Is Short-Termism Really a Problem?

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AFA, January 2021

Hillary Clinton Calls for Investors to Escape 'Tyranny' of 'Short Termism'

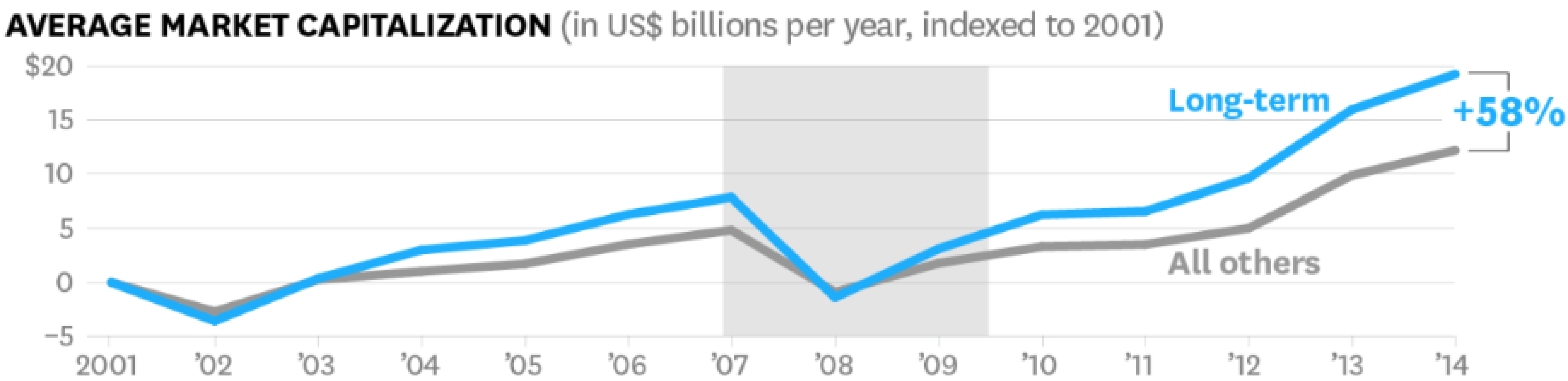
Short-Termism Is Harming the Economy

By Jamie Dimon and Warren E. Buffett
June 6, 2018 10:00 pm ET

Many academics and practitioners believe that myopia is a first-order problem faced by the modern firm. In the last century, firms were predominantly capital-intensive, but nowadays competitive success increasingly depends on intangible assets such as human capital and R&D capabilities (Zingales (2000)). Building such competencies requires significant and sustained investment. Indeed, Thurow (1993) argues that investment is an issue of national importance that will critically determine the U.S.'s success in global competition.

Joe Bower and Lynn Paine “had me at hello” (to quote *Jerry Maguire*) with their new HBR article, “The Error at the Heart of Corporate Leadership.” Laying out their data, they find that long-term oriented companies create more financial value and more jobs. In fact, if more American companies were focused on the long term, they estimate, investors would have an additional $1 trillion, workers would have an additional 5 million jobs, and the country would have more than an additional $1 trillion in GDP.

by Roger L. Martin



What if all U.S. companies had taken a similarly long-term approach? Extrapolating from the differences above, we estimate that public equity markets could have added more than $1 trillion in asset value, increasing total U.S. market cap by about 4%. And companies could have created five million more jobs in the United States—unlocking as much as $1 trillion in additional GDP.

Is Short-Termism a Problem?

- The wrong question – almost by definition, it's a problem
- Just like asking: "is mortality a problem?"
- What are the causes of short-termism?

1. Short-Term Shareholder Value

- European Commission: "The focus of corporate decision-makers on short-term shareholder value maximisation"
  - Advocates a move towards "stakeholder capitalism"
- Finance 101: shareholder value is an inherently long-term concept
  - The solution may be *more* shareholder capitalism, not less
  - The problem isn't shareholder capitalism, but managerial capitalism
    - Bebchuk and Tallarita (2020), Raghunandan and Rajgopal (2020)
    - Flugum and Souther (2020): "Stakeholder Value: A Convenient Excuse for Underperforming Managers?"
  - Kaplan (2019), Roe (2020): other evidence that short-termist claims may be overblown

1a. Governance Through Voice

- Brav, Jiang, Partnoy and Thomas (2008): Stock price increases by 7%
  - No long-term reversal
  - Bebchuk, Brav, and Jiang (2015): After exit (2 years), stock prices keep rising for next 3 years
- Brav, Jiang, and Kim (2015):
  - Increased ROA
  - Increased total factor productivity (output relative to labour input)
  - Increased labour productivity

1a. Governance Through Voice

- Brav, Jiang, Ma, and Tian (2018): R&D expenditure *falls*
  - But number and quality of patents rises
- Increased performance of plants and patents sold

1b. Governance Through Exit

- "Long-term capital is more valuable than short-term capital, plain and simple. If you give me $100 but say that you have the right to take it back with 24 hours notice, it isn't nearly as valuable to me" (Roger L. Martin)
- *Holding period* of a shareholder is critically different from her *horizon*
  - ST selling could be based on LT information: Edmans (2009)
  - Governance through exit improves firm value: Bharath, Jayaraman, and Nagar (2013), Edmans, Fang, and Zur (2013)
  - Loyalty schemes reward doing nothing (VW)
- Problem is fragmented shareholders, not ST shareholders

2. Share Buybacks

- Elizabeth Warren: “stock buybacks create a sugar high for the corporations. It boosts prices in the short run, but the real way to boost the value of a corporation is to invest in the future, and they are not doing that”
- William Lazonick: 91% of net income goes to buybacks and dividends. “That left very little for investments in productive capabilities or higher incomes for employees.”

2. Share Buybacks

- Ikenberry, Lakonishok, and Vermaelen (1995), Manconi, Peyer, and Vermaelen (2019): positive ST *and* LT returns to buybacks
- Fried and Wang (2019): cash balances rose > 50% from 2007-2016
- Bennett, Bettis, Gopalan and Milbourn (2017) and PwC/Edmans (2019): buybacks don't inflate CEO pay

3. Executive Pay

- Stein (1988, 1989): short-term pay leads to underinvestment
  - Edmans, Fang, and Lewellen (2017): vesting equity leads to investment cuts
  - Ladika and Sautner (2020): accelerated option vesting leads to investment cuts
- Edmans, Gabaix, Sadzik, and Sannikov (2012), Marinovic and Varas (2019): long-term pay boosts investment
  - Flammer and Bansal (2017): shareholder proposals to implement long-term pay increase profitability, innovation, and ESG performance

4. Quarterly Reporting

- Empirics: Graham, Harvey, and Rajgopal (2005); Theory: Gigler, Kanodia, Sapra, Venugopalan (2014), Edmans, Heinle and Huang (2016)
- Almeida (2019)
- Almeida, Fos, and Kronlund (2016): buybacks induced by EPS forecasts lead to lower employment and investment
- Almeida, Ersahin, Fos, Irani and Kronlund (2020): with labor unions, investment cuts are across-the-board, irrespective of plant productivity

Conclusion

- Short-termism does affect investment, but only certain causes of short-termism (executive pay, quarterly earnings)
  - Shareholder capitalism is inherently a long-term concept
  - Buybacks are a symptom of quarterly earnings, not an underlying cause