Short-Termism: Leverage Points for Encouraging a Longer-Term Focus in Capital Markets

The Aspen Institute

On April 23, 2010, a group of twenty-four senior law, economics, finance and accounting faculty and business practitioners was jointly convened by The Aspen Institute, the UCLA School of Law and the UCLA Anderson School of Management for an off-the-record roundtable discussion on the topic of short-termism in business and the capital markets.

The resulting discussion was wide-ranging. Participants were united in their concern for the healthy functioning of the U.S. financial system, and their interest in helping to create solutions for economic recovery in the wake of an unprecedented financial crisis. BlackRock CEO Laurence Fink opened the day with cogent remarks on the state of the financial system and the broader economy.

The expertise of the participants was deep and varied, and their opinions were diverse both on the nature and extent of short-termism in business and the markets, and also about whether and to what degree short-termism is problematic. The purpose of the roundtable was to generate interest in and dialogue around the topic of short-termism rather than to yield a single consensus or coherent set of recommendations. However, the discussion circled around several key elements that recurred throughout the discussion.

Refining Vocabulary

Many participants expressed a concern that the term "short-termism," while widely used, may not be well-enough defined. Two major reasons were given for this concern.

First, a number of participants pointed out that the term can be used to describe many different business and market phenomena, some of which may be related to one another and some of which may not. Phenomena named ranged from the broad and systemic to the specific. They included high turnover in investment portfolios, the creation of derivatives with a set termination date, the short tenure of CEOs and board members, the moral hazard created by contracts that give rewards even to CEOS whose companies do poorly, the spread of mark to market accounting, a high discount rate, the misaligned incentives of financial intermediaries, and inherent human behavioral biases. Participants questioned whether "short-termism" was useful as an umbrella term to describe all of these and other phenomena, or whether these behaviors and phenomena might be better addressed by describing and discussing them individually.

In addition to a concern that the term "short-termism" may be so broad as not to be a particularly meaningful descriptor, participants also pointed out that in many cases a broader ideological point of view is implied in the use of the term, in ways that may be misplaced. Specifically, participants noted that discussions of short vs. long-term behavior are often conflated with discussions of business sustainability and stakeholder impact. While both of these are legitimate topics for discussion, they are not the same topic. Participants also noted that the term "short-termism" is frequently used to suggest that short-term behavior is always and inherently irrational and that long-term behavior is inherently rational. Participants asserted that while this may sometimes be the case, it is not always so—for example, short-term behavior may in some cases be a rational reaction either to a lack of information or to others' irrational behavior.

Defined Contribution vs. Defined Benefit Saving

A second major recurring theme of the day's conversation centered around changes in the market that result from the increase in retirement saving through defined contribution plans and a shift away from defined benefit plans.

Discussion participants were relatively united in a concern that this change may not be best for the broader economy, in large part because it has caused individual investors to be a more significant force in the markets. Participants expressed concern that the average individual investor does not have the knowledge, expertise or time to make good investing choices. Individual investors may focus their attention on quarterly statements, which may lead the institutional investors that manage those funds to engage in destructive short-term behavior, in turn affecting the broader market.

Participants also pointed to the potential for wider negative effects for society that may be brought on by the shift away from defined benefit contribution plans. They expressed concern that many baby boomers may wind up with inadequate funds to retire, even as they age and become unable to work. A number of participants were vocal in their assertion that a return to defined benefit plans would have positive effects for the markets and the economy, and for society at large. They asserted that defined benefit plans are less costly for firms to manage, and that presence of fewer unskilled investors in the market would reduce the "noise" in the system. Some also argued that a return to defined benefit would be a boon to economic growth because such savings plans can serve as a powerful mechanism to attract

employees, thus contributing to a strong labor base.

Ambivalence about Policy Intervention

Discussion participants expressed ambivalence about the possibility of using public policy to drive individual and company behavior. While the majority of those present agreed that the interventions taken by the Bush and Obama administrations to offset the effects of the financial crisis were necessary and appropriate, a number of participants (including those who supported the bailout and a strong regulatory regime in general) also cautioned that policy and regulation should not be viewed as an economic panacea.

Some participants were quite vocal in defense of the usefulness of broader regulation, arguing that when society bears the cost of the bad decisions of a small number of people or institutions that the government has a responsibility to intervene to stop those decisions. These participants asserted that strong regulation is necessary to safeguard the integrity of the U.S. and global financial system, and that there should be international cooperation in developing this regulation so as to prevent arbitrage among different regimes.

Participants also named several specific concerns about the potential negative consequences of regulatory policy. Some expressed the belief that law and policy are a "blunt instrument" that is ill-suited to navigating the vagaries and complexities of the markets and economy. Some noted that even well-intentioned policy decisions can have unintended negative consequences. Others suggested that bailing out financial institutions creates moral hazard that in the future may disincentivize these institutions from performing their fiduciary duties. Finally, a number of participants expressed the concern that policy and regulation can be a form of paternalism.

Participants

Iman Anabtawi, Professor of Law, UCLA School of Law

Steven A. Bank, Vice Dean and Professor of Law, UCLA School of Law

Sanjai Bhagat, Professor of Finance, Leeds School of Business, University of Colorado at Boulder

Sanjeev Bhojraj, Associate Professor of Accounting, S.C. Johnson Graduate School of Management, Cornell University

Margaret Blair, Professor of Law, Vanderbilt University Law School

Joseph Boateng, Chief Investment Officer, Casey Family Programs

Stephen Brown, Director & Associate General Counsel, Corporate Governance, TIAA-CREF

Colin Camerer, Robert Kirby Professor of Behavioral Finance and Economics, California Institute of Technology

Roger Farmer, Distinguished Professor of Economics, UCLA

Laurence Fink, Chairman & CEO, BlackRock

Mark Grinblatt, J. Clayburn LaForce Endowed Chair in Management, UCLA Anderson School of Management

B. Kipling Hagopian, Managing Partner, Apple Oaks Partners

Carla Hayn, Senior Associate Dean for the Fully Employed MBA and Executive MBA Programs, Professor of Accounting, UCLA Anderson School of Management

Henry T. C. Hu, Director, Division of Risk, Strategy, and Financial Innovation, U.S. Securities and Exchange Commission; Alan Shivers Chair in the Law of Banking and Finance, University of Texas at Austin School of Law

Mats Isaksson, Head of Corporate Affairs at the Organization for Economic Co-operation and Development (OECD); Visiting Scholar, Stanford University

Sanford Jacoby, Howard Noble Professor of Management, UCLA Anderson School of Management

Terrance Odean, Rudd Family Foundation Professor of Finance, Haas School of Business, University of California, Berkeley

Judy D. Olian, Dean and John D. Anderson Chair in Management, UCLA Anderson School of Management

Jeffrey Pfeffer, Thomas D. Dee II Professor of Organizational Behavior, Stanford Graduate School of Business

Richard Roll, Professor and Japan Alumni Chair in Finance, UCLA Anderson School of Management

Judith Samuelson, Executive Director, Aspen Institute Business and Society Program

Lynn Stout, Paul Hastings Professor of Corporate Securities Law, UCLA School of Law

Avanidhar Subrahmanyam, Goldyne and Irwin Hearsh Chair in Money and Banking, UCLA Anderson School of Management

Adam Winkler, Professor of Law, UCLA School of Law

Eric Zolt, Michael H. Schill Professor of Law, UCLA School of Law