

ISSN 1936-5349 (print)  
ISSN 1936-5357 (online)

# HARVARD

JOHN M. OLIN CENTER FOR LAW, ECONOMICS, AND BUSINESS

## CORPORATE SHORT-TERMISM - IN THE BOARDROOM AND IN THE COURTROOM

Mark J. Roe

Published in *The Business Lawyer*, Vol. 68, No. 4 (2013)

Discussion Paper No. 760

02/2014

Harvard Law School  
Cambridge, MA 02138

This paper can be downloaded without charge from:

The Harvard John M. Olin Discussion Paper Series:  
[http://www.law.harvard.edu/programs/olin\\_center/](http://www.law.harvard.edu/programs/olin_center/)

The Social Science Research Network Electronic Paper Collection:  
<http://ssrn.com/abstract=2239132>

## Corporate Short-Termism—In the Boardroom and in the Courtroom

By Mark J. Roe\*

*A long-held view in corporate circles has been that furious rapid trading in stock markets has been increasing in recent decades, justifying corporate governance and corporate law measures that would further shield managers and boards from shareholder influence, to further free boards and managers to pursue their view of sensible long-term strategies in their investment and management policies.*

*Here, I evaluate the evidence in favor of that view and find it insufficient to justify insulating boards from markets further. While there is evidence of short-term stock market distortions, the view is countered by several underanalyzed aspects of the American economy, each of which alone could trump a prescription for more board autonomy. Together they make the case for further judicial isolation of boards from markets untenable. First, even if the financial markets were, net, short-term oriented, one must evaluate the American economy from a system-wide perspective. As long as venture capital markets, private equity markets, and other conduits mitigate, or reverse, much of any short-term tendencies in public markets, then a potential short-term problem is largely local but not systemic. Second, the evidence that the stock market is, net, short-termist is inconclusive, with considerable evidence that stock market sectors often overvalue the long term. Third, managerial mechanisms inside the corporation, including compensation packages with a duration that is shorter than typical institutional stock market holdings, and managerial labor markets across firms, including managerial efforts to get good results on their watch, are important sources of short-term distortions; insulating boards from markets further would exacerbate these managerial short-term-favoring mechanisms. Fourth, courts are not well positioned to make this kind of basic economic policy, which, if determined to be a serious problem, is better addressed with policy tools unavailable to courts. And, fifth, the widely held view that short-term trading has increased dramatically in recent decades over-interpret, the data; the duration for holdings of many of the country's major stockholders, such as mutual funds run by Fidelity and Vanguard, and major pension funds, does not seem to have shortened. Rather, a high-velocity trading fringe has emerged, and its rise affects average holding periods, but not the holding period for the country's ongoing major stockholding institutions.*

*The view that stock market short-termism should affect corporate lawmaking fits snugly with two other widely supported views. One is that managers must be free from tight stockholder influence, because without that freedom boards and managers cannot run the firm well. Whatever the value of this view and however one judges the line between managerial*

---

\* Professor, Harvard Law School. Thanks for comments and discussion go to Martin Bengtzen, Martin Fridson, Jesse Fried, Federico Raffaele, David Sorkin, Leo Strine, and Norman Veasey.

*autonomy and managerial accountability to stockholders should be drawn, short-termism provides no further support for managerial insulation from the influence of financial markets. The autonomy argument must stand or fall on its own. Similarly, those who argue that employees, customers, and other stakeholders are due more consideration in corporate governance point to pernicious short-termism to support their view further. But these stakeholder considerations can be long-term and they can be short-term. As such, the best view of the evidence is similarly that the pro-stakeholder view must stand or fall on its own. It gains no further evidence-based, conceptual support from a fear of excessive short-termism in financial markets. Overall, system-wide short-termism in public firms is something to watch for carefully, but not something that today should affect corporate lawmaking.*

## Contents

Introduction.....	978
I. The Influence of the Short-Termist Argument.....	981
A. Takeovers in the Boardroom.....	981
B. Current Views from the Delaware Judiciary.....	983
C. The Media and Corporate Commentary.....	984
II. The Short-Termist View.....	985
A. The Argument.....	985
B. The Evidence in Favor.....	986
III. Difficulties with the Basic Argument: Concept.....	987
A. Market Correctives.....	987
B. Trade-offs.....	989
C. Short-Termism in the Courtroom: Limits to Judicial Correctives.....	989
D. Regulatory Correctives.....	992
IV. Difficulties with the Basic Argument: Facts.....	992
A. The Economic System.....	993
B. Stock Market Long-Termism.....	993
C. Short-Termism Inside the Corporation.....	996
D. Interpretive Error?.....	998
E. More Powerful Core Causes? Speeding Technology, Increasing Globalization, and Unstable Government Policy.....	1001
V. The Short-Termist Argument as Proxy.....	1003
A. As Proxy for the Need for Managerial Insulation.....	1003
B. As Proxy for the Need to Attend to Stakeholders.....	1004
Conclusion: No More than Watchful Waiting.....	1005

## INTRODUCTION

The belief that short-term stock market trading undermines corporate decision making at the top has long been part of the corporate governance discourse and policymaking, and in recent years has picked up articulate judicial adherents. One of the most vivid and effective classic attacks on financial market

short-termism came as the takeover wars of the 1980s opened up, via Martin Lipton's well-known justification to empower managers further 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 . . . ?*"<sup>1</sup> Over the years, the chairs of the Securities and Exchange Commission, Congress,<sup>2</sup> business analysts,<sup>3</sup> and the business media have regularly excoriated trading markets as perniciously shortening corporate time horizons, justifying corporate law rules insulating boards from markets. And more recently, leading Delaware corporate law judges have indicated in off-the-bench analyses that the short-termist issue is something they take seriously as people with deep experience in corporate lawmaking and policy. This all leads us to the question posed for us to examine here: Should short-termism weigh heavily, or at all, in corporate lawmaking today? Should it become a basic consideration in making corporate law, from the bench or in the legislature?

\* \* \*

Despite the short-termist argument's grip on the corporate legal imagination, the view has not benefited from a sustained examination. I give it that examination here, review the logic of the views and the extensive financial evidence that has become available in recent years, and conclude overall that we lack evidence to give much, or any, weight to the short-termist view in basic corporate lawmaking, that the balance of evidence is considerably more mixed than the consensus among legal commentators and lawmakers has it, and that underanalyzed but critical aspects of the modern corporation and securities markets point away from according the short-termist view much, or possibly any, weight in corporate lawmaking.

Management's attention to quarterly earnings is well known, inducing dubious, perhaps misleadingly illegal, shifts in sales and profits.<sup>4</sup> The questions I pose here, though, are not really whether such shifts occur, as they surely do, but whether they result in systemically degrading real investment and real economic activity, and whether the policy tools available to courts making corporate law are appropriate for remedying the purported problem.

The short-termist argument is afflicted with five substantial debilities. First, one must evaluate the American economy from a system-wide perspective. The American economy is replete with venture capital markets, private equity markets,

1. Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 *BUS. LAW.* 101, 104 (1979).

2. E.g., *Examining Short-Termism in Financial Markets: Hearing Before S. Subcomm. on Econ. Policy of the Comm. on Banking, Hous. & Urban Affairs*, 111th Cong. 2 (2010), available at <http://www.gpo.gov/fdsys/pkg/CHRG-111shrg61654/pdf/CHRG-111shrg61654.pdf>.

3. See, e.g., Robert H. Hayes & William J. Abernathy, *Managing Our Way to Economic Decline*, *HARV. BUS. REV.*, July–Aug. 2007, at 67; Edmund S. Phelps, *Short-Termism Is Undermining America*, 27 *NEW PERSP. Q.*, Fall 2010, at 16.

4. E.g., John Graham, Campbell R. Harvey & Shiva Rajgopal, *Value Destruction and Financial Reporting Decisions*, 62 *FIN. ANALYSTS J.*, Nov.–Dec. 2006, at 27, 31, 36–37; Alfred Rappaport, *The Economics of Short-Term Performance Obsession*, *FIN. ANALYSTS J.* May/June 2005, at 65, 65–66 (2005).

and many privately held firms. As long as venture capital markets, private equity markets, privately held firms, and similar conduits mitigate or reverse enough of any short-term tendencies in the public securities market, then the purported problem is not a systemic economic issue. The possibility that some public firms are more short-term focused than they ought to be should then have no more weight in corporate lawmaking than the likelihood that some firms are poor manufacturers (but good marketers) and other firms are poor marketers (but good manufacturers). We would have no corporate law reason to reorient the system to pick up one type of slack.

Second, the evidence that the stock market is, net, short-termist is hardly conclusive. There is indeed much evidence supporting the conclusion that it undervalues long-term value. But there is also much evidence that stock market sectors are often enough *overvaluing* the long term, most obviously in the intermittent bubbles in technology and other new industries. The lofty price-earnings multiples long accorded Amazon, Apple, and Google are suggestive of a market that appreciates the long term; the dot.com bubble of a decade ago suggests that the markets can *over-value* the long term. Hence, we cannot focus solely on evidence of short-termism in our evaluation, but must evaluate excessive long-termism as well, because the market has substantially *over-valued* the long term, repeatedly. Intermittent over-valuation in the stock market is not a virtue, but its frequent occurrence tells us that the market is not uniformly short-term. This over-under problem is what one would expect from an imperfect institution: sometimes it overshoots, sometimes it undershoots, and sometimes it is on target.

Third, mechanisms inside the corporation may well be important sources of short-term distortions and these internal distortions can be, and would be, exacerbated by insulating boards further from external financial markets. CEOs will prefer that good results occur on their watch, and prefer that poor results be pushed into the future, beyond their tenure. With average overall tenure for CEOs now at seven years, the typical CEO can expect about three more years at the top. The CEO is still the most important decision maker inside the firm, and human psychology suggests a typical CEO would weigh results during his or her expected tenure above longer-term results. (And collateral costs of excessive managerial autonomy, in increasing managerial agency costs, must be added to the mix.) Senior managers not yet at the top but with an eye on their future job prospects in the labor market want strong results before the next headhunter calls them. There is considerable evidence consistent with managerial distortions being a major source of short-term focus. Boards and managers may well have leeway in setting the horizon for compensation, and that horizon may be shorter than it needs to be: the time duration for executive pay packages appears to be *shorter* than the duration of institutional investor holdings.

Fourth, courts are not well equipped to evaluate this kind of economic policy and should leave this task to other regulatory institutions, many of which have better remedies available than do corporate lawmakers and some of which are better positioned than courts to assess the extent, location, and capacity for lawmaking to ameliorate the purported problem. For reasons similar to those that

underpin the business judgment rule, courts should be as reluctant to make economic policy decisions as they are to second-guess unconflicted board business decisions.

Fifth, the widely held view that short-term trading has increased dramatically in recent decades is unquestioned but may well misinterpret the data. The duration for holdings of the country's major stockholders, such as mutual funds at Fidelity and Vanguard, and major pension funds, has not shortened. Rather, a high-velocity trading fringe is moving stock rapidly through their computer systems. But these new high-velocity trading patterns do not affect the major stockholding institutions and, hence, should not yet affect corporate law thinking.

Each of these five problems with the short-termist view for corporate lawmaking is largely independent of the other four. Each could alone justify the view that courts and corporate lawmakers should be reluctant in allowing short-termism to join the considerations that go into the lawmaking balance. Together, the five make the standard short-termist view untenable.

## I. THE INFLUENCE OF THE SHORT-TERMIST ARGUMENT

In this Part, I examine the persistent influence of the short-termist argument on corporate law policy thinking, particularly its implication that managers should be isolated from financial markets so that they are free to pursue longer-term horizons. Of course, the long term is not to be preferred, just for its own sake, if it yields poorer returns and wastes resources. The short-termist view is rather that financial mechanisms induce corporate directors and managers to favor immediate but lower-value results over more profitable long-term results.

### A. TAKEOVERS IN THE BOARDROOM

Rapid trading in stock markets, with a diminishing breed of long-term holders, is thought to be the primary culprit in inducing too strong a focus on short-term results inside the corporation. Quarterly results trump long-term investment, particularly long-term technological development.<sup>5</sup> These pernicious effects of securities markets are then taken up by those seeking to influence policymaking that would insulate managers and boards from markets. Thus, Martin Lipton, the corporate world's most prominent and persistent promoter of board autonomy over the decades, offered short-termism as a primary reason why hostile takeovers needed to be stopped. "It would not be unfair," he wrote in the well-known article in *The Business Lawyer* that was quoted above, "to pose the policy issue as: *Whether the*

---

5. See John R. Graham, Harvey R. Campbell & Shiva Rajgopal, *The Economic Implications of Corporate Financial Reporting*, J. ACCT. & ECON., Dec. 2005, 3, 5 (78 percent of CFOs state in survey that they would sacrifice some real value for smoother reported earnings); Kevin J. Laverty, *Economic "Short-Termism": The Debate, the Unresolved Issues, and the Implications for Management Practice and Research*, 21 ACAD. MGMT. REV. 825, 831 (1996); James M. Poterba & Lawrence H. Summers, *A CEO Survey of U.S. Companies' Time Horizons and Hurdle Rates*, MIT SLOAN MGMT. REV., Fall 1995, at 43, available at <http://sloanreview.mit.edu/article/a-ceo-survey-of-us-companies-time-horizons-and-hurdle-rates/>.

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 . . . ?"<sup>6</sup> Shareholder-induced corporate short-termism threatened the overall health of the economy.<sup>7</sup> And it is said that it still does: the first key issue facing boards in 2013 is that money managers "are wildly skewed to short-term results."<sup>8</sup>

And those views on shareholder short-termism, as justifying managerial and boardroom autonomy, recurred in the 1980s,<sup>9</sup> the 1990s,<sup>10</sup> and the last decade,<sup>11</sup> justifying board insulation from leveraged buyout pressures, from hedge fund activism, and from capital markets generally. The view justifies board autonomy from more market influence via five-year board terms.<sup>12</sup> Overall, it is perhaps corporate law's longest running modern refrain: financial short-termism demands that managers and boards be further insulated from financial markets, with enhanced autonomy to resist market pressure for performance, for fear that the pressure will over-emphasize short-term results.

The issue has persisted in media and corporate discourse. Arthur Levitt and William Donaldson, chairs of the Securities and Exchange Commission, saw the securities markets' propensity to induce corporate short-termism as a problem needing public attention.<sup>13</sup> Prominent executives and corporate analysts have pushed forward parallel points.<sup>14</sup> Media attention to short-termism has further delegitimized the securities markets' influence on corporate decision making. The Aspen Institute, a well-known think tank, issued a report signed by a

---

6. Lipton, *supra* note 1, at 104.

7. *Id.*

8. Martin Lipton et al., Some Thoughts for Boards of Directors in 2013 (Dec. 17, 2012), available at [www.wlrk.com/docs?SomethoughtsforBoardsOfDirectorsin2013.pdf](http://www.wlrk.com/docs?SomethoughtsforBoardsOfDirectorsin2013.pdf).

9. Martin Lipton, *Takeover Bids in the Target's Boardroom: A Response to Professors Easterbrook and Fischel*, 55 N.Y.U. L. REV. 1231, 1233-35 (1980); Martin Lipton & Andrew R. Brownstein, *Takeover Responses and Director's Responsibilities—An Update*, 40 BUS. LAW. 1403, 1413-14 (1985); Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 5-6 (1987).

10. Martin Lipton, *An End to Hostile Takeovers and Short-Termism*, FIN. TIMES, June 27, 1990, at 21; Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 205-14 (1991) (LBO transactions were inducing short termism, just as activist institutional stockholders and hostile takeovers had been excessively fostering a board focus on the short term previously, because the buyout funds were too heavily indebted to focus on the long term); Martin Lipton & Jay W. Lorsch, *A Modest Proposal for Improved Corporate Governance*, 48 BUS. LAW. 59, 65 (1993).

11. Martin Lipton, *Twenty-Five Years After Takeover Bids in the Target's Boardroom: Old Battles, New Attacks and the Continuing War*, 60 BUS. LAW. 1369, 1370-78 (2005).

12. Lipton & Rosenblum, *supra* note 10, at 224-29.

13. Arthur Levitt, *Renewing the Covenant with Investors: Speech at the Center of Law and Business, New York University* (May 26, 2000), available at <http://www.sec.gov/news/speech/spch370.htm>; William H. Donaldson, *Speech at 2005 CFA Institute Annual Conference* (May 8, 2005), available at <http://www.sec.gov/news/speech/spch050805whd.htm>; CFA CTR. FOR FIN. MKT. INTEGRITY & BUS. ROUNDTABLE INST. FOR CORP. ETHICS, *BREAKING THE SHORT-TERM CYCLE 4* (2006) (citing William H. Donaldson, *The New Environment in Corporate Governance: Taking Stock and Looking Ahead*, *Speech at the Business Roundtable Forum on Corporate Governance* (2006)).

14. Robert Monks, *Corporate "Catch-22"*, WALL ST. J., Jan. 5, 1988, at 25; Michael E. Porter, *Capital Disadvantage: America's Failing Capital Investment System*, 70 HARV. BUS. REV., Sept.-Oct. 1992, at 65; John G. Smale, *What About Shareowner's Responsibility*, WALL ST. J., Oct. 16, 1987, at 24.

slew of corporate luminaries, to the effect that shareholder short-termism is eroding the quality and competitiveness of the American corporation.<sup>15</sup>

## B. CURRENT VIEWS FROM THE DELAWARE JUDICIARY

Today, the state corporate judiciary decides corporate election rules, the ease of insurgent proxy contests, and the rules governing the occasional takeover offers. Influential thinkers and decision makers in the Delaware corporate law-making structure have come to see the short-termist argument as important and as one that should influence corporate law election rules and frequency. None has articulated this broad view in judicial decisions, but rather has offered the power of the short-termist view in off-the-bench writings, with the judicial attention to short-term horizons narrower and more transactional.<sup>16</sup> The thesis here is that although the subject is one ripe for out-of-court consideration, it is not one that should influence election rules, proxy rules, and the rules governing takeovers.

Thus, Justice Jacobs of the Delaware Supreme Court seeks means by which Delaware's corporate law can bolster long-term investment capital,<sup>17</sup> justifying three-year board terms.<sup>18</sup> The Chancellor views the short-termism problem as a "substantial policy dilemma."<sup>19</sup> "It is jejune," he said, "to demand that CEOs and boards manage for the long term when the stockholders who can replace them buy and sell based on short-term stock price movements, rather than the long-term prospects of firms."<sup>20</sup> With important judges thinking in their extra-judicial analytics that short-termism is a problem and wondering whether corporate law could help combat the problem, we must consider whether the issue *should* affect corporate lawmaking more directly. I conclude here that it should not.

The issue is not just American, but international. In Britain, for example, much attention has recently been accorded the 2012 official Kay Report, which

15. ASPEN INST., *OVERCOMING SHORT-TERMISM: A CALL FOR A MORE RESPONSIBLE APPROACH TO INVESTMENT AND BUSINESS MANAGEMENT* (Sept. 9, 2009), available at [http://www.aspeninstitute.org/sites/default/files/content/docs/bsp/overcome\\_short\\_state0909.pdf](http://www.aspeninstitute.org/sites/default/files/content/docs/bsp/overcome_short_state0909.pdf). To be sure, the Aspen study does not push further board isolation as the solution. It does, however, indicate that shareholder short-termism demands that reforms to empower shareholders be reexamined and, presumably, rejected.

16. See the discussion of *Airgas*, *infra* notes 53–58 and accompanying text.

17. Jack Jacobs, "Patient Capital": *Can Delaware Corporate Law Help Revive It?*, 68 WASH. & LEE L. REV. 1645, 1661–63 (2011).

18. William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1096, 1100 (2002); Jacobs, *supra* note 17, at 1660 (reiterating that boards need more insulation from shareholder elections—to plan for the long term—via five-year election terms).

19. Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 BUS. LAW. 1, 1–2 (2010) (written while the author was a vice chancellor). "Many activist investors hold their stock for a very short period of time and may have the potential to reap profits based on short-term trading strategies that arbitrage corporate policies. . . . [T]here is a danger that activist stockholders will make proposals motivated by interests other than maximizing the long-term, sustainable profitability of the corporation." *Id.* at 8.

20. *Id.* at 17.

excoriated public company short-termism and sought means to reduce that short-termism.<sup>21</sup> The Organization for Economic Cooperation and Development in 2011 launched a major initiative to combat corporate short-termism.<sup>22</sup>

In brief, important and influential lawmakers have seen short-termism as costly and in need of correction. That correction could come from corporate law, and some commentators may well wish that corporate law adjust to combat short-termism. The argument here in this article is that corporate law should not adjust for any short-termist possibilities.

### C. THE MEDIA AND CORPORATE COMMENTARY

Many in the media believe and repeat the concept that shareholder short-termism misdirects large firms. The motif has been common and persistent since the takeover-rich 1980s. Peter Drucker, the well-known organizational guru, bemoaned the problem of quarterly earnings management and stock market trading.<sup>23</sup> *The Washington Post*, sympathetically reporting the Aspen Institute's criticism of short-term investing, tells its readers that "Wall Street's Mania for Short-Term Results Hurts [the American] Economy," because "the focus on short-term financial performance by investors, money managers and corporate executives has systematically robbed the economy of the patient capital it needs to produce sustained and vigorous economic growth."<sup>24</sup> More tellingly, says the *Post*, the short-term critics "get to the root cause of the [2008] financial crisis in ways that other reform proposals have not."<sup>25</sup> "[O]nly long-term shareholders [should] be allowed to elect directors or vote on corporate governance issues."<sup>26</sup> An influential *New York Times* business columnist tells its readers that American "executives . . . hav[e] had it beaten into them that the only thing that matters is delivering . . . short-term profits—and chief executives who have ignored this mantra have often found themselves kicked to the street by impatient investors."<sup>27</sup>

---

21. JOHN KAY, *THE KAY REVIEW OF UK EQUITY MARKETS AND LONG-TERM DECISION MAKING* 12, 26, 40 (2012), available at <http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-631-kay-review-of-equity-markets-interim-report>. "Short-termism has plagued the UK economy for decades, so the Kay Review of UK Capital Markets . . . is hugely welcome. . . . John Kay's final report . . . recognizes that a sharp shock is needed to break today's short-termist mind-set." John Chapman, *Time to Tackle UK Short-Termism*, *FIN. TIMES*, May 27, 2012, at 13 (Chapman advised UK policymakers).

22. GERT WEHINGER, *FINANCIAL MARKET TRENDS: LONG-TERM INVESTMENT AND GROWTH* (2011).

23. Peter Drucker, *A Crisis of Capitalism*, *WALL ST. J.*, Sept. 30, 1986, at 31. Other leading managerial theorists have been in accord. See MICHAEL T. JACOBS, *SHORT-TERM AMERICA: THE CAUSES AND CURES OF OUR BUSINESS MYOPIA* (1991); Hayes & Abernathy, *supra* note 3; Porter, *supra* note 14.

24. Steven Pearlstein, *Wall Street's Mania for Short-Term Results Hurts Economy*, *WASH. POST*, Sept. 11, 2009, at A20 ("this wasn't just any blue-ribbon committee," said the *Post*).

25. *Id.*

26. *Id.* Such a requirement would demotivate shareholders seeking to assemble a major block of stock to effectuate corporate change.

To be sure, the article and the Aspen authors focus on other, noncorporate strategies to thwart short-termism, such as a Tobin tax on securities trades, improved compensation practices, and better disclosure.

27. Joe Nocera, *What Is Business Waiting For?*, *N.Y. TIMES*, Aug. 16, 2011, at A21.

## II. THE SHORT-TERMIST VIEW

### A. THE ARGUMENT

The core short-termist concept is that because securities traders hold their stock for such a short duration, they look for strong corporate results during the period they hold the corporation's stock, so that they can sell profitably.<sup>28</sup> Many institutional investors, such as mutual funds, are said to be afflicted with this short horizon because they seek to show strong short-run results so that they can attract new investors to their funds.<sup>29</sup> Pension fund managers seek good short-term results so that they can renew their management contracts and obtain new ones,<sup>30</sup> while hedge fund managers are often compensated on immediate results.<sup>31</sup> Even institutional investors not afflicted by this short-term sales problem have short-term preferences. Because they cannot evaluate complex, long-term, technologically sophisticated information well, they rely on simple signals to evaluate the value of the corporate stock in their portfolio. Quarterly earnings results accordingly loom larger than they would otherwise, because of their relative simplicity.<sup>32</sup>

For the trading argument to have traction, however, these stock market trading structures need a transmission mechanism into the corporation to affect corporate time horizons. That is, even if the short-term traders furiously moved a company's stock every nanosecond, managers could still be fully free to decide on corporate investments and time horizons, as the furious traders might simply pay no attention to the firm's horizons and would be incapable of intervening in corporate governance decision making. A transmission mechanism from market to boardroom is needed. In an earlier era, it was thought to be the hostile takeover. In the current era it would be shareholder activism and executive compensation, with boards more willing to fire CEOs if short-term financial results are poor, partly because directors fear for their own jobs or reputations. And, if senior management is compensated based on stock market returns, then management will tend to replicate the time horizons of the market.

The concept then is that stock market short-termism is transmitted inside the corporation, causing boards and senior managers to forgo long-term value maximization for short-term results, often managing and sometimes manipulating earnings, all toward the end of pleasing the stock market.

28. Rappaport, *supra* note 4, at 66 ("Today, the average holding period in professionally managed funds is less than a year and annual portfolio turnover is greater than 100 percent.").

29. See ASPEN INST., *supra* note 15, at 2.

30. See *id.*; Jenny Anderson, *Pension Funds Still Waiting for Big Payoff from Private Equity*, N.Y. TIMES, Apr. 10, 2010, at B1.

31. See Carl Ackermann, Richard McEnally & David Ravenscraft, *The Performance of Hedge Funds: Risk, Return, and Incentives*, 54 J. FIN. 833, 834 (1999).

32. For sophisticated academic modeling of the phenomena, see Patrick Bolton, Jose Scheinkman & Wei Xiong, *Executive Compensation and Short-Termist Behaviour in Speculative Markets*, 73 REV. ECON. STUD. 577 (2006); Jeremy C. Stein, *Efficient Capital Market, Inefficient Firm: A Model of Myopic Corporate Behavior*, 104 Q.J. ECON. 655 (1989); Jeremy C. Stein, *Takeover Threats and Managerial Myopia*, 96 J. POL. ECON. 61 (1988).

That then is the basic problem and its transmission into the public firm. By breaking the transmission mechanism (via longer election periods for directors or via greater managerial and board autonomy from the market), corporate leaders have sought to foster sensible long-term corporate behavior.

## B. THE EVIDENCE IN FAVOR

There is indeed hard evidence supporting the short-termist argument. Matched samples of privately held and publicly held firms show that the privately held firms invest more in their firm's operations than the publicly held half of the sample.<sup>33</sup> Matched samples of firms that went public and similar firms that did not show key personnel leaving the public firm shortly after the offering, which suggests an inability of the relevant firm to manage and create for the long term.<sup>34</sup> Corporate managers attuned to short-term thinking (as evidenced by their persistent reference to the short term in their communications with investors) had a short-term investor base with higher turnover than average. (Whether the first fact is caused by the second is not shown, but the possibility that causation runs from shareholder horizons to managerial orientation cannot be dismissed.<sup>35</sup>) Private equity funds with shorter time horizons invest in firms at a later development stage than those with a longer horizon.<sup>36</sup>

There is evidence that markets underestimate long-term corporate cash flows.<sup>37</sup> And there is evidence that mispriced public firms invest in line with the time horizons of their major investors.<sup>38</sup> Earnings management and earnings manipulation are regularly evidenced.<sup>39</sup> Initial public offers often use dual class stock, with insiders obtaining higher voting rights that insulate them from stock market pressure. More generally, corporate managers regularly bemoan the pres-

---

33. John Asker, Joan Farre-Mensa & Alexander Ljungqvist, *Comparing the Investment Behavior of Public and Private Firms* (Nat'l Bureau Econ. Research, Working Paper No. 17394, 2011), available at <http://ssrn.com/paper=1931164>; John Asker, Joan Farre-Mensa & Alexander Ljungqvist, *Corporate Investment and Stock Market Listing: A Puzzle* (Apr. 22, 2013) (unpublished manuscript) (available at [www.ssrn.com/abstract=1603484](http://www.ssrn.com/abstract=1603484)); cf. Alex Edmans, *Short-Term Termination Without Deterring Long-Term Investment: A Theory of Debt and Buyouts*, 102 J. FIN. ECON. 102 (2011) (blockholders incentivized to ascertain reasons for any poor short-term performance).

34. Shai Bernstein, *Does Going Public Affect Innovation?* (Oct. 14, 2012) (unpublished manuscript) (available at [www.ssrn.com/abstract=2061441](http://www.ssrn.com/abstract=2061441)).

35. François Brochet, Maria Loumioti & George Serafeim, *Short-Termism, Investor Clientele, and Firm Risk* 4 (Harv. Bus. Sch. Acct. & Mgmt. Working Paper No. 12-072, 2012), available at [www.ssrn.com/abstract=1999484](http://www.ssrn.com/abstract=1999484) (evidence is bidirectional).

36. Jean-Noel Barrot, *Investor Horizon and Innovation: Evidence from Private Equity Funds* (Dec. 5, 2012) (unpublished manuscript) (available at [www.ssrn.com/abstract=2024601](http://www.ssrn.com/abstract=2024601)).

37. Angela Black & Patricia Fraser, *Stock Market Short-Termism—An Internal Perspective*, 12 J. MULTINATIONAL FIN. MGMT. 135 (2002).

38. François Derrien, Ambrus Keckés & David Thesmar, *Investor Horizons and Corporate Policies*, J. FIN. QUANTITATIVE ANALYSIS (forthcoming), available at [www.ssrn.com/abstract=1491638](http://www.ssrn.com/abstract=1491638).

39. Brian J. Bushee, *The Influence of Institutional Investors on Myopic Investment Behavior*, 73 ACCT. REV. 305 (1998); Daniel A. Cohen et al., *Real and Accrual-Based Earnings Management in the Pre- and Post-Sarbanes Oxley Periods*, 83 ACCT. REV. 757 (2008); Sugata Roychowdhury, *Earnings Management Through Real Activities Manipulation*, 42 J. ACCT. & ECON. 335 (2006).

sure from shareholders to produce strong quarterly results<sup>40</sup> and report in a prominent study that they would give up shareholder value to report better earnings.<sup>41</sup>

### III. DIFFICULTIES WITH THE BASIC ARGUMENT: CONCEPT

But the short-termist argument faces counter-arguments that largely neutralize the idea that short-termism can bear weight in corporate lawmaking. One class of counter-arguments is primarily theoretical, the other primarily factual. As far as I can tell, several of these theoretical arguments have not previously been made.

#### A. MARKET CORRECTIVES

If short-term stock market pressures are inducing firms to give up value over the long run, then firms and markets would find themselves with incentives to develop institutions and mechanisms to facilitate that long-run profitability. Those that do will over the long run make more money. For example, if short-term trading reduced firms' time horizons perniciously, then some funds could profit by trading for the long term, by placing longer-term bets, and by developing credible mechanisms so that they will hold onto profitable long-term ventures. Such efforts may be incomplete,<sup>42</sup> but the market system would have incentives to push in that direction. If small holders find it not to be worthwhile to evaluate long-term, complex information, then the market has incentives to produce mechanisms that facilitate larger block holdings for longer time periods. Persistent rules and politics stymieing such efforts are plausible, particularly in the United States, which has had a long history until recently of cutting finance down and keeping blockholders small, intermittent, and ineffective; I previously analyzed these rules as likely to hinder blockholder efforts to overcome the information transmission breakdowns.<sup>43</sup> But market incentives to counterbalance have been in play, even if restrained and insufficient.

Private equity could correct some short-termism. If the public markets are inducing a publicly held firm to be excessively short-term oriented because of its focus on the next financial quarter's earnings or its inability to evaluate a technology, then private equity holders, often with time horizons of years, sometimes

40. John Graham, Campbell R. Harvey & Shiva Rajgopal, *The Economic Implications of Corporate Financial Reporting*, 40 J. ACCT. & ECON. 3 (2005); Claire L. Marston & Barrie M. Craven, *A Survey of Corporate Perceptions of Short-Termism Among Analysts and Fund Managers*, 4 EUR. J. FIN. 233 (1998).

41. Graham, Harvey & Rajgopal, *supra* note 4, at 31. Consistently, an experiment in which managers were offered a choice between a short-term-weighted project and a higher value long-term project showed them more often choosing the first. Sanjeev Bhojraj & Robert Libby, *Capital Market Pressure, Disclosure Frequency-Inducted Earnings/Cash Flow Conflict, and Managerial Myopia*, 80 ACCT. REV. 1 (2005). However, changing the reporting period from quarterly to semiannually did not affect the decision.

42. Andrei Shleifer & Robert W. Vishny, *The Limits of Arbitrage*, 52 J. FIN. 35 (1997).

43. See MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE 19-49* (1994) [hereinafter ROE, *STRONG MANAGERS, WEAK OWNERS*].

stretching toward a decade, could buy the company, take it off the public market, and reorient its business model toward the longer term. If a firm produced poor profits because it overly focused on quarterly results, the marketplace incentives would be to move the firm into private equity's hands, where the horizons are longer.

One example of a problem and a cure is the buyout of Dollar General, a mass market retailer in the mode of Wal-Mart, but with smaller stores, located in some markets closer than Wal-Mart to consumers' homes. At a time when Dollar General was doing poorly, some managers in the firm and some outsiders thought that there was a niche market that Wal-Mart was not serving, of smaller communities that could support a discount retailer like Dollar General, if Dollar General could improve its stores and product line-up. Others in the market concluded that Dollar General could not compete effectively with Wal-Mart over time and that Dollar General was doomed to shrink. Although the optimists' business model was simple, relevant players wondered whether the model could be communicated credibly to the public markets, given Wal-Mart's success and Dollar General's weaknesses. A private equity firm, KKR, took the firm private and facilitated remodeling the chain's stores, improving product offerings, and expanding the number of stores into the niche markets that Dollar General thought it could serve better than Wal-Mart.<sup>44</sup> As a financial observer concluded: "Going private gives them a year or two to rebuild their business and invest more aggressively to expand without Wall Street pressure[.]"<sup>45</sup> In November 2012, Dollar General had more than 10,000 store locations, compared to the 8,000 it had when it came off the public market. After the new strategy succeeded, it returned to the public market via a public offering and a New York Stock Exchange listing. Market problem, market solution.

Another transactional example: Seagate Technologies was losing technological position to competitors Maxtor and Western Digital when the firm was taken private. Its patenting activity picked up post-buyout, and its industry deterioration slowed sharply.<sup>46</sup>

Aggregate data is consistent with private equity providing a longer-term alternative to public markets, when that alternative is useful. Firms that private equity takes private have increased patenting efforts in the target firms' core areas of strength.<sup>47</sup> An older study finds increased spending on research after

---

44. Cf. Daniel Gross, *The Almighty Dollar (Store)*, SLATE.COM (June 13, 2009), [http://www.slate.com/articles/business/moneybox/2009/06/the\\_almighty\\_dollar\\_store.html](http://www.slate.com/articles/business/moneybox/2009/06/the_almighty_dollar_store.html) (Dollar General markets to a niche not well-served by WalMart.). For the generality, see Tor Brunzell, Eva Liljebloom & Mika Vaihekoski, *Short-Term Expectations in Listed Firms: The Mitigating Impact of Private Equity Owners 1* (July 1, 2011) (unpublished manuscript) (available at <http://ssrn.com/abstract=1400734>) (finding that "a large private equity owner [in our sample of Norwegian public firms] is able to significantly reduce perceived pressure for short-term actions").

45. Jeremy W. Peters, *KKR Signs a Record \$6.9 Billion Buyout of Dollar General*, N.Y. TIMES (Mar. 12, 2007), [http://www.nytimes.com/2007/03/12/business/worldbusiness/12iht-dollar.4887326.html?\\_r=0](http://www.nytimes.com/2007/03/12/business/worldbusiness/12iht-dollar.4887326.html?_r=0).

46. Josh Lerner, Morten Sorensen & Per Strömberg, *Private Equity and Long-Run Investment: The Case of Innovation*, 56 J. FIN. 445, 455-56 (2011).

47. *Id.* at 447.

firms are taken private.<sup>48</sup> Other studies find that higher inside block ownership is associated with more long-term investment.<sup>49</sup> A recent study shows hedge fund ownership associated with “better quality, higher impact innovations and greater R&D efficiency” than that in firms lacking hedge fund ownership.<sup>50</sup> Shareholder value holds up over the long term after activist hedge fund intervention.<sup>51</sup>

More generally, product market competition can partially correct short-term financial markets. For some excessive short-termism, the firm will find itself behind the curve technologically or otherwise at a later date. When it finds itself lagging, it will have the incentive to catch up.

## B. TRADE-OFFS

If stock markets are indeed excessively inducing corporate short-termism, and if board and managerial isolation from financial markets is a partial solution, then unintended costs need to be accounted for in any cost-benefit analysis. Obvious other costs come from further insulating boards and managers from financial markets. If managers drift away from efficient, competitive behavior, financial markets can sting them into returning to a better corporate strategy. If boards and managers can freely dismiss market signals as the misguided views of short-term traders, if corporate policymakers bless that view, and if their blessing of that view leads to further isolation of boards and managers from markets, then the short-termist corrective could (1) go too far and (2) facilitate managerial drift. This trade-off of agency costs and monitoring costs is well known. The point here is that there is a trade-off of costs and benefits, even if the market is, net, short-term oriented.<sup>52</sup>

## C. SHORT-TERMISM IN THE COURTROOM: LIMITS TO JUDICIAL CORRECTIVES

Is the courtroom an appropriate venue to consider short-termism? Proponents of board autonomy may well wish that short-termism be part of the judicial decision making mix and could hope that if the short-termist view proved to be

---

48. Frank R. Lichtenberg & Donald Siegel, *The Effects of Leveraged Buyouts on Productivity and Related Aspects of Firm Behavior*, 27 J. FIN. ECON. 165 (1990).

49. Jennifer Francis & Abbie Smith, *Agency Costs and Innovation: Some Empirical Evidence*, 19 J. ACCT. & ECON. 383 (1995) (management and block ownership associated with more indicators of innovation); James Mahoney, Chamu Sundaramurthy & Joseph Mahoney, *The Effects of Corporate Antitakeover Provisions on Long-Term Investment: Empirical Evidence*, 18 MANAGERIAL & DECISION ECON. 349 (1997).

50. Ying Wang & Jing Zhao, *Hedge Funds and Corporate Innovations 2* (Dec. 1, 2012) (unpublished manuscript) (available at [www.ssrn.com/abstract=2191744](http://www.ssrn.com/abstract=2191744)).

51. Lucian Bebchuk, Alon P. Bray & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism* (July 9, 2013) (unpublished manuscript) (available at [www.ssrn.com/abstract=2291577](http://www.ssrn.com/abstract=2291577)).

52. In forthcoming work, Lucian Bebchuk is similarly skeptical of the short-termist view, defending the concept that shareholder power will enhance corporate performance against the criticism that increasing shareholder power will increase short-termism. Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. (forthcoming 2013); see also Bebchuk, Bray & Jiang, *supra* note 51.

generally persuasive, it would affect the atmospherics of corporate judicial decision making. Litigants have pressed that view on the Chancery Court.<sup>53</sup> However, even when astute judges have sympathized with the short-termist view in off-the-bench analyses, the view is not yet regularly being explicitly weighed in corporate lawmaking.

The recent *Airgas* takeover opinion does reveal some explicit courtroom viability for the short-termism argument—rejected at first in the opinion and then seen to be relevant in the decisional mix. The target firm defendants asserted in *Airgas* that the short-term stockholder base justified strong defensive antitakeover measures. Said Chancellor Chandler:

Defendants' argument . . . [is] based on the particular composition of Airgas's stockholders (namely, its large "short-term" base). In essence, Airgas's argument is that "the substantial ownership of Airgas stock by these short-term, deal-driven investors poses a threat to the company and its shareholders."<sup>54</sup>

And

[The defendants assert that the board should have more defensive room because of a] risk . . . that a majority of Airgas's [excessively short-term focused] stockholders . . . will tender into Air Products' offer despite its inadequate price tag, leaving the [longer-term] minority "coerced" into taking \$70 as well.<sup>55</sup>

The Chancellor rejected this short-termist argument, at first: "The defendants do not appear to have come to grips with the fact that the [short-term] arbs bought their shares from long-term stockholders who viewed the increased market price generated by Air Products' offer as a good time to sell."<sup>56</sup>

The Chancellor's strong rejection of the time horizons argument, however, did not persist. He ultimately ruled for the defendants and, with time horizons in mind, he turned the defendants' assertion into a question: Were enough stockholders "so 'focused on the short-term' that they would 'take a smaller harvest in the swelter of August over a larger one in Indian Summer?'" he asked, quoting the defendants.<sup>57</sup> Yes, he concluded: Both sides' experts testified that the short-term arbitrageurs would tender "regardless of whether the price is inadequate," even if it failed to reflect the company's long-term value.<sup>58</sup> The rhetoric of short-termism was in play in *Airgas*, in the context of a takeover.

Despite the judicial appearance of the short-termist view in *Airgas* and its partial acceptance, Justice Jacobs calls short-termism "a national problem that needs to be fixed,"<sup>59</sup> not a narrow corporate law problem. That usual absence of

---

53. See *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 108–09 (Del. Ch. 2011).

54. *Id.* at 108.

55. *Id.* at 109.

56. *Id.* at 108–09 (footnotes omitted).

57. *Id.* at 111.

58. *Id.* at 111–12.

59. Jacobs, *supra* note 17, at 1657 (emphasis added).

the view from foundational corporate law reasoning should continue, I argue here. Nor should short-termist views condition the atmosphere and the background to judicial decision making that allocates authority between boards and shareholders.

Courts are not the right institution to make this kind of economic policymaking. Consider that the judicial deference embedded in the business judgment rule is based in large measure on the presumption that judges are poorly positioned to make, or to second-guess, boardroom business decisions. The corporate judiciary ought to be even more reluctant to assess whether the corporate economy is too short-term, too long-term, or just right. Even a state legislature, with its parochial funding concerns, is ill-placed to make such judgments beyond firms operating primarily within the state's own borders. To allow short-termism issues into the courtroom is to facilitate a type of business and economic engineering that the best business judges rightly decline to do in more compelling situations, such as that of a single mistaken business decision for a firm.<sup>60</sup>

Other institutions and other policymakers are better suited to assess how well the economy is handling time horizons. Moreover, other policy avenues beyond corporate lawmaking, such as tax policy or policy on ownership structure, are better suited to handle any short-termism, if policymakers conclude that stunted horizons are real and pernicious. On ownership structure, a longstanding view has seen impediments to large blockholding as inducing more short-termism than is optimal, particularly because some information travels badly from inside the firm to diffuse public markets. Blockholders, I have previously argued, could better handle complex, technological, and subtle information than diffuse stock markets. They could signal to public stock markets the blockholder's view that a managerial long-term decision was good for shareholder value.<sup>61</sup> Says the global managerial director of McKinsey & Company in discussing the problems of short-termism, "[t]he most effective ownership structure tends to combine some exposure in the public markets (for the discipline and capital access that exposure helps provide) with a significant, committed, long-term owner."<sup>62</sup>

---

60. Even favored corporate structural solutions, like giving long-term shareholders greater voice in the corporation, see COLIN MAYER, *FIRM COMMITMENT* (2013); Julia Werdigier, *A Call for Corporations to Focus on the Long Term*, N.Y. TIMES DEALBOOK (May 14, 2012), <http://dealbook.nytimes.com/2012/05/14/group-calls-on-companies-to-focus-on-long-term-goals/>, can readily backfire. Jesse M. Fried, *The Uneasy Case for Favoring Long-Term Shareholders* (Mar. 18, 2013) (unpublished manuscript) (available at <http://ssrn.com/abstract=2227080>).

61. For blockholder suppression as increasing the short-term problem, see ROE, *STRONG MANAGERS, WEAK OWNERS*, *supra* note 43, at 240–47. For the concept that diffusion erodes complex information flow, see Stein, *Efficient Capital Market*, *supra* note 32. For evidence associating blockholders with more long-term innovation, see Julian Atanassov, *Do Hostile Takeovers Stifle Innovation? Evidence from Antitakeover Legislation and Corporate Patenting*, 68 J. FIN. 1097 (2013). For the idea that even blockholders who trade can encourage long-term investments, by processing information more effectively than small shareholders, see Alex Edmans, *Blockholder Trading, Market Efficiency, and Managerial Myopia*, 64 J. FIN. 2481 (2009).

62. Dominic Barton, *Capitalism for the Long Term*, HARV. BUS. REV., Mar. 2011, at 85, 90.

#### D. REGULATORY CORRECTIVES

Consider, moreover, that the other remedy that has been prominently touted often over the years has been a Tobin tax on rapid trading. When policy-thinkers such as Joseph Stiglitz, Lawrence Summers, or the blue-ribbon Aspen Institute have considered short-term stock markets a problem, they have turned to a Tobin tax as the appropriate mechanism to reduce short-termism, not to using corporate law to increase board and managerial insulation.<sup>63</sup> Others have proposed a sliding scale on capital gains rates, with the rate decreasing as the shareholders' holding period increases.<sup>64</sup> Similarly, critics of the new finance argue that favorably treating qualified financial contracts, like derivatives and repos, prioritizes them over long-term debt. The favorable treatment of these short-term obligations distorts financial markets to favor these short-term instruments at the expense of other, longer-term forms of financing.<sup>65</sup>

Thus, three of the most prominent policy measures to reduce unwarranted short-termism have been a Tobin tax on securities trading, a sliding scale capital gains tax tied to the length of the holding period, and facilitating more and larger blockholders. The corporate judiciary and state legislatures constructing corporate law cannot implement most such measures, and cannot well assess whether such measures would be the best means to mitigate any securities market short-termism.<sup>66</sup>

#### IV. DIFFICULTIES WITH THE BASIC ARGUMENT: FACTS

The short-termist theory faces offsetting facts, which make it unwise to place much weight on the short-term theory in corporate policymaking. First, even if the stock market is excessively short-run focused and even if there are transmission mechanisms that bring financial markets' time horizon into corporate decision making, policymakers need to see the American economic system as a whole, where there are countermeasures. Second, there is considerable evidence of stock market long-termism. Third, substantial, albeit unheralded sources of

---

63. See ASPEN INST., *supra* note 15; Joseph E. Stiglitz, *Using Tax Policy to Curb Short-Term Trading*, 3 J. FIN. SERVICES RES. 101, 109 (1989); Lawrence H. Summers & Victoria P. Summers, *When Financial Markets Work Too Well: A Cautious Case for a Securities Transactions Tax*, 3 J. FIN. SERVICES RES. 261, 272 (1989). *But see* G. William Schwert & Paul J. Seguin, *Securities Transaction Taxes: An Overview of Costs, Benefits and Unresolved Questions*, FIN. ANALYSTS J., Sept.–Oct. 1993, at 27. Implementing a Tobin tax is not straightforward. Some traders could move to a jurisdiction without the tax; some traders will find how to avoid the tax; others will find untaxed near-substitute transactions. *Cf.* Steven M. Davidoff, *Tax on Trades Is a Simple Idea with Unintended Outcomes*, N.Y. TIMES, Feb. 27, 2013, at B5; James Fontanella-Khan & Chris Giles, *Britain Challenges EU over 'Tobin Tax'*, FIN. TIMES, Apr. 19, 2013, at 3.

64. LOUIS LOWENSTEIN, *WHAT'S WRONG WITH WALL STREET—SHORT-TERM GAIN AND THE ABSENTEE SHAREHOLDER 204–05* (1988) (attributing the idea to Warren Buffett).

65. See generally Franklin R. Edwards & Edward R. Morrison, *Derivatives and the Bankruptcy Code: Why the Special Treatment?*, 22 YALE J. REG. 91 (2005); Mark J. Roe, *The Derivatives Market's Payment Priorities as Financial Crisis Accelerator*, 63 STAN. L. REV. 539 (2011) [hereinafter Roe, *Derivatives Priorities*]; Mark J. Roe, *Clearinghouse Overconfidence*, 101 CAL. L. REV. (forthcoming 2013).

66. A fourth measure, not yet prominent, would focus on the legal favoritism for the very short-term instruments financing many financial institutions. *Cf.* Roe, *Derivatives Priorities*, *supra* note 65.

excessive short-termism come from inside the corporation. The average duration for executive compensation appears to be shorter than the average duration of institutional investor stock market holdings, for example. Fourth, the purported shortening of investor holding periods may be exaggerated. Fifth, the new short-termism, if it exists, may be an appropriate reaction to changes in the economic environment: more rapid technological change, increased globalization, and excessively influential government short-term policies.

I take each of these in turn.

#### A. THE ECONOMIC SYSTEM

There are major alternatives to public ownership that can be readily structured to plan for the long term: venture capital markets and private equity markets, privately held firms, and government financing of long-term research. If these alternative economic institutions provide much of the long-term orientation that securities markets purportedly do not, and if securities markets provide substantial other benefits—in diversification, liquidity, and aggregation of capital from disparate investors—then the system’s complementarity may make the short-termism problem a problem for one firm or another, but not a problem for the American economy overall. They may not provide enough—venture capital and private equity often have horizons of five to ten years. Perhaps that is not long enough, and sometimes it is even shorter. Privately held firms may weaken as founders age. Governments make mistakes. The point is not that these institutions are fail-safe but that they are offsets, and often substantial offsets.

#### B. STOCK MARKET LONG-TERMISM

The substantial evidence of simultaneous financial market *long-termism* tends to be ignored in this debate, as public firms often over-invest when compared to their private counterparts.<sup>67</sup> And financial economists return results inconsistent with institutional investors causing corporate short-termism. “Indeed,” say two prominent researchers, “we document a positive relation between industry-adjusted expenditures for [property, plant, and equipment] and R&D and the fraction of shares owned by institutional investors.”<sup>68</sup> After analyzing “corporate expenditures for property, plant and equipment (PP&E) and research and development (R&D) for over 2500 US firms,” they conclude that “[w]e find no support for the contention that institutional investors cause corporate managers to behave myopically.”<sup>69</sup> And again, “[c]ontrary to the view that institutional

67. Sreedhar T. Bharath, Amy K. Dittmar & Jagadeesh Sivadasan, *Does Capital Market Myopia Affect Plant Productivity? Evidence from Going Private Transactions* (Dec. 2010) (unpublished manuscript) (available at [www.ssrn.com/abstract=1735508](http://www.ssrn.com/abstract=1735508)). Over-investment would map to a long-standing critique of managerial incentives in public firms, evidencing not pernicious short-termism but empire-building, excessive continuance in dying industries, and excessive long-termism.

68. Sunil Wahal & John J. McConnell, *Do Institutional Investors Exacerbate Managerial Myopia?*, 6 J. CORP. FIN. 307, 307 (2000).

69. *Id.*

ownership induces a short-term focus in managers, we find that their presence boosts innovation.<sup>70</sup> Particularly when managers are *less* entrenched, the authors find, institutions induce the firm to innovate more effectively.

Companies whose managers' compensation is tied to volatile stock prices *over*-invest in R&D, compared to companies whose managers' compensation is not so closely linked.<sup>71</sup> The bulk of the studies show institutional ownership to be associated with higher R&D intensity;<sup>72</sup> firms that become *more* insulated from financial markets *reduce* long-term R&D investments.<sup>73</sup> Takeover protection has been one of the most prominent policy prescriptions induced by those who see stock-market-induced short-termism as a serious problem. If the prescription were on average correct, then isolating boards and management from takeovers would lead to higher R&D and other results. But, although two studies are consistent with this view,<sup>74</sup> as many or more studies do not find such increases following takeover protection.<sup>75</sup> The most recent extensive studies on the issue find that patents and innovation *decrease* "for firms incorporated in states that pass antitakeover laws relative to firms incorporated in states that do not."<sup>76</sup>

70. Philippe Aghion, John Van Reenen & Luigi Zingales, *Innovation and Institutional Ownership*, 103 AM. ECON. REV. 277, 302 (2013).

71. Carl Hsin-Han Shen & Hao Zhang, *CEO Risk Incentives and Firm Performance Following R&D Increases*, 37 J. BANKING & FIN. 1176 (2013). The influence of the stock market here may well be pernicious, by inducing managers to over-invest in less-than-profitable R&D, so as to falsely signal good corporate prospects. But the point is that the stock market is not facilitating R&D cuts—the usual short-termist *bête noir*—but inducing greater R&D, contrary to the short-termist prediction.

72. Gary S. Hansen & Charles W. Hill, *Are Institutional Investors Myopic? A Time-Series Study of Four Technology-Driven Industries*, 12 STRATEGIC MGMT. J. 1 (1991). To the same effect: Barry D. Baysinger, Rita D. Kosnick & Thomas A. Turk, *Effects of Board and Ownership Structure on Corporate R&D Strategy*, 34 ACAD. MGMT. J. 205, 205–14 (1991); Li Eng & Margaret Shackell, *The Implications of Long-Term Performance Plans and Institutional Ownership for Firms' Research and Development (R&D) Investments*, 6 J. ACCT., AUDIT. & FIN. 117 (2001); Jennifer Francis & Abbie Smith, *Agency Costs and Innovation: Some Empirical Evidence*, 19 J. ACCT. & ECON. 383, 383–409 (1995); Peggy M. Lee & Hugh M. O'Neill, *Ownership Structures and R&D Investments of U.S. and Japanese Firms: Agency and Stewardship Perspectives*, 46 ACAD. MGMT. J. 212, 212–25 (2003).

73. "[Our] results contradict the managerial myopia hypothesis: firms significantly decrease R&D intensity relative to industry R&D intensity following an antitakeover amendment." Lisa K. Meulbroek, Mark L. Mitchell, J. Harold Mulherin, Jeffrey M. Netter & Annette B. Poulsen, *Shark Repellents and Managerial Myopia: An Empirical Test*, 98 J. POL. ECON. 1108, 1115 (1990).

74. William N. Pugh, Daniel E. Page & John S. Jahera, Jr., *Antitakeover Charter Amendments: Effects on Corporate Decisions*, 15 J. FIN. RES. 57 (1992); Ali R. Malekzadeh, Victoria B. McWilliams, Nilanjan Sen, *Antitakeover Amendments, Ownership Structure, and Managerial Decisions: Effects on R&D Expenditure (2005)* (unpublished manuscript) (available at <http://citeseerx.ist.psu.edu/viewdoc/download?sessionid=57D23E4DDCE0A94BCFE2037029A5D3B5?doi=10.1.1.17.3513&rep=rep1&type=pdf>). Cf. Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, in CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 33 (Alan J. Auerbach ed., 1988) (lower managerial incentives to invest in innovation, managerial effort, and firm-wide human capital when shareholders have strong takeover power).

75. Ravi Jain & Sonia Wasan, *Adoption of Antitakeover Legislation and R&D Expenditure*, 6 INVESTMENT MGMT. & FIN. INNOVATIONS 63 (2009); Mark S. Johnson & Ramesh P. Rao, *The Impact of Antitakeover Amendments on Corporate Financial Performance*, 32 FIN. REV. 659 (1997); Paul Mallette, *Antitakeover Charter Amendments: Impact on Determinants of Future Competitive Position*, 17 J. MGMT. 769 (1991).

76. Atanassov, *supra* note 61; Mahoney, Sundaramurthy & Mahoney, *supra* note 49, at 349 ("This paper's empirical results indicate that the average effect of antitakeover provisions on subsequent long-term investment is negative."); Meulbroek et al., *supra* note 73.

Consider the regular, but intermittent high valuations accorded to one sector or another of the financial market. At the very beginning of the twenty-first century, there was a boom, many now say bubble, in internet stocks.<sup>77</sup> People saw that the internet would restructure retailing, information distribution, and more. New companies arose, went public, and were accorded high—sometimes astronomical—valuations.<sup>78</sup> These high valuations can be, and should be, interpreted as stock market *long-termism*, in that the market was valuing firms with no immediate prospect for strong earnings as very good investment prospects. Indeed, some epochs of widespread high valuation could well be interpreted as excessive long-termism, as analysts concluded that many high-tech, dot.com firms would need to grow at unprecedented rates for the high prices of the late 1990s to be accurate long-term prices.<sup>79</sup> With stock market valuations high, including those of firms that were not themselves tech firms but just stock market beneficiaries of rising equity prices, firms invested more in capital—i.e., more in the long term—than they otherwise would have.<sup>80</sup> During this period, the “run-up in equity prices allowed for new projects to be undertaken by these [high-priced] firms—*projects that otherwise would likely be underfunded.*”<sup>81</sup>

These bubbles and their manifestation of excessive long-termism are not testimonials to our having an efficacious stock market. They are themselves problems. The point is that they are not short-termist problems but excessively long-termist problems.

Nor are these market overvaluations isolated and unique. Railroads, automobiles, the telephone, and plastics have at various times been overvalued.<sup>82</sup> In the classic bubble example, tulips in seventeenth century Holland were in the conventional account valued for a time much higher than their rational expected value.<sup>83</sup> The point is not that markets are therefore efficient, or even that they are good. The point of overvaluation is that it fits better with a market that is giving excessive weight to the long term. It is not short-term.

---

77. John M. Griffin, Jeffrey H. Harris, Tao Shu & Selim Topaloglu, *Who Drove and Burst the Tech Bubble?*, 66 J. FIN. 1251, 1284 (2001).

78. See Robert J. Hendershott, *Net Value: Wealth Creation (and Destruction) During the Internet Boom*, 10 J. CORP. FIN. 281, 282 (2004); Alexander Ljungqvist & William J. Wilhelm, Jr., *IPO Pricing in the Dot-Com Bubble*, 58 J. FIN. 723, 723 (2003).

79. Eli Ofek & Matthew Richardson, *Dot.Com Mania: The Rise and Fall of Internet Stock Prices*, 58 J. FIN. 1113 (2003); Eli Ofek & Matthew Richardson, *The Valuation and Market Rationality of Internet Stock Prices*, 18 OXFORD REV. ECON. POLY 265 (2002). *But cf.* Lubos Pastor & Petro Veronesi, *Was There a Nasdaq Bubble in the Late 1990s?*, 81 J. FIN. ECON. 61 (2006).

80. Murillo Campello & John R. Graham, *Do Stock Prices Influence Corporate Decisions? Evidence from the Technology Bubble*, 107 J. FIN. ECON. 89 (2013); Michael Jensen, *Agency Costs of Overvalued Equity*, FIN. MGMT., Spring 2005, at 5.

81. Campello & Graham, *supra* note 80; *cf.* Jensen, *supra* note 80.

82. *Id.* at 6 n.5.

83. CHARLES KINDLEBERGER & ROBERT Z. ALIBER, *MANIAS, PANICS, AND CRASHES: A HISTORY OF FINANCIAL CRISES* 17, 109–11, 273 (6th ed. 2011). The text relates the classical tulipmania bubble story. Recent work casts some doubt, however. A new, rare, high-in-demand bulb should have commanded a high initial price. Peter M. Garber, *Tulipmania*, 97 J. POL. ECON. 535 (1989).

And, more prosaically, analysts sympathetic to the short-termist viewpoint should focus on the planning horizons for firms that must focus on returns over decades. Oil production companies, for example, invest in oil fields that will produce for multiple decades, often over a good fraction of a century.<sup>84</sup> These firms are disproportionately public firms with scattered, trading stockholders. At the same time, the bond market has historically had little problem in making long-term financing commitments to much of the American economy.<sup>85</sup>

### C. SHORT-TERMISM INSIDE THE CORPORATION

Short-termism can arise inside the corporation and can do so in ways that insulating boards further from markets would exacerbate.

The first intuition is simple: The CEO is still the most influential corporate decision maker in most large public firms. It is basic human nature that the CEO would want good results to come to fruition during his or her tenure. With the average CEO's tenure at about seven years,<sup>86</sup> many CEOs could well think that there are only a few years left to their time as CEO. They have personal reasons to emphasize projects that will have good results during those few years, as a matter of personal pride or more, since CEO turnover is associated with weak firm performance.<sup>87</sup> Older CEOs put their firms on a low-risk path when their firms become more insulated from shareholder influence (while younger CEOs do the opposite).<sup>88</sup> Older CEOs reduce research and development as well as their firm's overall riskiness by diversifying more.<sup>89</sup> While some of these CEOs may worry that they will be replaced by powerful shareholders, an equally logical hypothesis is that they favor short-term results because they want results to be

84. BRIAN HICKS & CHRIS NELDER, *PROFIT FROM THE PEAK: THE END OF OIL AND THE GREATEST INVESTMENT EVENT OF THE CENTURY* 23 (2006).

85. Cláudia Custódio, Miguel A. Ferreira & Luís Laureano, *Why Are US Firms Using More Short-Term Debt?*, 108 J. FIN. ECON. 182, 182, 211 (2013). They find that debts markets have become less willing to finance long-term operation than previously. They link the shortening debt maturity largely to the increasing number of new, smaller, riskier firms accessing the bond market. This suggests an issue that is not one for corporate law courts but is one that arises from the changing nature of the economy.

86. Steven N. Kaplan & Bernadette A. Minton, *How Has CEO Turnover Changed?*, 12 INT'L REV. FIN. 57, 58 (2012) (seven years in the 1992 to 2007 period; six from 2000 to 2007). According to the Spencer Stuart study, 6.6 years. Joann S. Lublin, *CEO Tenure, Stock Gains Often Go Hand in Hand*, WALL ST. J., July 6, 2010, at 3. According to a recent Conference Board Study, 8.1 years. CONFERENCE Bd., CHART OF THE WEEK, DEPARTING CEO AGE AND TENURE, CEO SUCCESSION PRACTICES: 2013 EDITION (2013), available at <https://www.conference-board.org/retrievefile.cfm?filename=TCB-CW-019.pdf&type=subsite>.

87. Kaplan & Minton, *supra* note 86, at 67. The problem is more complex and causation need not be one way. Financial markets could press firms to produce results, which in turn could press boards to fire CEOs more frequently, which in turn could press CEOs to emphasize immediate firm performance. But the fact that older CEOs seem more susceptible to under-investment suggests that at least some of the cause emanates from the CEO, in that older CEOs are more likely to expect their current position to be the one from which they retire.

88. Jon A. Garfinkel, Jaewoo Kim & Kyeong Hun Lee, *External Governance, Risk Taking and Outcomes: The Importance of CEO Career Concerns* (2012) (unpublished manuscript) (available at <http://ssrn.com/abstract=2171005>).

89. Matthew A. Serfling, *CEO Age and the Riskiness of Corporate Policies* (Jan. 25, 2002) (unpublished manuscript) (available at <http://ssrn.com/abstract=2158973>).

good before they retire. A “one standard deviation increase in CEO age decreases [a measure of R&D intensity] by almost 20%.”<sup>90</sup>

Several theoretical studies are consistent with this view—that younger CEOs will invest more for the future and older ones less.<sup>91</sup> Several are not.<sup>92</sup> But empirically, several studies show entrenched, older CEOs investing less than younger ones.<sup>93</sup> These results suggest that enhancing CEO autonomy from financial markets will lead to more short-termism, not less. Dechow and Sloan, for example, find that CEOs increase their firms’ research and development spending during their first year as CEO, and reduce it in their final years as CEO.<sup>94</sup> Managers not at the top of the firm but who are mobile want to show good short-term results to managerial labor markets.<sup>95</sup> This is short-termism, and potentially pernicious short-termism, but it originates in managerial labor markets, not stock markets. And internal organizational metrics can overemphasize immediate results.<sup>96</sup> Lastly here, overconfident managers, who abound at the top, suggest several authors, “are likely to delay recognition of losses . . . , [perceiving] poorly performing negative NPV projects . . . as positive NPV projects.”<sup>97</sup>

Overall, there is considerable evidence that the internal organizational structure of the large firm is a source of significant short-term impulses. More prosaically, boards and executives do have capacity to design longer-term compensa-

90. Jaideep Chowdhury & Jason D. Fink, *Managerial Myopia: Tests and Implications 2* (Dec. 21, 2012) (unpublished manuscript) (available at <http://ssrn.com/abstract=2055353>); see also Jaideep Chowdhury, *Managerial Myopia: A New Look 6* (Jan. 24, 2012) (unpublished manuscript) (available at <http://ssrn.com/abstract=1991429>) (“faced with [a] one unit increase in growth opportunities[,] there is a 35.29% drop in the increase in investments when there is [a] one standard deviation increase in CEO age. My results point[] to significant deviations from optimal investments as CEO[s] age.”).

91. Canice Prendergast & Lars Stole, *Impetuous Youngsters and Jaded Old-Timers: Acquiring a Reputation for Learning*, 104 J. POL. ECON. 1105, 1126 (2006); Xiaoyang Li, Angie Low & Anil Makhija, *Career Concerns and the Busy Life of the Young CEO 29* (Charles A. Dice Center, Working Paper No. 2011-4, July 21, 2011), available at [www.ssrn.com/abstract=1761523](http://www.ssrn.com/abstract=1761523).

92. Bengt Holmström, *Managerial Incentive Problems: A Dynamic Perspective*, 66 REV. ECON. STUD. 169, 179 (1999); David S. Scharfstein & Jeremy C. Stein, *Herd Behavior and Investment*, 80 AM. ECON. REV. 465, 476 (1990).

93. Yakov Amihud & Baruch Lev, *Risk Reduction as a Managerial Motive for Conglomerate Mergers*, 12 BELL J. ECON. 605, 609 (1981); Marianne Bertrand & Sendhil Mullainathan, *Enjoying the Quiet Life? Corporate Governance and Managerial Preferences*, 111 J. POL. ECON. 1043, 1072 (2003); Paul Gompers, Joy Ishii & Andrew Metrick, *Corporate Governance and Equity Prices*, 118 Q.J. ECON. 107, 133 (2003); Li, Low & Makhija, *supra* note 91; Andrei Shleifer & Robert W. Vishny, *Management Entrenchment: The Case of Manager-Specific Investments*, 25 J. FIN. ECON. 123, 125 (1989).

94. Patricia Dechow & Richard Sloan, *Executive Incentives and the Horizon Problem: An Empirical Investigation*, 14 J. ACCT. & ECON. 51, 52 (1991).

95. Tim Campbell & Anthony Marino, *Myopic Investment Decisions and Competitive Labor Markets*, 35 INT’L ECON. REV. 855, 858 (1994); Bengt Hölmstrom & Joan Ricart i Costa, *Managerial Incentives and Capital Management*, 101 Q.J. ECON. 835, 841 (1986); M.P. Naryanan, *Managerial Incentives for Short-Term Results*, 40 J. FIN. 1469, 1470 (1985); Richard P. Rumelt, *Theory, Strategy and Entrepreneurship*, in *THE COMPETITIVE CHALLENGE* 137 (David J. Teece ed., 1987).

96. Lavery, *supra* note 5, at 831–32, 840–47; Kevin J. Lavery, *Managerial Myopia or Systemic Short-Termism?—The Importance of Managerial Systems in Valuing the Long Term*, 42 MGMT. DECISION 949 (2004).

97. Anwer S. Ahmed & Scott Duellman, *Managerial Overconfidence and Accounting Conservatism*, 51 J. ACCT. RES. 1, 2 (2013).

tion contracts to mitigate market features they see as deleteriously short-term.<sup>98</sup> But there is evidence that shorter than optimal vesting periods come at the behest of the CEO<sup>99</sup> and that when the salary, bonus, restricted stock, and option components of CEO and senior executive pay are weighted, their duration is about a year.<sup>100</sup> The average duration until senior executives receive their pay thus appears shorter than the average duration of institutional investors' stockholding.<sup>101</sup> One would think that that if the internal organizational dynamics were more long-term than the external stock market pressures, the average duration of senior executive pay would exceed the average duration of investors' ownership. Hence, short-termist thinkers need to assess whether insulating boards further would make executive pay more short-term-based, not less.

A commonly cited short-termist mechanism comes when corporate managers are unable to communicate complex or technological information to a diffusely held market of nonexperts. But if this is a primary problem, a significant solution would be rules that facilitated blockholders in the large American corporation. Such blockholders would have incentives to process the more complex information that distant, smaller stockholders cannot readily process and understand.<sup>102</sup> That the core cure that is promoted is often to insulate boards from stockholders, by according boards greater autonomy, and neither to facilitate more blockholding<sup>103</sup> or lengthen the duration of executive compensation, makes it plausible that for some adherents the short-termist view is proxying for a more general managerialist view of what makes the corporation run well.

#### D. INTERPRETIVE ERROR?

It is a widely held view that the holding duration of equity has dramatically shortened in recent decades. Trading volume is up and traders' holding periods are down, making even the limited shareholder attention span of the 1970s flicker as shareholders buy and sell, in this view. Program traders can move much stock through the system in microseconds.

---

98. Cf. Brian D. Cadman, Tjomme O. Rusticus & Jayanthi Sunder, *Stock Option Grant Vesting Terms: Economic and Financial Reporting Determinants*, REV. ACCT. STUD., Nov. 2012, at 13, 13 ("vesting schedules are longer in growth firms where lengthening the executive's investment horizon is more important and . . . firms with more powerful CEOs and weaker governance grant options with shorter vesting periods").

99. *Id.* at 13, 14. Jianxin Chi & Shane A. Johnson, *The Value of Vesting Restrictions on Managerial Stock and Option Holdings* 5 (Mar. 9, 2009) (unpublished manuscript) (available at [www.ssrn.com/abstract=1136298](http://www.ssrn.com/abstract=1136298)).

100. Radhakrishnan Gopalan et al., *The Optimal Duration of Executive Compensation: Theory and Evidence* 10, 16 (Aug. 10, 2012) (unpublished manuscript) (available at [www.ssrn.com/abstract=1656603](http://www.ssrn.com/abstract=1656603)) ("[T]he average total compensation for an executive in our sample is \$2.16 million, which consists of \$0.45 million of salary, \$0.21 million of bonus, \$0.72 million of stock options, and \$0.79 million of restricted stock grants. . . . We find that the average duration of executive pay in our sample is 1.18 years. Thus, executive pay vests on average about one year after it is granted.").

101. Compare *supra* note 100 with *infra* note 109 and their underlying sources.

102. This is the view I offered in ROE, STRONG MANAGERS, WEAK OWNERS, *supra* note 43, at 240–47.

103. See Lipton, *supra* note 1; see also articles cited in *supra* notes 2–15.

Delaware's Chancellor, Leo Strine, the chief of the chancery court, where the country's major corporate litigation usually transpires, for example, accurately quotes several commentators who indicate that hedge funds and mutual funds suffer from "gerbil-like trading activity."<sup>104</sup> "[C]hurning renders the institutions more short-term speculators than committed, long-term investors."<sup>105</sup> Similarly, "the stockholder base of public companies turns over nearly completely on an annual basis."<sup>106</sup> Short-termism and stock turnover are being taken as a serious corporate issue by important corporate policymakers.

As we have seen, churning would not in itself be dispositive for a short-termist view for corporate lawmaking, if (1) short-term trading did not much affect corporate decision making if there were no transmission mechanism bringing trading horizons into the firm's decision-making process, (2) there were sufficient market correctives if it did affect corporate decision making, or (3) the costs of correction were too high. The prior three sections discuss the likelihood that these three possibilities are true. This section discusses a fourth reason for continued reticence in corporate lawmaking here—that interpreting the market turnover data as showing a shortening duration for America's core stockholders may well be erroneous. It may not even be shortening.

Consider this possibility: In 1985, 100 shareholders each hold 100 shares of the XYZ Corporation for three years. They sell their shares, after holding their shares for three years, to other investors, who in turn hold their shares for three years and then re-sell them. The average, median holding duration for each 100-share shareholder is three years.

Thereafter, by 2013, ten of those 100 shareholders become active traders. They sell their shares every four months to a new set of shareholders. For this group we have ten holders every four months, thirty holders every year, and ninety holders every three years. For ninety holders, the average duration of ownership is four months. For another ninety holders, the average duration is still three years. One might be tempted then to say that for the entire stock of 180 holders of XYZ stock during the past year, the average duration for holding was only twenty months, while in the good old days it was thirty-six months. Holding duration has nearly halved.

These statements would be accurate counts, but the question is whether they are the best way to interpret the changing holding duration for policymaking purposes. For 90 percent of the shareholder mass, their turnover period and their holding duration are just as they always had been. For 90 percent of the shareholders, nothing has changed and their holding period has not shortened.

This analytic problem is hardly unique to short-termism. When a distribution is skewed and not symmetrical, the average—the mean—can fail to describe properly the population and its change over time. To illustrate, posit that a

104. Strine, *supra* note 19, at 10.

105. *Id.* at 11.

106. *Id.* at 17 (citing Marcel Kahn & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 *Geo. L.J.* 1227, 1232 (2008)).

suburb of Seattle, with a population of 10,000, had an average annual income per capita of \$50,000 in 1970. By 1980, the average income had spectacularly doubled to \$100,000 annually. Policymakers, analysts, and academics might seek to know the source of this doubling of wealth and income, so that they could use the winning strategies elsewhere to increase wealth. Was it superior education, good policing, infrastructure development, or something else?

Someone digs deeper and finds that the reason the mean income doubled in that decade in that Seattle suburb—Redmond—was because of the success of Bill Gates. By 1980 his ordinary 1970 income of, say, \$50,000 had increased to, say, \$50 million. Is it meaningful to say that average income in Redmond had doubled in the decade when for 99.99 percent of the population income was unchanged, while one very successful businessperson did very well? The mode could better describe for the suburb's average income over time. The mode was unchanged over the decade.<sup>107</sup>

Emerging evidence suggests that this interpretive consideration may well be in play for the duration of stock ownership in the United States. A team of finance economists—Martijn Cremers, Ankur Pareek, and Zacharias Sautner—recently assembled data showing that two of America's primary shareholders—Fidelity and Vanguard—have holding durations that have not budged since 1985.<sup>108</sup> The overall holding duration for mutual funds and pension funds—America's core stockholder class—*increased* during the quarter century from 1985 to 2010.<sup>109</sup> These institutional investor holding durations seem to exceed the managers' time-to-realization—the duration—for executive pay.<sup>110</sup>

The authors of the stock holding duration study report that they investigated “institutional investors' holding durations since 1985 and find that holding durations have been stable and, if anything, slightly lengthened over time.” In 1985, the average duration for stock holding in the United States was 1.2 years; in 2010 it had increased to 1.5 years.<sup>111</sup> This data erodes the typical short-termist factual foundation on directionality.

\* \* \*

True, even if this reinterpretation of the data trends comes to be seen as accurate, the short-termist view can persist, but it would have to be recast. The typ-

107. See STEPHEN JAY GOULD, *FULL HOUSE* 159 (1996) (from which a variant of the Gates distortion is drawn). Gould applies the analytic concept to refute several pieces of biology's received conventional wisdom.

108. Martijn Cremers, Ankur Pareek & Zacharias Sautner, *Stock Duration and Misvaluation* 11 (Feb. 14, 2013) (unpublished manuscript) (available at <http://ssrn.com/abstract=2190437>) (“while [s]tock [d]uration lengthened [from 1985 to 2010], share turnover has substantially increased from 72% per year . . . to 276% per year”).

109. *Id.* at 44. From less than a year for pension funds to over two years, and from just over a year for mutual funds to just under 1.5 years.

110. Compare *supra* note 100 with *supra* note 109 and their underlying sources.

111. Cremers et al., *supra* note 108, at 3. The study, however, would not pick up intra-quarterly trading, as it tracks the persistence of holdings, quarter to quarter (as the holding data is available only for end-of-quarter reports). Round-trip trading inside a quarter would not diminish the measured duration number.

ical holding duration has not shortened, short-termists would concede, but it is still too short-term now, they would need to contend, so as a policy matter shareholders must be neutered from corporate governance influence. And, even if shareholders' typical holding duration is somewhat less short-term today than in the 1980s, they might argue, their corporate strength and influence has changed. Proponents of the short-termist view would argue that shareholders have become more powerful—staggered boards are largely gone, many firms have majority voting, SEC rules favor shareholder voice, and hedge funds allow some shareholders influence that disaggregated holdings do not. Others would argue the contrary—that the central governance event of the past quarter-century was the hostile takeover's demise, with offsetting shareholder gains in strength being pale, weak substitutes for the lost takeover.

People could disagree here on the overall direction of shareholder power, but the point to be made is that this disagreement is a very different argument from one that says that shareholders have become more short-term over the past quarter-century and that corporate America needs a remedy for the shortening of that duration. The most recent data analysis suggests the contrary.

#### E. MORE POWERFUL CORE CAUSES? SPEEDING TECHNOLOGY, INCREASING GLOBALIZATION, AND UNSTABLE GOVERNMENT POLICY

Whether or not stock markets are moving faster, the world is moving faster in the twenty-first century than it moved in the twentieth. Technological change is faster, the internet is destroying old distribution systems, computers change how business is done, and modern telecommunications make global markets local. International trade more quickly hits local businesses that were once isolated from world markets. Government policies—whether it is the American fiscal cliff or the European potential for an imploding euro—make it hard for businesses to plan for the long term.

\* \* \*

Keep in mind again that conventional long-term production requiring massive investment does happen in large public firms: shale oil and gas is being produced for the long term,<sup>112</sup> as is oil and gas from conventional fields that must be developed with infrastructure investment requiring thirty- or forty-year horizons. These investments do not support the idea that the stock market cannot handle the very long term.

But other investments do not have the same long-term luxury. Consider the speed of technological change. Earlier we noted that financial markets have not deterred major technological firms from their tasks. Amazon, Apple, and

---

112. WORLD ENERGY COUNCIL, 2010 SURVEY OF ENERGY RESOURCES 99 (2010), available at [http://www.worldenergy.org/documents/ser\\_2010\\_report.pdf](http://www.worldenergy.org/documents/ser_2010_report.pdf).

Google come to mind as public companies with a focus on innovation and the long term. Amazon's CEO is aggressive on the issue:

In 1997, the year Amazon.com went public, its chief executive, Jeff Bezos, issued a manifesto: "It's all about the long term," he said. He warned shareholders "we may make decisions and weigh tradeoffs differently than some companies" and urged them to make sure that a long-term approach "is consistent with your investment policy." Amazon's management and employees "are working to build something important, something that matters to our customers, something that we can tell our grandchildren about," he added.<sup>113</sup>

The recent controversy concerning shareholder pressure for Apple to release its large cash hoard fits.<sup>114</sup> For years, Apple was in hyper-growth mode; recently its rate of growth has become likely to slow, with innovation plausibly likely to be readily funded by ongoing cash flow, a result that would make its cash holdings not useful and tempting to use in unrelated, lower-growth businesses, a common problem. Activism for Apple to release unneeded cash can thus facilitate it to focus on its viable long term.

\* \* \*

There is also a reverse side to the disruption wrought by rapid technological change, such as that which Amazon has pursued. Critics might look at bricks-and-mortar bookstores that fail to expand, invest, and discover new means to market their business. If the companies are public, critics might blame public markets for that unwillingness to invest. But the underlying problem may well be simpler, in that technological changes could be eroding the viability of such firms' business models.

And, finally here, consider the reported corporate reaction to the risks of the fiscal cliff if U.S. budget problems remained unresolved, with the media reporting that American companies are cutting investment and spending due to fiscal and economic uncertainty. "Companies fear that failure to resolve the fiscal cliff will tip the economy back into recession."<sup>115</sup> "Half of the nation's 40 biggest publicly traded corporate spenders have announced plans to curtail capital expenditures."<sup>116</sup> "At Vanguard, [the large mutual fund complex,] we estimate that policy uncertainty has created a \$261 billion drag on the U.S. economy."<sup>117</sup> To observers looking at ownership structure, stock market trading of these firms' equity may seem to be the root cause of the drop-off in investment spending—a basic indicator of a preference for the short term over the long term. But

113. James B. Stewart, *Amazon Says Long Term and Means It*, N.Y. TIMES, Dec. 17, 2011, at B1. Cf. Amir Bhidé, *Efficient Markets, Deficient Governance*, HARV. BUS. REV., Nov.–Dec. 1994, at 128, 135.

114. Andrew Ross Sorkin, 'Shareholder Democracy' Can Mask Abuses, N.Y. TIMES DEALBOOK (Feb. 25, 2013), <http://nyti.ms/15Lvwoh>; Mark Roe, *Apple's Cash-Flow Problem*, PROJECT SYNDICATE (Apr. 18, 2013), <http://www.project-syndicate.org/commentary/why-apple-should-release-its-cash-hoard-by-mark-roe>. Apple's cash hoard also embeds a tax issue, in that much of Apple's cash is abroad.

115. Sudeep Reddy & Scott Thurm, *Investment Falls Off a Cliff—U.S. Companies Cut Spending Plans Amid Fiscal and Economic Uncertainty*, WALL ST. J., Nov. 19, 2012, at A1.

116. *Id.*

117. Bill McNabb, *Uncertainty Is the Enemy of Recovery*, WALL ST. J., Apr. 29, 2013, at A17.

identification of markets over policy as the more fundamental cause may be mistaken here.

One controversial study concluded what many businesspeople already know: “[B]usinesses and households are uncertain about future taxes, spending levels, regulations . . . and interest rates. . . . [T]his uncertainty leads them to postpone spending on investment . . . and to slow hiring.”<sup>118</sup> Or, consider Federal Reserve Chair Ben Bernanke’s PhD thesis:

When Ben S. Bernanke wrote his doctoral thesis in 1979, he could have been channeling the quandary that C.E.O.s face today. “Uncertainty about the long-run environment which is potentially resolvable over time thus exerts a depressing effect on current levels of investment,” he wrote at the Massachusetts Institute of Technology. “Uncertainty provides an incentive to defer such investments in order to wait for new information.”<sup>119</sup>

The corporation may indeed *need* to plan more today for the short run than for the long run. But the explanation for the shortened planning horizon may lie more in the nature of shortening technological life cycles, globalization, and changing government policy than in the financial markets external to, or the structures internal to, the large public firm.

## V. THE SHORT-TERMIST ARGUMENT AS PROXY

The short-termist argument is closely associated with two views of corporate governance and may proxy for, or be used to bolster, these views. These views, though, must stand on their own. They get no extra weight and no extra persuasive power by using the short-termist argument.

### A. AS PROXY FOR THE NEED FOR MANAGERIAL INSULATION

Shareholders, it has been said, are best served by managers with enormous discretion and autonomy. Shareholders will not be well-informed generally, it is asserted, will disagree with one another on corporate strategy, and will disrupt

118. Scott R. Banker, Nicholas Bloom & Steven J. Davis, *Measuring Economic Policy Uncertainty 1–2* (2012) (unpublished manuscript) (available at [http://policyuncertainty.com/media/BakerBloomDavis\\_Old.pdf](http://policyuncertainty.com/media/BakerBloomDavis_Old.pdf)). The study’s controversy arose from its politics and its methodology, see Paul Krugman, *Phony Fear Factor*, N.Y. TIMES, Aug. 9, 2013, at A19; Mike Konczal, *What Is the Economic Policy Uncertainty Index Really Telling Us?*, *Next New Deal*, ROOSEVELT INST. BLOG (Aug. 8, 2012), <http://www.nextnewdeal.net/fortybomb/what-economic-policy-uncertainty-index-really-telling-us>; see also Huseyin Gulen & Mihai Ion, *Policy Uncertainty and Corporate Investment* (Apr. 4, 2013) (unpublished manuscript) (available at <http://ssrn.com/abstract=2188090>) (abstract states: “Policy-related uncertainty is negatively related to firm and industry level investment, and the economic magnitude of the effect is substantial. Our estimates indicate that approximately two thirds of the 32% drop in corporate investments observed during the 2007–2009 crisis period can be attributed to policy related uncertainty.”); Andrew Ross Sorkin, *Business Between Worlds: Facing Uncertainty in 2013, But Not for the First Time*, N.Y. TIMES, Dec. 12, 2012, at F1, F10. Cf. Paola Conconi et al.,  *Policymakers’ Horizon and Trade Reforms 1* (2011) (unpublished manuscript) (available at <http://ssrn.com/abstract=1930305>) (testing how policymakers’ short-term election horizons “represent a key obstacle to the adoption of structural [economic] reform”).

119. Sorkin, *supra* note 114.

boardroom decision making if given too much authority to affect corporate decision making directly.<sup>120</sup>

The short-termist view may proxy here for the managerialist view, in that managerialists see shareholders as afflicted by a wide range of debilities and see boards as needing to be separated from shareholders' influence in order to lead the corporation coherently and keep it competitive.

Here I make no claim on the appropriateness of this view, positively or negatively. I do assert, though, that this view gains no added persuasive power from the short-termist argument, which is insufficiently strong, empirically and theoretically, to affect corporate rulemaking.<sup>121</sup> Perhaps boards need to be left largely unaffected by shareholders, but the short-termism argument is not one of the reasons for it. The board insulation view must stand or fall on its own, without reference to short-termism.

## B. AS PROXY FOR THE NEED TO ATTEND TO STAKEHOLDERS

Similarly, the view is widely but not universally held that short-term-oriented shareholders induce firms to be less attentive to stakeholders, to government regulation, and to societal values generally. The firm will treat labor badly, will sell defective products, will take excessive risks with public funds in the financial sector, and will degrade the environment, all in ways that make our society worse off.<sup>122</sup> Shareholder voice degrades each of these stakeholders in the corporation, many think. Short-termism is the catch-all term to embody these negatives. But this is an incorrect use of the short-termist view. We ought not to conflate corporate bad behavior with short-termism. Bad behavior could be long-term or short-term.<sup>123</sup>

Many perceive these negatives as serious faults of the large public corporation, warranting public policy attention. I do not evaluate this view here. But the purported tendency of shareholders to shorten the corporate time horizon must not figure into the balance. The stakeholder view, like the managerialist view, must stand or fall on its own.

---

120. Stephen Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW U. L. REV. 547 (2003).

121. Cf. Charles Nathan, *Debunking Myths About Activist Investors*, CONF. BD. GOVERNANCE CENTER BLOG (Mar. 3, 2013), <http://www.tcbblogs.org/governance/2013/03/03/debunking-myths-about-activist-investors/> (activist investors are sometimes long-term, sometimes short-term, but pose questions whether they produce sufficient value, whatever the time horizon). The best recent data show ongoing positive shareholder value. Bebchuk, Bray & Jiang, *supra* note 51. For similar results, see Dionysia Katelouzou, *Myths and Realities of Hedge Fund Activism: Some Empirical Evidence*, 7 VA. L. & BUS. REV. 459 (2013).

122. Cf. Christophe Moussu & Steve Ohana, *Are Leveraged Firms Focused on the Short-Run? Evidence from Health and Safety Programs in U.S. Firms* (Dec. 12, 2012) (unpublished manuscript) (available at <http://ssrn.com/abstract=2188303>).

123. Cf. Fried, *supra* note 60, at 20 (long-term shareholders' interests are not necessarily more aligned with stakeholders than short-term shareholders).

---

## CONCLUSION: NO MORE THAN WATCHFUL WAITING

We have here evaluated the longstanding short-termist argument in corporate law, using modern thinking and data on markets and the economy, and have found it wanting. It should be given no weight in corporate lawmaking.

Overall, the evidence that financial markets are excessively short-term is widely believed but not proven, and there is much evidence pointing in the other direction. We have seen bubbles and overvalued companies with little more than a business plan, strongly suggestive that financial markets can be excessively long-term. Markets undershoot and overshoot, as one should expect. We see technology companies and prosaic natural resources companies making major long-term investments that far exceed stock market holding periods and CEO job tenure.

Second, policymakers must evaluate the American economy from a system-wide perspective. System-wide, the American economy is replete with venture capital markets, private equity markets, and many privately held firms, all of which are capable of longer-term planning than the public firm is thought in some circles to be capable of. As long as venture capital markets, private equity markets, and other conduits mitigate or reverse enough of any short-term tendencies in the public securities market, then the purported problem is not a systemic economic issue. These institutions are themselves imperfect, but must still be considered when evaluating whether stock market short-termism, if it is excessive, is a system-wide problem.

Worse for the short-termist view is that mechanisms inside the corporation may well be important sources of short-term distortions and these internal distortions can be, and would be, exacerbated by further insulation of boards from external financial markets. It seems obvious (but underexamined) that CEOs will prefer that good results occur on their watch, and that poor results be pushed off into the future, beyond their tenure. There is considerable evidence consistent with this likelihood that a major source of short-term focus originates inside the corporation and not outside in financial markets. Senior managers with an eye on a new position want good results and they want them soon. Potentially telling is unpublished data that has executive compensation duration—the time to realization of salary, bonus, and stock—to be *shorter* than the average holding period for America's core institutional shareholders. Presumably the board and the CEO should be able to structure compensation to have a duration at least that of their shareholders but, as best as can be seen now, they do not.

It is not impossible that the short-termist view captures a rhetorical high ground in the case for board autonomy by contrasting the positive connotation of patient long-term capital against short-termist frenzy. But it is at least possible that some of the phenomena is better captured by contrasting dynamic firms that change and adapt quickly, i.e., in the short run and sometimes due to shareholder pressure, with lackluster, encrusted organizations that do not move as nimbly.

Fourth, if proponents of the short-termist view are seeking to influence courts and state legislatures that make corporate law, their view should be rejected.

Courts are poor places to make this kind of basic economic policy. They may even find it difficult to assess accurately whether the economy is too short-term, too long-term, or just right. If such considerations are to make their way into economic policy, these should be national policies, coordinated with tax policy, and perhaps implemented via the tax code and securities laws, and the rules that influence the size of stockholdings, not via parochial corporate law.

Fifth, the widely held view that short-term trading has increased dramatically in recent decades is unquestioned but may misinterpret the data. The best recent evidence indicates that the duration for holdings of the country's major stockholders, such as mutual funds at Fidelity and Vanguard, and major pension funds, has not shortened. Instead, a high-velocity trading fringe is moving stock rapidly through their computer systems. Their holdings, when averaged into marketwide data, make the duration appear to be shortening across the entire financial market. But these new trading patterns do not affect the major stockholding institutions and, hence, should not affect corporate law thinking.

Any one of these features should induce substantial caution among corporate law policymakers in using the short-termist view to buttress law that would further insulate managers from markets. In combination, they tell us that corporate law courts and corporate lawmaking legislators should view the short-termist argument for further board and CEO insulation as one that should be accorded no weight today.