MUTUAL FUNDS REPORT: OFF THE SHELF; Investors of the World, Unite!
By PAUL B. BROWN (NYT) 972 words
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LONG before Page 1, where he describes today's financial environment as "a pathological mutation" of capitalism, John C. Bogle, the founder and former chief executive of the Vanguard Group of mutual funds, makes clear what went wrong and who is to blame.
From the book's dedication (to his 12 grandchildren): "my generation has left America with much to be set right."

From the acknowledgments: "Capitalism has been moving in the wrong direction. We need to reverse its course so that the system is once again in the interest of stockholder-owners rather than in the interest of managers."

In case anyone has missed the point, Mr. Bogle, in his introduction, deliberately echoes "The Decline and Fall of the Roman Empire," by Edward Gibbon, to underscore that the markets have lost their way, adding that by the end of that epic, "the Roman Empire was no more."

Subtle Mr. Bogle is not.

Readers understand that, even when reading the resounding blurbs at the front of the book. They are from the likes of Arthur Levitt, the former chairman of the Securities and Exchange Commission; Henry Kaufman, former vice chairman of Salomon Brothers; and Burton G. Malkiel, a Princeton economics professor.

In fact, all you really need to know about where Mr. Bogle is heading is the title: "The Battle for the Soul of Capitalism: How the Financial System Undermined Social Ideals, Damaged Trust in the Markets, Robbed Investors of Trillions -- and What to Do About It." (Yale University Press, $25). The book will be in stores soon.

Here is Mr. Bogle's clear, well-reasoned and forcibly stated argument in a nutshell: Over the last 100 years, we have moved from "owner's capitalism," a system in which the bulk of investment returns went to the people who put up the risk capital, to "manager's capitalism," which provides "vastly disproportionate rewards" to those hired to watch their interests -- people like company executives and mutual fund managers.

How does he feel about the change? "Managers' capitalism is a betrayal of owners' capitalism, a system that worked with remarkable effectiveness for the better part of two centuries." And he blames three groups for this shift:

MANAGERS OF CORPORATE AMERICA -- He is particularly critical of how management chooses to pay itself. The "megagrants" of stock options to senior executives, he says, can lead to managers trying to make the stock price climb as quickly as possible, potentially forsaking the needs of the company they are supposed to serve. He also criticizes the "onset of quarterly earnings guidance, accompanied by financial engineering designed to produce the promised results," a situation that he says has been "abetted by the attendant laxity in traditional accounting standards."

Ultimately, he holds corporate boards responsible for allowing both situations to occur. "The failure of corporate governance lies at the heart of why corporate America went astray," he writes.

FINANCIAL INSTITUTIONS -- "The stockholders of investment America -- dominated by our giant financial institutions -- hold awesome power," Mr. Bogle writes. "Yet these firms all too rarely exercise that power."

He is referring to institutions such as investment and pension funds. They don't exercise that power, he says, because they don't hold a stock long enough to care about how the company is run. They just want the share price to go up, abrogating what he sees as their ownership responsibility.

MUTUAL FUNDS -- Fees and charges are far too high, Mr. Bogle contends, adding that "the fund industry is the consummate example of managers' capitalism gone awry."

"While the shareholder wealth consumed by the managers of corporate America has been far from trivial," he writes, "the shareholder wealth consumed by the managers of mutual funds has been enormous."

He adds: "More than one-fifth of the robust annual gross returns generated for investors in the financial markets -- stocks, bond and money markets alike -- during the past two decades has been siphoned off by fund managers," who, he contends, have placed their own interests "ahead of fund owners."

None of these allegations are new. Critics of corporate America have long argued that pay and stock option awards for executives no longer have any basis in reality. (Mr. Bogle points out that in 1980, total pay for the average C.E.O. was 42 times that of the average worker; by 2004, the multiple was 280.)

Other arguments have also been heard before. There is the idea that investment banks and pension funds, with few exceptions, have not taken a stand against decisions of companies in which they invest.

Finally, the firm that Mr. Bogle founded, Vanguard, has argued for years that the fees charged by its competitors are far too high, which, of course, is one way to get across the point that Vanguard is a lower-cost alternative.

But just because the arguments aren't new or may be somewhat self-serving doesn't detract from their legitimacy. On the other hand, you can certainly quibble with his proposed solutions. After all his tough talk, they are surprisingly weak. A main recommendation from Mr. Bogle, who describes himself as a lifelong Republican, calls for a new "national commission to recommend policies that respond to the development of our 'intermediation society.'"

You would have expected him to call for free-market solutions to what are, after all, free-market problems.

Still, the fact that he is standing up and railing against a system that has helped make him well known should generate some attention.

Ultimately, as even he concedes, it is up to the shareholders to insist that things change. After all, he asks, "when the owners of corporate America don't care about governance, who on earth should care?"