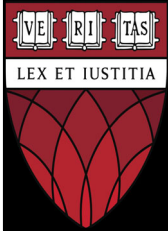


# Stock-Market Short-Termism?

Asian Institute of Corporate Governance  
Korea University Business School

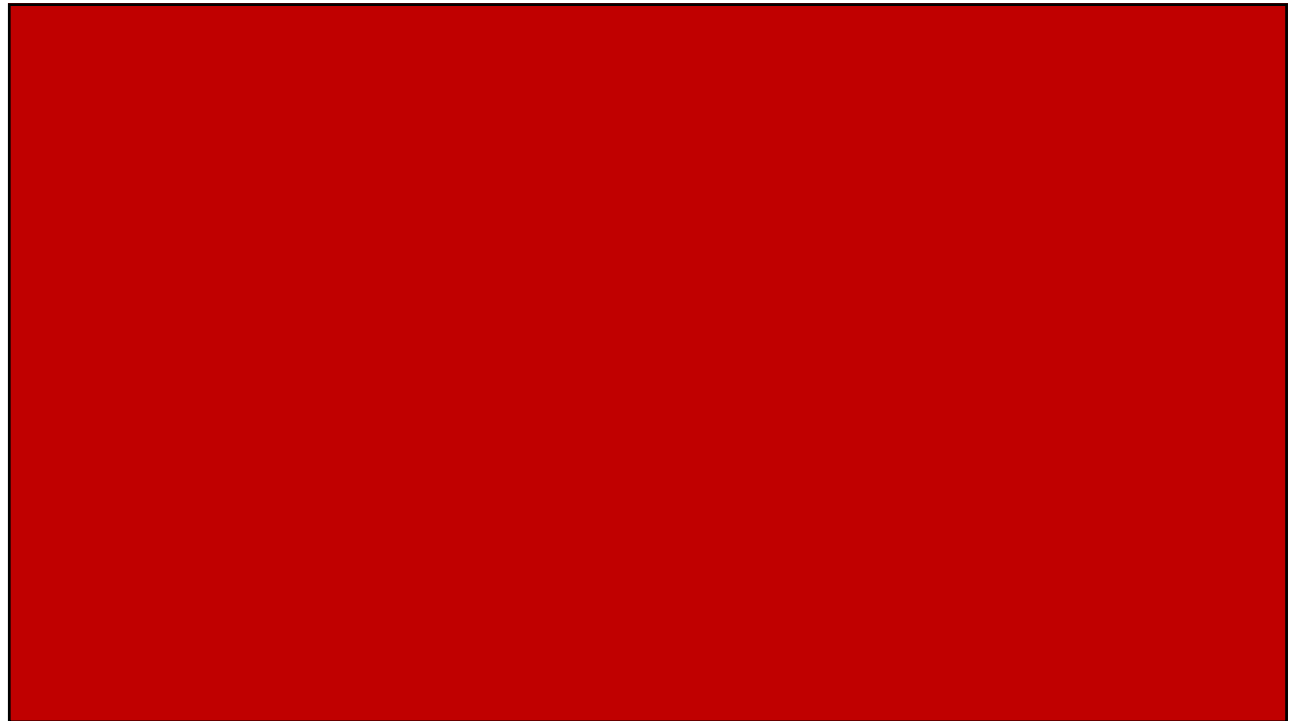


Mark J. Roe

Missing the Target: Why Stock Market Short-Termism Is Not the Problem (Oxford, 2022)



1



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## Four short-termism issues

3

## Four short-termism issues

- 1. What Is Stock Market Short-Termism?

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## Four short-termism issues

- 1. What Is Stock Market Short-Termism?
- 2. What Does the Evidence Tell Us?

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## Four short-termism issues

- 1. What Is Stock Market Short-Termism?
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## Four short-termism issues

- 1. What Is Stock Market Short-Termism?
- 2. What Does the Evidence Tell Us?
- 3. What are the Cures and their Costs?
- 4. Why the (Over-)Attention to Short-Termism? Politics and Psychology

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## Four short-termism issues

- **1. What Is Stock Market Short-Termism?**
- 2. What Does the Evidence Tell Us?
  - Macro
  - Firm-level
- 3. What are the Cures and their Costs?
- 4. Why the (Over-)Attention to Short-Termism? Politics and Psychology

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"The finance world's short-termism will destroy our communities, economies and the planet," the **World Economic Forum** was told in Davos.

See **Klaus Schwab, Ending Short-Termism by Keeping Score**

---Schwab is the Forum's founder and leader

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## Klaus Schwab, Stakeholder Capitalism

- The World Economic Forum, again!
- “Companies do not have to stop pursuing profits for their shareholders,” he indicates.
- “[T]hey [only need to] shift to a long-term perspective.”
  - Klaus Schwab & Peter Vanham, Stakeholder Capitalism: A Global Economy That Works for Progress, People and Planet 185-86 (2021).

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An Example

### The EU’s Sustainable Corporate Governance Project

1. Sustainable is long-term
2. Stock market trading is short-term
3. Therefore, make the stock long-term to be sustainable.

(Common thinking in US SEC filings.)



Critics pointed out that the climate issue is primarily an externality issue, with time horizons of ind'l investors and corporations secondary.

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“The ESG movement has compelled corporate leaders to reconsider the shareholder-centric model that has guided investment and corporate decision making through much of our country’s history. **Central to this movement are criticisms that companies today are too short-term oriented**, exposing themselves to long-term risk and **generating externalities that are harmful to society.”**

--Brian Tayan and David F. Larcker,  
*Seven Gaping Holes in Our Knowledge of Corporate Governance*

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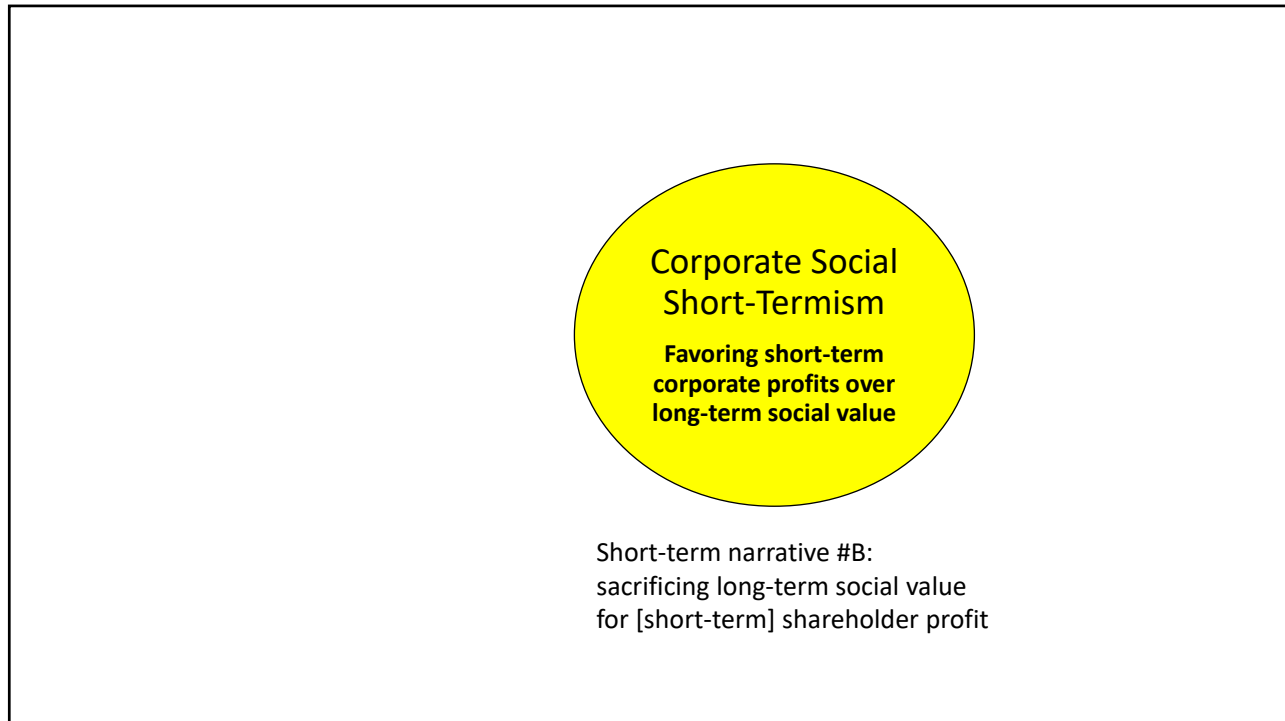


### Corporate Short-Termism

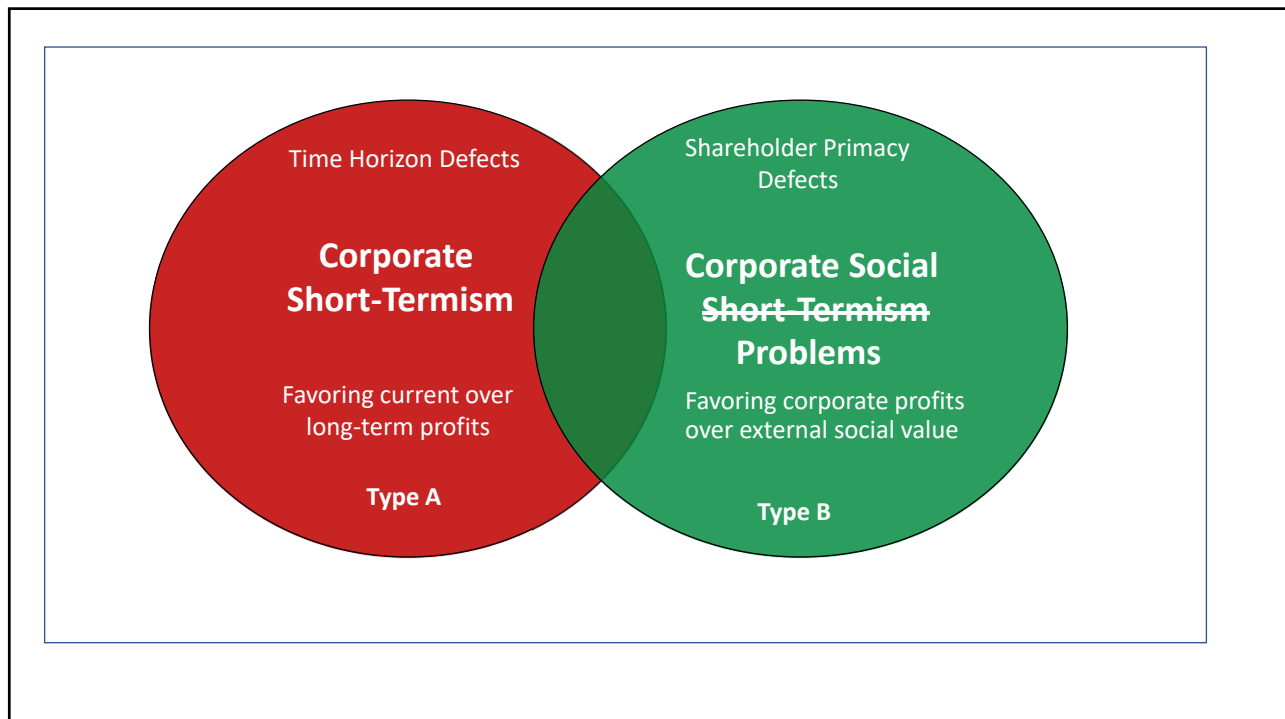
Favoring current over  
long-term profits

Short-term narrative #A:  
sacrificing long-term profits for  
short-run profits and stock price.

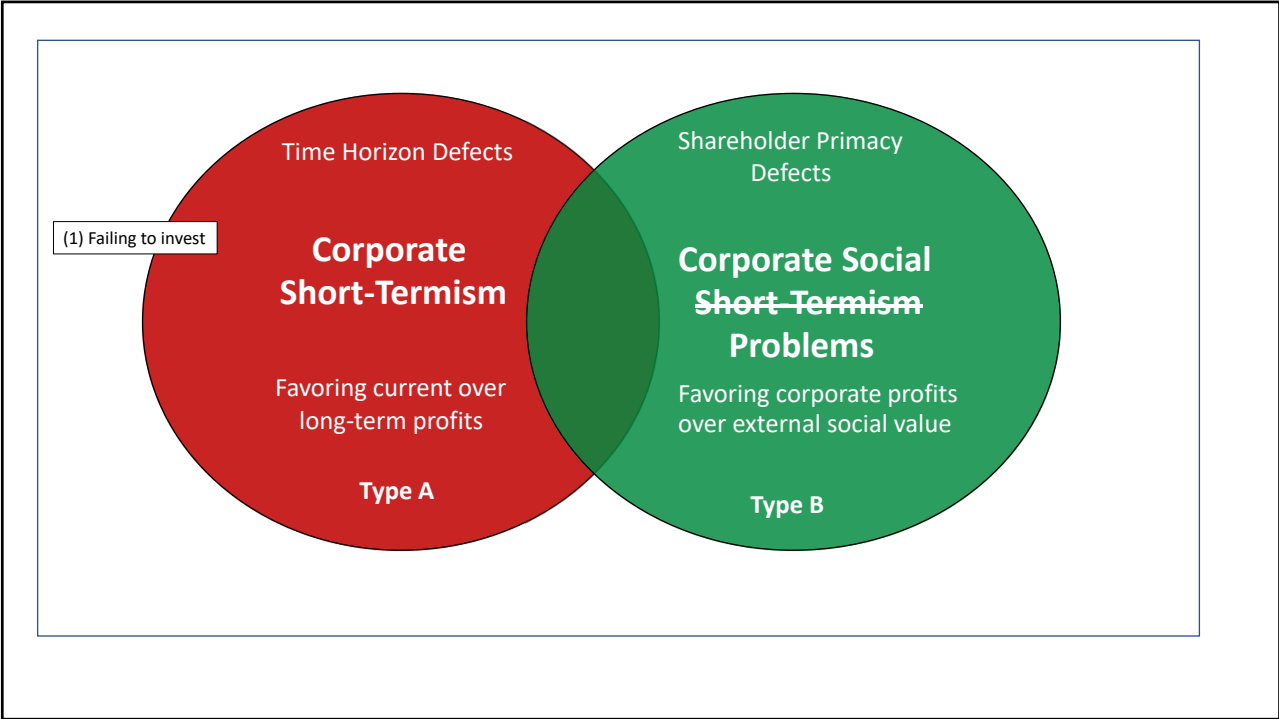
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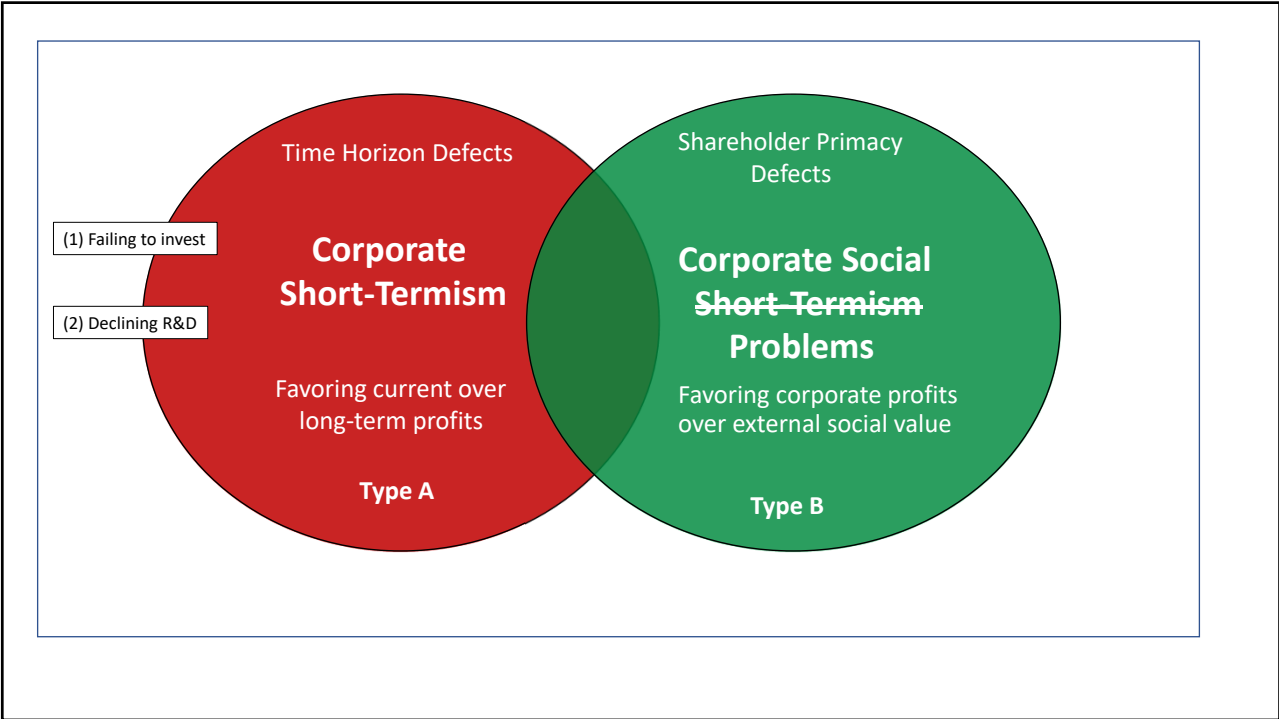
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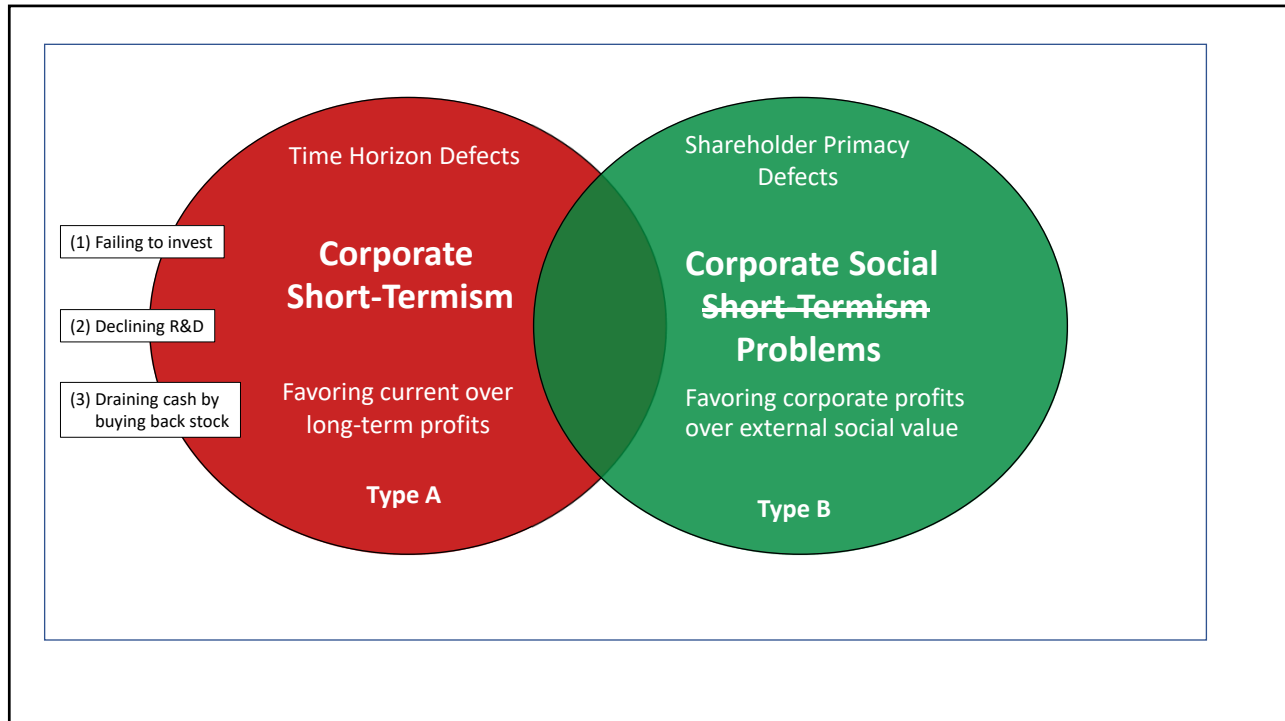
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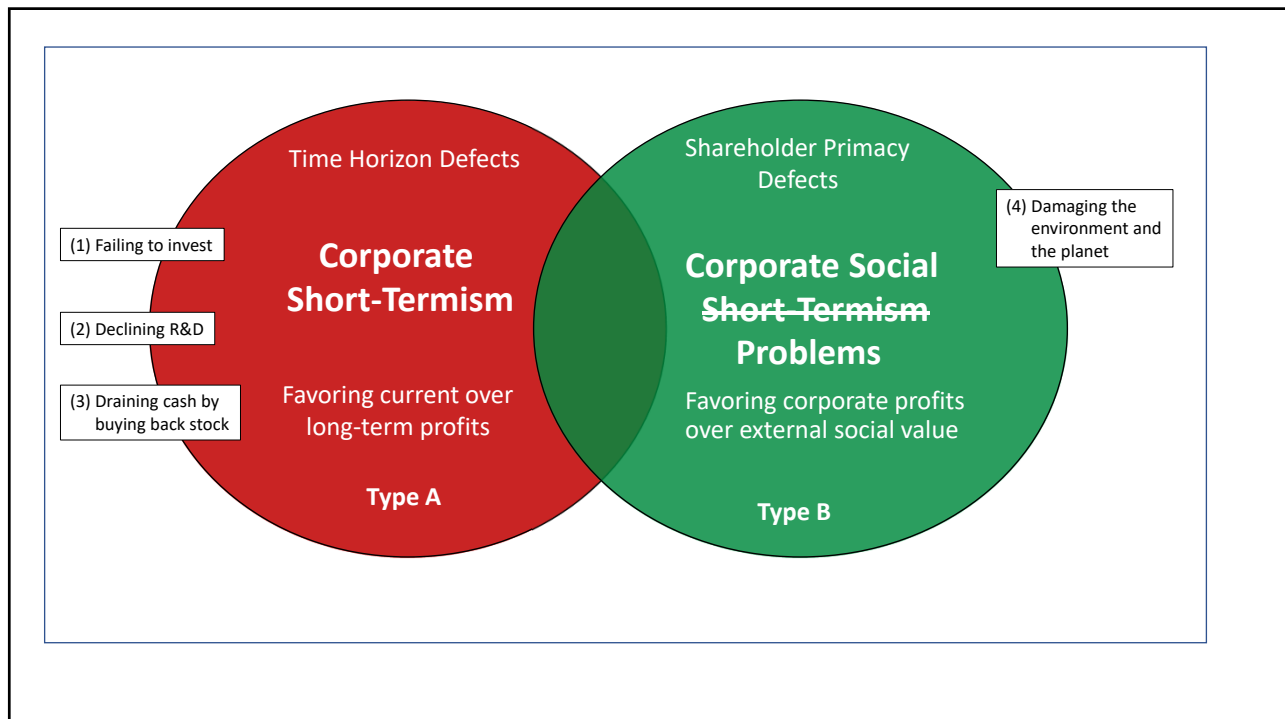
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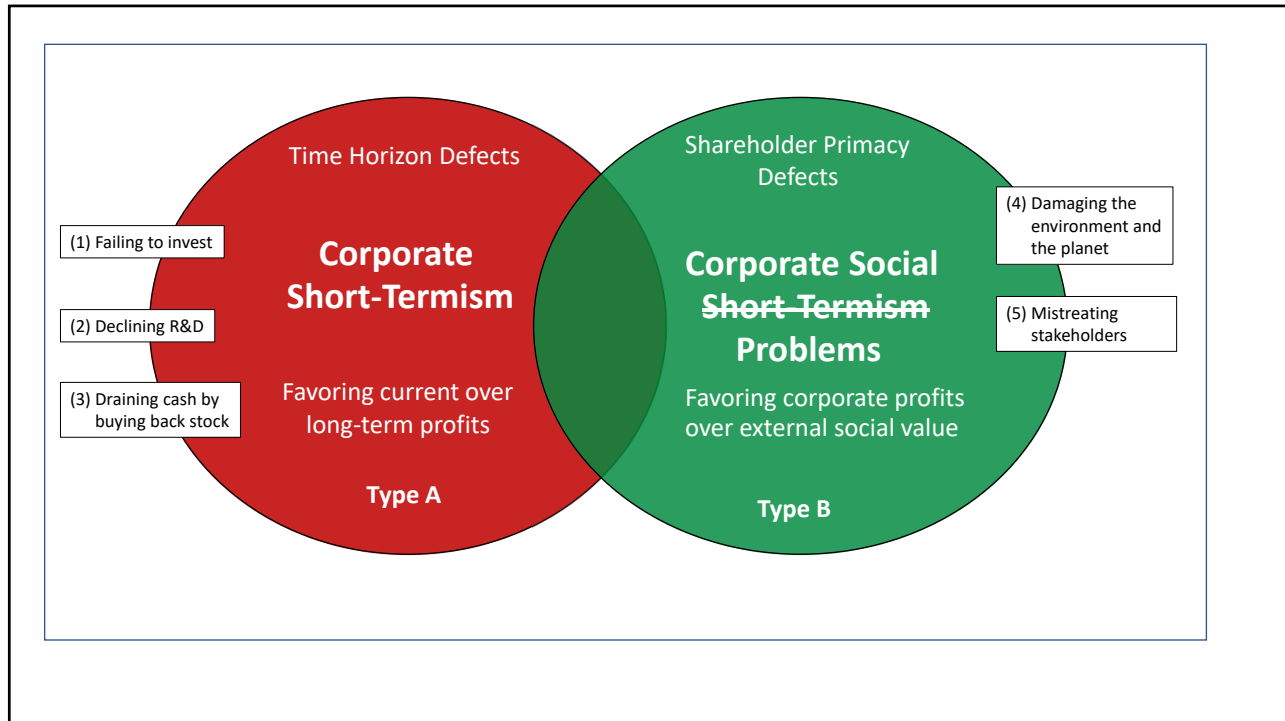
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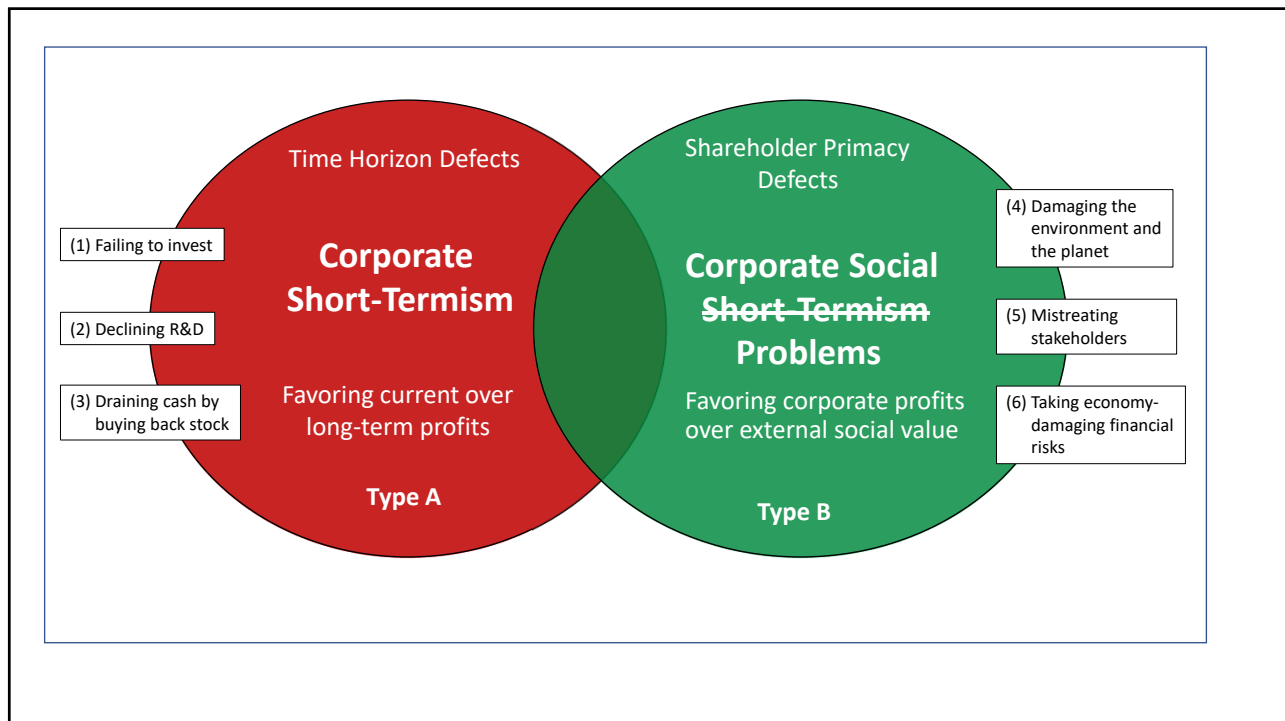
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**Stock Market Driven**  
**Short-termism**

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Consider ExxonMobil (or Total, or Shell)

- Climate change critics: short-term stock market value dominates
- But is ExxonMobil really a short-term operation?
- It is planning where to get petroleum in the 2050's
- The analytic issue is one of externalizing costs

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## (Part IV:) Opportunity to coopt

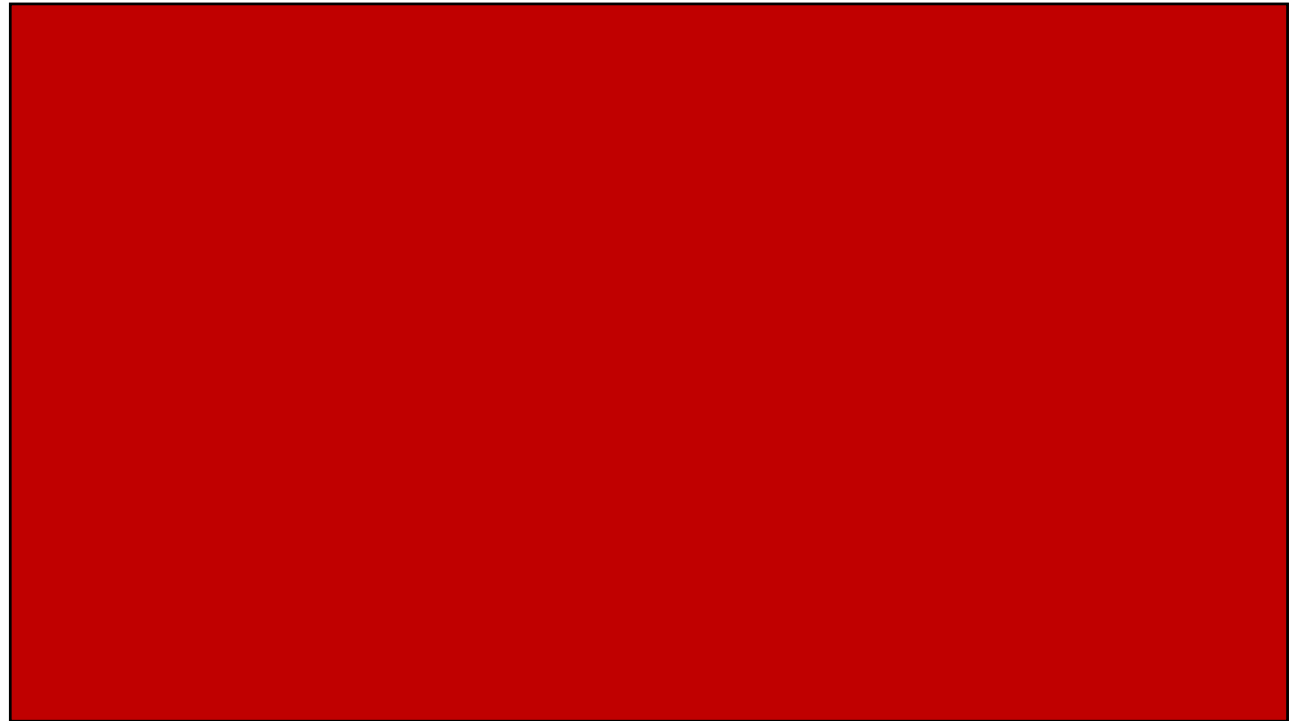
- Short-term companies pollute more and are climate unfriendly
- Stock market is short-term; management is long-term
- Therefore give more authority to management
  - (Implication: it's for the good of the planet.)

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## Conclusion for Part I: What Is Stock Market Short-termism?

- Policymakers and the media see stock market short-termism as a major debility holding back the economy.
- First message for policymakers:
  - **Don't over-aggregate** problems: ***much*** that is ***labelled*** short-termism is really a problem of externalities
    - Hence, the short-termism problem is smaller
      - (And the externalities problem is BIGGER!!)
    - And the cures (for externalities) are NOT from manipulating corporate time horizons

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## Four short-termism issues?

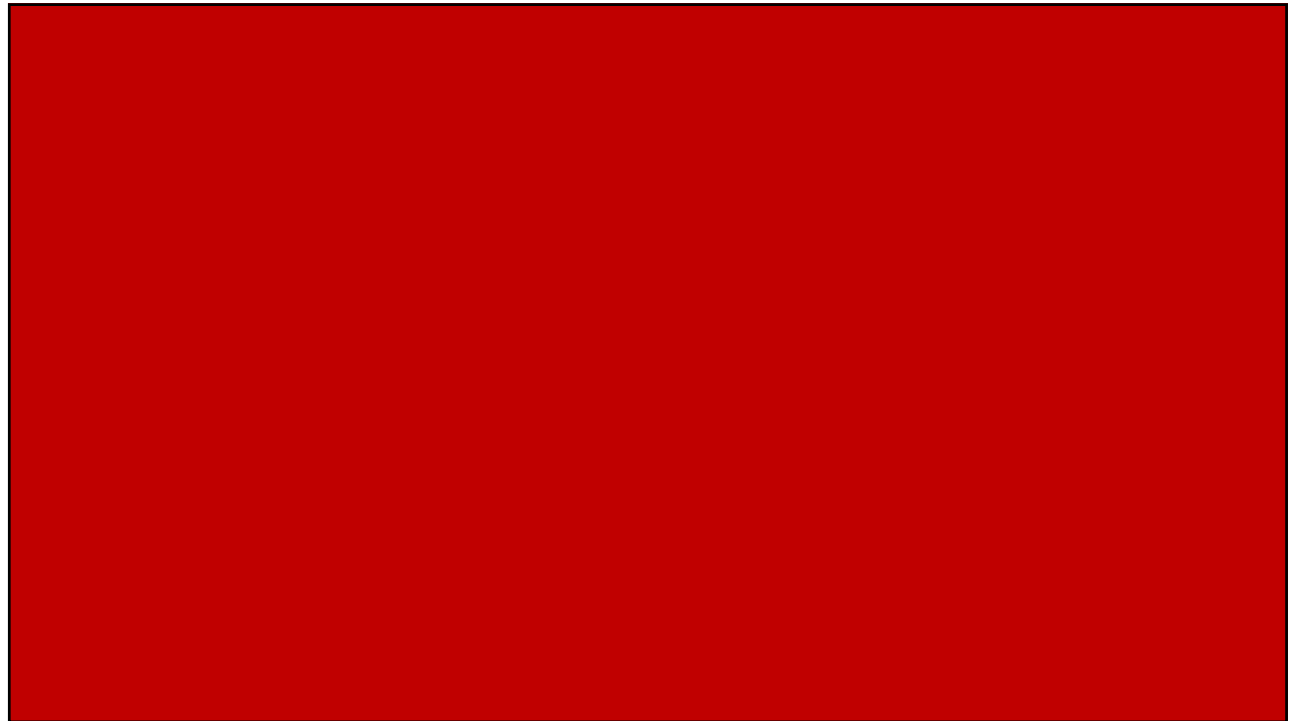
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- **2. What Does the Evidence Tell Us?**
  - Macro
  - Firm-level
- 3. What are the Cures and their Costs?
- 4. Why the (Over-)Attention to Short-Termism? Politics and Psychology

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## Brief look at the “macro” evidence

- 1. Divided.
- 2. On Narrative A, true time horizons:
  - Declining R&D
  - Declining investment
  - Stock buybacks
- 3. The “partial equilibrium” problem

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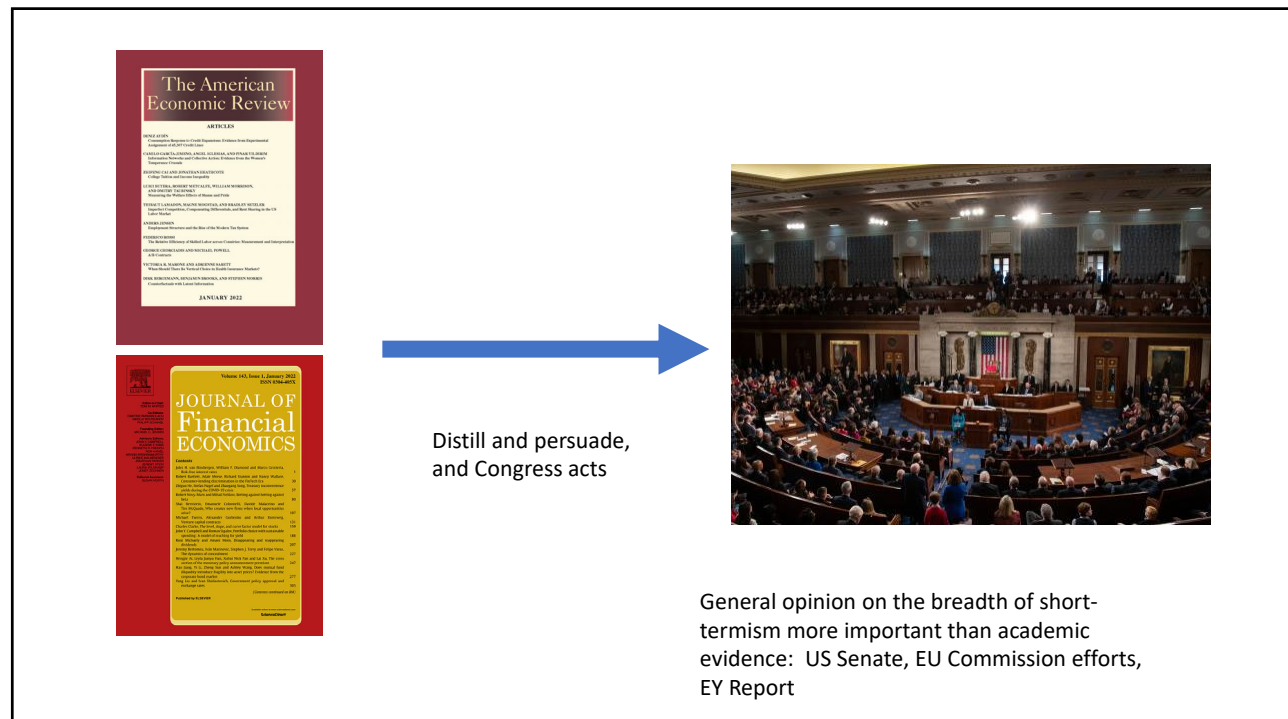


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## Four short-termism issues

- 1. What Is Stock Market Short-Termism?
- 2. *What Does the Evidence Tell Us?*
  - *Macro*
  - ***Firm-level (or “micro”)***
- 3. What are the Cures and their Costs?
- 4. Why the (Over-)Attention to Short-Termism? Politics and Psychology

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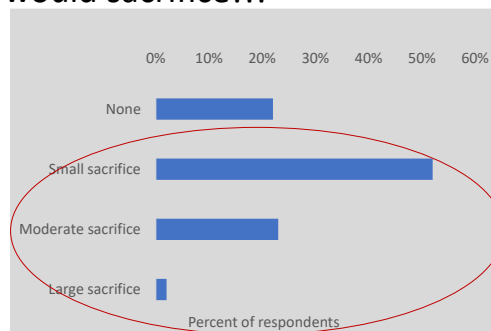
## Divided

- Look at one major study
- What do the CFO's say: "we'd sacrifice value to avoid earnings volatility"
  - 78% would!!!
- Graham, Harvey & Rajgopal's famous study
  - Big result, lots of attention
- Conceptual problems (as authors recognize)
  - 10% return rate: selection effect?
  - Executives THINK they're sacrificing. Are they? How often?
  - 78% say, if circumstance arises, we'd sacrifice
- Public companies invest less than a matched sample of private companies
  - Asker et al.

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## "How Large a Sacrifice in Value Would You Make to Avoid Volatile Earnings?"

- "Astounding 78% would sacrifice!!!"

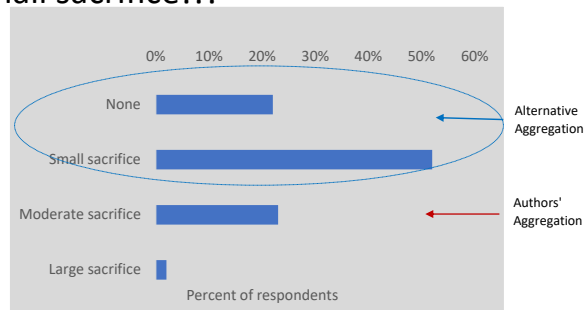


<sup>111</sup> Graham, Harvey & Rajgopal, at 49.

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## Alternative interpretation of the data?

- **Despite all the talk of short-termism**, only 25% would make anything more than a small sacrifice!!?



© Graham, Harvey & Rajgopal, supra note 25, at 49. Abraham Schwartz, a Harvard Law School student, pointed out the alternate aggregations in a seminar discussion.

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## 78%!!

- What they say
  - Could be long-term
  - Signal from stock market
  - Lower earnings signals management of a potential problem
    - That some ignore
- 78% of what?
  - Of all firms in every quarter?
  - No!
  - 78% says what they'd do IF they faced volatility
  - Many/most do not
  - And of those that do, only 25% say they'd do anything more than small

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	Projected Decrease in Earnings (End of Quarter)	Actual Decrease in Earnings	Change in S&P 500 index	Unemployment Rate (%)
Q1 2020	<b>-7.0%</b>	<b>-15.0%</b>	<b>-20.0%</b>	3.5
Q2 2020	<b>-44.2%</b>	<b>-31.6%</b>	<b>25.5%</b>	14.7
Q3 2020	-21.2%	-5.7%	<b>7.9%</b>	10.2
Q4 2020	-9.2%	3.9%	11.1%	6.9

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## Conclusion from Part II: The Evidence

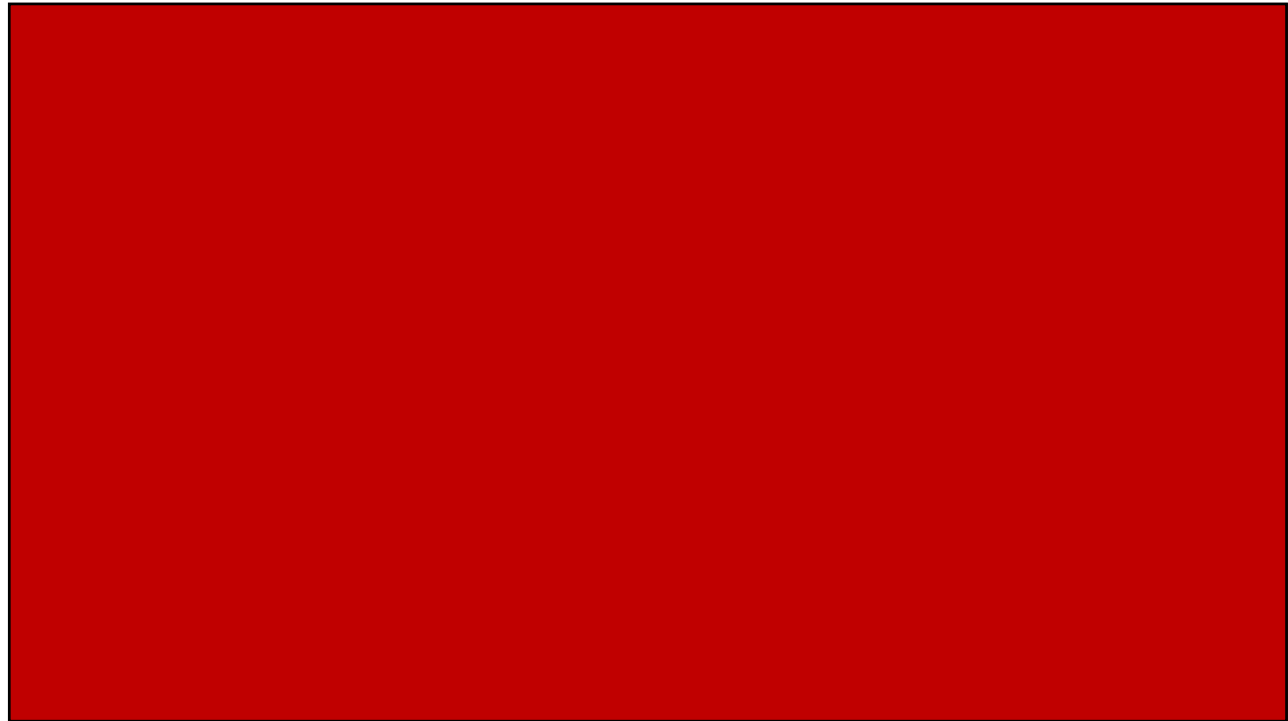
- For policymakers:
  - Don't assume we have a severe case of stock market short-termism. The evidence points to it being a small problem
  - Don't over-aggregate problems: ***much*** that is ***labelled*** short-termism is really a problem of externalities
    - Hence, the problem is smaller
    - And the cures (for externalities) are NOT from manipulating corporate time horizons

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## Market Structure (U.S.)

- 1. Very large private equity financing
  - Not subject to stock market pressure (as much, as directly)
  - If public companies miss profit opportunities, private equity should grab them.
- Where does breakthrough R&D come from?
  - US government financing?
  - Cf. Covid multi-billion-dollar US bet
- What reform if worried about US R&D?
  - Fund NIH better??

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## Four stock-market short-termism issues

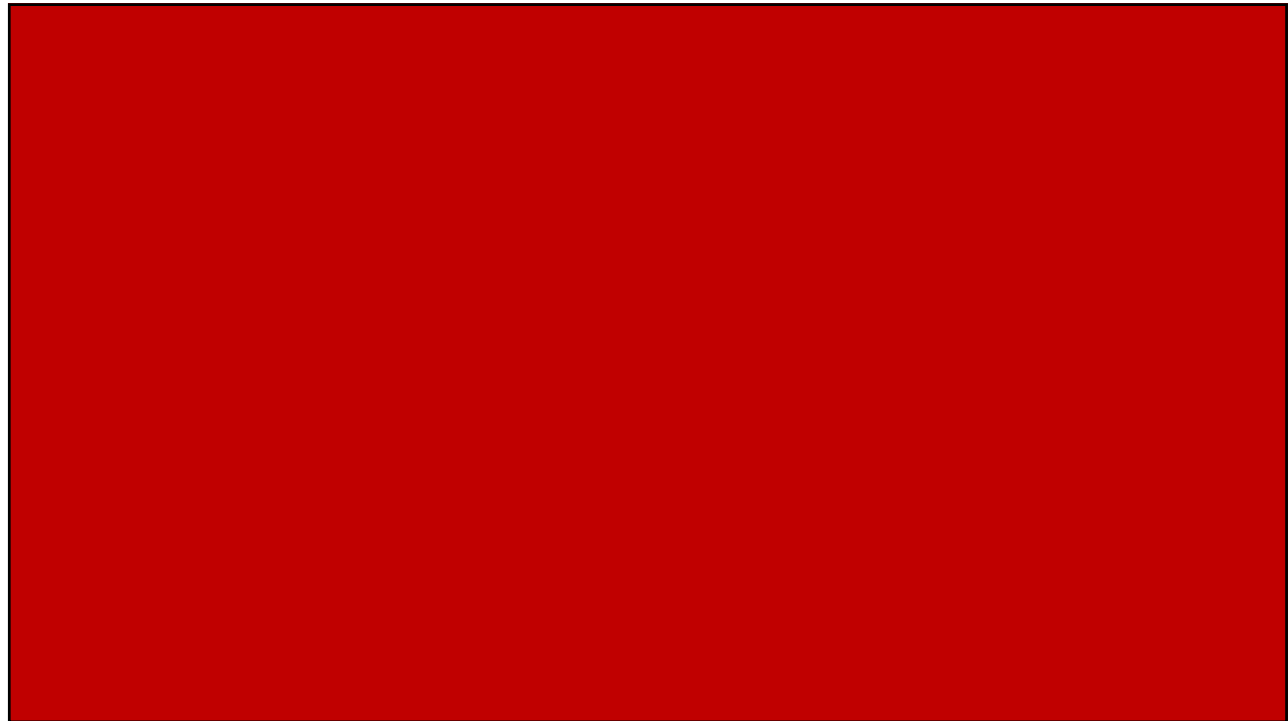
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## Cures and costs

- Many of the cures involve weakening shareholder power inside the corporation
  - Belief that management and boards are more long-term than the stock market
- Many cures involve dampening trading
  - Taxing trades themselves
  - Lower taxation of long-term holding
- Less frequent reporting

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## Four short-termism issues

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## Explanations

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## Explanations

- The interests

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## Explanations

- The interests
  - *Executives* and boards

48

## Explanations

- The interests
  - ***Executives*** and boards
  - ***Employees and social critics*** of the large corporation

49

## Explanations

- The interests
  - ***Executives*** and boards
  - ***Employees and social critics*** of the large corporation
- Psychology

50

## Explanations

- The interests
  - **Executives** and boards
  - **Employees and social critics** of the large corporation
- Psychology
  - Long-term psychologically better than short-term

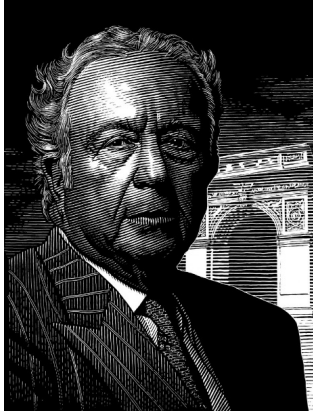
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## Explanations

- The interests
  - **Executives** and boards
  - **Employees and social critics** of the large corporation
- Psychology
  - Long-term psychologically better than short-term
  - Traders seem short-term
    - Even if the abstraction---the market---is longer term
  - See work with Roy Shapira

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**Corporate discourse**  
**Martin Lipton's well-known justification to further empower managers to defeat hostile takeovers:**



**“It would not be unfair,” he wrote, “to pose the policy issue as: *Whether the long-term interests of the nation’s corporate system and economy should be jeopardized in order to benefit speculators interested . . . only in a quick profit . . . ?*”**

- Martin Lipton, *Takeover Bids in the Target’s Boardroom*, 35 BUS. LAW. 101, 104 (1979).
- Repeated regularly

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## Management spokesperson in 2023

- Is “the purpose of the corporation . . . to maximize **short-term profits** for shareholders or, instead, to operate in the interest of all of its various stakeholders to promote the long-term value of the corporation.
- Martin Lipton 2023 memo

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DJIA 25256.00 -1.04% ▼    S&P 500 2799.21 -0.83% ▼    Nasdaq 7203.81 -0.53% ▼    U.S. 10Yr 2.72% Yield 2.83% ▲    Crude Oil 44

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<http://www.wsj.com/articles/how-short-termism-saps-the-economy-1470018287>

OPINION | COMMENTARY

## How Short-Termism Saps the Economy

Paying CEOs so much in stocks puts their focus on the share price instead of building for the long run.




PHOTO: GETTY IMAGES/ISTOCKPHOTO

By Joe Biden  
 Sept. 27, 2016 7:14 p.m. ET

Short-termism—the notion that companies forgo long-run investment to boost near-term stock price—is one of the greatest threats to America’s enduring prosperity. Over the past eight years, the U.S. economy has emerged from crisis and maintained an unprecedented recovery. We are now on the cusp of a remarkable resurgence. But the country can’t unlock its true potential without encouraging businesses to build for the long-run.

Private investment—from new factories, to research, to worker training—is perhaps the greatest driver of economic growth, paving the way for future prosperity for businesses, their supply chains and the economy as a whole. Without it robust growth is nearly impossible. Yet all too often, executives face pressure to prioritize today’s share price over adding long-term value.

Biden: “Short-termism---the notion that companies forgo long-run investment to boost near-term stock price---is one of the greatest threats to America’s enduring prosperity.”

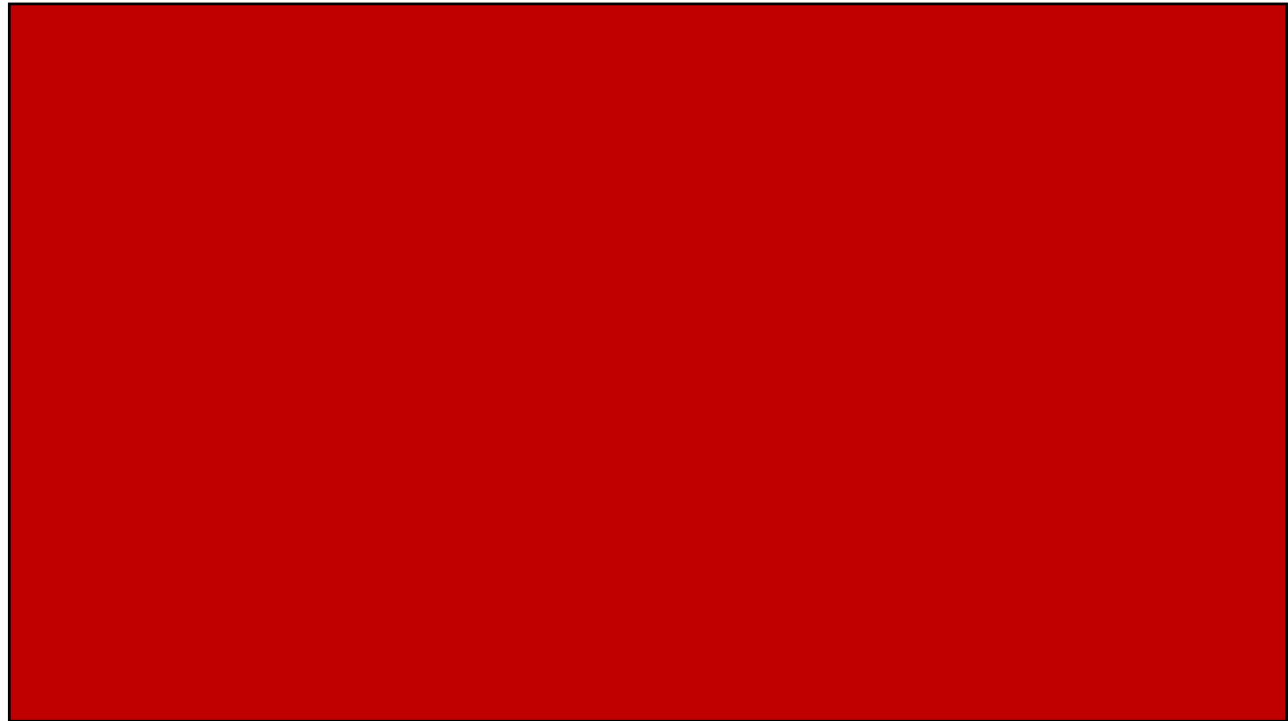
Biden, when “asked . . . to describe the big forces that have flattened working-class wages over the decades . . . [,] pointed to two institutional failures—[one being xxx] and [the other being] the way Wall Street forces business leaders to focus obsessively on the short term.”

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## Why it Matters: Powerful Narratives Make Bad Policy?

- Crowds out more worthy solutions
- Used by interests to push bad solutions

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## Four Issues:

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