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RESEARCH ARTICLE / ARAŞTIRMA MAKALESİ

Short-Termism in Publicly Listed Companies and Corporate Governance

Halka Açık Şirketlerde Kısa Vadecilik ve Kurumsal Yönetim

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Abstract

Short-termism is known as sacrificing long-term sustainable earnings for short-term returns. The pressure on management to obtain short-term results usually generates negative medium and long-term outcomes. This is because investors are inclined to sell their stocks when they hear about a shadow of bad news. In this context, business executives can decide to meet short-term shareholders expectations or prioritise the growth of their company. In other words, on the one hand, the company management should consider all possible economic variables within the scope of the necessity of protecting the company's capital, on the other hand, it should also ensure the participation to the capital that will benefit the financial structure of the company, especially from the cash flow point of view. Short-termism hinders effective company management, particularly for publicly listed companies, due to the convenience of trading stock transactions and more transparent management decisions. Considering abovementioned facts, this study examines the increasing trend in short-termism as an intertemporal choice and discusses solutions that can be offered through corporate governance principles.

Keywords

Short-Termism, Publicly Listed Companies, Corporate Governance, Intertemporal Choice Problem

Öz

Kısa vadecilik, pay sahiplerinin kısa dönemde kar elde etmek için uzun dönemli sürdürülebilir gelirlerini feda etmesi olarak tanımlanmaktadır. Kısa vadede getiri elde etmek isteyen şirket ortaklarının şirket yöneticilerine yaptıkları baskı orta ve uzun vadede olumsuz sonuçlar doğurmaktadır. Aslında bu durum, pay sahiplerinin ortağı oldukları şirketlere dair olumsuz bir duyum almaları halinde, paylarını derhal satışa çıkarmaya meyilli olmalarından kaynaklanmaktadır. Hal böyle iken, yöneticiler pay sahiplerinin kısa dönemli getiri beklentilerini karşılamak ya da şirketin uzun dönemli büyüme hedeflerini yerine getirmek hususlarında bir öncelik ayrımına sürüklenmektedirler. Başka bir deyişle, şirket yönetiminin bir yandan şirket sermayesinin korunması gerekliliği kapsamında olası tüm ekonomik değişkenleri derpiş etmesi gerekirken, bir yandan da şirketin finansal yapısına, özellikle nakit akışına, fayda sağlayacak sermayedar katılımını da sağlaması gerekmektedir. Bu kapsamda, özellikle halka açık şirketlerde pay devri işlemlerinin kolaylığı ve alınan kararların şeffaf olması gerekliliği gibi hususlar etkin bir yönetimin sağlanabilmesine engel teşkil etmektedir. Bu makale, yukarıda açıklanan nedenler bağlamında, kısa vadecilik cereyanını zamanlararası bir tercih problem olarak incelemekte ve kurumsal yönetim ilkeleri bağlamında sunulabilecek potansiyel çözüm önerilerini irdelemektedir.

Anahtar Kelimeler

Kısa Vadecilik, Halka Açık Şirketler, Kurumsal Yönetim, Zamanlararası Tercih Problemi

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Short-Termism in Publicly Listed Companies and Corporate Governance

I. Introduction

Publicly listed companies usually focus heavily on their quarterly earnings due to the popularity of short-termism, rather than focusing on annual, five-year, or ten-year earnings; this is focusing on the short-term yields of corporate decisions in lieu of long-term benefits. In simple terms, short-termism is making management decisions that can benefit in the short term but have the potential to impair the company in the future;[1] it is managerial myopia.[2] Consequently, one of the most frequent discussions on corporate governance over the past decade has been the disagreement on company decision-making in respect of their short and long-term strategies.[3]

There is a difference of opinion in the literature as to whether short-termism really poses a problem.[4] On the one hand, it has been argued that short-termism (also known as quarterly capitalism) leads to a major problem for public firms and the economy.[5] From another point of view, some scholars, who argued short-termism poses a problem, are sceptical to what extent it produces social harm.[6] On the other hand, there are some other scholars finding short-termism beneficial in terms of providing market discipline.[7] For the sake of contributing to this debate, this study examines to what extent stakeholders will benefit from short-termism in a micro perspective in terms of long-term appreciation of shareholders of companies.

1 Kevin Laverty, ‘Economic “Short-Termism”: The Debate, the Unresolved Issues, and the Implications for Management Practice and Research’ (1996) 21(3) The Academy of Management Review 825-60; David Marginson and Laurie McAulay, ‘Exploring the debate on short-termism: a theoretical and empirical analysis’ (2008) 29(3) Strategic Management Journal 273.

2 Maurizio Catino, *Organizational Myopia: Problems of Rationality and Foresight in Organizations* (Cambridge University Press 2013); Alex Edmans, Vivian Fang and Allen Huang, ‘The Long-Term Consequences of Short-Term Incentives’ (European Corporate Governance Institution, Finance Working Paper No. 527/2017, June 2020) 15 <http://ssrn.com/abstract_id=3037354> accessed 19 April 2021.

3 Gavin Hinks, ‘EU urges firms to focus on long-term strategy over short-term goals’ (Board Agenda, 3 August 2020) <https://boardagenda.com/2020/08/03/european-commission-urges-long-term-strategy-over-short-term-goals> accessed 19 April 2021.

4 Martin Petrin and Barnali Choudhury, ‘Corporate Purpose and Short-Termism’ in Afra Afsharipour and Martin Gelter (eds), *Comparative Corporate Governance: Research Handbooks in Comparative Law Series* (Edward Elgar 2021); Robert Rhee, ‘Corporate Short-Termism and Intertemporal Choice’ (2018) 96(3) Washington University Law Review 495-557.

5 Mark Joe, ‘Stock Market Short-Termism’s Impact’ (2018) 167(71) University of Pennsylvania Law Review 71-121; Filip Gregor and Frank Bold, ‘How EU can end corporate short-termism and create sustainable financial system’ (Euractiv, 22 August 2017) <https://www.euractiv.com/section/energy-environment/opinion/how-eu-can-end-corporate-short-termism-and-create-sustainable-financial-system> accessed 19 April 2021; John Coffee Jr. and Darius Palia, ‘The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance’ (Columbia Law School Working Paper 1928, 2015) <https://scholarship.law.columbia.edu/faculty_scholarship/1928> accessed 19 April 2021; Ronald Gilson and Jeffrey Gordon, ‘The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights’ (2013) 113(4) Columbia Law Review 863-927; Gregory Milano and Fortuna Advisors, ‘Corporate Short-Termism and How It Happens’ (2018) 30(4) Journal of Applied Corporate Finance 27; Gregory Milano, *Curing Corporate Short-Termism* (Fortuna Advisors 2020); Alfred Rappaport, *Saving Capitalism from Short-Termism: How to Build Long-Term Value and Take Back Our Financial Future* (McGraw-Hill 2011) 5.

6 Eugene Fama, ‘Efficient Capital Markets: A Review of Theory and Empirical Work’ (1970) 25 Journal of Finance 383; Michael Jensen, ‘Some anomalous evidence regarding market efficiency’ (1978) 6(2-3) Journal of Financial Economics 95-101; Rappaport (n 5).

7 Lawrence Summers, ‘Corporate long-termism is no panacea – but it is a start’ (Financial Times, 9 August 2015) <https://www.ft.com/content/97f3db5e-3d11-11e5-bbd1-b37bc06f590c> accessed 19 April 2021.

The structure of the paper covers five sections including this preliminary section, which presents an introductory remark, Section 2 established a theoretical background for corporate short-termism by arguing the difference between shareholder and stakeholder primacies. Section 3 discusses potential remedies for short-termism via corporate governance by taking the issue from European and American perspectives. Section 4 debates short-termism as an intertemporal choice problem through particularly indicating the issue of quarterly capitalism. Finally, Section 5 provides concluding remarks.

II. Corporate Short-Termism Amidst Shareholder and Stakeholder Primacies

The issue of corporate short-termism in corporate decision-making could be argued under mainstreams of shareholder and stakeholder primacies. Scholars, lawmakers, and institutions have plunged into a quest for arriving at a sub-optimal consensus between shareholder and stakeholder primacy, particularly in the last decade. Before arguing this dichotomy, these terms should be defined. While the term of shareholders is only used for company partners, the term of stakeholder is a more inclusive concept including employees of the company, other companies with a professional relation, bondholders of corporate debt securities, customers, and even the state at a macroeconomic level. To put it simply, shareholder refers only to people and institutions having the company's shares, whereas stakeholder refers to "persons or groups that have, or claim, ownership, rights, or interests in a corporation and its activities, past, present, or future."[8] Therefore, wealth maximisation of shareholders by establishing a legal and organisational framework is expected with the shareholder primacy.[9] On the contrary, stakeholder primacy supporters hold the view that companies need to manage the coordination of internal and external interests, and companies should consider generating and protecting shareholders' interests as well as other constituencies.[10]

It increasingly draws more attention to pursue the long-term interests of all stakeholders in a broader framework, rather than corporations primarily serving the interest of shareholders.[11] Global issues such as the 2008 economic crisis and the

8 Max Clarkson, 'A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance' (1995) 20(1) The Academy of Management Review 92-117. On the other hand, there is another view that argues the ambiguity concerning the limits of the stakeholder definition. See, Emerson Mainardes, Helena Alves and Mario Raposo, 'Stakeholder theory: Issues to Resolve' (2011) 49(2) Management Decision 226-52.

9 Franklin Allen, 'Corporate Governance in Emerging Economy' (2005) 21(2) Oxford Review of Economic Policy; Bob Tricker, *Corporate Governance Principles, Policies, and Practice* (OUP 2008) 38.

10 Andrew Crane and Dirk Matten, *Business Ethics: A European Perspective: Managing Corporate Citizenship and Sustainability in the Age of Globalization* (OUP 2010); Edward Freeman, *Strategic Management: A Stakeholder Approach* (Pitman Publishing 1984); Gérard Charreaux and Philippe Desbrières, 'Corporate Governance: Stakeholder Value Versus Shareholder Value' (2001) 5 Journal of Management and Governance 107-28; Peter Koslowski, 'The Limits of Shareholder Value' (2000) 27 Journal of Business Ethics 137-48.

11 David Katz and Laura McIntosh, 'The Long Term, The Short Term, and The Strategic Term' (Harvard Law School Forum on Corporate Governance, 27 September 2019) <https://corpgov.law.harvard.edu/2019/09/27/the-long-term-the-short-term-and-the-strategic-term> accessed 19 April 2021.

Covid-19 crisis accelerated the understanding of the importance of the transformation towards stakeholder primacy. In particular, the 2008 crisis led shareholders to focus on more short-term investing strategies. So, with a Keynesian expression, the understanding of 'we are all dead in the long run' has prevailed. On the other hand, it should be considered that failures of companies negatively affect economic development and employment (i.e. wellbeing of the society) in the long run, since corporations play significantly large societal roles. To take a step further, according to Dodd, stakeholder primacy should be regulated at a basic level by the state and the functioning should be in the favour of the society as a whole, not just for the benefit of shareholders,[12] as short-termism culture causes the decrease of economic growth, employment, and welfare in general.[13] In this regard, the main task of the managers is to maintain a balance between these two priorities, as overwhelming one of these would likely pose problems.[14]

Shareholder primacy is associated with Friedman's shareholder value maximisation thesis, which demonstrates the sole purpose of companies is to increase profits by using their all resources in the most effective manner.[15] Furthermore, shareholder primacy is also directly associated with the agency theory, which shows company directors as performing on behalf of shareholders with the transference of authority as a nexus of contract. Accordingly, these managers are expected to act in the best manner, and in favour of shareholders, since the performance evaluation is made to what extent they meet and protect shareholders' expectations.[16] Incentive systems and pre-determined performance criteria are used for controlling managers. Therefore, even if the shareholders want to make risky investments, a more risk-averse approach would likely be followed by managers.[17] Nevertheless, managers might seek ways to benefit from these incentives by misleading shareholders with the help of information asymmetry.

12 Merrick Dodd, 'Is Effective Enforcement of Fiduciary Duties of Corporate Managers Practicable' (1935) 2(2) The University of Chicago Law Review 184-207.

13 Milano and Fortuna Advisors (n 5) 27-36.

14 For instance, Thyssenkrupp, a German firm focusing on steel production, could be taken as an example of pro-stakeholder primacy. Activist institutional shareholders (also known as short-term shareholders) of Thyssenkrupp insisted on selling the lift department for making money hand over first, this request startled stakeholders due to its potential long-term detriments. Thyssenkrupp's largest shareholder is a charity, and it has been argued that it has a responsibility to increase its share values to fund charity activities while carefully observing its requirements to protect the integrity of the company. See, Jordi Gual, 'When the problem is short-termism, foundations are a solution' (Financial Times, 2 February 2020) <https://www.ft.com/content/5fb1540e-434e-11ea-a43a-c4b328d9061c> accessed 19 April 2021.

15 Milton Friedman, 'The social responsibility of business is to increase its profits' (New York Times Magazine, 13 September 1970) <https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html> accessed 19 April 2021.

16 Michael Jensen and William Meckling, 'Theory of the firm: Managerial behavior, agency costs and ownership structure' (1976) 3(4) Journal of Financial Economics 305-60; Eugene Fama and Michael Jensen, 'Separation of Ownership and Control' (1976) 26(2) The Journal of Law and Economics 301-25; Razeen Sappideen, 'Focusing on Short-Termism' (2011) 20 Singapore Journal of Legal Studies 413-8.

17 Malcolm Salter, 'How Short-Termism Invites Corruption …And What to Do About It' (Harvard Business School Working Paper, 12 April 2012); Andrew Keay, 'Risk, shareholder pressure and short-termism in financial institutions: does enlightened shareholder value offer a panacea?' (2011) 5(6) Law and Financial Markets Review 436-9.

From another point of view, it has been demonstrated that managers who can act in accordance with their personal interests will maximise their benefits if they act in favour of the company within the scope of the stewardship theory. This theory shows that collectivist behaviours in the interest of the company are superior to stewards acting individually in their own goods. Hence, there is no conflict of interest between shareholders and managers.[18] It has been also theorised that the purpose of the company should not only be to maximise the profits of its shareholders, but also to maximise the benefits of all other segments (i.e. stakeholders such as employees, suppliers, customers, society, and the state) that will be affected by its long-term success.[19] The crux of the matter is to put theory into practice, where there is no directive determining how managers will behave towards other social partners as well as their shareholders, it is also unclear what kind of sanctions will be imposed on the contrary case. Despite corporate social responsibility announcements, they are generally not binding.

Apart from the agency and stewardship theories, although there have been other related theories developed in academic literature such as managerial tyranny and transaction theory, the most relevant theory with this paper is a myopic market theory, which argues that the great interest of the market for short-term returns leads to corporate governance failures.[20] In other words, short-term wealth increases are preferred by sacrificing long-term interests. In order to respond to the myopic view of the market, executives focus on projects that will contribute to company valuation by providing short-term returns by focusing on shorter-term results.[21] Although short-term results are important intensives for short-term financing of the company, it carries great risks for long-term investors.[22]

The European Commission (EC) stated that the main focus of companies' decision-makers is to maximise the value of their stakeholders and long-term shareholders. In this context, it was stated that the legislation should be revised to support more sustainable company management. In particular, changing the scope of responsibility and accountability for the management of the company, and preventing the sole focus of board policies on short-term goals were emphasised.[23]

18 Melinda Muth and Lex Donaldson, 'Stewardship Theory and Board Structure: A Contingency Approach' (1998) 6(1) Scholarly Research and Theory Papers 5-6.

19 Thomas Donaldson and Lee Preston, 'The Stakeholder Theory of the Corporation: Concept, Evidence, and Implications' (1995) 20(1) Academy of Management Review 70.

20 Kevin Keasey, Steve Thompson and Mike Wright, *Corporate Governance: Economic and Financial Issues* (OUP 1997).

21 It is also worth noting that in terms of capital market law, the peak of the share price will not mean that the welfare of the partners has reached the highest point.

22 Roland Bénabou and Jean Tirole, 'Intrinsic and Extrinsic Motivation' (2013) 70(3) The Review of Economic Studies 489-520.

23 European Commission and EY, 'Study on directors' duties and sustainable corporate governance' (2020) <https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en> accessed 19 April 2021.

It would not be wrong to say that the EU is on course for stakeholder capitalism.[24] The EC has also found that short-term business thinking does not contribute to the United Nations Sustainable Development Goals, specifically the Goal 10 of financing sustainable growth, nor to the Paris Agreement on climate change**.** Regarding the environmental point of view, fierce competition forces companies to employ more short-term strategies, which lowers the environmental performance of companies.[25] Under-investment for long-term promising companies would likely be detrimental to social purposes, such as boosting human capital and innovation as well as investments made towards a more sustainable environment.[26] All in all, the EC proposed three options as a solution for short-termism. Although two of these options are soft and non-legislative approaches, which are not legally binding, a legally binding way is also proposed as the third option.[27]

The first option includes encouraging sustainable corporate governance actions by increasing awareness through publishing communiqués and reports. The second option is about promoting national regulatory initiatives aimed at making corporate governance approaches more sustainable through recommendations. Finally, the third option covers setting minimum rules for long-term value creation by levelling the playing field through legal interventions at the Union. These three options could be considered with three types of directors defined by Lorsch and Maciver, namely traditionalists, rationalists, and broad constructionists. While traditionalists give particular prioritisation to shareholders, rationalists find what is beneficial to shareholders, beneficial to stakeholders. On the other hand, broad constructionists have a more sense of responsibility in terms of stakeholders.[28] This paper proposes to combine applying these options with said director types as indicated below.

24 For an in-depth study, which focuses on managerial capitalism instead of shareholder and stakeholder capitalism, see, Lucian Bebchuk and Roberto Tallarita, 'The Illusory Promise of Stakeholder Governance' (2020) 106 Cornell Law Review 91-178; Ryan Flugum and Matthew Souther, 'Stakeholder Value: A Convenient Excuse for Underperforming Managers? (2020) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3725828> accessed 19 April 2021.

25 Johan Graafland, 'Price competition, short-termism and environmental performance' (2016) 116 Journal of Cleaner Production 125-34.

26 European Securities and Markets Authority, 'Survey on undue short-term pressure on corporations from the financial sector' (Explanatory Note, ESMA30-22-620, 24 June 2019).

27 European Commission and EY (n 23) 7-12.

28 Jay Lorsch and Elizabeth Maciver, *Pawns or Potentates: The Reality of America's Corporate Boards* (Harvard Business Review Press 1989).

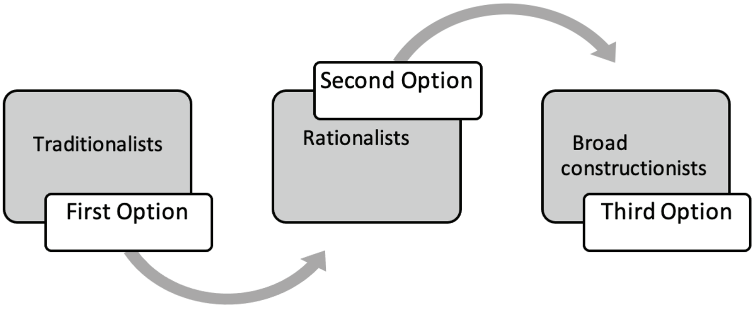

Table 1. *Trivet application in regard to manager types*[29]

Countries that want to generate solutions for short-termism could follow these options after they identify their predominant director type or types. It should be noted that there is no restriction of applying two or three approaches together.

III. Remedies for Short-Termism Via Corporate Governance

One of the main corporate problems of companies is deemed to be managerial myopia concerning short-termism trends in the current financial order due to the uncertainty of long-term outcomes. It should be noted that the European Union recognised and gave utterance to the short-termism issue before the 2008 economic crisis by necessitating to make provisions against it.[30] In this regard, changes have been planned in the Shareholder Rights Directive, and it is planned to reward long-term shareholders with tools such as additional voting rights and loyalty dividends to discourage short-termism.[31] In terms of corporate governance, the main purpose is to secure investors' returns from their investments with an effective check and balance mechanism. Hence, it is a matter of managing and controlling the company's activities with the efficient use of the company's capitals.[32] Therefore, corporation law mechanisms could offer substantial remedies for fleeting hitches by safeguarding managerial boards from financial market pressure.[33]

29 İbid.

30 Although short-termism has been analysed in the US, UK, and EU, there are not many studies for reform efforts against short-termism. See, Kim Willey, *Stock Market Short-Termism: Law, Regulation, and Reform* (Palgrave Macmillan 2019) 3; Andrew Johnston and Paige Morrow, 'Commentary on the Shareholder Rights Directive' (University of Oslo Faculty of Law Research Paper No. 2014-41, 2014); Dieter Pesendorfer, 'Capital Markets Union and Ending Short-Termism: Lessons from the European Commission's Public Consultation' (2015) 9(3) Law and Financial Markets Review 202-9; Lucia Quaglia, *Governing Financial Services in the European Union: Banking, Securities and Post-Trading* (Routledge 2010) 82; European Commission, 'Green Paper: The EU Corporate Governance Framework' (2011) COM(2011) 164 final.

31 Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement, COM(2014) 213 final, Brussels, 9 April 2014; For more regulatory measures after crisis, see, Izabela Jedrzejowska-Schiffauer, Peter Schiffauer and Eleftherios Thalassinos, 'EU Regulatory Measures Following the Crisis: What Impact on Corporate Governance of Financial Institutions?' (2019) 22(3) European Research Studies Journal 432-56.

32 John Paterson, 'The Company Law Review in the UK and the Question of Scope: Theoretical Concerns, Practical Constraints and Possible New Directions' in Robert Cobbaut and Jacques Lenoble (eds), *Corporate Governance: An Institutional Approach* (Kluwer Law International 2003) 141.

33 Mark Roe, 'Corporate Short-Termism: In the Boardroom and in the Courtroom' in Jeffrey Gordon and Wolf-George Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (OUP 2018).

There is no doubt that investments made by companies in technology or in their employees increase the welfare level. Indeed, it has been demonstrated that companies making long-term investments could create greater financial values as well as greater standards for their employees.[34] On the other hand, companies focusing on short-term gains postpone long-term problems in order to redound to their investors' gains. Under these circumstances, it is a fact that companies with more profit-making potential in the short term attract a lot of attention from short-term investors, but these companies are more volatile and riskier to invest due to their fragile nature concerning all related negative news that weakens shareholders' ties with the company.[35] The fact that long-term investments are not encouraging enough for investors is the underlying phenomenon of the current short-term understanding.[36] Data on the increasing trend towards short-termism can be verified from the table below, which shows the holding periods of investors' stocks on the NYSE from 1930 to 2020.

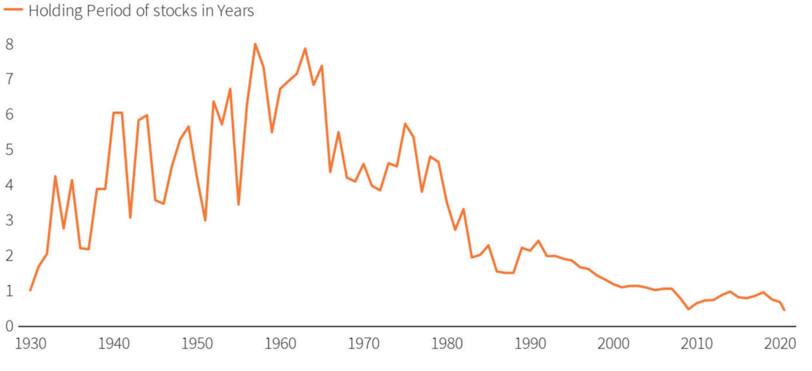

Table 2. *Holding Stock Periods of New York Stock Exchange*[37]

As can be seen from the graph, there has been a fundamental decline since 1970 with the collapse of Bretton Woods. Accordingly, it would not be wrong to say that this trend does not only reflect American tendency but a global one. Since the mind focused on short-termism causes delaying current costs to the future, this future externality is instrumental for shareholders as it eases to push off costs, whereas stakeholders' interests are harmed.[38] However, it is very contradictious that shareholders holding

34 Joseph Bower and Lynn Paine, 'The Error at the Heart of Corporate Leadership' (Harvard Business Review, May-June 2017).

35 Francois Brochet, Maria Loumioti and George Serafeim, 'Short-Termism, Investor Clientele, and Firm Risk' (Harvard Business School Working Paper No. 12-072, 2012).

36 Alana Semuels, 'How to Stop Short-Term Thinking at America's Companies' (The Atlantic, 30 December 2016) <https://www.theatlantic.com/business/archive/2016/12/short-term-thinking/511874> accessed 19 April 2021.

37 David Hunkar, 'Average holding period for U.S. Stocks is Just 5-1/2 months in 2020' (Top Foreign Stocks, 4 August 2020) <https://topforeignstocks.com/2020/08/04/average-holding-period-for-u-s-stocks-is-just-5-1-2-months-in-2020> accessed 19 April 2021.

38 Kent Greenfield, 'The Puzzle of Short-Termism' (2011) 46 Wake Forest Law Review 625-40; Dirk Hackbarth, Alejandro Rivera and Tak-Yuen Wong, 'Optimal Short-Termism' (European Corporate Governance Institution, Finance Working Paper No. 546/2018, November 2018) <http://ssrn.com/abstract_id=3060869> accessed 19 April 2021.

stocks for the short term do not care what would happen to the company after selling their assets, but their impact on the management is highly remarkable.[39] Hence, investor-oriented mainstream impairs long-term investments of companies through putting managers under the cosh by shareholders. This consequently necessitates corporate law regulations to be shaped in light of the stakeholder model in order to ensure more financially stable and sustainable companies.[40]

Concerning the inclusion of short-termism in corporate cultures, it was determined that the managers are inclined to overreact when severe changes in the total demand and supply of companies' shares in line with the future predictions occur[41] despite the fact that these expectations generally do not reflect reality .[42] As a consequence of this, several managers admitted that they are acting to the detriment of the long-term interests of the company in order to meet short-term expectations.[43] Furthermore, managers generally try to maximise their companies' profits by prioritising short-term goals to secure their interests by usually hiding long-term issues from the board.[44]

The consequences of short-termism on corporate governance could be listed as the shrinking tenures of managers together with the neglect of investment and human capital. In addition, short-termism also negatively affects companies' performance in the long run, economic growth, social welfare, and intergenerational justice.[45] According to a study conducted by Masouros about the great reversal in corporate governance and shareholders, it was observed that after the collapse of the Bretton Woods system, five foremost markets, namely Germany, France, the Netherlands, the UK, and the US have been affected with the low GDP levels due to the mainstream of short-termism.[46]

39 Greg Milano and Fortuna Advisors (n 5) 27.

40 Jesse Fried and Charles Wang, 'Short-Termism, Shareholder Payouts, and Investment in the EU' (2021) 1 European Financial Management 1-25; Hana Horak and Kristijan Poljanek, 'Fighting Short-Termism in EU Company Law after the Financial Crisis' (2020) 17(4) European Company Law 115-22.

41 Jose Barrero, 'The Micro and Macro Managerial Beliefs' (SocArXiv fctsb, Center for Open Science, 2020); Pedro Bordalo and others, 'Real Credit Cycles' (National Bureau of Economic Research Working Paper No. 28416, 2020); Stephen Terry, Toni Whited and Anastasia Zakolyukina, 'Information versus Investment' (Becker Friedman Institute for Research in Economics Working Paper 2020-110, 2020).

42 Luis Armona, Andreas Fuster and Basit Zafar, 'Home Price Expectations and Behaviour: Evidence from a Randomized Information Experiment' (2018) 86(4) The Review of Economic Studies 1371-1410; Olivier Coibion, Yuriy Gorodnichenko and Saten Kumar, 'How Do Firms Form Their Expectations? New Survey Evidence' (2018) 108(9) American Economic Review 2671-2713.

43 Lawrence Mitchell, *The Speculation Economy: How Finance Triumphed over Industry?* (Berrett-Koehler Publishers 2007).

44 Ralph Walkling, 'CEO-centric Firms: Risks and Remedies' (Directors and Boards Magazine, January 2010); Pornsit Jiraporn, 'Corporate Governance, Shareholder Rights and Firm Diversification: An Empirical Analysis' (2006) 30(3) Journal of Banking and Finance 947-63.

45 Kim Wiley, *Stock Market Short-Termism: Law, Regulation, and Reform* (Palgrave Macmillan 2019); Andrew Haldane and Richard Davies, 'The Short Long' (29th Société Universitaire Européene de Recherches Financières Colloquium, 2011); Roeland Veld and Louis Meuleman, 'Sustainable development and the Governance of Long-term Decisions' in Roeland Veld (ed), *Knowledge Democracy: Consequences for Science, Politics, and Media* (Springer 2010) 255-81; Elke Weber and Howard Kunreuther, 'Aiding Decision Making to Reduce the Impacts of Climate Change' (2014) 37(3) Journal of Consumer Policy 397-411.

46 Pavlos Masouros, 'Corporate law and economic stagnation: how shareholder value and short-termism contribute to the decline of the Western economies' (PhD thesis, Leiden University 2012) 319.

IV. Short-Termism as an Intertemporal Choice Problem

The main reason for the problems related to short-termism is the gradual shrinkage of time horizons regarding the interaction between managers and shareholders. Short-term trading is becoming very common in stock markets with the help of a computerised dealing system. Moreover, the volume of trading has also increased with institutional shareholders and robotic investors equipped with artificial intelligence. Therefore, it can be said that the increasing pressure on managers stems from the accelerated trading transactions through newer technologies and media coverage that catalyse commercial occupations.[47]

The current phenomenon is quarterly capitalism, which simply represents the quarterly announcement of earnings.[48] Depending on whether the quarterly profits meet the expectations of the analysts for the relevant quarters, it brings positive or negative changes in the stock market shares of the company. The pressure of meeting these expectations causes detrimental consequences,[49] although the company management is strengthened by legal principles such as transparency and accountability. In this context, it is of primary importance to consider long-term performance evaluation in the calculation of managers’ remuneration.[50] Apart from this, it may be a solution to give managers longer tenures for taking the burden away from managers.[51]

There is also an opinion that the existence and continuity of the company depend on the success in short-term results that could potentially boost the long-term performance of the company.[52] According to this view, short-termism in stock trading has been a topical issue for a long time.[53] The paradox is that share prices increase when short-term strategies overweigh long-term strategies.[54] If capital markets had

47 Bartosz Olesiński and others, ‘Short-termism in business: causes, mechanisms and consequences’ (EY Poland Report 2014) <https://assets.ey.com/content/dam/ey-sites/ey-com/en_pl/topics/eat/pdf/03/ey-short-termism_raport.pdf> accessed 19 April 2021.

48 However, it should be noted that quarterly reporting of companies has not empirically been proved to lose their share values in the long-term. See, Malgorzata Janicka, Aleksandra Pieloch-Babiarz and Artur Sajnóg, ‘Does Short-Termism Influence the Market Value of Companies? Evidence from EU Countries’ (2020) 13 Journal of Risk and Financial Management 271.

49 Martin Lipton, ‘Takeover Bids in the Target’s Boardroom’ (1979) 35(1) The Business Lawyer 101-34; Alex Edmans, Vivian Fang and Katharina Lewellen, ‘Equity vesting and investment’ (2017) 30(7) Review of Financial Studies 2229-71; Jamie Dimon and Warren Buffett, ‘Short-Termism is Harming the Economy’ (Wall Street Journal, 6 June 2018) <https://www.wsj.com/articles/short-termism-is-harming-the-economy-1528336801> accessed 19 April 2021.

50 Although executive compensation reform is considered essential for the development of managers’ long-term understanding, other pressures on the stock price will neutralise these reforms. See, David Walker, ‘The Challenge of Improving the Long-Term Focus of Executive Pay’ (2010) 51(2) Boston College Law Review 435, 441-2; Gregg Polsky and Andrew Lund, ‘Can Executive Compensation Reform Cure Short-Termism?’ (2013) 58 Issues in Governance Studies 1-9.

51 Gregory Jackson and Anastasia Petraki, *Understanding Short-Termism: The Role of Corporate Governance* (Glasshouse Forum 2011) 7.

52 Kenneth Merchant and Wim Van der Stede, *Management Control Systems: Performance, Measurement, Evaluation and Incentives* (Prentice-Hall, 3rd ed, 2011).

53 Emeka Duruigbo, ‘Tackling Shareholder Short-Termism and Managerial Myopia’ (2012) 100(3) Kentucky Law Journal 53; Marjorie Kelly and Allen White, ‘Corporate Design: The Missing Organizational and Public Policy Issue of Our Time’ (2008) 42 New England Law Review 763; Carolyn Brancato and Michael Price, ‘The Institutional Investor’s Goals for Corporate Law in the Twenty-First Century’ (2000) 25 Delaware Journal of Corporate Law 35.

54 Polsky and Lund (n 50) 1-9.

worked truly efficiently, the focus on short-sighted strategies would have affected stock prices negatively. However, the long-term growth of companies needs to be encouraged by investors for the increase in patient capital. These investors are generally institutional shareholders, such as hedge funds, endowments, and sovereign wealth funds despite a large number of individual mom-and-pop investors.[55]

Large shareholders (also known as blockholders), which usually care about long-term investments and growth of the company, may threaten corporate management with selling their large number of shares.[56] These shareholders play an essential role to hinder managerial myopia.[57] While this could likely pose managerial opportunism, corporate failures could also occur. So, it should be considered that either undervaluing or overvaluing long-term profit predictions would pose problems.[58] Another factor that should be noted is castle-in-the-air investing, where investors do not specifically focus on estimating the intrinsic value of the firm but analysing the majority of investors' tendency to plant seeds for an uncertain future of revenues/profits. [59] However, in this point of view, it is worth noting that people do not generally go by the book, i.e. behave rationally.[60] As theorised by Thaler and Sunstein, people are susceptible to make poor choices due to biases.[61] This could bring unexpected buying or selling of shares of the company regardless of truly promising valuations. For example, investors could hold the opinion that there is safety in numbers of other investors' transaction volumes. Nevertheless, this also might count for nothing. Therefore, the management of the company should dissociate shareholders' pressure from the company's short- and long-term plans as far as possible.[62]

V. Conclusion

This study observed the tendency of short-termism in public companies that leads to pressure on management due to urgent shareholder profit expectations and the reduction in transaction times and fees, with the help of technology and media coverage. It was suggested that short-termism reduces the board of directors' tenure, which results in neglecting human capital. Moreover, short-term performance

55 The Aspen Institute, 'Overcoming Short-Termism: A Call for a More Responsible Approach to Investment and Business Management' (Business and Society Program, 16 September 2009).

56 Anat Admati and Paul Pfleiderer, 'The "Wall Street Walk" and Shareholder Activism: Exit as a Form of Voice' (2009) 22(7) Financial Studies 2645-85.

57 Sang Cho, Chune Chung and Chang Liu, 'Does Institutional Blockholder Short-Termism Lead to Managerial Myopia? Evidence from Income Smoothing' (2018) International Review of Finance 1-11.

58 Ken Favaro, 'Long-Termism is Just as Bad as Short-Termism' (Harvard Business Review, 25 September 2014) <https://hbr.org/2014/09/long-termism-is-just-as-bad-as-short-termism> accessed 19 April 2021.

59 Wiley (n 45).

60 Greg Milano and Fortuna Advisors (n 5) 32.

61 Richard Thaler and Cass Sunstein, *Nudge: Improving Decisions About Health, Wealth, and Happiness* (Penguin Books 2009).

62 Lynne Dallas, 'Short-Termism, the Financial Crisis, and Corporate Governance' (2012) 37(2) The Journal of Corporation Law 267-364.

pressure with regard to quarterly company earnings damages the long-term company value. Many companies respond to this pressure by reducing their promising research and development expenditures or changing the managerial board. Instead of temporary solutions, companies need to develop their financial benefits, such as long-term and sustainable cost reduction. It was consequently seen that companies focusing on short-term investment horizons are less willing to meet concerns with regard to long-term growth and productivity, which would likely harm the economy as a whole. This strong trend with shareholder activism hinders propelling future investments due to the appetence of getting short-term gains; consequently, this issue is getting worse as it triggers budget cuts in research and development activities at the expense of providing immediate outcomes. What makes this problem insolvable is the satisfaction of both shareholders and managers in the absence of long-term corporate culture. In this context, optimal corporate law remedies should be generated against short-termism via adhering to corporate governance principles. The transition from shareholder primacy to stakeholder primacy is significant because if executives are accountable not only to shareholders but to all stakeholders, it will ensure more effective and secure markets, as well as long-lasting companies.

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