the firm's human and social capital." (Lazega, 1999, p. 262).

himself laid off so as to collect a big share package, was aiming to set up a hedge fund with a friend from Bank E –"What interested me is that we got along really well"– and hire ten or so colleagues and friends from that same bank.(27)

Strong, cohesive relations make it possible to develop a stable, mobile core that then develops from close contact to close contact, heads to subordinates, subordinates to fellow subordinates and friends, etc., ultimately attracting all the activity in a given market department. This is why the trading room management unit and the quality of relations between the head and his direct lieutenants are so important in determining that head's bargaining power. The hold-up of the two heads analyzed at the beginning of this article was so successful because they were threatening to hire up all their former teams once they had got things running at the competitor's. It is not that they were necessarily friends with all the traders and salesmen in their rooms, but they had enough confidence in the quality of their relations with their desk heads, and the quality of relations between those desk heads and the subordinates, to think they could bring them with them –if not the entire trading room at least the most useful, productive part.

Moving teams by buying them up or setting up a new business in some cases actually corresponds to displacing business activities and may even amount to a company transfer. The job market can therefore figure as an alternative to the stock market in the acquisition of financial companies or their departments. With respect to immaterial assets, in the hypothetical extreme case of the whole set of employees leaving one company for another, the company itself would change hands without any exchange of shares on the stock market.

The head of Bank A's marketing department relates that one of his English "market-making" teams collectively resigned and left for Bank B when Bank A tried to impose a "RAROC threshold" on the collective bonus formula,(28) i.e., a capital risk-remuneration profit threshold below which the trading team would not receive any bonus: "They said, 'We're going to put a RAROC threshold on the bonus formula.' 'Fine!' they said, and they all left.[...] They left in a block for Bank B, which didn't have enough market-makers at the time. [...] They all left –fifty persons. Even the ones on vacation sent in their letters of resignation." In *Homme du marché*, Jean-François Lepetit, former director-general of Indosuez, offers a highly detailed description of a team-purchasing operation (2002, pp. 115-117). In March 1990, immediately after Drexel Burnham Lambert went bankrupt, Lepetit met Richard Sandor at a cocktail party. Sandor was in the process of negotiating with another French bank for the sale of three teams he had headed –60 persons. The first was in swaps activities, the second in structured operations, and the third in futures in Chicago. Sandor thought Indosuez was already very active in derivatives

(27) Similarly, the team that was working with John Meriwether on LTCM was made up primarily of former Salomon Brothers colleagues (MacKenzie, 2003).

(28) The RAROC (Risk-Adjusted Return on Capital) is a profit indicator obtained by deducting incurred capital risk from the accounting result.

products and would not be interested in taking on the teams. He nonetheless suggested to Lepetit that they do a deal on the weekend before giving the other bank an answer. With the CEO's support, Lepetit left with a few collaborators and lawyers to negotiate a contract "in the finest Wall Street merger-acquisition operation tradition":

> The coach negotiated with us. When we had agreed on one point, he left to consult with his three team heads, who than got in touch with their troops.[...] On Sunday at about 5pm I called AJG to tell him I was ready to close on two-years salary and bonus guarantees amounting to $40 million, a sum totally out of line with what we were used to. The contract stipulated dividing up the bonus; the team heads –and especially the coach– had planned hefty bonus for themselves (Lepetit, 2002, p. 117).

Lepetit told me this story when I interviewed him in 2001, adding: "I thought I had made a very good deal because I was buying a business, not goodwill,(29) and the only thing I had to pay for was the people." Buying up teams as described here does indeed resemble buying up activities, and it cannot be reduced to mere hiring. When the team is sold as a team, existing and already productive, it acquires much more value than the sum of individual transactions. To take advantage of this leverage effect, Sandor used three features of the situation: his comradely relationship with Lepetit (they had already collaborated around launching Indosuez's options department in New York in the mid-1980s), the competition between two rival banks, and the fact that the allotted bargaining time was so short. But what appears just as determinant in the transaction is negotiation centralization. Sandor brought in and incarnated the group and obtained a benefit for both the group and himself. But a year later, when Sandor's role as team provider and federator was less salient, his lieutenants revolted and brought him down like pirates throwing a captain overboard who had gotten too greedy when the booty was being shared out. "The funniest thing in it all is that Richard Sandor was thrown out by whom? Not by me –by those guys!" commented Lepetit in our interview. Having the power to bring entire teams along during employee movements on the job market did not prevent the representative of one of those subordinate teams from trying to use that power in his own interest and to the detriment of the first go-between. Though in terms of content and process, there is nothing military or feudal about relations in the financial industry, they do have points in common with political-military relations in the late Middle Ages (Lebecq, 1990). Being at the head of a hierarchically ordered set of relations does of course mean having a certain power, but that power is never fully safe from felonious attack or being undermined by scissiparity.

While collective hiring can indeed be seen as a kind of transfer of activities, another way of implementing an acquisitions policy, a kind of cheap takeover, the gain involved in this kind of transfer is perhaps lower for the company that buys an existing group than for a group with a monopoly over the rents of its own activity. By buying an existing group, the firm integrates a

(29) Goodwill is an intangible asset such as a label, a reputation, etc. that provides a competitive edge. During acquisition, goodwill appears on the acquirer's tally sheet as the difference between acquisition price and the price of the acquired company's tangible assets.

close-knit team into a new, larger whole with which that team shares fewer solder points than it did with the whole it extricated itself from. It is therefore more mobile and detachable than it was in the former configuration, and it will not hesitate to use this leverage effect either to obtain internal advantages or advantages in other companies. This is why replacing the team that had left for Bank B by a team from Bank F as the marketing head did, or even buying an activity as a whole, like Jean-François Lepetit did, is not necessarily a good deal for the company. Investments in this new entity might not be as lasting as they would have been if they had been made in a collective composed of employees gradually hired one by one and coming into their first job. The three teams hired by Lepetit left Indosuez after two to three years. Lepetit puts this down to bad luck (2002, p. 117).

In contrast to more material industries such as the oil, car and chemical ones, financial assets are much more readily appropriated, detached and transferable. Such transfers can be effected to the advantage of the employees who organize them. Whereas industry employees cannot take the factory with them, in the finance industry employees can indeed leave with the till –not all of its contents but all the contents that give it value. They cannot leave with the company funds, but once those funds have been stripped of all that made it possible to make them multiply above market levels, the funds can no longer be the residual claimant of the rents and must, in the extreme, settle for normal "pay": the compulsory interest rate plus a slight risk premium.

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* *

Wage relations in the financial industry seem exceptional. Are the mechanisms found in them particular to this sector or, on the contrary, are they more general and likely to operate in wage relations in other sectors?

Though there are no systematic studies of the assets that employees transport when they move from one company to another, we do find scattered elements of this phenomenon outside the financial industry. Historians have remarked that during the Industrial Revolution a number of skilled English workers were poached by French entrepreneurs in exchange for high wages because they were in a position to bring new technologies with them (Verley, 1997, p. 486). More recently, in a study of high-growth companies, Bhide (2000, p. 94) notes that 71% of the extremely high-growth American firms on the Inc 500 were set up by persons who had replicated or modified an idea they encountered in a former job. My study of the financial industry shows that the phenomenon of asset transfer goes beyond questions of innovation, industrial confidentiality and human capital; that it concerns forms of material capital as well (computers, software, data bases) and other forms of social capital.(30)

(30) Zingales (2000, p. 1643) claims that this appropriation capacity, fundamentally linked as he sees it to the increasing role of human capital in economic life, is likely to

While potentially general, however, the hold-up phenomenon and asset transfer by employees can vary in intensity by sector, nature of production, solidity of legal protection, and work organization. In heavy industry, material assets protected by property rights are hard to move, and technologies themselves, protected by patents and relatively specific to the singular production technique the company uses, are not that much more readily transferable. In the world of services, immaterial assets are both easier to move and not as well protected legally. The deterritorialization of production and sales relations, quite pronounced in the key "globalization" sectors, renders non-competition clauses ineffective. The world of consulting is an economic sector known for group defections. Luigi Zingales (2000, p. 1641) notes a particularly striking case of collective departure in the advertising sector. In 1994, the main shareholder of Saatchi and Saatchi, an American retirement fund, refused to grant the CEO Maurice Saatchi the right to award himself a generous stock-options package. The Saatchi brothers quit the company with a large segment of their personnel to set up a rival company, a move that left their former company, renamed Cordiant, much weaker.

Sill, as Emmanuel Lazega has shown in his study of an American commercial law firm (2001, pp. 182-200), companies where the risk of collective defection is potentially high may have a type of work organization and a system of social relations that sharply reduce this threat. The administrative system of rotating clients and employee teams among partners, and the relational dependence between partners who bring in clients and those who administer the firm, prevents the formation of a tight-knit team likely to leave as a group and take clients with it. This first outline of a comparison and generalization is an invitation to analyze variations, above and beyond the financial industry context, of certain employees' appropriation and displacement of collectively constituted assets.

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modify the borders of the firm and relations between shareholders and employees. The growing role of social capital in companies' lives, a role diagnosed by many authors, is even more likely to subvert the frontiers of the firm.

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