20/20 Vision in the Long & Short-Termism Debate

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What is an optimal investment time horizon—for institutions, individual shareholders *and* corporations? This question can evoke emotional, ideological, and theoretical responses. The answers usually deeply entrenched debates over the fundamental roles of markets versus regulation and between the appropriate loci of corporate power: the board of directors versus the shareholders.[1] Too long-term and it is myopia; too near-term and is it short-termism. Neither label is inconsequential, so the debates are not tepid, academic, or marginal.[2]

Readers are likely familiar with the characterizations assigned to either end of the investment time horizon spectrum. Long-termism can be viewed as a source of sustainable growth, real economy investment, and durable value for retirement investors. It can also be portrayed as a practice of myopic, self-serving directors underutilizing existing corporate assets to protect their power and interests. Short-termism can be seen as the financialization of corporate management where earnings affect governing business plans and priorities, eroding the fundamental value and

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*Anne M. Tucker, Associate Professor of Law, Georgia State University College of Law. On June 4–6, scholars gathered in Atlanta, Georgia for the ninth annual Berle Symposium. Each Berle symposium makes its own unique contribution to the study of the modern corporation, and the Berle IX Symposium follows in this tradition. The Berle IX Symposium focused on investor time horizons and drew deeply from the wisdom of law, finance, management, and neuroscience reinforcing the interdisciplinary tradition of the Berle symposia. Years before Charles O'Kelley and I collaborated on the Berle IX Symposium, I wrote him thanking him for his encouragement in big and small ways, his generous mentorship, and his work in generating timely scholarship on important corporate law topics. Those sentiments ring even truer today than when originally written. It is with big shoes to fill, and a sense of gratitude, that I introduce readers to this collection of scholarship on investor time horizons produced in conjunction with the Berle IX Symposium.

1. *See, e.g.*, Mark J. Roe, *Corporate Short-Termism-in the Boardroom and in the Courtroom*, 68 BUS. LAW. 977 (2013).

2. Presidential candidates even invoked investor time horizon concerns over short-termism in 2016 stump speeches and policy reforms. *See generally* Mark J. Roe, *The Imaginary Problem of Corporate Short-termism*, WALL ST. J. (Aug. 17, 2015), https://www.wsj.com/articles/the-imaginary-problem-of-corporate-short-termism-1439853276; Jim Tankersley, *Hillary Clinton has a very detailed plan for the economy. That may be a problem.*, WASH. POST: WONKBLOG (July 29, 2016), https://www.washingtonpost.com/news/wonk/wp/2016/07/29/hillary-clinton-has-a-very-detailed-plan-for-the-economy-that-may-be-a-problem/?utm_term=.c4658232f4da.

innovation of corporations. Short-termism can also generate corporate value for investors, deter managerial myopia or complacency, and encourage value-unlocking transactions. Navigating the debate feels like operating a broken compass with conflicting evidence and arguments pointing in different directions, producing more questions than answers and leaving one disoriented. The binary policy and value choices between long- and short-termism strike me as incomplete; investor time horizons are more nuanced than the black or white dichotomy of long- and short-termism and their assigned value by supporters and detractors.[3]

I have come to think of corporate time horizons in terms of 20/20 vision—balanced and clear. Just as individuals need near and far sight to see correctly, corporate managers also need a clear view of the near and far term. The ninth annual Berle symposium—the Berle IX Symposium—provided a platform for interdisciplinary scholars from law, finance, management, and neuroscience to share their understanding of the complexity, consequences, and interventions available in the investor time horizon debate. The Berle IX Symposium and this dedicated Issue are products of a collaboration between Charles O'Kelley of Seattle University School of Law's Adolf A. Berle, Jr. Center on Corporations, Law, and Society and Georgia State University College of Law. We invited Berle IX participants to contribute to three main inquiries, which are each addressed in more detail below: (1) What does it mean to be long- or short-termist, and what are the consequences of these time horizons?; (2) What are the different time horizons that exist among various investors and the theoretical and empirical bases for identifying the corresponding interests?; and (3) What governance tools could balance competing investor time horizons and help corporate management achieve 20/20 vision?[4]

Owen Jones of Vanderbilt Law School and the MacArthur Foundation Research Network on Law & Neuroscience was the aptly cast Keynote Speaker for Berle IX. Jones shared his seminal work on time-shifted rationality, describing the mismatch between evolved information processing and current conditions that create irrational behaviors.[5] Jones' speech, the transcript of which is included in this Issue, introduced wisdom

3. In Claire Hill's article, *An Identity Theory of the Short- and Long-Term Investor Debate*, she makes this point with more wit, passion, and force than I dare attempt. Claire A. Hill, *An Identity Theory of the Short- and Long-Term Investor Debate*, 41 SEATTLE U. L. REV. 475 (2018) [hereinafter Hill, *An Identity Theory*].

4. Many of the resulting contributions are described below. A complete list of participating academics and presented papers can be found at https://law.seattleu.edu/centers-and-institutes/berle-center/symposium/berle-ix [https://perma.cc/4VWC-ZDKZ].

5. Owen Jones, *Time-Shifted Rationality and the Law of Law's Leverage: Behavioral Economics Meets Behavioral Biology*, 95 NW. L. REV. 1141 (2001).

from behavioral biology, evolutionary biology, and neuroscience fields relevant to temporal processing and choice. Jones' undeniably interdisciplinary approach to time horizons, and his pleas for more research around a converging questions approach,[6] set the tone for the Berle IX Symposium. I trust his transcript will do the same heavy lifting for this Issue by demonstrating the deep insight available when researchers invest in examining the underpinnings of problems and collaboratively explore them across disciplines. We have the same hope for this Issue of the Seattle University Law Review Berle IX.

LONG-TERMISM, SHORT-TERMISM, & WRONG-TERMISM

Readers looking to orient themselves to the long- and short-termism debate will glean insights from each contribution in this Issue. A few articles provide a particularly useful introduction for readers new to the field. Martijn Cremers and Simone Sepe's *Institutional Investors, Corporate Governance, and Firm Value* summarizes the financial literature, empirical evidence, and the theory on why some investors and firms are short- or long-term.[7] In *Wrong-Termism, Right-Termism, and the Liability Structure of Investor Time Horizons*,[8] Andrew Verstein offers an incisive summary of the long- and short-termism debate; he summarizes it as "principally ask[ing] two questions."[9] First, he asks the empirical question of whether firms inefficiently telescope their investment timelines to satisfy impatient patrons—in particular, public shareholders.[10] Second, he asks the normative question of whether particular changes—oftentimes changes to the scope of shareholder influence—are accordingly justified.[11] Verstein challenges readers to think past short- and long-termism and consider whether there is a third category, wrong-termism, which occurs whenever a particular time period is valued over the return offered.[12] Elisabeth de Fontenay's *The Myth of the Ideal Investor* provides a useful overview of the field and applies long- and short-termism tropes to different shareholder identities.[13]

6. Owen Jones, *Why Behavioral Economics Isn't Better & How It Could Be*, *in* RESEARCH HANDBOOK ON BEHAVIORAL LAW AND ECONOMICS (J.C. Teitelbaum & K. Zeiler eds, 2015).

7. K.J. Martijn Cremers & Simone M. Sepe, *Institutional Investors, Corporate Governance, and Firm Value*, 41 SEATTLE U. L. REV. 387 (2018).

8. Andrew Verstein, *Wrong-Termism, Right-Termism, and the Liability Structure of Investor Time Horizons*, 41 SEATTLE U. L. REV. 579 (2018).

9. *Id.* at 580.

10. *Id.*

11. *Id.*

12. *See generally id.*

13. Elisabeth de Fontenay, *The Myth of the Ideal Investor*, 41 SEATTLE U. L. REV. 425 (2018).

Claire Hill's contribution, *An Identity Theory of the Short- and Long-Term Investor Debate*, highlights the complexity, interdisciplinary nature, and seeming intractability of the long- versus short-termism debate.[14] Hill draws parallels between the debate about investor time horizons and other iconic corporate governance debates such as management versus activists and shareholder versus stakeholder.[15] Hill argues that identity affects and in some ways impedes constructive debate because listeners weight proof against their prior beliefs.[16] Hill urges that persuasion should be the starting point for building bridges between the two camps.[17] Hill challenges readers to consider that "starting points are both as to matters of fact—matters that are, in principle, capable of being resolved one way or the other by some sort of empirical or maybe theoretical demonstration—and values, which are not capable of this sort of resolution."[18] Readers of this Issue can judge for themselves the proof, persuasion, and perspective provided in this collection of contemporary, interdisciplinary work on the complexity of investor time horizons.

SHAREHOLDER FRAME TIME HORIZONS

Identifying the shareholder interests driving time horizons is a matter of first principles in any investor time horizon discussion. Shareholders are not monolithic; they encompass a vast expanse of different identities and interests including hedge funds, mutual funds, pensions, retail investors, retirement investors, and everything in between. Berle IX participants examined shareholder identities, their different time horizons, and the theoretical and empirical bases for identifying the corresponding interests.

For example, Elisabeth de Fontenay's *The Myth of the Ideal Investor* unpacks three shareholder architypes—the major mutual fund, the activist hedge fund, and the private equity fund—and maps their attributes and behaviors to the long- and short-termism debate.[19] Concluding that none of these archetypes fit the ideal, patient, value-maximizing shareholder, de Fontenay rejects corporate policy attempts to incubate one investor over another, instead preferring a diverse and robust corporate finance ecosystem.[20] Noting the temporal time lag between problem identification,

14. Hill, *An Identity Theory*, *supra* note 3.
15. *Id.* at 482–84.
16. *See generally id.*
17. *Id.*
18. *Id.* at 480.
19. de Fontenay, *supra* note 13, at 428.
20. *Id.* at 425.

policy solution, and implementation, de Fontenay foreshadows policy questions raised by the third group of papers addressing interventions.[21]

Rachelle Sampson & Yaun Shi's contribution, *Are Investor Time Horizons Shortening?*,[22] a distillation of their prior empirical,[23] offers empirical evidence of short-termism. For example, Sampson and Shi point to trends of more transient (short-term) institutional investors from 1980–2013 over dedicated (long-term) investors. Sampson and Shi investigated firm-level market discount rates using a capital asset pricing model with an assumed 5-year ownership and observed increasing market discounts at both the market and firm levels.[24] Sampson & Shi also establish a relationship between market discounting and short-term oriented attributes. For example, transient (short-term) investors correlated with higher discount rates whereas dedicated (long-term) investors correlated with lower discount rates.[25] Additionally, Sampson and Shi correlate higher discount rates with lower research and development spending, and higher analyst coverage.[26] While Sampson and Shi acknowledge that not all firms are discounted the same (heterogeneity) and explore the reasons why some firms are discounted, despite similar attributes, more than others.[27] Sampson and Shi telegraph their empirical findings to broader questions about optimal time horizons, optimal firm investments, and the relationship between corporate decisions and national economic health.[28]

In *Institutional Investors, Corporate Governance, and Firm Value*, Martijn Cremers and Simone Sepe focus on aggregate institutional investor behavior and introduce a taxonomy of institutional investor behavior derived from holding periods and activism.[29] Cremers and Sepe focus on information asymmetry as an explanatory force in the long- and short-termism debate and ask why different firms attract institutional investors with different investment horizons and levels of shareholder activism.[30] They demonstrate a relationship between increased stock turnover and poison pill adoptions, increased institutional investors, and firm age, which connects their observations to information asymmetry

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21. *Id.* at 427–28.
22. Rachelle Sampson & Yuan Shi, *Are Investor Time Horizons Shortening?*, 41 SEATTLE U. L. REV. 543 (2018).
23. Rachelle C. Sampson & Yuan Shi, *Evidence & Implications of Short-termism in US Public Capital Markets: 1980-2013* (Oct. 31, 2016), https://ssrn.com/abstract=2837524.
24. Sampson & Shi, *supra* note 22.
25. *Id.*
26. *Id.*
27. *Id.*
28. *Id.*
29. Cremers & Sepe, *supra* note 7, at 389.
30. *Id.*

theories.[31] Cremers and Sepe test the influence of staggered boards, finding no significant impact on institutional investors' behavior but finding higher firm value as measured by Tobin's Q when staggered boards are combined with patient institutional investors.[32] Importantly, their article posits that staggered boards commit investors to a corporate strategy and facilitate boards of directors' focus on long-term value creation.[33] Cremers and Sepe's contribution demonstrates the value of cross-discipline conversations.

Harold Weston and Conrad Ciccotello, on the other hand, wield the heterogeneity of shareholders to argue against shareholder time horizons' influence over corporate time horizons because any signal as to shareholder horizons is incomplete and unreliable.[34] In *Flash Traders (Milliseconds) to Indexed Institutions (Centuries): The Challenges of an Agency Theory Approach to Governance in the Era of Diverse Investor Time Horizons*, Weston and Ciccotello further their argument by focusing on other temporal governance claims arising from bond, debt, and contract rights holders while highlighting the fiction that shareholders are corporate "owners."[35] Weston and Ciccotello propose an asset-centric vision of corporate governance and expanded directorial duties shaped in the image of trustees and as alluded to in *in Re Trados Shareholder Litigation*.[36] These contributions and the conversations during the Berle IX Symposium underscore how shareholder identities frame time horizon inquiries.

DIFFERENT TIME PERSPECTIVES

Several Berle IX contributions expanded the binary, temporal frames of long- and short-termism. For example, Jim Hawley and Jon Lukomnik, in *The Long and Short of It: Are We Asking The Right Questions? Modern Portfolio Theory and Time Horizons*, encourage investors and researchers to seek beta—market performance as a whole—rather than the conventional investment model of seeking alpha—abnormal returns above market averages.[37] Hawley and Lukomnik turn modern portfolio theory on its head by asserting that investment decisions can affect systemic risk and,

31. *Id.* at 412–14.

32. *Id.* at 414–16.

33. *Id.* at 417.

34. Harold Weston & Conrad Ciccotello, *Flash Traders (Milliseconds) to Indexed Institutions (Centuries): The Challenges of an Agency Theory Approach to Governance in the Era of Diverse Investor Time Horizons*, 41 SEATTLE U. L. REV. 615, 618–20 (2018).

35. *Id.* at 624–25.

36. *Id.* at 645; *In Re Trados, Inc. SH. Litig.*, 73 A.3d 17 (2013).

37. Jim Hawley & Jon Lukomnik, *The Long and Short of It: Are We Asking the Right Questions? Modern Portfolio Theory and Time Horizons*, 41 SEATTLE U. L. REV. 449, 449 (2018).

therefore, change beta.[38] In developing their beta theory, Hawley and Lukomnik, posit that early adopters of performance-enhancing measures, like environmental, social, and corporate governance (ESG), may generate alpha.[39] When "ESG out-performance is recognized by the larger market, alpha fades (it regresses to the mean), and ESG's systemic impact becomes embedded in equity (and bond) pricing, it becomes part of market beta."[40] It is clear in reading Hawley and Lukomnik's work that beta matters; it comprises a significantly greater portion of investment returns than alpha.[41] In connecting their work to time horizons, Hawley and Lukomnik note that beta investors would be permanent market participants with constant beta exposure, thus eliminating time horizon pressures driven by securities.[42] Their piece imagines a post-time horizons investment world where beta management is the catalyst for markets, not time horizons.

Frank Partnoy, drawing upon his book *Wait*[43] in his symposium contribution, *Specificity and Time Horizons*, encourages focusing on investment time horizons separate from investor types or products.[44] Partnoy proposes four categories of time horizons: pre-conscious, fast-conscious, slow conscious, and discounting.[45] Partnoy's time horizons span from less than one-half of a second (pre-conscious, algorithmic trading) to over a year (discounting).[46] Temporal categories are related to, but not dependent upon, investor attributes.[47] Partnoy argues that focusing on the time buckets themselves may help illustrate the appropriate role of interventions and policy.[48] For example, pre-conscious and fast-conscious time horizons may call for more regulation with decreased private ordering and greater reliance on bias, whereas slower time categories may be better suited for private ordering solutions.[49] Partnoy links his intuitions about time categories to juridical doctrines that alternate between short-term (e.g., zone of insolvency, *Revlon*) and long-term (e.g., the business judgment rule).[50] Disclosed time categories could aid investors in

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38. *Id.*
39. *Id.*
40. *Id.* at 457.
41. *Id.* at 449.
42. *Id.* at 461.
43. FRANK PARTNOY, WAIT: THE ART & SCIENCE OF DELAY (2013).
44. Frank Partnoy, *Specificity and Time Horizons*, 41 SEATTLE U. L. REV. 525 (2018).
45. *Id.*
46. *Id.* at 535–37.
47. *Id.*
48. *Id.*
49. *Id.* at 538.
50. *Id.* (citing Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986)).

identifying temporally matched investments and managers if investment products made time world disclosures.[51]

In *Federalism of Personal Finance: State & Federal Retirement Plans*, William Birdthistle, focuses on retirement investors.[52] He writes,

> In an America in which workers must save—and invest those savings—in their own retirement accounts without substantial assistance from pensions or Social Security, the critical time horizon is the length of the lay-investor's career. In those four decades or so, Americans must amass and deploy a nest-egg that will help them to survive the remaining two decades or so in retirement. The challenges of this task are enormous.[53]

Firmly fixing the investment time horizon around the working life of retirement investors, Birdthistle proposes a federally sponsored thrift saving account as a retirement saving solution.[54] Birdthisle offer a well-constructed blueprint for the plan with automatic, opt-out contributions; simulated market scrutiny and competition to keep fees lows because of the size; and an appropriate focus on maximizing savings for the investors, not profits for the financial intermediaries.[55] Birdthistle's piece illustrates the reach of investment time horizon governance questions as an increasing percentage of American workers save for retirement through securities investments and what it is at stake if the wrong balance is struck.

Returning to Andrew Verstein's *Wrong-Termism, Right-Termism, and the Liability Structure of Investor Time Horizons*, he offers a third category to the short- and long-term debate: wrong-termism. Verstein defines wrong-termism in thought process rather than time, as occurring whenever decision-makers value a specific time horizon regardless of the ultimate return. Verstein identifies three sources of wrong-termism, which emanate from (1) investors as either impatient or irrationally patient, (2) assets such as debt, Research and Development (R&D) investment or dividends, and (3) market sources such as activism and market demand.[56] Verstein explores specific interventions and focuses on the potential of liability transfers through fund de-risking.[57]

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51. *Id.* at 539.

52. William A. Birdthistle, *Federalism of Personal Finance: State & Federal Retirement Plans*, 41 SEATTLE U. L. REV. 367 (2018).

53. *Id.* at 367.

54. *Id.* at 370–75.

55. *Id.*

56. Andrew Verstein, *Wrong-Termism, Right-Termism, and the Liability Structure of Investor Time Horizons*, 41 SEATTLE U. L. REV. 579, 594 (2018).

57. *Id.* at 608.

TIME HORIZON INTERVENTIONS

Caroline Flammer, in *Long-Term Executive Compensation as a Remedy for Corporate Short-Termism*, translates her empirical work in the management and strategy literature.[58] Flammer posits that long-term executive compensation addresses time-based agency conflicts that arise when managers' time preferences are misaligned with those of the shareholders.[59] Newly adopted long-term compensation plans, including restricted stock, restricted options, and long-term incentive plans, are correlated with abnormal (high) returns, increased return on assets and net profit margin, increased R&D expenditures, increased patents and patent citations, and increased stakeholder engagements.[60] Flammer's work connects private ordering solutions through employment and compensation contracts to the public policy questions of optimal corporate time horizons in decision making and resulting firm value.

In *Corporate Governance as Privately-Ordered Public Policy: A Proposal*, Lynn Stout and Sergio Gramitto propose a universal fund—a donation-based equity fund in which all U.S. citizens would receive a share—as a means to align management time horizons with the time horizons of investors invested in the market as a whole.[61] The proposed blueprint for the universal fund outlines funding sources (donations), management, voting rights, and transferability of universal shares.[62] Stout and Gramitto's universal fund would address more than investor time horizon conflicts, as it would also address systemic problems such as income inequality, the need for corporate innovation, and the costs of negative corporate externalities.[63] They write:

> [G]overnments are not the only institutions that can solve collective social and economic problems . . . . Many of today's corporations rival nation-states in weight, influence, and reach. Collectively they control tens of trillions of dollars in assets and affect hundreds of millions of customers, employees, and shareholders. Indeed, the

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58. Caroline Flammer, *Long-Term Executive Compensation as a Remedy for Corporate Short-Termism*, 41 SEATTLE U. L. REV. 419, 420 (2018) [hereinafter Flammer, *Long-Term Executive Compensation*]. For Flammer's empirical work in management and strategy, see Caroline Flammer & Pratima Bansal, *Does a Long-Term Orientation Create Value? Evidence from a Regression Discontinuity*, 38 STRATEGIC MAN. J. 1827 (2017).

59. Flammer, *Long-Term Executive Compensation*, *supra* note 58, at 420.

60. *Id.* at 421–22.

61. Lynn Stout & Sergio Gramitto, *Corporate Governance as Privately-Ordered Public Policy: A Proposal*, 41 SEATTLE U. L. REV. 551 (2018).

62. *Id.* at 555–58.

63. *Id.* at 559–69.

> corporate sector can be analogized to a kind of parallel state or shadow government that touches all our lives, and on a daily basis.[64]

More than a thought piece, Stout and Gramitto paint a thought-provoking image of corporate securities leveraged for public good.

Jennifer Hill's *Good Activist/Bad Activist: The Rise of International Stewardship Code* offers an international perspective on the shareholder narrative and a path forward in the long- and short-termism debate.[65] Hill focuses on stewardship codes, which provide a framework to constrain board power through encouraged shareholder votes, proxy access, and increased activism.[66] Hill contrasts the United States perspective on investor time horizons and shareholders' appropriate governance roles to those in the United Kingdom and Japan, as exemplified through their stewardship codes.[67] Hill's piece demonstrates the breadth of jurisdictions incorporating stewardship codes, naming nineteen countries with stewardship codes helpfully organized around the initiating party behind the code: regulators, industry participants, and investors.[68] Hill embraces a positive view of shareholder activism as an integral component of the corporate governance system.[69]

Interventions—of framing and policy—abound in the other works already mentioned. Weston and Ciccotello envision directors as trustees after shedding the scaffolded fiction of shareholders as capable of having a time horizon, as owners, or as principals of the corporation.[70] Elisabeth de Fontenay advocates for no regulatory intervention or preference for certain investors, instead letting the "eco system" of financial markets thrive.[71] Frank Partnoy frames the issue around time categories, not investor-driven time horizons, and would encourage disclosures of these buckets and let investors match themselves with the right temporal window.[72] Birdthistle endorses a federal thrift-saving account as a tool to protect retirement investors' saving time horizons.[73] Readers can access full accounts of all suggested interventions in the individual articles.

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64. *Id.* at 552.

65. Jennifer G. Hill, *Good Activist/Bad Activist: The Rise of International Stewardship Codes*, 41 SEATTLE U. L. REV. 497 (2018) [hereinafter Hill, *Good Activist/Bad Activist*].

66. *Id.* at 497–98.

67. *Id.* at 511–21 (2017); Fin. Reporting Council, THE U.K. STEWARDSHIP CODE, July 2010; The Council of Experts on Japan's Stewardship Code, PRINCIPLES FOR RESPONSIBLE INVESTORS: JAPAN'S STEWARDSHIP CODE, Feb. 26, 2014, 1–2.

68. Hill, *Good Activist/Bad Activist*, *supra* note 65, at 505–09.

69. *Id.* at 521.

70. Weston & Ciccotello, *supra* note 34, at 634–39.

71. de Fontenay, supra note 13, at 425.

72. Partnoy, *supra* note 44, at 539–40.

73. Birdthistle, *supra* note 52.

CONCLUSION

The Berle IX presentations and colloquy among all attendees shaped my thinking on time horizons and helped produce the resulting articles that are in conversation with one another. Each article contributes its own perspective, evidence, and proposed interventions regarding investor time horizons. This collection of articles, as a whole, is greater than any contribution alone and provides an excellent primer for those new to questions of investor time horizons as well as an advanced, interdisciplinary examination of the issues for those who are already experts. We owe a debt of gratitude to the contributing authors for sharing their insights with us in this Issue.