AOL Time Warner announces record loss

Nick Beams
29 April 2002

The extent of the financial bubble that developed in the US economy in the late 1990s and the scale of false accounting that accompanied it has been underscored by the announcement last week by AOL Time Warner, the world's largest media conglomerate, of the biggest quarterly corporate loss in history.

The company announced a $54.2 billion loss after taking account of the sharp decline in the value of stock used to finance the merger of the two companies in January 2001. It beat the previous record set by the fibre-optics company JDS Uniphase which announced a loss of $41.8 billion in March last year.

The massive AOL Time Warner writedown—equivalent to the entire gross domestic product of countries such as Croatia, Uruguay or Bulgaria—was made necessary by new accounting rules governing the valuation of so-called goodwill. Under the new regulations, a fall in the value of goodwill—the premium paid for an acquisition above the stated value of the assets obtained—can no longer be written off over a period of 40 years but must be recognised when it occurs.

In the case of AOL Time Warner, the collapse has been dramatic. Two years ago, when the deal was first proposed at the height of the hi-tech boom in January 2000, the two companies had a combined stock market value of $290 billion. Today AOL Time Warner's market value is around $85 billion.

Underlying this decline has been the emergence of recessionary trends throughout the world economy, in particular in the hi-tech sector.

As the *Financial Times* commented: "Only a year ago, it looked as though AOL was immune to the economics of the internet bubble. The popular online service was gaining new subscribers at the rate of about one million every two months, and it continued to rake in advertising revenue.

"Now, however, things look very different. Subscriber growth is slowing, and the lucrative online advertising agreements that it signed at the height of the internet boom have run out. Worse, AOL's strategic vision of its future—that its growth would be fuelled by new, high-speed internet services—is now in doubt."

Overall AOL Time Warner's advertising revenue fell by 13 percent, with the decline in the America Online division falling by 31 percent. In the words of one analyst, the "online ad business has collapsed."

While the loss from the asset writedown is a paper one so far as AOL Time Warner is concerned, it does have real consequences. Above all, the losses will be born by millions of ordinary workers whose pension fund contributions played such a key role in boosting the share market.

The escalation in share values over the past decade was not the product of a "new economy" or the result of increased real profits arising from the employment of new technology. Rather, it was the outcome of a continuous inflow of finance into the equity markets as a "wall of money" pushed share values way beyond historically normal levels. The more money which came into the market, the higher the share values rose. And ever-larger amounts of money were directed towards share market investments as millions of workers and professional people found there was no other way to secure the resources for the education of their children and their own eventual retirement.

The scope of the increase is indicated by figures produced by the OECD for the first half of the 1990s. These show that the value of financial assets held by investor institutions in member states (insurance companies, pension funds and investment companies) rose by $9.8 trillion between 1990 and 1995 (an amount roughly equivalent to the present GDP of the United States), an increase of 75 percent. The average annual increase of almost $2 trillion was equivalent to 10 percent of the GDP of the OECD countries during that period.

This flow of funds into financial markets boosted share prices, and enabled the financing of the type of merger deals which led to the formation of the AOL Time Warner conglomerate. That was not its only effect. Escalating share prices, financed to an ever-increasing degree by the savings, pension funds and 401(k) plans of workers and professional employees, facilitated the siphoning off of massive amounts of wealth by a thin layer of executives and executive staff, a veritable redistribution of wealth up the income scale.

An article in the May 6 edition of *BusinessWeek* noted that management theorist Peter Drucker argued in the mid-1980s that no CEO should receive more than 20 times the company's lowest paid employee in order not to make a mockery of the contribution of other employees.

"After massive increases in compensation," it continued, "Drucker's suggested standard looks quaint. CEOs of large corporations last year made 411 times as much as the average factory worker. In the past decade, as rank-and-file wages increased 36 percent, CEO pay climbed 340 percent, to $11 million."

This concern with income inequality reflects a fear that the increasing revelations of the outright fraud and looting at the heart of corporate America could have far-reaching political consequences.

As *BusinessWeek* commented: "Faith in Corporate America hasn't been so strained since the early 1900s, when the public's furor over the monopoly powers of big business led to years of trust-busting by Theodore Roosevelt. The latest wave of skepticism may have started with Enron Corp's ugly demise, but with each revelation of corporate excess of wrongdoing, the goodwill built up by business during the boom of the past decade has eroded a little more, giving way to suspicion and mistrust. An unrelenting barrage of headlines that tell of Securities & Exchange Commission investigations, indictments, guilty pleas, government settlements, and financial restatements, and fines has only lent greater credence to the belief that the system is inherently unfair."

According to the magazine's editorial, the problems arose because between 1997 and 2000 "some proportion of the business elite moved into a different moral landscape from the rest of the country" and broke the rules of "fairness and equity." Therefore it is necessary to reform "corporate governance" in order to reinstate them.

It is doubtful, however, such explanations—based on the assertion that a previously healthy system suddenly became afflicted with the disease of greed and corruption at the end of the 1990s—are going to wash. As more facts come to light, it will become clear that the looting of the economy, which has destroyed the life savings and future of millions of people, is endemic to the profit system itself.