

Who is Short-Term?

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Standard story

- Financiers look to quarterly return
- Hence, they ignore (or, more realistically) down-play) long-term investment in a company's employee morale, employee skills, R&D, brand

Standard story

- Financiers look to quarterly return
- Hence, they ignore (or, more realistically) down-play) long-term investment in a company's employee morale, employee skills, R&D, brand
- Not convincing

Not convincing, in standard form

- Why?
- Short-term traders must sell to another investor
- Hence, the *market's* time horizon is not just the next quarter but the horizon of the next investor
- And the next investor's horizon is the horizon of its purchaser
- And so on
- A succession of short-run, quarterly returns becomes the long-run

Compensation?

- Compensation is short-term
- Investment manager paid in quarterly, or maybe annual, bonuses
- Very poor results this year can mean that the investment manager isn't employed in the long-run
- But this too suffers from the “chain-of-horizons” problem
- To get a “pop” in price, have to sell to someone whose horizon stretches out an extra quarter, who in turn must sell to someone who has a horizon stretching longer
- Again, the long-run as a succession of short-runs

A more convincing, non-standard story?

- Yes.
- Even in a rational market.
 - (Irrationality, bubbles, over-reaction are another story)
- Information.
- For a stock to be properly valued for the long-run, the stock market must be able to assess the long-run potential of the company.
- But, can the stock market process that information well?

Information story

- Complexity, but worth 100
- Misunderstood by investors, trades at 80
 - Marked down
- Carl Icahn can buy-up, force company to be simpler, but worth less, at 90.
 - Re-sells for 90, but has diminished value
- If internal information is frequently too hard for the market to process, then this story is plausible
 - Contra: data on R&D

But ...

- Stock market does ***not*** punish R&D expenditures
- As measured by dividend pay-outs, US SHs are ***more*** long-term than other countries' SH
 - US dividend yield (i.e., cash NOW) lower than rest of the world
 - Marsh; Bengzten
- These two findings are inconsistent with broad short-term nature of stockholdings

Net?

- Can't trust the stock market
 - Although not for the usual reasons

Other players?

- If the analysis/results for the investors are mixed, is anyone else subject to short-term pressures?
- Consider the CEO.

Or, CEO is short-term?

- Nears retirement
 - Peak of career
- Pay?
 - Could motivate for long-term
 - Solutions:
 - Can't cash out equity for X years
 - Compensate in debt
 - But who will monitor/control?
 - Bright-line rule from outside?
 - No cash out for 5 years?
 - Problems
 - BUT CEO often controls/influences comp package
 - CEOs are rich. Harder to incentivize

CEO tenure

- Average tenure shortening (in U.S.)
- Now down to 5 years
- So average CEO is expecting to be in place for 2½ years
 - So, even aside from compensation, CEO just looking to make an impression will have a shorter time horizon than usual
 - Legacy is short-term performance

Survey data

- CEO's say they would sacrifice some long-term earnings for a hit to short-term reported profits
 - Graham, Bengzten
 - Impact on job security
 - Personal embarrassment
 - Negative for stock analysts

So?

- Can't trust the stock market
- Can't trust the CEO

Anyone else?

- If stories for investors and CEOs are mixed, who else could influence short-term vs. long-term?
- Consider individual or family owners as the potential solution to short-termism

So, promote an ind'l owner

- Large blockholder unites incentives and control. Motivated to gather and assess long-term value
 - Strongly mitigates short-term information problem of stock markets.
 - Strongly mitigates horizon of CEO nearing retirement, esp if the family cares about the next generation
- Really a solution?
 - But, under-diversified
 - Ind'l/family is overly risk-averse
 - Once wealthy enough, ind'l/family/blockholder adds other, non long-term \$\$ goals (Demsetz)
 - Whether or not short-term, has incentives inconsistent with long-term value

So?

- Can't trust the stock market
- Can't trust the CEO
- Can't trust the family/individual owner

So?

- Can't trust the stock market
- Can't trust the CEO
- Can't trust the family/individual owner
- How about the Board of Directors?
 - (Lots of faith in Board in the U.S., less faith elsewhere in the world)

Or, board is short-term

- Outside directors cannot understand the nitty-gritty of a complex company
- They might do better than distant SH, but still can't figure out the engineering potential of this process, the organizational value of investing in employee skills
 - So:
 - Outside directors suffer from SH horizon debilities
 - Inside directors suffer from CEO horizon debilities

So?

- Can't trust the stock market
- Can't trust the CEO
- Can't trust the family/individual owner
- Can't trust the Board of Directors
 - Which combines the short-term problems of outside SH with problems of insider CEO
- How about employees?

Or, employees are short-term?

- Employees with jobs today want stability
 - Even if technology is making their jobs obsolete
- Average age of the company's work-force?
- Level of concern for future employees (as proxy for long-term)?
 - Less than level of concern for their own jobs
 - Use up invested capital to protect their own jobs. (US auto industry)
 - Chrysler-FIAT

Employee-SH complexities

- Could the long-term/short-term argument be this:
 - Employees and others make long-term skill investments in the production process
 - Shareholders do not
 - Sometimes these skills become redundant
 - SH would kill off this firm
 - But killing off this firm will discourage future long-term investments

Logic?

- It's plausible. But....
- Possibility does not show how important
- And giving vent to this consideration is risky:
 - It can then justify continued public investment in losing enterprises
 - Cf. General Motors, Chrysler, US steel industry
 - Perhaps some EU heavy industry as well

Or, public authorities?

(such as public investors)

- Quasi-political players satisfy incumbent groups
 - That's where the votes are
- So, they are pressed to slow down change
 - U.S.: auto industry
 - Today's voters have jobs and want to keep them
 - The long-term is made up of *new* jobs, but the next generation doesn't vote
- So, CalPERS, Club of Long Term Investors have potential, but pressed to favor today's interests, not tomorrow's

Future of US Auto Industry?

- Long-term contraction of core US automakers
- Over 4 decades
- Most industry projections: niche players, making SUVs is their future
 - Unless something changes
- So what does government do?
 - FIAT/Chrysler
 - Is it the government here that's short-term?

Alternate goal for public investors

- Talleyrand: “statesmanship is to foresee the inevitable and expedite its occurrence.”
 - In one dimension, public authorities and public investors are well-positioned to thwart a short-term melt-down
 - If there’s a crisis and backlash against institutions, public authorities might dampen the backlash with investment decisions that reduce a polity’s destructive appetite.
 - How often does this happen?

The really big picture

- Should we sometimes pay a short-term price in productivity, SH value, to preserve the long-term viability of the economy?
- Usually it's not an issue
- It's historically been less of an issue in the U.S. than elsewhere

But sometimes it is an issue

- Could a (slightly) less productive corporation have more long-term viability?
- Could a slightly less productive society be more viable in the long-term?

Consider Greece

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ΤΕΡΜΑ ΠΙΑ ΣΤΗΝ ΚΟΡΟΪΔΙΑ
ΤΗΝ ΚΡΕΙΤΤΗΡΑ ΔΙΑΧΕΙΡΙΣΗ
ΤΗΣ ΠΛΟΥΤΟΚΡΑΤΙΑΣ
ΕΤΗΝ ΑΝΤΙΛΑΪΚΗ ΠΟΛΙΤΙΚΗ

ΕΤΑΙΡΕΙΑ ΜΠΕΤΟ ΕΡΓΑΝΗ
ΠΟΥ Π...
ΔΗΝ...
ΦΤΑ...
ΡΟΤ...

ΤΩΡΑ ΟΛΟΙ ΣΤΟΥΣ
ΠΑΔΑΚΟ ΣΤΗΝ ΑΝΤΕΡΓΑΤΙΚΗ ΑΡΟΜΟΥΣ
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ΣΥΝΔΙΚΑΤΟ ΟΙΚΟΔΟΜΩΝ ΑΘΗΝΑΣ

Role for gov't

- To keep social tensions from getting out-of-hand
- Usually that doesn't occur inside the corporation itself
 - But via social policy
- But some aspects of the corporate structure affect social stability
- And here long-term, government affiliated investors could play an important role

Role for government

- Government's role in reconciling the long-term with the short-term explosive pressures may be inside the corporation
- But it may be different from what we've thought
- It might be to transfer some social protections from the gov't --- which cannot afford to pay --- to the corporation

Product market competition

- Analysts often confuse the imperatives of **product** market competition with short-term SH biases
- Increasing intensity of product market competition and technological innovation **force** owners, managers, CEOs, and everyone else to act AS IF SH value was central.

Conclusion

- Not obvious who in the corporate structure is best positioned to promote the long-term
 - SH usual seen as culprits
- But each major corporate governance player has significant short-term biases
 - Shareholders
 - CEOs
 - Boards
 - Work-force
 - Public investors
- Who has the weakest short-term bias?
- Don't trust anyone!