An Edited Transcript from a Round-Table Conference on Short-Termism

Edited by Kay Glans & Johanna Laurin

Glasshouse Forum

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Glasshouse Forum brings together concerned capitalists and researchers from different disciplines and provides an arena for critical reflection on the merits and problems of capitalism.

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Glasshouse Forum is dedicated to deepening the debate about capitalism through various forms of meetings, seminars and publications.

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Preface

In their classic study *Built to Last: Successful Habits of Visionary Companies* (1994) Jim Collins and Jerry Porras show that successful long-term companies are not really profit-seeking machines, but are pervaded by a strong feeling of "core ideology". This classic capitalist culture is increasingly being challenged by a new culture, which, instead of developing the company in the long term, strives to maximise short-term profit for the shareholders.

Will Hutton has formulated the development in the following way: "The culture of the first half of the twentieth century, with professional management teams dedicated to creating companies focused around investment, innovation and R&D, and with a compact between labour and management, has become a financial engineering culture. Raising the share price has become the dominant objective of the CEO, the board and the wider management team. A new logic holds sway: shareholders own the corporation and put their money at risk and, because the sole purpose of ownership is to maximise profits, the only strategic purpose of the corporation is to maximise the financial returns to shareholders." (Will Hutton, *The Writing on the Wall: China and the West in the 21st Century*, 2007.)

The general perception is that short-termism has gained ground and become increasingly dominant in the world of business as well as in society as a whole. But we need empirical evidence. Which is why Glasshouse Forum, within the framework of the project "Short-termism in the long run", brought together a group of researchers from different disciplines and countries for a round-table discussion in Stockholm on June 16–17, 2008. One aim of the conference was to make an initial inventory of the existing knowledge in the field. Another aim was to lay the foundations for an empirically-based critical evaluation of short-termism's range and its consequences for the individual, for the company and for society as a whole.

The following people participated in the discussion:[1]

Rachel Briggs, Moderator, Director of the charity Hostage UK, freelance researcher and writer and Member of the Glasshouse Forum Advisory Board, UK
Kay Glans, Editorial Coordinator of Glasshouse Forum, Sweden
Maria Grafström, Dr., Department of Business Studies, Uppsala University, and analyst at the media intelligence company Cision, Sweden
Jaan Grünberg, Dr., Department of Business Studies, Uppsala University, Sweden
Gregory Jackson, Professor of Business and Society, School of Management, University of Bath, UK
Johanna Laurin, Head of Glasshouse Forum, Sweden
Lars Magnusson, Professor in Economic History, Vice-Rector of Uppsala University, Sweden
Geny Piotti, Dr., Researcher at the Max-Planck-Institut für Gesellschaftsforschung, Germany
Xavier Ragot, Associate Professor, Paris School of Economics, France
Shivaram Rajgopal, Professor in Accounting, Michael G. Foster School of Business, University of Washington, Seattle, USA
Daniel Sachs, CEO of Proventus and Chairman of the Concerned Capitalists Foundation, Sweden
Lennart Schön, Professor of Economic History, Lund University, Sweden
Paul Windolf, Professor in Sociology, University of Trier, Department of Social Sciences, Germany

Executive Summary

The discussion revolved around the following questions: What proof is there that short-termism really exists? What drives the development? Can we see a convergence on an Anglo-Saxon model of shareholder value? What consequences does short-termism have for businesses, employees and society at large?

General conclusions from the discussion are: 1. The definition of short-termism is unclear; the concept needs to be defined more precisely. What is, for example, a short or long time horizon respectively? 2. The problems of measurement are many and in part major. It is, for example, difficult for an outsider to prove value destruction as a result of short-termism. But if one wishes to influence business one has to be able to quantify. 3. Short-termism is a multidimensional phenomenon created in an interaction between a large number of actors, for example owners, managers, the media, analysts, professional valuers and rating institutions. What the interaction between them looks like, however, remains to be studied.

A number of themes of significance for the spread of short-termism and its causes crystallised out: 1. The significance of the institutions in different eras and models of capitalism. 2. Cyclical changes. 3. Types of owners and change of ownership. 4. The rapid tempo of the media. 5. Paradigms, the dissemination of dominant ideas and herd behaviour.

Lennart Schön began with an economic-historical perspective relating short-termism to two important processes: globalisation and the ICT revolution, which have both involved major changes as regards capital, labour and natural resources. An important similarity between the 19th and 20th century globalisation processes is that both saw industrial revolutions as tending to recur with a certain regularity, 80 or 90 years apart. One can distinguish two phases, an initial phase characterised by intensive technological and economic innovation, and a subsequent phase dominated by the formation of institutions. An industrial revolution sets off many processes of tech-

1) See Appendix for the participants' biographies.

nological, economic and social change, but they take a long time to mature and the rapidity of today is somewhat illusory. We see cyclical change today with the credit crunch. Such a crisis on a global scale may turn trends into new directions, but the outcome of such a crisis is not automatic. Historical experience indicates that the tide may turn towards longer term perspectives within the next decade. But we need new institutions which provide greater security on the global market and reduce the uncertainty which causes a rise in the price of long-term investments leading to a shortening of time horizons.

Paul Windolf, who is also interested in the significance of the institutions, tested the hypothesis that explanations of short-termism are to be found in the deregulation and deinstitutionalisation in all markets (labour, financial, products) on a global level. Institutions create path dependency, which reduces uncertainty and makes it easier to forecast the future. When institutions are destroyed, the volatility of the markets increases, and one would assume that a rational reaction of the risk-averse investor is to prefer short-term investments. But a comparative study of the volatility of the Dow Jones Index, with its basis in the deregulated liberal American market economy, and DAX in the German coordinated economy, shows that this connection is weak. Xavier Ragot pointed out nevertheless that you can understand short-termism as the economic outcome of excessive volatility of financial markets according to the simple logic that, when the music is playing fast, you have to dance fast.

Paul Windolf instead pointed to another possible explanation: the type of owner and change of ownership. What we see today is a "financialisation", a gradual shift towards an increasing proportion of institutional owners, and a parallel increase in turnover rates; today it is only one year, that is to say an institutional owner retains his shares on average for a year before he sells them. The reason is that the market is segmented and there can be considerable competition between owners for higher rates of return.

Lars Magnusson, who has studied the role of pension funds in short-termism, did not fully agree. There are different theories and views as to whether pension funds act in the short term, but a considerable proportion of the literature says that it is not necessary that

these institutions should be more short-term than other investors. Without a long-term perspective they would ruin their owners. On the other hand strong incentive systems for managers might encourage short-term behaviour, just as may certain irrational and herd-like behaviours on the part of financial analysts and professional valuers. Shivaram Rajgopal presented a survey of American CFOs, aiming to provide credible evidence on whether short-term concerns cause value destruction. The survey showed that CFOs will give up some long-term value just to be able to meet an analyst consensus earning forecast. This is ultimately a career concern problem; CFOs are expected to stay in the job for only four years, and will therefore make decisions with a short-term focus.

But Lars Magnusson reminded us, the relationship between managers and owners is very complex, and a discussion that has been carried on over the last 15 years about returns for the owners, the decline of managerial capitalism and the rise of shareholder capitalism, is often oversimplified.

Xavier Ragot also emphasised different types of owner as an important explanation for why the time horizons are shifting, and introduced two dimensions of shareholder: time horizon and control. French capitalism is moving from passive shareholders towards more active ones. The question one is now asking oneself is: Will this change in the strategy of shareholders continue after the financial crises? It is clear that French capitalism is going to evolve towards a new model. But will it be a German, a US or a UK model?

Gregory Jackson underlined the fact that shareholders are not a heterogeneous group with the same motives and time horizons. Shareholder value is, therefore, a myth. For example, private equity, pension funds and hedge funds acquire completely different values when one measures the short-term versus long-term portfolio turnover of investors. What is more, a discussion on the consequences of short-termism for businesses, employees and society must take into account "varieties of capitalism", that there are different models of capitalism. A cluster analysis of the effects of different forms of ownership on the labour market and for employees produces two major clusters: the first includes all of the English-speaking countries with market-oriented capital markets and market-oriented employment systems. The second cluster is the rest of the world and that is heterogeneous.

The causes of short-termism may also exist in the dominant ideas created in the interplay between the media, PR consultants, analysts and businesses. The greater tempo in journalism helps create and reinforce short-term economic behaviour (Maria Grafström). Media reporting of quarterly reports is an institutionalised production of news, providing little scope for new angles of approach and contextual or long-term perspectives. The analysts are producers of a message which is in tune with, or beyond, expectations, and is being produced extremely fast (Jaan Grünberg). Public debate helps create and diffuse ideas, but it also spreads information about the strategies adopted by other actors, which also influences the willingness to conform and to follow what others are doing. Geny Piotti's research shows, for example, that public debate encourages off-shoring by emphasizing short-term arguments (e.g. cutting costs).

DAY 1, MONDAY 16 JUNE

1) Introduction

Rachel Briggs: You have heard of the Chatham House Rule which states that you can use what you hear but not attribute it to an individual without their prior consent. It seems to me as if there is a Glasshouse Forum rule emerging. While you are in a Glasshouse Forum meeting, it is about openness, curiosity, and creativity. Those are for me three key words to bear in mind for the way in which we are going to conduct discussions over the next 24 hours. The point of these meetings is to open up debate rather than close things into very narrow conclusions. One of the reasons for starting with a meeting of this kind is to help us think about where we take our work on short-termism, so we get to unashamedly pick your brains over the next 24 hours. We are looking for ideas or inspiration on where we should be taking this.

I now hand over to Johanna and Kay to say something about the Glasshouse Forum.

Johanna Laurin: Welcome to the first meeting of the Glasshouse Forum project on short-termism. We are very happy to have been able to gather so many experts here today. Before we start we would just like to say a few words on how this project is linked to the other projects within the Glasshouse Forum. We are trying to keep a coherent profile and always strive to ensure that relevant linkages between the projects are being made.[2]

Kay Glans: Yes, we are trying to make Glasshouse Forum into some kind of ongoing working project, an analysis of present day capitalism. Some studies could move between the projects – there is that kind of constructive overlapping.

We have started four projects this year. Most recently we had a meeting in Paris focusing on "The return of the capitalist-authori-

2) For more information about Glasshouse Forum's projects: www.glasshouseforum.org

tarian great powers". The question is: do we really have reason to believe that China needs to be democratised to develop its economy? Or will China show an alternative way to modernity? This analysis of the alternative path to modernity of course touches upon many other themes that constitute discontentment with liberal capitalism.

In January we started a project called "A consumed society?" focusing on different questions about consumerism. Some claim we are moving into a new state of hyper-consumption. We need to investigate that empirically. There is also the question whether we need to permanently increase consumption to keep the economy going? It is possible? Will the environment take it? Will it bring satisfaction? We have also initiated a project on the European middle class. Is the middle class sliding away from the middle? We have commissioned several studies on the income differentials in Europe and the US. There is a ghost walking around in Europe, to paraphrase Marx, the fear of declassation. You see it in Germany and France and so forth. Is there a foundation for this fear? What political and economic consequences would it have?

And now short-termism... which also of course touches upon many of these themes of discontent in capitalist society and culture. The less the belief in the market solutions, the more people will look to state capitalism and to alternative modernities. So all these questions are interconnected. We commissioned a study on sovereign wealth funds for this project on short-termism, but realized it belonged more to the project about the return of the capitalist-authoritarian great powers. These things overlap, they mirror each other and this makes it for us at Glasshouse Forum a fantastic journey of discovery and I hope it will be for others also.

Daniel Sachs: To me as a practitioner it seems that most of the problems of capitalism can be derived from short-termism. Look at environmental issues or social issues or the lack of innovation in certain industries for instance. I travel and talk a lot about these challenges we have, not least in Europe, one of the foremost being the erosion of the industrial base. And people ask: What is driving these developments? And to understand this, short-termism is a kind of looming ghost and I think it would be interesting to hear where these discussions will end up to understand more about the issues. One particular thing that we have been discussing is pension funds that have extremely long-term commitments on the one hand but on the other still in many cases work with the same kind of short-term incentive system and structures as mutual funds or very short-term actors. I have very big hopes for this project, I think it is for Glasshouse Forum really a key piece to the puzzle to understand what short-termism is and what kind of consequence it has on these other matters.

2) A historical perspective on short-termism

Lennart Schön: First I would like to thank you for the invitation to this exciting event and to this marvellous place. I'm an economic historian from Lund University, and I've been mainly interested in long-term economic growth, in particular long cyclical behaviour in the modern economy from industrial capitalism onwards. And one question of particular interest is of course where we are today in such perspective, and whether that has an impact on the concept of short-termism.

A long-term perspective is of course very central to an economic historian. I'll try to put such a perspective on short-termism in this lunch talk and will do it by relating to two processes that you all are very well aware of: globalisation and the ICT revolution. Does the immense increase of information flows make the future more uncertain, more uncertain than ever? Does it shorten the time horizons? Or is short-termism itself a short-lived phenomenon? We can come back to that discussion, perhaps.

Clearly, globalisation and the ICT revolution have mainly produced imbalances in the world economy on the factor markets. While on one hand, the greatly reduced transaction costs have enormously increased the mobility of capital, on the other hand labour has become less internationally mobile. This is partly due to the ICT revolution that has transformed production processes, raised knowledge intensity overall in production and, particularly, raised the need for culturally bound communication, which has now, over the last 10 to 15 years, made English the lingua franca, much more so than 15 to 20 years ago. And it has led to an increase, very noticeably, in the economic growth in all English-speaking countries and relatively English-speaking countries, that is to say, countries with a good command of English as a second language, and an overall increase in interest in Anglo-Saxon phenomena.

That's very different from the situation in the late 19th century when we had another period of globalisation. The movement of labour and capital was much more in balance where both labour and capital moved to new areas. But that is only one of the major differences, I would say, between this globalisation and the prior one.

Another very important one is that in the late 19th century there was a sudden great shift in the supply of natural resources available to the capitalist economy and, in particular, to the Europeans. There was a shift in the availability of land, for food, for minerals, for energy, that raised the value of both labour and capital in the capitalist centres. Now, the shift is clearly in another direction, an enormous shift in the supply of standardized industrial labour and in service labour, of course, due to the industrial catch-up in China and India, raising the value once again of capital, primarily from the 1980s onwards but increasing the demand for land-based natural resources. And that will be a most important trend for the future, I think, in relation to labour in our economies.

There is another similarity between the 19th and 20th century globalisation processes that is seldom referred to that I would like to point out here. Both these periods saw industrial revolutions, major technological shifts that in a short time transformed production sectors and opened up new trajectories for technological, economic and social development, and had a strong impact upon the structure of transaction costs, upon the way we organize firms and, in the longer term, the way we organize societies, i.e. our institutions.

We have the second industrial revolution at the end of the 19th century that brought to the forefront the electric motor, the combustion engine, a spectrum of new sophisticated industries, particularly in engineering and chemistry. And we have the third industrial revolution, starting with the microprocessor in early 1970s. We had the PC, the mobile phone, the Internet and the digital ICT revolution.

I would like to place our own time and the trends of our own time into this perspective of industrial revolutions that open up new epochs that lead to a dynastic shift in industrial capitalism. The first industrial revolution with the steam engine and the factory system provided the basis for industrial capitalism. It is also clear that the second industrial revolution gave rise to a new class of industries, to a new organization with scientific management with the system of mass production in the fordist sense. And so has the third industrial revolution, with a new breed of capitalist organization with greater flexibility in many ways. The question then is: will this also lead to a shortening of time horizons?

I will put these events into a wider perspective because they have appeared with certain regularity. The first industrial revolution gained momentum at the end of the 18th century. The second industrial revolution occurred at the end of the 19th century. And the third industrial revolution appeared at the end of the 20th century. So the timeline is quite clear: industrial revolutions occur at the end of centuries. Well, it may be a coincidence that it was at the end of those centuries, but still I think that the time pattern here is quite important, that they occur roughly a century apart. To be more precise, the decisive term of trends occurs rather 80 or 90 years apart. But we could say that we have a practically centennial cycle in industrial capitalism. The number of observations is rather meagre though. I have two observations here, and we have to wait for the third one.

The industrial revolution set off a lot of processes of technological, economic, and social changes that take a long time to mature. That is the most important message here: it takes a long time to mature. It has taken a long time to develop the full potentials of industrial revolutions and I am certain that it is so today as well. The rapidity of today is somewhat illusory when it comes to more fundamental changes.

The industrial revolutions have transformed production sectors, and after some 40, 50 years, roughly a generation, development has changed character. From the mid 19th century, it was no longer the factory system that was at the centre of development: the construction of railways and steamships came to the forefront as well as institutional changes on a broad scale to adapt society to these new phenomena. It was infrastructures and institutions that created the basis for further economic growth and for development of steam technology.

We see the same thing in the 20th century. From 1930s onwards, transformation pressure shifted again towards infrastructures based upon the electric motor and the combustion engine, and how to organize society based upon these technologies; into institutions that were adapted to the new industrial society. In both cases, these shifts towards infrastructures and institutions meant shifts towards long-term investments – brought new actors onto the scene

– and towards the wider social distribution of the benefits of the industrial revolutions.

From this moment, economic growth really accelerated. It was when the effects of the industrial revolutions were broadened, in a social sense, that the full potential of the industrial revolutions were realized and economic growth took off. So what we can see is a shift after some 40 years from pure technological development to institutional and social development. That is what we can hope for.

One can say there is a shift when the marginal returns from further development of new gadgets or incremental technological innovations within these trajectories are falling, while the need for infrastructure and institutional adaptation to change is rapidly rising, a shift from new gadgets to new social goods in a way. Such a trend shift occurred some 40, 45 years after the industrial revolutions. Today, it is 35 years since the microprocessor appeared, and the pressure for transformation for new trends is rising. And it is rising all the more through the pressure on natural resources from widespread industrialization and through the pressure on American and European economies from new competitors.

We see the cyclical changes today with the credit crunch and the augmenting difficulties. I would say that this fits very well into a long-cyclical pattern where we are heading for a critical term, a crisis on a global scale that may turn trends into new direction. But the outcome of such a crisis is not automatic. There are always vested interests in the prevailing order prepared to resist any change, and European experiences from the first half of the 20th century showed clearly how such shifts may run through periods of prolonged and bitter conflict.

So let me conclude this lunch talk by saying: historical experience indicates that the tide may turn towards longer term perspectives within the next decade. That experience also indicates that such a turn does not come mechanically. So, history does not serve any free lunches in this respect.

Rachel Briggs: Somebody should do a study on the blood pressure of historians, because they have this unique ability to say, “Don’t worry. We’ve seen it all before, it’s part of the three century-long cycle." I've got a question to kick us off. You said that the pace of technological change, its rapidity, hasn't increased in this current cycle. I just want to know if you thought that maybe one thing that was different about this cycle from the previous two is actually the complexity of the technological change, and whether because it's more complex, it has different kinds of impact.

Lennart Schön: The general development is, of course, towards more and more complex systems, and our ability to communicate enables building more complex systems. I think it's a rather curious phenomenon that there seems to have been a balance over time between our ability to create new innovations to communicate more rapidly and our ability to build more complex systems. So, the time it takes to really fundamentally change institutions or the way economies behave has been rather constant, about the span of one generation. But certainly, every epoch has its peculiarities; history does not repeat itself exactly.

Paul Windolf: The steam locomotive had a life expectancy of approximately 50 to 60 years. That was the time horizon of an investment. The computer has a life expectancy of about 2 years. So the investment horizon drops to 2 years and you don't know exactly what comes next. You can have a guess about the next generation of computers, but already, what forms the second generation after it becomes very difficult to forecast. So my question is whether short-termism is technologically driven? That would be my conclusion of your presentation.

Lennart Schön: You could easily draw that conclusion, but I don't think it's correct. I don't think the computers themselves are that important. It's more the organization, the competence you build, the way you organize people that is important. If you change the computers, it won't matter that much. The steam engine, the factory and the computers have an impact upon transaction costs and the way you best organize first the enterprises and then society. If you change the transaction cost, you will take decisions in quite another way than you did before and you bring in information in another way.

That is most easily done within enterprises with a clear and narrow idea, while society itself is a much more complex organization. But these technologies have over a couple of decades a very strong impact upon the institutions as well. Today we need institutions that are able to take more long-term decisions. If you don't create new institutions that make people take more part in development and giving more security on global markets, then we will have all the negative reactions that we had from the late 19th century that culminated in the 1930s. If you have a low level of infrastructure or investments, for instance, or you have a delay in institutional change, you shorten the time horizon, since the future becomes more uncertain. And if the future is very uncertain, then the price for long-term investments will be high. People are driven into a short-term perspective.

3) Panel 1: Scope and depth of short-termism

Theme of the panel: In order to be convincing in our analysis we need clear definitions and indicators that the phenomenon has become more common and that it is in the process of spreading from the Anglo-Saxon countries to other parts of the world.

Shivaram Rajgopal:

3.1 The American experience of short-termism

Unless you can measure something convincingly and document it, then no matter how much we talk, it's extremely hard to convince policy makers. One way to provide credible evidence on whether short-term concerns cause value destruction is to actually ask chief financial officers about the problem. That is what we try to accomplish in our survey of CFOs (Graham, Harvey and Rajgopal).

[Download Shivaram Rajgopal's powerpoint presentation here]

One of the interesting things that came out of that paper was that these CFOs were willing to admit in the survey, obviously anonymously, that they will give up some long-term value just to be able to meet an analyst consensus earnings forecast. Large-sample studies that look at accounting and stock price data have a hard time documenting value destruction, partly because it is hard to clearly model the optimal investment policy of a company. Hence, it is hard to document under-investment and associated value destruction. This invariably leads sceptics to ask: "So what? What you document is not really value destruction." But if you go inside the company and actually talk to the people who make decisions, hopefully this evidence is more credible.

The other study I've seen (Bhojraj and Libby) does something similar except it doesn't use a survey. The authors conduct an experiment with real managers. In the US, as you know, companies have to report every quarter. This experiment shows that more frequent disclosures might push managers to window-dress, show better

results and perhaps destroy value. These are the only two pieces of evidence that I've seen where at least you can make some claims that value destruction might really be going on due to the pressure to report frequently to the market.

Why does it happen? My take on it is that it's ultimately a career concern problem. Managers in the internal labour market or in the external labour market seem to view quarterly earnings as some kind of report card on their performance. I guess managers have a hard time credibly communicating their value-creating activities to outsiders. So they communicate their competence by meeting or beating quarterly earnings targets.

We found that CFOs are expected to stay in the job for only four years. This is remarkably short. And I suspect that at least in the US, we don't have any kind of long-term compensation left. Stock options were supposed to be a long-term compensation device which aligned managers' interests with a long-term shareholder's interests. But if you look at the data, most stock options vest in four years and most managers have change-in-control provisions, meaning if they sell the firm, all their options vest immediately.

If managers' time in the job is short, they are essentially going to make decisions with a short-term focus. Thus, we have evolved into an equilibrium where the CEO/CFO expects to stay at the top job for 4 or 5 years and gets compensation that essentially guarantees that he/she need not work again. Then, these officers take short-term actions to maximize this expected compensation amount and as expected get replaced in 4 or 5 years, on average.

The desirability of providing quarterly earnings guidance is another big issue in US. One set of commentators argues that providing regular guidance to the market about upcoming quarterly earnings can be potentially good because such a process can impose operational discipline inside the company. Everybody's working towards the target. The downside is that managers do anything they can to meet that target and in that process, they burn value. Now, which of these two tensions dominate in the data? That is hard to tell.

One study (Chen, Matsumoto and Rajgopal) shows that only a hundred firms have actually given up earnings guidance. And it turns out that even such renunciation of earnings guidance is essentially self-serving because firms who gave up guidance are underperforming firms whose stock price has been falling for the last year or so, and have a hard time meeting earnings benchmarks. The managers of these firms perhaps think that it may be better not to promise an earnings target than give a target and fail to meet it.

Stock market myopia? It's fairly hard to show that the stock market as a whole is myopic although some investors may have short investor horizons and may push firms to take myopic actions that burn long term value. Some folks say: "Look at what happens when a firm misses its quarterly earnings number by a cent. The stock falls 10 per cent. Isn't that market myopia?" However, this phenomenon might not necessarily be myopic. These are typically growth stocks and the market typically tends to have high growth expectations impounded into the stock price. So, let's say you miss by a penny. It's like spotting a cockroach. You walk into a room. You turn on the lights and you found a cockroach. Chances are there are many other cockroaches hiding somewhere else in the woodwork. If you miss the forecast by a penny, you must have run out of slack, which must mean that there are some other unknown problems hidden in the company. And, if that's the case, if the market revises down its growth expectations, it's not hard to see why the stock price would fall by 10 per cent. The market is essentially capitalizing future earnings and even a small fall in expected earnings growth can cause a relatively large fall in the stock price.

My bottom line is that we need much more work to measure the existence of managerial and market myopia. Otherwise, it's hard to convince people that this phenomenon exists and burns long term value.

Paul Windolf:

3.2 Financialisation and the future of German coordinated capitalism

I tried to figure out four explanations for short-termism. I don't believe that there are only four, but because we don't have so much time I will limit my comments to four explanations.

[Download Paul Windolf's powerpoint presentation here]

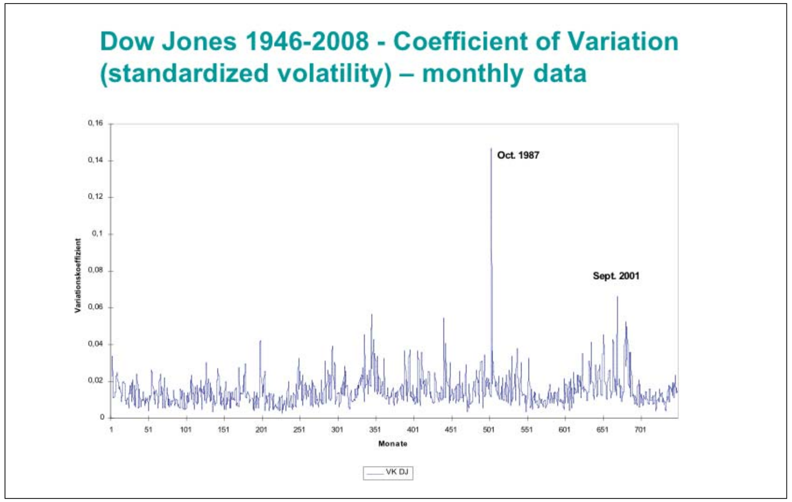
The first is deregulation and the deinstitutionalization in the global markets. Short-termism is not a phenomenon only in the financial market, we observed it particularly in the labour market. In Germany, long-term contracts have been changed and we now have a lot of what are termed flexible work contracts. We find short-termism also in the product market. Product cycles have been shortened dramatically. So, it's a phenomenon not only limited to financial markets. And therefore we have to find an explanation that would also illuminate the processes of short-termism that is going on in the labour market and the product markets.

The first idea I would like to present is that global competition has increased and that we observe a kind of deregulation and deinstitutionalization in all markets on a global level. My definition of institution is very simple: institutions are constraints on human action and they create path dependency. If you have processes that are path dependent, then it is much easier to forecast the future, but if you destroy institutions then you'll lose path dependency in what's coming up in the future. Not only in financial markets but also in the labour market and global markets, the level of risk is increasing. That is to say, markets became more uncertain as the level of risk increases and short-termism is one way to react to these changes. At least it is a rational reaction of the risk-averse investor to prefer short-term investments. If you're losing the institutional environment, the volatility of the markets is increasing, and then it makes sense to invest in short-term securities. So that's the first idea.

Now I would like to present some ideas about financial markets. The share price is determined by the sum of future earnings, of future dividends. There are some studies, particularly for the United Kingdom, that show that the discount rate of future earnings is rising. The weight of future earnings is decreasing and the share price is determined more and more by earnings in the next year or perhaps in two years' time. The consideration of earnings in four or five years' time is reduced to almost zero.

If you're a manager, you have to think about long-term investments; and you may know that your earnings this year and next year will be very low, but because of your long-term investment they will be very high in three or four years' time. But at the same time, you know that your stockholders have a very high discount rate, then you would be almost an idiot to invest long-term because your stock price is falling. If this is the situation that investors and managers have to face, the explanation for short-termism is again rising uncertainty in the market. The higher discount rate that investors have is a rational reaction towards risk. If you know more or less nothing about the future and if you really don't know what the company earnings are in two or three years' time, then it makes sense to look at a short-term planning. So that is my second explanation.

If it is correct that uncertainty is rising, and that risk is rising, then we should observe it in the stock market. I have done a very simple exercise. These are data for the Dow Jones from 1946 to 2008.



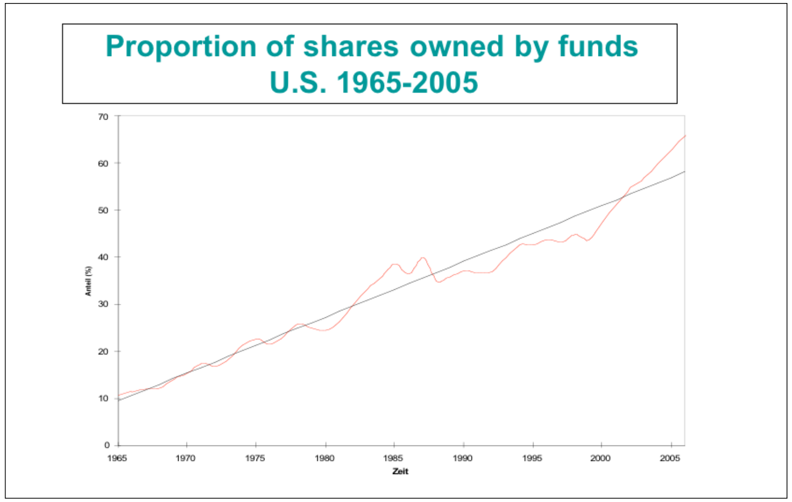
The coefficient of variation is a standardized measure for volatility, and volatility is the measure for risk in the stock market. What is interesting in this picture is that volatility is *not* rising. The Dow Jones Index, of course, has increased dramatically and volatility in absolute terms has become very large, but not in relative terms. If the argument was correct that the risk has been increasing in the market

we should observe it in the stock market but it seems that this is not the case, at least not for the Dow Jones.

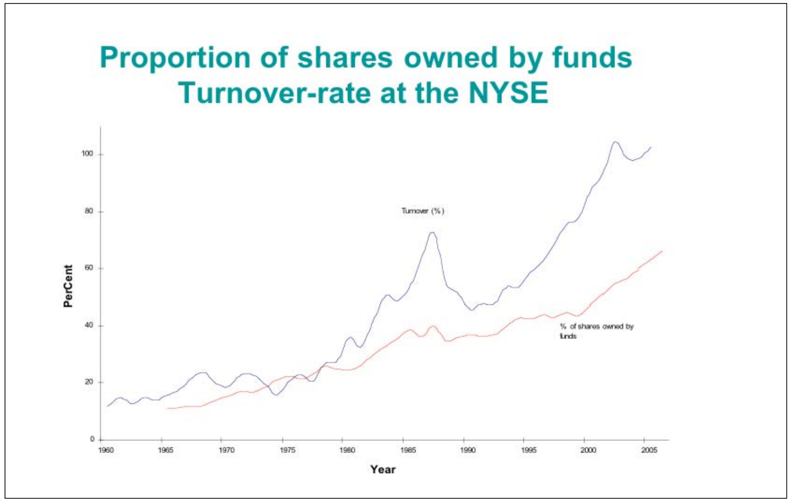
I have the same picture for Germany. There is a slightly positive trend in the standardized volatility of the DAX. We can observe rising volatility in the market but the trend is not very strong. So, it seems that we may have some doubt about the explanation that I've provided in my second point, that volatility in the market is rising, at least we can't see it in the stock market in the data shown here.

Why should the stock market in Germany behave differently from that in New York? This goes back to my argument about institutions. Assume that in one country, in let's say the coordinated market economy, the institutions are still stronger, then you have reason to believe that the volatility would be lower compared to the United States as a liberal market economy. But it seems that the opposite is the case and that is what I find interesting. For instance, during the first 10 days after September 11, 2001 the fall on the DAX (Frankfurt) was greater than on the Dow Jones. DAX: -18.9 per cent; Dow Jones: -14.3 per cent.

So then we move on to my next explanation: the type of owner and the change in ownership. This is a picture I assume you are all familiar with:



If you look at the year 1965, approximately 10 per cent of the shares were owned by investment funds of different types. If you look at the year 2005, approximately 2/3 of the shares of the large American corporations are owned by the different types of investments funds. Now we have a different type of ownership. And my paper "What is Financial-Market Capitalism?" that has been translated by Glasshouse Forum makes an argument about financial market capitalism as a new regime of capitalism. What you can see here is that it is not a sudden regime change. It wouldn't make sense to say that we entered the age of financial market capitalism, let's say in the 1980s. It is a continuous change that we observe here. Year by year, the percentage of institutional owners has increased. The turnover rates increased parallel to the increase of the ownership of the investment funds. It is now one year, i.e. on average the institutional owners hold their shares for only one year and then sell them again.



It's surprising that on average the institutional investors hold the shares for one year and the forecast horizon of analysts is also one year. So we have to see the link between the different phenomena that we can observe and that gives us perhaps an idea of where short-termism comes from. The fundamental point that I would like to make is that these institutional owners find very strong competition one against the other. This is a highly segmented atomized market with very small market shares. That is I think the new phenomenon. The widow of a very rich man who held shares from Ford was not in competition with another widow who also had shares of Ford. But two investment funds, two pension funds are in a very strong competition, one against the other for higher rates of return. I think that is the fundamental issue for short-termism.

Lars Magnusson: My paper "Pension Funds – A New Stage in the Development of Capitalism?", commissioned by Glasshouse Forum, goes in the other direction. I am not at all certain that pension funds work this way. The pension fund would be stupid to not invest significantly in a long-term perspective. Otherwise it would also ruin its owners.

Paul Windolf: They put their money into hedge funds, into equity funds, in funds of funds. 35 per cent of the money that is available in Germany for equity funds comes from pension funds. I have figures for Germany that almost 40 per cent of the money that private equity uses to buy up medium-sized firms in Germany comes from pension funds. The beneficiaries of pension funds of course have a long-term horizon, but it does not necessarily mean that pension funds themselves have a long-term horizon.

Shivaram Rajgopol: How about the agency problem? Who's the owner? How does he or she exercise control on the manager of the pension fund?

Xavier Ragot:

3.3 Financialisation and the French state capitalism

French capitalism is fast moving in a new direction. Many big French firms were nationalized between around 1981 and 1993. The process of privatization started in 1986. What the government did was to impose on firms cross-holdings between each other. All big firms held shares of other big French firms. The capital structure was locked, the power was in the hands of managers and they were all monitoring each other. The cross-holding capital structure ended in the early 90s, partly because the big insurance company AXA took over UAP, a bank. This new merger changed the French equilibrium in the big firms, because this actor, which was crucial within the French system of cross-holding, decided to sell all its holdings in big French firms.

[Download Xavier Ragot's powerpoint presentation here]

The outcome of all of this for French firms was a windfall. They received huge amounts of money because they sold their shares in other French firms and they managed to buy other firms in Europe, the US and other countries. Many French firms achieved a strong international position, for instance in the banking sector. Another outcome was that the locked capital structure dispersed very rapidly and became open for other investors. Between the 1990s, and say 2003, many institutional investors from the US invested in France, which is much more open than Germany for instance. The share of US investors in French firms is very high, something like more than 30 per cent.

Institutional investors took positions in French firms but they do not interfere with the management of French firms. In a general shareholder assembly, where the Board of Directors is elected, they do not vote for the Board of Directors. They do not try to interfere with the strategy of the firm. If the firm has a strategy which is not good from their point of view, they sell those shares. It increases volatility but it doesn't really affect the strategy of these French firms.

What is changing now is this: there have been new investors in France since 2004, European investors which bought important positions in French firms thanks to cheap credit. Many French firms have new shareholders who are active, i.e. who want to affect the strategy of the firm. That is a big shift.

To differentiate the various types of shareholders in France, it is useful to introduce two dimensions of shareholders. The first dimension is the time horizon. Some investors have short-run time

horizons, two years or less. Other investors, like family owned firms, can have a much longer time horizon. The second dimension, which is crucial, is control. Do you have control or not over the strategy of the firm?

First, investors who don't have control are called passive shareholders. They have strategies such as value and growth. Most of the shareholders in France from the US are like this. They do not interfere with the strategy of the firm. Second, there are investors who have more control. Typically in France, that's family firms. Many firms are owned by families and the capital is locked. Third, some investors have a short-term horizon and lots of control, like private equity. Some of them have aggressive strategies to increase their short-term profits. Fourth, when the firms were controlling each other during the cross-holding period, one can say that firms had an intermediate amount of control and a long-term time horizon. Fifth, if one considers the French state as a shareholder, it used to provide a long-term horizon to some firms, but it was not very efficient in monitoring the manager function. There are some very good outcomes and there are some very bad outcomes in firms controlled by the state.

To summarize, the history of the French capitalism is a move from passive shareholders towards more active ones. And the debate today in France is: will the change in the strategy of shareholders continue after the financial crisis? Will more active shareholders have a short or a long horizon? Our active shareholders are taking important positions and I can go into detail about the precise agreements between shareholders and Boards of Directors as regards accepting new members in the Board of Directors. They have agreements saying that new shareholders must see to longer term values as well, i.e. long-term strategy of all stakeholders. That's the agreement signed recently in some firms, but these agreements are under pressure because of the financial turmoil. These financial actors need some return to pay back their debt, because of their high leverage.

That's the issue in French capitalism today. There are various actors within these various sectors with different time horizons. Does the state have to influence financial regulations to marginally increase the power of shareholders who have the longer time horizon? It may be a problem that shareholders who have a short-term discount factor increase their control at the expense of other people within the firm – other shareholders, minority shareholders – because of the unstable macroeconomic situation. So must we prevent the power of short-term shareholders or not?

Changing the regulations includes a discussion about the definition of a creeping takeover, i.e. when an investment bank or shareholder takes control of the firm with a very small amount of the capital structure. Sometimes you gain control of the firm and are criticized because you do not compensate the other investors for their loss of control. Another debate is about the definition and regulations for a hostile takeover. The other issue is about how to increase the power of long-term investors. And it's about the independence of the Board of Directors with respect to shareholders. Is the Board of Directors directly controlled by the shareholders like in the UK? Or, is it more independent from shareholders like in Germany, or even in the US, where the Board of Directors has more power and can use more strategies?

French state capitalism is going to evolve towards a new model. But will it be a German model, a US model or a UK model? The goal is to increase the power of long-term shareholders, for the long-run strategy of firms, in order to allow for some benefit for wage-earners who need a long-term strategy to insure against events of life.

Lennart Schön: Are family firms less myopic or better at foreseeing the future than public firms?

Xavier Ragot: There is no consensus on this. Some people say that French family firms indeed have less short-termism, meaning that the return is earlier than the market returns and the volatility is lower.

Shivaram Rajgopal: You can turn that around and say that family firms have too much power. They can decide to shaft the minority shareholders. The fact that they have so much control might mean that they can do whatever they want.

Rachel Briggs: What does the literature tell us about innovation within family firms?

Shivaram Rajgopal: In US at least these are typically old-economy firms. So innovation is not a big deal. They're typically cash cows. It may be very different in Europe.

Xavier Ragot: In Europe it depends on which country you look at. In France we have some very good innovative family firms. The cut-off of the expenditure is linked to a change of shareholders to short-term investment hedge funds. When some of the short-term shareholders arrive, they cut the R&D, so future innovation should be less.

Lars Magnusson: The question you raise now about the owners, of the relationship between the owners and the firms, is a crucial one. That has always been said to be the difference between US, France and Europe. The European experience has been named *Rheinischer Kapitalismus*, emphasizing the long-term, personal sort of a collaborations or connections between especially banks and the firms. Would you say from your experience, when talking about France and Europe, that this is not the case any more? Are these links dissolving? If one takes the view that there has been more short-termism in the Anglo-Saxon countries than in France and Germany, as well as other European countries, are we moving towards a kind of Anglo-Saxon model here?

Paul Windolf: The ego-network of Deutsche Bank in 1914, is a spider's web. One could count the connections. In 1928, it's almost impossible to count the connections. It has become a very, very dense network. In 2004, the CEO of Deutsche Bank declared that in the future members of the management Board of Deutsche Bank will not take over the position of the chairman of the supervisory board in any German company. The density of the ego-network of the Deutsche Bank decreased very strongly during the past decade.

Dense corporate networks existed for a hundred years or so in Germany. We had on the one hand personal connections, networks between the management of different firms and on the other hand capital connections. Capital connections were almost as important as they were in France. Since the late 1990s the Deutsche Bank is being transformed into a new investment bank, heavily involved in the present financial market crisis, as most banks are.

Since the late 1990s these networks have been dismantled and they don't exist anymore. They could not be recreated; at least I don't believe it would be possible because of globalisation and the transformation of the capital markets.

The largest American corporations are 66 per cent owned by institutional investors. In Germany, the statistics are not as good as in the United States. A recent survey of the 30 DAX firms (Frankfurt Stock Exchange) shows that 54 per cent of these firms are owned by foreign funds of which 18 per cent are US investment funds. 21 per cent are owned by German investment funds. If we add these percentages (54 + 21 = 75) we see that a higher proportion of domestic (DAX) firms is owned by investment funds compared to the United States. That's how I believe the same forces that had moved American capitalism in a particular direction are now in place at least for those firms that are listed in the DAX. The principle is that we agree upon the importance of the type of owner, not a particular owner or this or that fund, but the type of owner and that this has changed.

Xavier Ragot: It looks like German capitalism is still a little bit stronger than the French, which is much more inclined towards foreign investments. I think that we must make a distinction between what is going on in the UK, where shareholders have lots of power, and the US where the shareholders are not empowered over the Board of Directors. In France, the feeling is that the power of the shareholder is even more important for the firm than in US firms. People are more afraid than they were 2 or 3 years ago of hostile takeovers by foreign firms.

Gregory Jackson: To make an impact measurement is really critical. The composition of ownership is changing, the turnover, so something seems to be happening, time horizons are going down, but it's

very hard to make the kind of social-scientific case about what influence it has, how it matters, why is it shorter, why is it short-termist. For that, you need to benchmark against something else, either theory or behaviour of other investors.

One anecdote is this debate on private equity which flared up in the UK. It was a seminar on financial markets at the London School of Economics led by a Professor of Private Equity, and with talks given by private equity fund managers. All these people from the DTI (Department of Trade and Industry) came down and asked critical questions, but nobody could touch them. At the end the private equity managers had beaten down all the tough questions and then they said: the real secret how we make all this value, how we make our money, is that we just pay the managers so much that they get the results. It's kind of simple as that. It becomes very hard to criticize this kind of self-congratulatory view of the economy without knowing what our baseline measurement is.

Rachel Briggs: We had the same kind of discussion when we talked about consumerism in Glasshouse Forum's project "A consumed society?". It's so easy to look at this and find various different indicators that on their own seem to suggest a new kind of time horizon or a new kind of behaviour, but I guess one of the things that we need to be thinking about today is: does all of this add up to something we could genuinely call short-termism? And how do we show it's different from what went before? And does it really matter if it's different? We need to be slightly more systematic about understanding what the negative intended and unintended consequences are. Because the danger in all of this is that you are kind of quite nostalgic. So, I guess we're looking for your lead on how we can fill some of those gaps in research terms to really put some meat on this idea of short-termism. Does it exist? Yes or no. If so, quantify. And if so, what are the ways it really matters? Then we can think out some kind of policy.

4) Panel 2: Causes of short-termism

Theme of the panel: Provided that short-termism exists and has indeed become increasingly common, what factors are driving it? Is there something in the global economy and competition that is influencing it? Have there been any changes in ownership structure which are of significance? Are company managements themselves behind it and in that case why? What role do the analysts play? What role do the media play in short-termism? Have general cultural factors any significance? A great deal points to the fact that we live in a more rapidly moving society concentrating on immediate gratification.

Maria Grafström:

4.1 Media's role in short-termism

In a study we did a couple of years ago, we wanted to understand how the media transform quarterly reports into business news, but we didn't want to study only the media organization themselves but also include other actors that were part of this production of business news. I myself was studying these processes in the newspaper organization, at a business desk, and our colleague Karolina Windell studied the news agency at the same time. It was in a certain week when more than 140 daily reports were announced. Jaan Grünberg was at the financial analyst department at a bank, and he will talk more about that in a minute. Our fourth colleague, Josef Pallas, was at the information department in a corporation listed on the stock exchange.[3]

I will talk mainly about Swedish business media and the context of Sweden. But I will also like to just make a point about the news agency. We found that the role of the news agency is very important to the whole process of the production of business news when it comes to quarterly reports. When we talk about short-termism and the role of business journalists or business reporters and their influence on the short-termism, I think that news agencies play a crucial role.

Business journalists, both at the newspaper and certainly at the news agency, participate in creating and influencing short-sighted economic ideas and behaviour. Three factors that drive this behaviour: First of all, quarterly reports, and also other recurrent and predated economic information. That's a type of information that offers easy and, I will call it, "safe" journalistic work processes. One of the news chiefs in our study said that periods of quarterly reports are hard work but at the same time they are very practical, because we will know that we can fill the newspaper during these periods, and we can plan it far ahead because you know exactly when the companies will announce their quarterly reports. That comes with all other predated economic information also of course. So the journalists know that they will get the information, when they will get it and from whom, and they know exactly how they are going to present it.

The process of the production of business news is very much institutionalized. You know beforehand what is going to come out of it, and there's not much room for new ideas, there's nobody expecting that you will do something different with this information. Along with that, there are no expectations to put it in a long-term perspective or a long-term context. This is more something that you fill up the newspaper or the Web with. At the same time, the main difference between newspaper work when it comes to quarterly reports and the work at the news agency is that at the newspaper, even though they do it and all newspapers, at least in Sweden still cover quarterly reports, there is an ambivalent attitude towards them. There is an ongoing discussion of whether this is really news, should we really do this, can we really make news out of these quarterly reports or other types of economic information of this kind? Isn't this free advertising for companies? And so on. The periods of the quarterly reports or other types of predated recurrent economic information, that's their work, so nobody is questioning whether they are to report this kind of information.

3) Grafström, M., Grünberg, J., Pallas, J. and Windell, K., 2006, "Ekonominyhetens väg. Från kvartalsrapporter till ekonominyheter", Stockholm: SNS Förlag.

Short-termism also follows media logic very well. What's new has, of course, news value. When we talk about journalism, we often hear about the drawbacks of routinizing the unexpected. But in the world of business journalism, this is not as necessary as in many other news areas, because a lot of this information is predated. The hub of business journalism is the stock exchange market, and that in itself always offers new information, and it is not very surprising that it is also mainly presented from a short-term perspective. That's the logic of the stock exchange itself, and that fits very well with the idea that everything you put in the newspaper should be new. That also makes quarterly or weekly or daily deviations easy to make into news stories. So again I think this is a rather efficient way to pursue journalism.

Research within the field shows us that the development of the Web is further strengthening the media's focus on short-termism. The work of news agencies has to be fast. The whole idea is that they are going to be quick. The first news flashes about the company should be published within 10–12 seconds, so they want to distribute the news flashes before the stock exchange price starts to fluctuate. We even have quotes that say: "Yes, we were faster than the market". And of course, there's no time to look up and put it in a longer perspective or in a long-term context. That should be the role of the newspapers maybe or other media channels, but with the development of the Web, we have an increased pace also in the journalistic work in general.

And in-depth reports are less common in the journalistic world on the Web, and time axes over longer periods are not that common. We also have a totally different news climate where news is published more and more instantaneously as journalists get to know something. Then they are updated continuously as new information appears instead of as it was done before. You collect a lot of information, you write your own story, you have a beginning and you have an end, and you can put it in this timeframe or longer time so you can decide that frame better by yourself. Nowadays you're getting more information, you have to deliver it as fast as possible, and you get pieces of information that you then update all the time. You have, of course, exceptions from that where we can see longer news

articles with a longer time perspective, but not as often as before. It can easily happen that this contextual or long-term perspective is being forgotten or just not being given time when news is produced today.

Jaan Grünberg:

4.2 On the run. The impact of the analysts on business behaviour

I'm going to give you a snapshot of the work of financial analysts whom I spent one intensive week with. They are a group of sell-side analysts of a large Swedish bank. The main rationale for having these analysts is attracting trade for the traders in the bank. I sat at one of the desks in the midst of a staff of approximately 60, not all analysts, some supporting staff. I have given this presentation the title "On the Run" because that summarizes very well what the work of the financial analyst is about. It's very much about creating efficiencies in terms of time management, and there were different techniques for efficiency.

Of course you have the financial modelling, you get your reports, you enter your data which I was fascinated to see was done manually. There is not yet a technology which allows the data to stream from companies into financial models. You prepare a spreadsheet the day before with former quarters' figures and then you have the empty cells, and when the flash comes from the news agency, you sit down, you pick up the report, and put the figures in. Then you can check out how it compare to your estimates, against consensus estimates.

This is a really quick process because when you have seen the figures compare, what you do as an analyst is to call out to the trading folks if there is something interesting, if there's information, and thus pick up your mike and a speaker goes onto the trading floor, and you can say something to a trader. You are working in terms of seconds. In about half an hour, after the reports arrived, you provide your first report to the large institutional clients of the bank, giving an assessment of the firm. So one technique is the modelling, but there are other techniques which are equally important.

The work of an analyst is very much like the work of a journalist. There is an editorial process going on because you have to create reports. The day after the report, you send out a 20-page document, and the way to routinize this as quickly and strongly as possible is to have computer programs that build the templates into which you put the information. They have language editors as well to read through the reports and check the English. Most people working in the bank are Swedish, and they target the international market. So there are a lot of editorial techniques which also serve this efficiency.

The next kind of technique is very much about salesmanship. An analyst is expected to spend almost half of the time with institutional investors, attracting them as customers to the bank. As soon as you produce a report, you are expected to start calling people at those investment firms or institutional investor firms and start attracting trade. This is then used when your efforts are evaluated, and your bonus is paid out. To be able to communicate, to be efficient in the salesmanship, you have to compress your information into very, very small packages, because you're trying to call as many people as quickly as possible and only speak to them for a short period. You have three points about each company as to what is important, and at the bank you gather the analysts and the chief traders to a morning meeting before trading starts at 8:30. You gather everybody, so you have 30 or 40 people in the room, and then the analysts start reporting on the companies that released their reports the day before. An analyst will get about a minute per company to present their analysis. So they will say "Well, earnings per share, it didn't fit the market estimate but it fits my estimates, so we did well there", and say that very, very quickly, bam bam bam, and they might get compliments. We see in those rituals what is rewarded. If you have been able to deviate from market expectations, you may get an estimate which sort of lies far off what everybody else was expecting, and if this is accurate, that is when you get compliments, "Well done!"

Then what are the implications for business behaviour? What are the corporate responses to this? There are two main things that we've seen. First is what we called boundary spanning. Since the 1980s companies have adopted specialized units for handling

investor demands, the investor relations units. Companies usually create these with the specialists from the profession, so we have journalists entering the press offices, we have people from investment banks moving into IR departments, with their professional knowledge and values as well.

The traditional way of viewing this sort of boundary spanning unit is, of course, as a kind of buffer. The question is whether it works. Instead of building buffers, you might build channels into the company through which the market logic enters much more easily. Studies have shown how much credibility managers get through the contact of the capital market. It works to create legitimacy in the firm that attracts those units at the boundary who are in contact with that type of legitimacy producing source.

Another interesting phenomenon is that we see different kinds of intermediation. When it comes to the contact with financial analysts, there are quite a few consultancies that work with trying to understand the perceptions, the views of the financial analyst, so a company just preparing to report might very well commission a perception study from a consultant which will call round to analysts and investors as well and ask them what are the perceptions of the firms and what are the key concerns, etc, to get a view of what the market expects. Lennart spoke earlier about the systems becoming more complex and tying in to each other. I think this system is getting extremely complex, people trying to predict what is actually moving in it, but I think we see these types of responses and intermediaries present in many other types of governance relations as well.

To try to come to a conclusion: we don't see the firms as production entities, but as producers of messages. Their key competence is not delivering a product, it's delivering a message which is in tune with expectations or beyond expectations. They are actually becoming quite routinized in doing it because the machinery, the connections between analysts, firms, newspapers, investors, is extremely close-knit, and it works extremely fast, since you're able to do things in terms of seconds: you receive information, you produce products, and you send them on. It is very much being on the run. If it is short-termism, I don't know, but it is very, very quick.

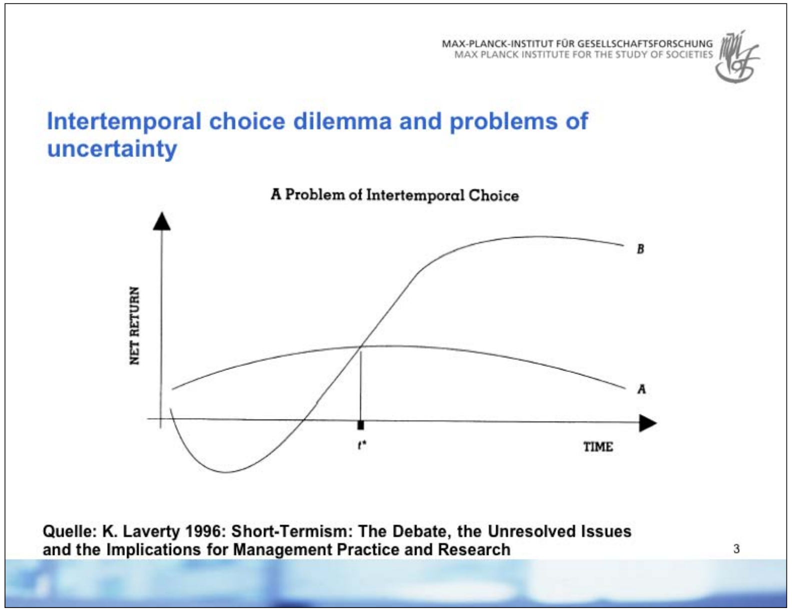
Geny Piotti:

4.3 Relocation as short-termism?

It was interesting to hear your presentation, Maria, because you analyzed the journalist side of things. What I'm trying to do is to estimate the extent to which the news, or at least information circulating in the news, and the message of the news, affect the behaviour of managers in general.

[Download Geny Piotti's powerpoint presentation here]

An important aspect of short-termism is the intertemporal choice dilemma, which can be synthesized in this graphic.



This means there is a sort of trade off between short-term strategies and higher long-term returns. Decisions that are advantageous in the short term might not be as advantageous in the long run. Curve A indicates the situation in which incremental investments are carried

out, and curve Y points to the higher returns of long-term strategies where initial costs are higher. But of course from the perspective of the actors, whether they will have higher returns after point T is not a matter of certainty.

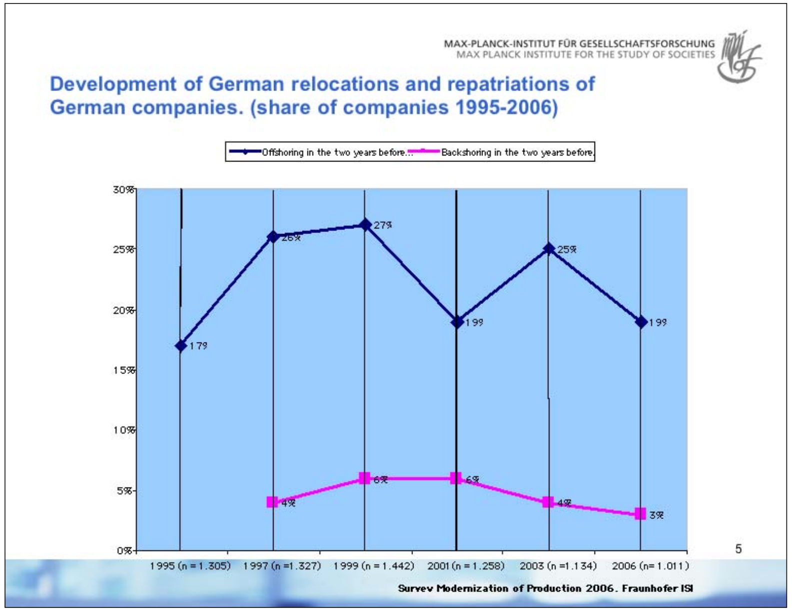
So actors take decisions about investments, be it on technology, on research and development, on entering new markets, or, as in my case, on investing in other contexts. They take all these decisions under conditional uncertainty. And the question is, how did they cope with that and what influenced their decisions? Do they overcome or do they not overcome this kind of uncertainty?

We have already heard – and it is probably also the topic of some presentations tomorrow – that one of the ways to cope with that is to follow institutions, and the literature particularly underlines the role of national institutions. We were talking about the varieties of capitalism, the uncoordinated and the coordinated market economies. In those countries in which, for example, corporate financing occurs primarily via the stock market, short-term practices are supposed to be more widespread than in other contexts where banks provide the necessary credit for companies.

But not only institutions have an influence. We have talked about managers today. Managers might also be attuned to particular practices that become part of their profession, and their profession is defined by these kinds of practices. One is for example accounting and we have heard today about this.

Finally, some recent studies point to the role of organizational culture and the way it helps overcome uncertainty, for example, by creating a sort of climate of confidence about the future. In some organizations, short-term practices may be compensated by other practices that push more long-term decisions compared to other companies where short-term practices are central. So there may be differences in organizational culture which also explain differences in the time horizon of companies.

What I'm doing here is something else. I will focus on the influence of public discourse in off-shore investments and particularly the influence in the phase of decision-making about off-shoring. I will focus on the social construction of short-termism in long-term investments. This is the result of a survey about off-shoring, relocations – and repatriations of German companies. At each point in time you have the share of German companies that have off-shored, relocated and repatriated in the previous two years.



Investing in production in a new country can be considered, or should be considered, as a long-term investment. It is not something that you can do for three months or something like that. You must have a quite longer time horizon. This is bringing me back to the questions: what is short term and what is long term? I think these are very relative concepts depending on what they are applied to. Making this kind of off-shore investment should be considered as long-term investments. Decisions are in fact associated with higher investments in the initial phase in order to get higher returns at least in the intermediate period. And if we look at the phenomenon of relocation or off-shoring in German companies as showed here in the graphic, we can argue that at least entrepreneurs and managers have been able to overcome, or at least strongly reduce, the uncertainty associated with investments in other countries.

If we look at the data since the beginning of the 90s, the share

of companies that have off-shored has oscillated between 17 per cent and 27 per cent, while repatriation has been calculated at between 3 per cent and 6 per cent. But if you consider the share of repatriation to that of relocations, repatriation amounts to 1/5 to 1/6 of the companies that have relocated in the same period of time, which is quite substantial if we consider that these companies should actually be competitive and experienced in their own country. So the question is on what grounds so many companies have decided to off-shore? On the one hand, the case of Germany tells us something about the precondition of overcoming short-termism, but on the other hand, the recent wave of off-shoring is characterized by ambiguity.

What are the preconditions for overcoming short-termism in the case of off-shoring? In a situation of uncertainty, overcoming short-termism requires the diffusion of ideas that redefine the actor's interest towards long-term goals. Interests are conceived here as actors' wants that are constructed on the basis of desires and beliefs. So, they are strongly linked to what actors believe are the consequences of their action. If they're behaving in a certain way, they will have an idea that tells them: if I behave in this way, these will be the consequences, and I want these consequences for me, I desire them. So ideas, be they cognitive constructs like paradigms, world views and symbols or be they normative constructs like norms and values respectively, presume theoretical cause-effects relationships and influence what is desirable. Applied to our case, interest in off-shoring among managers is necessarily based on ideas that attached positive results to the action of off-shoring. For example, one idea could be that competitiveness can be reached through cost saving rather than improving or investing in R&D or restructuring production in their own countries. There are always conflicting ideas about what is better for competitiveness, and managers will behave according to the dominant idea.

I argue that the public discourse in the media has pushed companies to off-shore or at least has provided strong justifications for off-shoring. Of course companies might have pressures from other sides – from competitors, but also from networks. If you are in the automobile industry, for example, Volkswagen decides that you have to follow them to China in order to produce there for them, you have very strong incentives to do it; otherwise, you lose your contracts at home, for example. So to a certain extent, you are compelled to go. However, you have also information and ideas that tell you that it is right to do it, that you don't have to worry a lot, that this is the way you have to do it if you want to keep on being competitive.

Public debate helps create and diffuse ideas but it also spreads information about the strategies adopted by other actors, which also influences the willingness to conform and to follow what others are doing. Since other companies are doing that too, this is certainly the right way to behave.

In fact, public debate encourages off-shoring by emphasizing short-term arguments, especially that of saving on costs. This has influence on the expectations of the actors when they off-shore. Why is it short-term? Apparently, if you go to China because you want to save on labour costs, you might also have a long-term perspective, but on the other hand, if we think about how the question of saving on costs is put and what indicators are used, then I think the message given from the media is too simplified. For example, they normally use indicators like the average net wage of target country, compared to Germany. However, other kinds of cost are strongly neglected in the debate, or at least they are not underlined as much as the formal labour cost indicators.

I carried out an analysis of the German press on relocation, i.e. the *Standort-Verlagerung* from the beginning of the 1990s to 2005. It is a qualitative content analysis which has become a quantitative one. You can see that the discourse here is much more focused on cutting costs than for example on more long-term goals like winning new markets. However, as I was saying before when talking about costs, indicators like the average net wage are much more on the line than others.

Of course, you can also find some other arguments, in the press for example, that in internationalization there are also hidden costs. But they are not in a majority. And if we interpret these data, we would also have to look at who the protagonists of the discourse are, meaning what actors have been quoted in the discourse. Then you can see that consultants are very much present in the press. They

have in fact an interest in saying, "You have to relocate because you have lower costs there but at the same time you have many problems you cannot solve alone, so just come to us." So consultants use the press in a way that fits their own business interests. Maybe it is a part of the logic of the press. As a journalist you may have connections with consultants which can be useful when writing the articles, and consultants use the press in a way to advertise their own business. This is quite widespread. Also economists and entrepreneurs or managers are quoted in the press, so entrepreneurs hear the voice of their peer group. I think it should be considered as a sign of the effects and the impact that the public discourse has on the decision making of entrepreneurs.

In fact, if we look at the reasons managers or entrepreneurs give for off-shoring in the years 2001–2003, then you see that production costs are mentioned first, while other aspects like quality, cost of coordination, communications, and availability of qualified employees are much less underlined or quoted by managers. At the same time, these are also the aspects upon which they base their decisions to move back. So there is clearly an overestimation of traditional production cost advantages and an underestimation of other costs, for instance training and transaction costs.

We can see some consequences of this in the following, because if companies focus on costs, and these costs are built on very simple indicators that do not account for other problems, then the danger is that companies focus on short-term goals and take questionable decisions. I would like to quote a consultant that I met in Shanghai. He was talking about practices of hiring general managers and on the relations of cost. So he said: "It used to be cheap once. You could get everything for a song. But you did not get anything sane in return. "You get what you pay for". "For a general manager, what should I pay?" "For you: 40,000 euro? Per year?" "What? So expensive?! Is China so expensive?" "Well, I can also find someone for 10,000. But whether he leads you to success, that is another question." .... In Germany one can get at best a technical assistant for that price, certainly not a general manager that speaks three languages, is an engineer, has 15 years' experience and has worked for good companies. 40,000 is really not that much for them. But they recruit very quickly “What? So expensive?” And then the company languishes…”

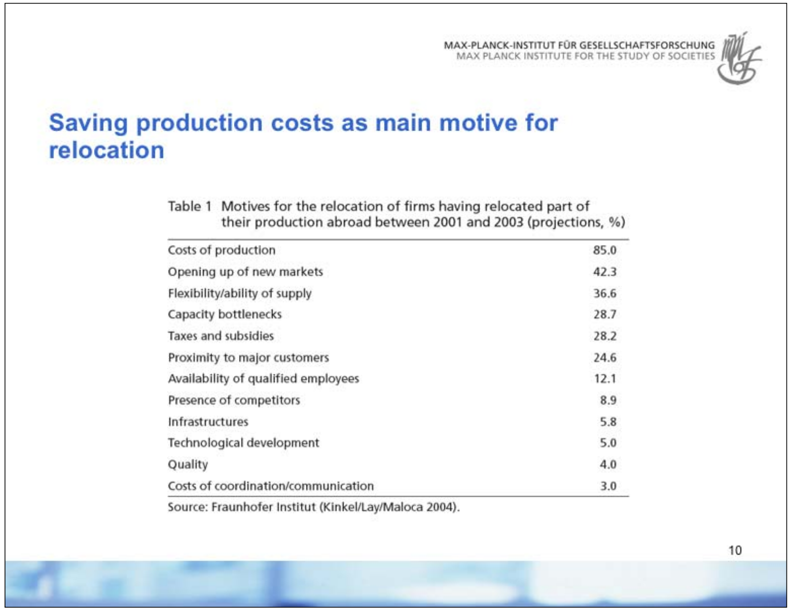


Table 1 Motives for the relocation of firms having relocated part of their production abroad between 2001 and 2003 (projections, %)

Costs of production	85.0
Opening up of new markets	42.3
Flexibility/ability of supply	36.6
Capacity bottlenecks	28.7
Taxes and subsidies	28.2
Proximity to major customers	24.6
Availability of qualified employees	12.1
Presence of competitors	8.9
Infrastructures	5.8
Technological development	5.0
Quality	4.0
Costs of coordination/communication	3.0

Source: Fraunhofer Institut (Kinkel/Lay/Maloca 2004).

And the company languishes. Why? Because by concentrating on cost saving, it’s not very uncommon that, for example, entrepreneurs, especially in small and medium-sized enterprises, hire their interpreter as a general manager. They go to China, they don’t know the language at all, they know very little about the country, they search for Chinese managers and do not want to spend much money because this is also the reason why they have gone there, to save money. And then they take decisions that they would never take if they were in Germany. This is really not uncommon. The consequence of the overestimation of cost saving through relocation is a relatively high share of repatriations.

Shivaram Rajgopol: So the presumption is that outsourcing is value-decreasing, right? Is there any evidence to support this? Based on what I have seen in the US, if you look at the stock price reaction or to the subsequent performance, there is no evidence that outsourcing is bad, at least, in that context. If it is on average not value-decreasing, then it’s okay.

Geny Piotti: I have focused on small and medium-sized enterprises, most of them not on the stock exchange. According to the interviews that I have made, at least 20 to 30 per cent of small and medium-sized enterprises that have invested in China produce inefficiently, so they produce at the same prices as in Germany. Of course, it is maybe worthwhile to go there if you have a very standardized production, but not if you are specialized in high quality products and maybe produce 40 pieces per year. Then producing there can become much more costly than you imagine. You have to outsource locally but the quality is not the quality that you want. You have to instruct your employees, which is always costly. Then you have the problem of employee turnover which is very high. In the end, at least for this kind of production, it is not necessarily profitable to be there unless you have very high market expansion perspectives. However, this is also a myth. The first myth here is probably that of saving money and the second myth is that of market expansion. It takes a long time, at least in China. I remember the chief of BSF talking in Shanghai at the Chamber Meeting, and he was saying that the market volume in China for German products can be compared to the Swiss one.

Maria Grafström: I think one of the keys is the myth that you are talking about – the dominant ideas. We know that dominant ideas are going to influence behaviour. We can talk of them as institutionalized ideas or institutional ways of behaviour, taking-for-grantedness, force of habit or whatever we call them, they will define or guide appropriate business behaviour. Who are creating these ideas, these dominant ideas that define and guide business behaviour? We know that the media play a credible part in these processes as in defining and creating ideas. Media definitely participate in those processes. If we ask journalists about them being part of creating ideas that influence our behaviour, they will say, “No, no, no, that’s not what we do. We just reflect, we just re-tell what other people tell us. We’re not part of this creating process.”

However, research shows, of course, that they are, but the media are only one actor in the process, and I think it will be very useful and interesting to dig deeper into this. Journalists are one group, but who are they giving air time to? Analysts are one really important group, when it comes to business media in particular; analysts are playing the role of experts, and are seldom questioned. Maybe they are questioning each other among themselves but not very often that even. Companies themselves, of course: Jaan mentioned companies as providers of messages. Research also shows that companies are spending more and more resources in presenting themselves, in creating the appropriate image of themselves. Consultants are another really important actor group in these processes. I can think of many other ones, and we have to look into relationships between these actor groups in order to understand the processes behind who is creating the dominant ideas that guide our behaviour. And coming back to short-termism: that is really one of the keys.

Kay Glans: I think there are interesting researchers within the United States who confirm your observations on outsourcing, like Suzanne Berger at MIT. People underestimate the cost especially of senior management at a location. And that we have a kind of lemming behaviour in business, I think that is obvious, we see it a lot of times. Look at the whole new economy, even the old economy bought it. But as regards the media, in media research you differentiate between push and pull. As journalist you can go out, you have tips and rumours and you investigate them, write your own story, you pull it out. It's of course always a very complex process who is telling you what, and when, and with what intentions. Then you have the push, someone pushes in their version of something as news. It's become much more common that companies are able to get their own messages reported as news. I don't know this empirically, but this whole flora of PR consultants and the like, doesn't it grow because companies suddenly understand wow, we can make journalists write what we want since newspapers are understaffed? The papers don't have the time to follow up. They are really happy to have something to fill the newspaper with. Doing research on your own is risky, it costs a lot, and you might end up with nothing.

Johanna Laurin: A comment to what Kay said about whether news is being planted or dug up: We tried to do something on that at SNS, but we just realized it was impossible to get really credible data because PR consultants refused to talk about their clients and journalists would never admit that they quickly take news from PR consultants. It would be really interesting to investigate, but I think it's also very, very difficult to study.

Maria Grafström: First just a short comment on this thing with PR agencies and push and pull. We found a problem when we tried to do research on PR agencies but Josef Pallas, who was also part of this project,[4] had just finished his dissertation about corporate communication and he has really interesting case studies. He has been interviewing corporate communicators, and they can show how often they create the stories and it's right there in the newspapers. He hasn't been interviewing PR consultants but the companies themselves.[5] And then another comment about this dominant idea. I think we also have to keep in mind and separate who creates the ideas, who starts something new, and who recreates or enhances already dominant ideas. From my research I think the media most often play the role of already enhancing dominant ideas and not really breaking the mould and starting something new. So if you're an actor and you want to push something out through the media, via the media to the rest of the world, you have to act in tune with the dominant ideas that are in place at that moment. I think it would be really difficult to get critical articles into the newspapers about the market in China at the moment, we can probably find that discussion elsewhere but not in the media at this time.

Jaan Grünberg: But these ideas, they do seem to have consequences in that firms choose an option which does not perform as well as if they had chosen the other options. You called it value destruction

4) The research project presented by Maria Grafström and Jaan Grünberg (above).

5) Pallas, Josef, 2007, "Talking Organizations: Corporate Media Work and Negotiations of Local Practice", Doctoral Thesis, Department of Business Studies, Uppsala University.

but in fact they're performing worse than they would have if they hadn't done it. So there are actually real consequences to it, and I suppose you could also think of who will be held accountable for that. Is there any accountability for producing such ideas? I don't know.

Rachel Briggs: So, let us just crack on. We have Gregory, then Paul and then Xavier. And then, we have got lots of scintillating discussion.

Gregory Jackson:

4.4 Varieties of shareholders and the sources of short-term pressures on companies.

What I will talk about is from a project that we did for the ESRC (Economic and Social Research Council). It was just last year at this time when the debate about private equity funds and hedge funds was really coming out in the press. We thought about doing qualitative research, to go out and try to interview these guys and find out what they are really doing. They did not have much interest to be interviewed, but luckily my contribution to the project was to look up some numbers and things. So what I would like to talk about is cross-national comparative research of corporate governance. When we talk about the shareholders in different countries, the shareholders are not the same and there are also some issues around the transformation of ownership. We still have not really yet got a good grasp of who the shareholders are, how they differ and how that may contribute to short-termism or who is contributing, and in what ways, to short-termism.

[Download Gregory Jackson's powerpoint presentation here]

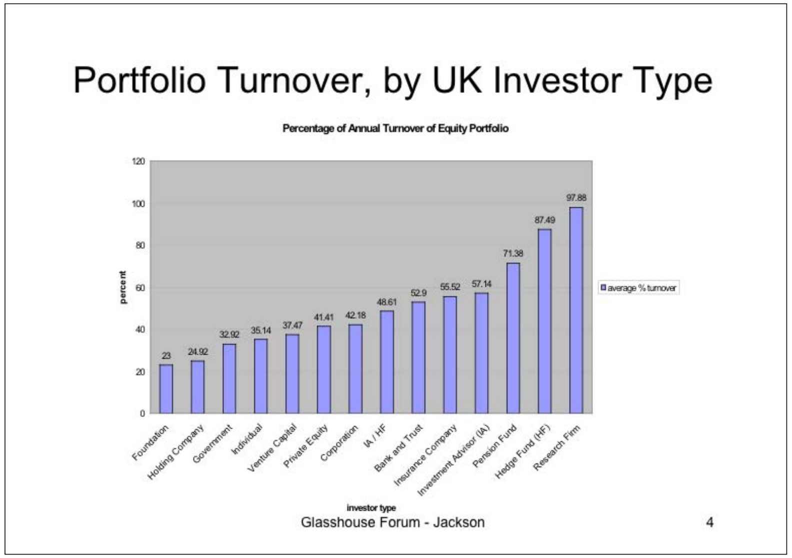
We talked about myth-busting. My favourite myth to bust would be the myth of a shareholder value. The idea of the shareholder as a single entity is a myth, and we really need to understand much better what is producing value for shareholders, value for whom.

And we also need to understand much better when and how that value is realized. Is it realized just by sitting back and collecting the dividends? Or is it actually that in equity investment, most values are realized by selling the moment that you exit the relationships? Any notion of creating or realizing value presumes exit which has some relation to a fixed time horizon, not an infinite time horizon because to realize the value you have to take it out at some point. You need to understand how the different investors actually take that value out.

When you look at the different objectives, time horizons of investors and how those relate to the different styles of involvement in corporate governance and the way investors engage or do not engage, the story that emerges in the 90s is around pension funds. The pension funds seek financial gain, but they may contribute to good corporate governance because they use index strategies and they get locked in and cannot really behave in a short-term fashion. If you diversify your portfolio, you are kind of locked in. Therefore pension funds are supposed to be kind of the saviours of American capitalism because they will be more active in exercising voice alongside exit and that will have some kind of beneficial effect. I also think that the Left in the US likes this idea of pension fund activism, because it is a long term notion.

Whereas hedge funds, yes, they also want to make money but they have very different strategies for investing and where they take the money out is also very different. And hedge funds sometimes have been very active, but that kind of activism is very different. It is very event-driven, trying to influence an event which would influence prices in a particular way and fit their strategy. It is not the kind of shareholder activism of the good benevolent long-term kind which the American Left wants. We can think of different motivations for shareholders, such as whether investors try to maximize their return on investment or have another kind of strategic reason. Ownership may be a means to some other end, such as keeping family control or underwriting some other type of business relations like in Japan.

There are different dimensions of ownership and if we look at the kind of data which we tried to calculate for the ESRC project, these show this kind of short term/long term portfolio turnover of UK investors.



This is not anybody who has invested in the UK but an investor who is an organization registered in the UK. Here [editors' note: on the left hand side in the figure] is the figure for foundations, which on average trade 23 per cent of their portfolios. That is a 4+-year time horizon. Individuals [editors' note: fourth from left] do not trade very much, although they could, I guess. Then you have venture capital and private equity. Even though private equity is not really considered a long term benevolent investor, they need a bit more time to put their money in, wait for something to happen, and take it out again, so you can see they are at 40 per cent a year. They are turning twice as much as these guys [editors' note: i.e. "Foundation"], but not as much as some of the others. Here you have the rest of the City, such as banks and trusts, insurance companies, investment advisories. And pension funds, surprisingly, up here [editors' note: at 71.38 per cent]. They are massively turning over their portfolios, although in very small steady increments because they have to realize that they have a long way. And then, also the hyper liquid,

the hedge funds, which are approaching the 1-year time horizons.

In our ESRC project, we are in the end comparing pension funds as traditional institutional investor and how they are different from hedge funds or private equity.

Comparison of Equity Portfolio Characteristics of Ten Largest UK Investors, by Type

	Number of Stocks in equity portfolio	Largest holding *as a % of portfolio*	Largest Purchase *as % of largest holding*	Largest Sale
Hedge Funds	302	15%	27%	-47%
Pension Funds	214	16%	20%	-19%
Private Equity	8.7	63%	10%	-46%

Source: own calculations, Thomson BankerOne Ownership

Glasshouse Forum - Jackson 5

Of those organizations registered in the UK, this figure shows the 10 largest. I have plucked out what they have in their portfolio, like how many stocks they own. For example, private equities have 8 or 9 stocks on average on their portfolio, so they have a small narrow portfolio. They are very committed and sometimes invest a lot in one or two firms. Pension funds own about 214 stocks and are much more diversified and they buy and sell in smaller increments. Hedge funds have the biggest portfolios. They grow quite diversified but they tend to enter and exit more rapidly. If something happens then they say: "let us take the money and get out". They have different strategies but what I am just trying to get out of this is that the way they realize the value is different, although we don't understand it very well.

These are the 10 biggest UK shareholders [editors' note: left column in the figure below].

Table 1 The Ten Biggest UK Shareholders in 2006, by Total Equity Assets

Investor Name	Investor Sub-type	Equity Assets ($MM)	Investment Style	Annual percentage turnover
Barclays Global Investors (UK) Limited	Investment Advisor	210,440.9	Index	41.16
Legal & General Investment Management Limited (UK)	Insurance Company	178,113.9	Index	19.36
Fidelity International Limited	Investment Advisor	136,796.8	Core Growth	44.63
BlackRock Investment Management (UK) Ltd.	Investment Advisor/Hedge Fund	105,658.1	Growth	56.86
JPMorgan Asset Management U.K. Ltd.	Investment Advisor	100,665.2	Core Growth	38.52
M & G Investment Management Ltd.	Insurance Company	100,138.7	Core Value	24.68
Schroder Investment Management Ltd. (SIM)	Investment Advisor/Hedge Fund	86,944.5	Core Growth	35.49
Standard Life Investments Ltd.	Insurance Company	76,630.1	Core Growth	34.57
Morley Fund Management Ltd.	Investment Advisor/Hedge Fund	74,630.3	Core Value	39.29

Source: Own calculations, Thomson Bank One ownership module.

Table 2 The Ten Biggest German Shareholders in 2006, by Total Equity Assets

Investor Name	Investor Sub-type	Equity Assets ($MM)	Investment Style	Annual percentage turnover
Allianz Global Investors Kapitalanlagegesellschaft	Insurance Company	107,053.9	GARP	48.9
DWS Investment GmbH	Investment Advisor	78,227.5	GARP	50.4
Union Investment Group	Investment Advisor	55,618.2	Core Growth	16.6
Deka Investment GmbH	Investment Advisor	43,713.1	Core Growth	26.0
Universal-Investment-Gesellschaft mbH	Investment Advisor	37,363.8	Core Growth	22.1
Volkswagen AG	Corporation	36,983.5	Strategic	6.8
Allianz SE	Holding Company	33,168.7	Strategic	0.2
Bayer AG	Corporation	25,735.2	Strategic	103.9
Pioneer Investments Kapitalanlagegesellschaft mbH	Investment Advisor	25,161.7	Core Growth	28.3
KfW (Kreditanstalt für Wiederaufbau) Bankengruppe	Government Agency	24,554.4	Strategic	12.6

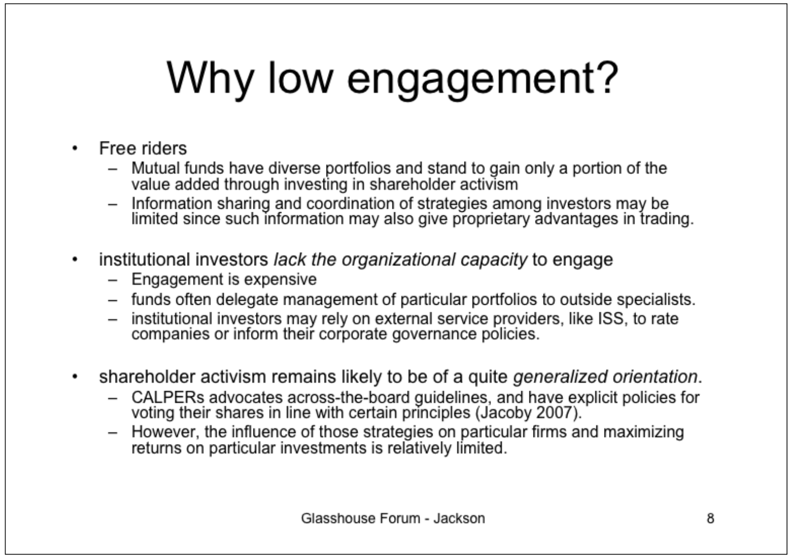
Source: Own calculations, Thomson Bank One ownership module.

If you look at the total value of the equity portfolio of the 10 biggest holders of equity in the UK – we have the Barclays, Fidelity, BlackRock, JP Morgan, M&G, Schroder, Standard Life, Morley. So no surprises here. And in the next column you have investor type – big investment banks, life insurance – and here in the following columns you have invested in dollars, the portfolio size and their turnover – this one [editors' note: Legal & General Investment Management Ltd] is 20 per cent but then you have the upper 30 per cent to 40 per cent rates every day, very big, very liquid.

If you look at Germany, there are a little bit more signs of relational capitalism or long-term capitalism. Here you have Allianz which in terms of size is about equivalent to the number 4 or 5 in the UK but again turning quite high. So these guys look pretty much like the British investors. But you also have the ones like Volkswagen who owns a lot of shares in Germany and does not sell them very much, or the Kreditanstalt für Wiederaufbau, the public banking group. The size of their equity portfolios is a bit smaller. In the UK, the City is just bigger, and there are more of these big investment funds trading. If you look at the picture in Germany, you can see something of this phenomenon but it is a little bit more of a mix of strategic investors.

What it is interesting also is the kind of diversity of instruments used – debt versus equity. Traditionally, you have the bank base and market base. These days it is interesting because of all the convertible things that make the distinction between debt and equity much messier. As for futures and options, we see a shift away from the "buy and hold" strategy of shareholders to more complex forms of risk bearing. And this is one big agenda really: how do we really understand this and how is that reflected in the notion of shareholder value or creating value for shareholders?

I have one other slightly different topic. What we found regarding the idea of activist pension funds was that this idea is an American myth. It is not really so straightforward as it looks. We try to ask why there is low engagement in the long term among traditional institutional investors.



One of the papers I circulated before this conference was my comment on another paper which is a case study of Fidelity. That study, published in the *European Management Review*, is asking why Fidelity is at the very centre of American financial capitalism, but does not seem to have any active involvement in the companies they invest in despite that they are so big. The main thing is, of course, a market failure – shareholders may free ride on other more active shareholders. If you are going to be active but you are only going to recoup part of that investment, you may choose not to engage in shareholders. What we found when we did the interviews in the UK was that most of it – be it pension funds or Morley Life Insurance – they do not really have that much capacity to engage in activism. They have just a few people, maybe 2 people who work in the corporate governance department. I am not saying they *could not* have any capacity, but they do not choose to really build up much capacity to engage on an individual company by company basis. This means that a lot of what we call shareholder activism is sort of blanket statements about some policies. I say this more like a hypothesis, as to why there could be low engagement.

Another interesting thing that comes out in the Fidelity story and from Gerald Davis' recent work on voting of US pension funds is really deep-rooted conflicts of interest. Mutual funds or pension funds adopt much more pro-management stance in corporate governance to the degree they are dependent on other sorts of business from corporations, such as managing corporate pension funds.

A lot of institutional investors engage through informal engagement which means they do not really care about voting. They just go along to the meetings, talk to the CEO and tell them what is on their mind behind closed doors. This is part of the short-termism – if they criticize a company that they own in public, the share price is going to go down. They would rather not do that and if they do have proprietary information it is much better to sell quickly and quietly first.

We want to study the sources of short-termism and I was very happy that the last session was not just about financial markets. Certainly we need to understand financial markets but also investors' incentives for exit, because exit is where you make the money, right? I think we need to study how investors realize gains and why. How come the system is biased very much to this kind of exit rather than voice? One of the things that we found with pension funds was that part of their portfolio is by hold and then a growing part of their portfolio they give to the hedge funds and to the private

equity funds. So pension funds have made money by selling on, but then they spend money over here [editors' note: speaker drawing arrows on the white board] and then they kind of get money over here when the private equity company releases or resells the company on. I started out by saying there are different types of shareholders and they have different strategies but in a way that is blurred as well because the money from traditional investors going so much into these new instruments makes studying this very complicated.

Rachel Briggs: Thank you very much. Paul?

Paul Windolf:

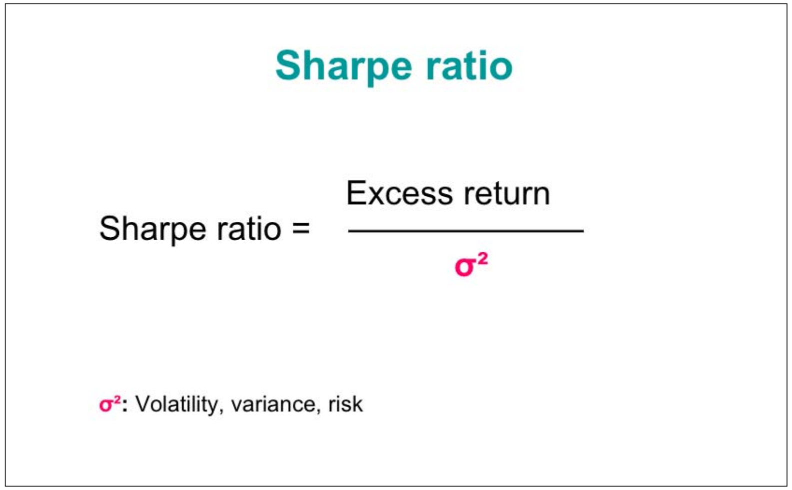
4.5 The importance of ownership structure

I come back to the steam engine. The steam engine has a life expectancy of 50 or 60 years and if you have invested in that company as an entrepreneur, your money is locked up for 60 years before you get it back because of the life expectancy of the steam engine.

The stock market has been invented because you want to get out before, because you want to be liquid at any time. The extreme case is the day traders. You sell in the evening what you have bought in the early morning. I think that is the fantastic innovation of the stock market. You can sell, you can become liquid, you get back your money anytime whenever you want and that is why I believe that short-termism is an inbuilt rationale of the financial market. It can be a long-term investment but it must not be. You can change your time horizon anytime if you have invested in the stock of a company with real investment with a very long-time horizon. Nevertheless you can exit anytime. Perhaps you remember my argument of an increasing discount rate that was given as an explanation for short-termism. Now, that presupposes that the risk in the stock market has increased the volatility. However, the slide that I have presented shows that the volatility of the stock market did not change. Therefore I was looking for a different explanation for short-termism.

My next idea was we have to look at the type of owner to explain short-termism. If we look at the model of the managerial capitalism, the managerial control, the famous formula was a separation of ownership and control. The owners have no control over the company and those who control the company are not the owners. There were buffers between the financial market and the real economy. The volatility of the financial markets did not directly affect the real economy. The share price may go up and down, but the managers will not care because they are sheltered at least under the regime of the managerial capitalism. If I express it in what we as sociologists call system theory, we say that the real economy is an environment for the financial markets and financial markets are an environment for the real economy, but both subsystems have relative autonomy. The financial markets can move through circles up and down to boost and bust without any consequences for the real economy. That is of course not the real story, but I only make a theoretical case to say that short-termism is part of the structure of financial markets.

Financial markets and stock markets have been invented precisely because actors wanted to have a short-term perspective. When we talk about short-termism in the real economy, then something must have happened at the interface between the financial markets and the real economy. At the interface we find the owners of the companies, the different types of owners. And I think what makes a difference between what was managerial capitalism and what I called financial market capitalism is that for the first time we have owners of the large corporations who compete one against the other. That is why I am looking for the reasons for short-termism in the performance of these firms. You can measure it to one decimal place; a pension fund that offers you 9.6 per cent per year is better than one that offers you 9.5 per cent. I do not know of any company that produces something in the real economy where you can measure the performance so exactly. If you buy a Mercedes, perhaps not until one year later you know what you have bought. It might break down before. But with your pension fund, you know exactly and that is why I believe that the competition is so strong in this market. Do you see the Sharpe ratio there?



The performance of pension funds and all the institutional investors is not measured by absolute return but by return in relation to the risk in their funds. If you look at this ratio, you can improve your performance by either increasing excess return, that is a very simple calculation, and private equity for instance is able to increase the return by using leverage and by introducing new risk into the economy, or by reducing the volatility, (variance, risk). So you have to reduce the volatility and one strategy for reducing the volatility is of course diversification. That is one reason why you find global diversification – because it is the only means to reduce market risk. Idiosyncratic risk or unsystematic risk you can reduce within one country. But market risk you can only reduce by global diversification. This ratio gives you an idea of different strategies. And one strategy to reduce volatility and to increase your performance ratio, the Sharpe ratio, is to go for short-term investments. Because from the starting point of your investment – you do not have hindsight – you are almost on the safe side if you invest in short-term companies or whatever, because you do not know what happens to your long-term investment.

Shivaram Rajgopal: A clarificatory question: Is the assumption that short-term investments have low volatility? Why is that?

Paul Windolf: That is precisely the question. If you look with hindsight there is no reason to believe that long-term investments have less volatility than short-term investments. But if you look at it from someone who has very limited information, it makes sense not to invest in the long-term strategy because intuitively you have a higher risk since you increase the number of events that may have positive or negative influences upon your investments. When financial analysts argue that you get more return if you invest in the stock market, that is an argument only after the fact, then you know it, but before you do not know it. You see the stock market going up and down.

This is not only a question of theoretical modelling but also of political regulation. Can we do something about it? And there is an interesting article by John C. Coffee at Columbia Law School about liquidity and control. He makes the argument that American law has constantly made sure that those actors who have liquidity have no control and those actors who have control have no liquidity. That is the reason for the extensive regulation for the institutional investors that their share of one company must not go beyond 10 per cent or whatever the limit is now. I think that is an interesting idea. It goes back to the very simple differentiation between exit and voice. Those who have control of course have the voice option. They can say to the management what to do and those who go for the exit option, that is, for short-termism, do not have control over the company. I think when we talk about regulation of financial markets it would perhaps be a good idea to think about that dichotomy.

Rachel Briggs: Thank you very much. Xavier?

Xavier Ragot:

4.6 The importance of excessive risk taking

Since Keynes many people think that short-termism is induced by the financial market and that the issue of short-termism is about financial markets. That is the way many economists put it. So what causes short-termism? I will first focus on three waves of literature.

[Download Xavier Ragot's powerpoint presentation here]

The first wave was in the early 90s in the US. The short-term actors in the economy at this stage were managers, and the problem with managers was that they are not efficient. The second wave of literature focuses on the behaviour of shareholders and the irrational behaviour of shareholders to try to understand these huge macroeconomic issues, one of which was excessive volatility. The third wave of economic literature on short-termism goes one step further and tries to understand why managers, or money managers in investment funds, are given contracts which force them to invest in the short term. The economic literature tries to understand short-termism as an endogenous economic outcome. It is not a sociological or psychological outcome, but a market failure.

If you look at the policies of money managers in investment banks and in hedge funds, you can argue that at least in some cases they are biased towards the short term. Shareholders or managers or owners of the firm or the bank create incentives to make money in the short term. Why? The answer is the very simple idea that when the music is playing fast, you have to dance fast – when there is a lot of volatility in the market, lots of events, follow them. The ultimate strategy is to benefit from arbitrage opportunity in the short run. You can understand short-termism as the economic outcome of excessive volatility.

This is a bit different from what has been said before. The cause of short-termism is the short-term excessive volatility of financial markets. At the core of the subprime crisis is high leverage. There are lots of actors in the economy who use contracts, like debt contracts, with lots of debt to invest. When you play with money, you take more risk than is reasonable to take. If you play with my money and lose it, I lose my money. But if you win, you will get all the excess return in your pocket. You will take more risks because it is other people's money.

This is possible because of cheap interest rates, and this is possible because of Alan Greenspan... Not enough regulation of investment banks, plus lax monetary policy with very low real interest rates, mean that a huge amount of credit is spreading into the economy and that financial institutions are taking lots of risks. That creates incentives to try to successfully take on all these risks in order to benefit from arbitrage opportunity in the short run and to reduce the time horizon of lots of investment banks.

What I am saying is, first, that short-termism definitely exists, and second that it is bad. So what should be done to prevent short-termism, excessive risk taking or excess leverage?

The debate going on in the US about the regulations for investment banks is interesting. There are shadow banking systems which are not regulated as banks and not by the Fed. So how do you regulate this sector of financial affairs? Investment banks themselves say "we do not want to be regulated", other economists say "we have to regulate because there is a bias towards short-termism". There are some legal issues in the debate, but I think we will end up with having to distinguish liquidity and control if we want to avoid having financial instability translate into real instability at company level.

The legal nexus where liquidity and control take place is the Board of Directors. It controls the manager, controls the everyday operating life of the firm and is at the same time the interface with the shareholders. This is the nexus where the power of the shareholders manifests itself. I think that the Board of Directors should be more representative of the various interests of both shareholders and stakeholders. This would separate liquidity and control, and that's where you see the effect of short-termism in the financial market. The other thing would be to look at the German model of long-termism and the Germans' view on independence of the Board. We cannot mimic the German model but it seems to work well on the industrial side and yields a good trade balance.

Paul Windolf: Let us think about a company with a hundred thousand small shareholders. The management announces an investment plan with a time horizon of, let us say, 7 years. During the first 3 years there will probably not be much to be gained from this investment, only after 4 or 5 years. Let us assume everybody believes this to be true, that management is honest, and that in year 6 and 7 there will be a huge profit from this company. In this theoretical experiment, what happens to the share price in the first year? If you are a small shareholder, you think about what the other 99,999 shareholders are doing. It would be stupid to invest in the first year in this company, but it is also almost impossible to invest in the year 6 – then everybody has already invested in it and then the share price will perhaps be higher than even the very high profit rate would justify. It would be irrational to do it.

What I want to explain with this experiment is that you have constantly to face opportunism and the prisoner's dilemma in a group of 100,000 small shareholders. What happens between year 2 and year 5? At what point do you expect the share price to rise and at what point do you think the first will sell? Because of the prisoner's dilemma he or she does not expect that the others will wait until the fruits are ripe because then there will be nothing left. That's why there are not many corporations engaged in long-term investments. You need a person that shelters you against the opportunism of the 99,999 small shareholders. You need a Warren Buffet, then it works.

5) Summary of day 1

Lennart Schön: The definition of short-termism is very crucial and Douglass North was mentioned earlier. If we put it in his wording, there would be a situation where there are investments potentially with a high social rate of return but low private rate of return, a few deficiencies in institutions and if we can pinpoint that, that would be one way of determining that there is short-termism – a deficiency in the economy.

I also thought about a Swedish concept launched some 50 years ago, the cause of the development blocks – that activities in different areas complement each other and support each other, mutually reinforcing the productivity and the profitability of these activities. Complementary activities were often organized in relation to banks, but could also be driven by the market if the market functioned well. In this case we may have complementary activities as well between the financial market and media for instance. We may have a development block of short-termism that is driving, producing, rather routinized, standardized information that may entice people into bubbles such as the Chinese economy, although I do not think it will burst before the Olympic Games and probably not before the World Exhibition in Shanghai in 2010. The question is of course whether short-termism is driven by the financial market itself in combination with new technological possibilities or whether it is driven by a high level of uncertainty in combination with large amounts of capital and low income distribution.

Geny Piotti: I will try to capture the key concepts that have emerged during the discussion. There is the question of uncertainty behind short-termism. These uncertainties might be of different kinds – on the one hand the cognitive uncertainties of people and actors who do not really know what will happen, what will be the consequences of their action, on the other hand strategic uncertainties, there are no incentives for other people to behave with loyalty. This dimension of uncertainty of a cognitive, but also strategic kind, is quite central to different topics that we have dealt with today. Another common aspect is the role of institutions in building incentives for long-term

orientation. I have the impression, especially after listening to the presentation about the press, that the question of standardization of information may be an expression that also calls for short-termism. This might be an interesting concept that could be attached to the question of short-termism.

Rachel Briggs: I will now ask you to sleep on a few questions overnight: First, is there short-termism, yes or no? Is it a meaningful concept? Is it really something that is taking hold that we can understand, that we can see is here now but was not here yesterday or 10 years ago. The second is: if it is, do we need to be concerned about this? Thirdly, which is the one myth you would really like to bust in this area?

DAY 2, TUESDAY 17 JUNE

6) Panel 3: Consequences of short-termism

Theme of the panel: What does the phenomenon imply for companies and owners in the long term? Is it also a threat to profitability? How are employees affected in a company characterised by short-termism? How does it affect society in general? Does short-termism contribute to the legitimacy crisis faced by capitalism and the demands for regulation?

Lars Magnusson:

6.1 Short-term investments and long-term financial security; case study: pension funds

Thank you very much. Good morning to you all. The title of the paper I wrote for this conference was "Pension Funds – A New Stage in the Development of Capitalism?". I do not necessarily believe in new stages of capitalism to be honest. But this has to some extent been presented as a new stage by several authors and that is why I chose this title. But let us see whether it is a new stage or whether this, in connection with short-termism, is something that is perhaps not as important as you might imagine. What I've tried to do in this paper is to collect some of the data and some of the opinions regarding pension funds.

Pension funds are of course very important, and in that sense it is a new stage, but they have, on the other hand, been around for at least 25 years. It was something that appeared in the discussion already in the 1970s. And at that time people like Peter Drucker talked about pension fund socialism rather than pension fund capitalism. Pension funds could be used as some kind of a tool for socialism, to socialize the economy. This view has come back very recently through influential people on the left, like Robin Blackburn, who is also discussing the possibilities to start social funds based on pension capital in order to make social investments. Blackburn's position is quite close to what Rudolf Meidner from Sweden said 30

years ago. The idea that all funds could be used in order to socialize the economy was launched in the 1970s.

Today most people will not talk about pension fund socialism, but about pension fund capitalism, and this is also why the debate on short-termism has become so important in our own time. There is nowadays a lot of money invested in pension funds that are used for buying up mainly equities. It is still a very Anglo-Saxon, and I would say very much an American, phenomenon. The role of pension funds in Europe is growing, but slowly. In countries like the United States or Britain or Holland, pension funds are huge and if you compare it to GDP, you could theoretically buy one year's production buy utilizing these funds. It is over 100 per cent related to GDP per capita. On the other hand, in countries like France and Germany, the percentage is much lower. You could buy perhaps 5 per cent or 10 per cent of one year's GDP with the domestic funds.

It is a very different picture which emerges when you look at different countries, and this has to do with traditions, politics, history, path-dependence or whatever you want to call it. But the fact is that in the European countries, the pension systems are still dominated by what we call pay-as-you-go systems, which means that taxpayers or equivalents of that are paying every year into such funds, to the state, or other bodies. This works as long as the demographic situation is not completely upset, because the share of people who work is falling rapidly and the proportion of pensioners is going up rapidly. Many states in Europe have now recognized that the demographic situation does not look so favourable, so the pay-as-you-go system is under pressure in many countries.

It is the relation between pension funds and short-termism which is our focus here. There are a lot of strong arguments about pension funds and, of course, institutional investors and increasing short-termism, but there are also different views about this. I have referred in my paper to a number of studies and a number of authors and interpreters who say that it is not necessary that these institutions should be more short-term than other investors. It would be very stupid for pension funds to invest in, for example, companies that do not invest long-term in R&D or have a very long perspective.

I especially referred to one of the main books on this by the British geographer Gordon Clark. He specifically talks about the stages of capitalism and he refers to the pension fund capitalism stage, something which will rather lead to less short-termism than to more short-termism, meaning the future will be less short-term even though we have more institutional investors. A lot of reports say that short-sightedness or myopia depends more on how the managers behave. If there are strong incentive systems for managers and top managers, that might encourage short-termism. We have seen some short-termism behaviour, with greedy managers, over the last 10 years or so.

In the paper I also discuss the financial analysts or the professional valuers who are becoming more and more powerful in this game. If they are just as irrational as everybody else and behave in a herd-like manner, that will also affect this whole game. On the other hand, it is very difficult to pin down exactly how important they are.

The last thing I discuss is the question of whether we can see a convergence towards the Anglo-Saxon model. On the one hand, it seems that we are going in this direction, the Scandinavian countries, the Central European countries, France, Germany and so on. The share of private pensions is going up partly as a consequence of the problems with the pay-as-you-go system and this publicly funded pension system that we have. When the private funds are increasing, that means that there is more capital available for such funds to be invested in equities or whatever also in Europe. But on the other hand, there are some estimates on how fast this will come up to the American share or the Anglo-Saxon share. It would take many decades and perhaps half a century if nothing very drastic happens. So there is evidence for the varieties of capitalism theory that have been developed during the last two decades or so. There are still quite big variations around and they will remain for some time still.

Rachel Briggs: Lars, can I just ask you to maybe put on your neck on the line slightly more? Do you think pension funds and the way they are behaving now are contributing towards and will increase short-termism? What is your best guess?

Lars Magnusson: Well, pension funds are big players. In that sense, they are very important to the managers. They want to show good figures in order to stay on and get bonuses and so on and so forth. But that is because they are very big players, not particularly because they are institutional owners or investors. In that sense, I think they have contributed to this kind of increased volatility and short-termism. But in principle, I do not find in the literature, or any argument, why in the long run they should behave more short-term. They will also be relying on the pension funds being used in a way so that they maximize the pensioners' capital in the long run. Right now we see a big debate in the US over this kind of destruction of capital. People are extremely angry about this and of course they want to have stable pensions, not pensions that to go up and down depending on the market. They want to have some kind of possibility to arrange or plan their life as a pensioner as well. There is a lot of anger today about the short-sightedness of these investors, and I think there will be institutional changes and political ones, some kind of regulations will be introduced.

Shivaram Rajgopal:

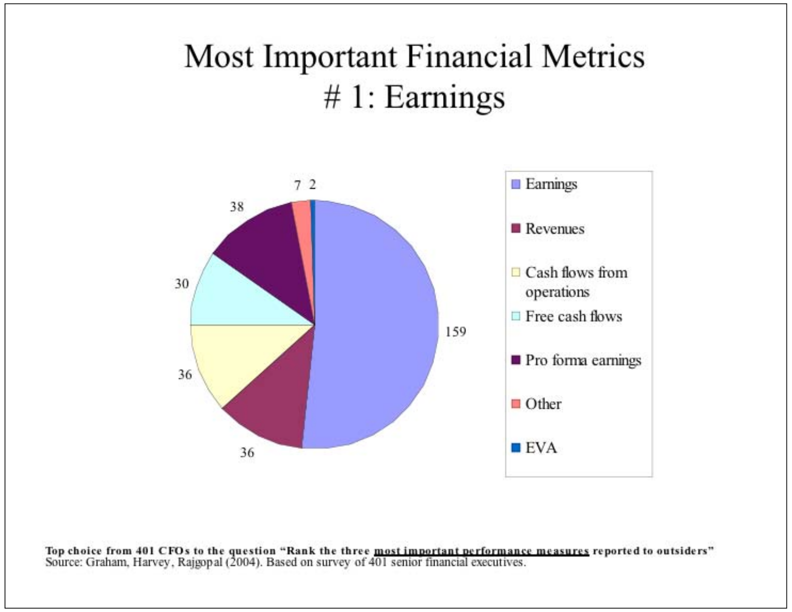
6.2 Value destruction and financial reporting – the economic implications of corporate financial reporting

I am going to present a survey of CFOs in the US. The nice part about the survey is that you actually ask decision-makers what they do. There are obviously limitations, as you know, with the survey methodology. Do they actually tell us what they think? Or, why should we look at what they say, should we not look at what they do, etc.? But we do find some interesting results here.

[Download Shivaram Rajgopal's powerpoint presentation here]

The first questions we asked was: "There are a whole bunch of metrics out there – there are earnings, there are cash-flows, there are free cash-flows, there is EVA, economic value added, and a whole bunch of things. What do you think is the most important financial metric that you guys report to the external market?". The overwhelming response was earnings. And why is it important? Well, if you believe that there is no myopia or everything is efficient, maybe the answer to this should have been cash-flows. Why should we care about earnings? But the answer was not cash-flow, it is earnings. And this sets the stage for the slides to follow.

The next question was: "Let us say your company's cost of capital is 12 per cent. It is getting to be close to the end of the quarter and you have a new opportunity that offers 16 per cent internal rate of return, and you keep risk constant. What is the probability that you will take this project in the following 4 scenarios?

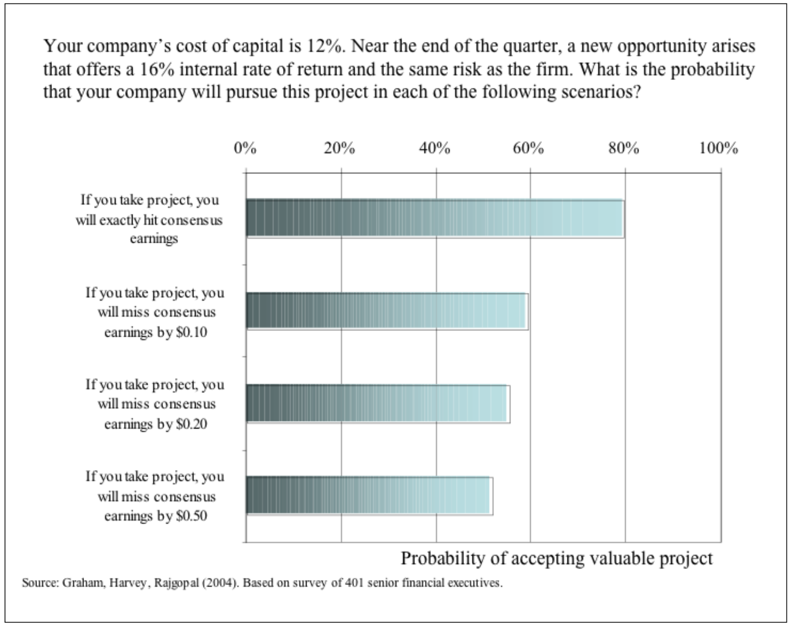


Scenario 1 says if you would take the project, you will exactly hit the analysts' consensus earnings estimate. The other scenario says that if you take the project, you will miss the consensus earnings estimate by 10¢, 20¢, 50¢. Before we look at the data, what should we expect? This is a positive NPV (net present value) project, right? The internal rate of return is 16 per cent and the cost of capital is 12 per cent. If earnings, short-term earnings – these are quarterly earnings

– do not matter, the answer should be 100 per cent throughout. Every manager should take the project. Why do we care whether we meet or beat one quarterly earnings estimate? It is trivial in terms of its contribution to overall firm value. But the results are pretty striking. Only 80 per cent of people said that they will take the project if they were to exactly hit the consensus earnings margin. 20 per cent will not take the project even if taking the project will not affect their ability to meet the analyst forecast. But if taking the project were to make them miss the earnings target, only 60 per cent would take the project.

So CFOs will essentially give up a positive NPV project just to be able to meet or beat a quarterly earning estimate. It is arguably an indicator of under-investment. And it kind of contrasts with Xavier's point about excessive risk-taking. Excessive risk-taking would argue for over-investment. So maybe in the investment banking world, we may have excessive risk-taking and over-investment, whereas in the corporate world, we have the opposite problem. People probably under-invest in projects more than they should just to manage reporting perceptions.

Another question was: "It is close to the end of the quarter and it looks like the company is going to come in below the desired earnings target, within what is permitted by GAAP. Within what is allowed by GAAP, which of the following choices would you make?"



And again, the surprising thing here is that people do not really say they would take accounting actions to meet the earnings target. The most popular answer seems to be that we will cut discretionary spending, meaning cut R&D, cut advertising, cut maintenance and this makes sense in the US context because as I have mentioned before, R&D is required to be expensed in the financial statements regardless of whether the R&D is likely to result in a valuable asset or not. So CFOs are saying that I would rather meet the earnings target and not spend money on other things which on average are value-increasing. And that is an overwhelming 80 per cent response. The second most popular response was that we will delay starting a new project even if this results in small loss in value. The third most popular response was an accounting action, that is, book revenues now rather than the next quarter. Provide incentives for customers to buy more products this year. The bottom line here is that CFOs say they would rather take real actions to lower value and meet or beat an earnings target than use accounting responses which are arguably benign and cash flow neutral. To place this in context, the

survey was done in 2004, after the Sarbanes-Oxley legislation in the US. There was a larger focus on accounting tricks to meet earnings targets. It is quite possible that the answers would have been different if we had done this pre-Enron.

The managers, we found, are obsessed with reporting smooth earnings. Every manager essentially wants an upward sloping 45-degree graph on his firm's earnings number. We are still trying to figure out why this is important. As a follow-up, we asked them: "Would you sacrifice some value to be able to report a smooth earnings path, keeping casuals constant?" And again, the interesting thing here is that 80 per cent of them said that they are willing to sacrifice some economic value just to be able to report smooth earnings.

In a way the managers are paranoid about reporting perceptions, delivering messages, spinning reality via investor relations groups, all the issues that came up yesterday. And the final point that I want to make here is: why are managers doing this? Who actually consumes these reported numbers? Who sets the stock price? The data says that the marginal price setter is institutional owners and sell-side analysts. Managers probably think that these stakeholders want smooth earnings. So, I guess the puzzle for us is trying to figure out why do these people want value destruction? Who are these people?

Just to wrap up: do you think myopia is going on? I think the managerial labour market is less efficient than the stock market. So if you want to look for myopia, the managerial labour market might be the place to start. That would be the place to invest time in trying to figure out why this is happening and what can be done about it.

Gregory Jackson:

6.3 The influence of capital markets and short-termism on employees and companies

What I am going to talk about today is a mix of several research projects on trying to understand how changes in corporate ownership and finance influence the employment system.

[Download Gregory Jackson's powerpoint presentation here]

The basic idea, at the country level, is that there are different models of capitalism. In countries like the UK, where you have market-oriented corporate governance based on active stock markets, takeovers and things, you also have a very market-oriented employment system with market flexibility, short-term employment contracts. In countries like Germany and Japan which have a long-term employment system, employees are participating as stakeholders in the company. In these countries, a possible prerequisite for this was a kind of corporate government system that is more bank-oriented, where companies were protected from hostile takeovers and therefore institutional limits were placed on the problem of short-termism. This made possible the German production system and Japanese type of capitalism. The convergence idea is that countries like Germany have changed to a slightly more market-oriented corporate governance system and this change is expected to have some impact on the employment system.

Let's look at some country level indicators such as the whether ownership is dispersed or concentrated, the family owners, or whether the shareholders' rights are protected etcetera, and correlate that against labour indicators like whether employees sit on the Board of Directors.

Table 2 Correlation of corporate governance and labour management in OECD countries in the mid-1990s

	Employee board	**Unionization**	**Employment protection**	**Long term employment**	**Downsizing rate**
Corporate governance indicators					
Dispersion[a]	-.18	-.03	-.60*	-.69*	.33
Concentration[b]	.04	.05	.51*	.35	-.33
Family owner[c]	-.21	.03	.35	.09	-.09
Investor rights[d]	-.21	-.13	-.54*	-.52*	.13
Accounting rules[e]	.14	.30	-.58*	-.38	.39
Private pensions[f]	-.23	-.08	-.63*	-.47*	.10
Market cap.[g]	-.34	-.20	-.48*	-.33	.48*
M&A[h]	-.16	.24	-.53*	-.56*	.46*
Bank restrictions[i]	-.30	-.18	-.07	.06	.08
State banks[j]	.29	.06	.52	.32	-.11
Labour indicators					
Employee Board[k]	1	- -	- -	- -	- -
Unionisation[l]	.56*	1	- -	- -	- -
EPL[m]	.20	-.06	1	- -	- -
LTE[n]	.16	-.03	.71*	1	- -
Downsizing rate[o]	-.20	.00	-.34	-.40	1

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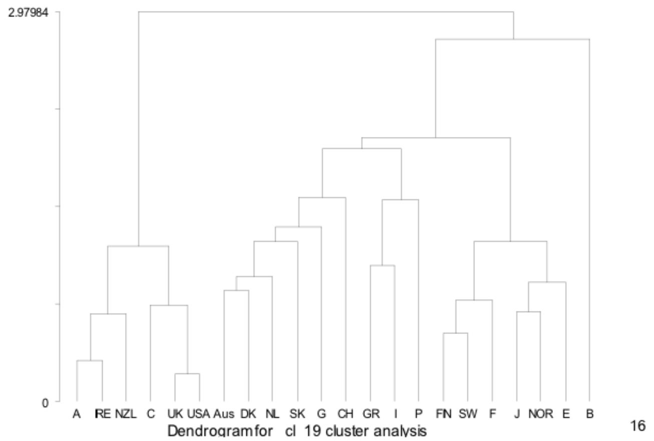
Actually, there is no correlation with union membership rates. But, for example, employment protection has a very strong, negative correlation in countries with dispersed ownership that tend not to have employment protection law. There seems to be a very strong negative trade-off between protecting shareholders and protecting employees. Why? There is no real theoretical reason why you could not protect all stakeholders, but countries do not seem to do these two things together. Then look at the OECD measure of average tenure of employees: how long on average do employees stay with the same company? Again, in both of these, you find this negative correlation so that dispersed ownership is associated with shorter tenures or, say, more private pension funds have shorter tenures.

If you put all those data into cluster analysis, you get two big clusters. Here are all the countries that speak English: Canada, the UK and the USA and they fall into a pretty homogenous group. They have market-oriented capital market and market-oriented employment systems.

Figure 2 Country clusters based on finance, governance, and industrial relations measures

The clusters are based on average linkages between ownership dispersion, investor protection, pension assets, downsizing, and employment protection.



The rest of world is more heterogeneous. This is a Scandinavian group with Norway, Sweden and Finland but also France and Japan. And you get some of the Latin countries over there. You can look at the rest of the world, yet they do not all fit neatly into the coordinated model of capitalism, unless of course you might say the Latin model in Europe, where the unions are not so powerful, is just the same as Scandinavia even if employment tenures are quite different. The model actually fits and describes these countries but the linkages are maybe not so tight as we look at all the other countries. As we are studying these countries facing some pressure, you might expect different effects in the different countries.

How do we study that issue? We need to disaggregate our analysis a bit and get away from this broad country typology. If we think of corporate governance, there are different dimensions of that. Maybe the ownership has changed? Do they have outsiders in the Board of Directors or not? Do they have to pay stock options or not? Is there an M&A market? Are there hostile takeovers? Yet again, what kind of changes are we talking about? What kind of changes in terms of labour market? Are we talking about downsizing? The basic story would be something like this: as companies

move toward lots of shareholder value, this notion of caring about the stock price, how would it really affect labour? Can you correlate into a few pretty robust things? And related to that: what kind of incentives for a drive to more performance-based pay?

I tried to research on these issues in Japan. There is a banking crisis in Japan and the proportion of foreign ownership has gone up to about 28 per cent. In terms of turnover – kind of short-termism – in the Japanese market, about 15 per cent is accounted for by foreign institutional investors. As foreign ownership increases, does that mean companies are more likely to lay people off? The degree of foreign shareholders has no significant influence on the likelihood of you downsizing or not, which is quite contrary to what you might expect. Also if you do downsize it has a small positive effect on your share price, which we did not expect under the short-termist hypothesis. Companies like Toyota, they have a huge number of foreign shareholders because they are a great company to invest in but it does not really mean that they automatically are thinking: “Oh, we have to do everything these shareholders say”. It is not that simple.

What is interesting is the company management, where if you adopt stock options, the company is much less likely to keep lifetime employment, or if you maintain the kind of insider board then you are more likely to maintain the lifetime employment system. The causal flow is perhaps not so direct from the shareholders to the employees. Rather, shareholders may or may not influence the board and the board can influence employees. It is interesting to tease out these links! Managers may try to do some kind of decoupling where they respond using different strategies.

By contrast, the changes in capital markets have fed in much more strongly into the kind of managerial incentives and changes in careers. German companies are much more willing or happy to adopt stock options than in Japan. Maybe this is because the career structures of Japanese management are rather different from European countries. So Japanese companies, even though labour is kind of weak compared to say Scandinavia or Germany, actually have remained much more resistant to implement this kind of short-termist or shareholder-value ideology.

Just to show you the percentage increase in value added of company and the shares paid to dividend stakeholders:

Table 10.8 Average Annual Percentage Changes in Value Added

	Value added	Labor	Directors	Interest	Rent	Dividends	Tax	Firm
1980 to 1986	5.49	7.38	8.56	−1.01	5.62	6.18	4.61	7.18
1986 to 1997	3.73	6.06	11.10	−1.30	13.28	4.39	2.58	0.85
1997 to 2001	−5.23	−0.75	−3.31	−5.97	0.74	0.30	−11.14	−16.02
2001 to 2005	10.40	−1.35	17.51	0.22	0.71	35.52	32.15	136.09

Source: MoF Yearly Statistical Survey of Business Corporations.
Refers to all corporations with capital of over 1 million JY.

- Directors earned 1.9 to 2.2 times average workers salary in period 1980-2001, but increase to 3.1 in 2004 and 3.4 in 2005.

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In the 80s, and then up here in mid 80s to mid 90s, the economy is growing, revenues are growing and everybody is getting something; shareholders getting dividends; directors, their salaries are increasing; labour is increasing; the state gets more tax money. Then we go to the recession period, the economic crisis from 1997 to 2001 and the labour share is plus/minus zero, and managers are being modest during this period. The banks are really suffering. The state is not getting much tax and the company is eating up its reserves. Now, we see a very dramatic recovery for big corporations in Japan since 2005 and what is interesting here is that a positive sum relationship has turned to a negative sum relationship. Despite the growth, the share of employees is going down, whereas the director's share is increasing very rapidly and there is an explosion of dividends even though they start from a very, very low or near-zero level of dividends and of course the finances of the state recovering somewhat. At the same time, the company tries to shrink the core of the good lifetime jobs. It is harder and harder to get these lifetime jobs and the

overall position of labour as a stable factor in the economy seems to be changed.

Last bit of information, this is the 20 or so largest German and British non-financial companies in the year 2000.

Table 2 Corporate Performance, Selected Averages 2000

	Germany	United Kingdom
Real returns to capital		
Price-earnings ratio	17.8	21.5
Dividend yield	2.7%	2.6%
Return on equity	18.2%	20.4%
Market valuation		
Market value (mill. euros)	20,754	42,337
Ratio of market value to turnover	0.51	2.14
Market value per employee (mill. euros)	0.14	0.97
Price-book ratio	2.5	4.6
Sales, profits, employment		
Turnover (mill. euros)	38,122	22,015
Return on sales (EBIT to sales)	9.4%	19.2%
Employees	138,072	60,676

Source: Handelsblatt Europa 500, Handelsblatt June 11, 2001. Averages are calculated from the 19 largest British and 20 largest German industrial firms belonging to the "Europa 500." For computational purposes, negative values or price-earnings ratios exceeding 50 were dropped.

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We did this for a paper on the case study of Mannesmann and we wanted to look at whether Mannesmann is poorly performing and whether German companies are in danger of being taken over. What we found if we look at the real returns to capital: price-earnings ratio, dividend yield, return on equity – these are pretty close in mature economies. So if you are an investor in Germany, you invest in the stakeholder-oriented companies and you are getting one and same rate of return as if you are a British investor, you invest in the British companies, which care about the shareholders so much more. So, what is the issue about short-termism on the stock market? Well, what is interesting about Mannesmann compared to Vodafone is that Vodafone is a much younger company that has this huge market value and they could use this to swap their shares and take over the 110-year-old industrial giant in Germany and smash it to bits and set it off, and keep part of the company.

This data shows a very different national pattern of market valuation which probably reflects the supply side of pension funds building up in the UK. The average stock market value in euros of these British companies was about twice as big as the ratio of the financial economy to the real economy. Market value to sales is about 4 times higher in the UK, market value per employee is 5 times higher than the price-book ratio, and German companies having higher turnover. There seems to be something going on here about the relation between the financial economy and the real economy. You can have the same marginal rates of return on stock investment, but here at a much higher level relative to the real economy. So to get the same 20 per cent return on equity, these companies have to produce much more profit in absolute terms than the German companies. They seem to have different distributive patterns in the real economy which underlie different patterns of financialisation. No academic papers really talk about this and my co-author and I have been thinking about it for six years. We have to go back and really study this across Europe but there seems to be something going on here which is interesting which would be a kind of consequence of short-termism.

7) Summary of the two days

Lars Magnusson: The first point is obvious, namely that it is difficult to define and also identify short-termism. There are different definitions around this table. It has to be clarified what kind of definitions we have; what kind of measuring stick to measure short-termism. You can have a more restricted kind of definition and talk about it, especially as Shiva has done, about value destruction. This is concentrating on the financial market but you could also have some more overall definition, as Lennart has, and speak about under-investment in for example infrastructure or in social capital which leads to higher returns now that could probably lead to lower returns in the long run. If we talk about financial market myopia and the causes of that – and there have been several suggestions around both yesterday and today – I think it was Shiva who started talking about this and mentioned that especially the time at the top job level is very short. It is a very important point, the time horizon of most managers is not like for academics. We are here forever it seems, but these people are moving very rapidly from one point to another and they are employed in order to do something. When you bring in a new manager, the whole idea, both in the public and the private sector, is that a new leader needs to do something in the first two years, or the first 100 days. Whether it is good or not is debatable, but he or she has to do something. And this, of course, affects these time horizons we talked about. I am certain about that.

You also mentioned the quarterly earnings reports. Of course, there has been a lot of discussion about that and how it affects the behaviour of managers. I said something about the incentive systems of managers at the managerial level running through this whole debate about greedy managers and their incentive systems and bonuses systems that are connected especially to the shareholder values or stock values development. There is empirical evidence for that. What I am a bit confused about is whether these new institutional owners prefer short-termism *par excellence* more than other kind of owners. I'm not certain, you could argue in both ways.

The third kind of issue that we have discussed is the question that lingers here all the time: whether we also, behind the financial market myopia or short-termism, can see a more general problem which affects a much broader spectrum of the economy and also other parts of society. You were talking about the labour market and we talked about other markets as well, the other parts of society which are probably also affected by this kind of short cycles or decreasing time horizons. We do not know yet; it is a very important question but it is very difficult to pin it down and see how this works and, of course, you want to find a single cause behind this, and that would be great, but I am not certain you can find that.

I also think there is some nostalgia in this. Every generation so far has said that our generation – and I mean the generation that we come from – in those days it was much more stable and we could plan our career futures and we could even have lifelong employment. But that is not true. We talk about the 50s, these "golden days of capitalism". It is not true for the majority of people and already in those times there was flexibility in the labour market. One forgets that. It is very easy to have this kind of nostalgic view about the past. This does not, of course, lead to the conclusion that short-termism has not increased. But it is an open question.

The fourth discussion we had was the role of journalism and the role of financial analysts and we talked about boundary spanning. Bodies like Standard & Poor and all these kinds of firms that evaluate the conditions of companies, on behalf of pension funds or whatever, are of course very important players. They are probably – hopefully – well informed but any kind of information is always to some extent biased and they might overreact and they might sort of look in the wrong direction or make mistakes which become very important in the economy as a whole as these valuators as a group are so important.

From my point of view, the most interesting question is the one about convergence. Is the world becoming Anglo-Saxon? If short-termism is more a phenomenon of the US financial economy, or perhaps the UK and the English-speaking world, will the rest of us follow the same path? If you look at the evidence now, it seems that we are slowly moving in that direction but very slowly, and unevenly for different countries.

The final thing that I would like to say is that over the last 15

years or so there has been a discussion about the return of the owners, the decline of managerial capitalism and the rise of shareholder capitalism. Well, I think our discussion has shown that it is much more complex than that. It is a very complex relationship between the managers and owners which, it seems to me, is changing or has changed. It is perhaps much more fruitful to look into that, rather than to say that the owners are back in full force because it is not the same kind of owners that we had 50 years ago. Are we living in managerial or shareholder-value capitalism?

Rachel Briggs: Thank you very much. Now, I will quickly go around the table for the answers to the first two questions: Short-termism, is it here? And, so what?

Lennart Schön: I would say that there is certainly under-investment in long term items and a shortage of long term perspectives but I am not quite sure that this is due to the capital market or the financial market function but perhaps rather to the market environment. There are a number of fundamental uncertainties that need to be straightened out within the next couple of years or within the next decade when taking into account the massive changes globally with the diffusion of industrialization, with the changes in the basic price structures, particularly natural resources and energy, and with the climate change issue. This leads, among other things, to the need to create new infrastructures where we integrate the internet, cars, electricity and the railways, thus infrastructures from different generations, into a new system. It will also need institutional changes and a clear goal in that direction. If we get there, we will go into a situation where there will be a massive flow of investments into more long-term areas. It is not certain of course that this will happen. There are real political and institutional issues involved here but I cannot see that the financial market itself would be a hindrance for such a development.

Paul Windolf: I do not have the crystal ball, sorry. But first I defend my stages of capitalism. I go back to Max Weber for this methodological idea of the ideal types. Max Weber explicitly said that ideal types are exaggerations of reality. That is to say we put forward particular structures or features of what we observe, the exceptional things, as an instrument to understand what is going on. And I would say that we have a new stage or different stage of capitalism. I think that the first structural change is the change in ownership. There is a nice saying of the famous banker Fürstenberg in Berlin. It was already before 1928. *Aktionäre sind dumm und frech. Dumm, weil sie Aktien kaufen, und frech, weil sie dann noch Dividende haben wollen.* “Shareholders are stupid and insolent. Stupid because they buy shares and insolent because they still want to get dividends.” It would be something that you could not say in these days. We now have professional ownership. These are professionals. They went to business schools and learned all the tricks.

My next point is that for the first time we see very tough competition not only on product markets but also among owners of the large corporations. That is a new structural phenomenon that we did not have before. Shareholders of the managerial age did not compete one against the other. The target was not profit maximization but you had to produce satisfying profits and that was it. Now the owners compete one against the other. I do not believe that short-termism is an explicit purpose of the new owners but it is an unintended consequence of the competition for higher and higher profits, under which the new owners have to operate. So, I would rather define short-termism, if it exists, as a kind of market failure. We can observe it in many markets.

Where is the entrepreneurial function in this system? Do managers still have the entrepreneurial function if they stay for only two years with the company? The data set I have available shows that until the 1990s the American CEO had a tenure with his firm of about 15 years before he became CEO. We are now observing a dramatic decline of tenure of the top-management. I think a very important question that is closely related to the problem of short-termism: where is the entrepreneurial function in this system? Is it with the pension funds? Are the pension funds the entrepreneurs? Are the managers still the entrepreneurs but only looking at stock options? And what kind of entrepreneurship is it if you only look at stock options?

Gregory Jackson: Does short-termism exist? Yes, I think it exists. There is some debate, but the locus of it is: it is the problem of the shareholders, it is the problem of the managers, it is the problem of the analysts and information intermediaries. It is all of that, the game the actors are playing, the actors define the game or the game defines the actors. It is a system of interlocking incentives. It is kind of merry-go-round which creates short-termism. I think it does have real consequences although they are very hard to measure.

Jaan Grünberg: Short-termism, yes or no? Yes, definitely. I think it is probably some kind of basic human property to seek immediate gratification knowing full well that it might have detrimental consequences. We need institutions that prevent us from this and of course we are adaptive, so the institutional arrangements fail after a while. We talked about the managerial labour market and the incentive contracts which might very well have had an important function in the 1980s and the changes of the large corporations and the waking up of the American conglomerates facing the Asian competition. Good things were done then probably, but now we see some of the detrimental consequences of it. We will have to live with it but we can live with it in a wise way or an unwise way. Then, another thought here, when we speak of short-termism we are dealing with a future time horizon, but I wonder, could we not turn it around and think about what the time horizons looked like in the past? Perhaps we can study how those time horizons changed, and it might also be interesting to see what the path-dependencies are, how our view of history influences the view of the future. Is that changing in some way?

Xavier Ragot: The answer is yes, short-termism does exist because the consequence is under-investment in long-run projects, meaning innovation, diversification of markets or countries or technologies.

Shivaram Rajgopal: If you want to do one thing, I would say let’s go out and measure indicators of managerial and market myopia. Even if it is very hard to measure things, we should take that one as a sort of a challenge. I mean, let us go out there and find measures even if they are imperfect in isolation. When you put them together, perhaps you might find something. But I think measurement is crucial. In terms of whether myopia exists, yes, I believe managerial myopia does exist. However, I do not believe there are massive market failures. There might be some but it is probably more in managerial and labour market. I am less convinced about stock market myopia. In terms of consequences, under-investment in the non-financial sector and perhaps over-investment and excessive risk-taking in the financial sector.

Geny Piotti: The idea that I have is that short-termism is a sort of orientation which is potentially present at every stage of capitalism, but that rules and ideas can lead to an acceleration or a weakening of short-term orientation. I like the idea of interlocking incentives and to see how different incentives are acting together and enhancing or reducing short-term orientation. But the possibility to be short-termed is always there.

Appendix
Participants' biographies

Rachel Briggs
Rachel Briggs is Director of the charity, Hostage UK, which is chaired by former Beirut hostage Terry Waite. Hostage UK aims to provide support to hostages and their families, and provides educational services for organisations sending employees to kidnap hotspots. She does this on a part-time basis, and combines it with freelance research, writing and policy advice. Rachel has written a number of reports, which have impacted on government and business policy. She is associate editor *Renewal* journal, a member of the Steering Group for the UK Foreign Office's Global Opportunity Fund's Economic Governance programme, a member of the Academic Council of Wilton Park (an executive agency of the Foreign Office), a Council member of the Risk and Security Management Forum, and a member of Glasshouse Forum's Advisory Board. She was previously Head of International Strategy and Head of Identity Programme at Demos, and Risk and Security Research Programme Manager at The Foreign Policy Centre.

Kay Glans
Kay Glans is Editorial Coordinator of Glasshouse Forum. He started his career as a freelance-writer for the Swedish daily newspaper *Svenska Dagbladet* in 1979. Recurrent themes in his essays are psychoanalysis and its relation to literature, and German and Austrian history and culture in the twentieth century. He published his first book of poetry in 1980 and a second collection in 1986. He has written the manuscript for a documentary about Vienna for the Swedish Television, worked for the Swedish Radio and was vice president of the Swedish PEN-club 1987–1990. In 1995 he became editor of the essay-section in *Svenska Dagbladet* and in 2001 he started the magazine *Axess*, published by the Ax:son Johnson Foundation. He was editor in chief for the magazine until August 2006 and simultaneously member of the advisory board of the Foundation. In that capacity he was also involved in research funding, book publishing and the Engelsberg conferences.

Maria Grafström
Ph.D., Department of Business Studies, Uppsala University, 2006. Researcher and lecturer at Uppsala University's Department of Business Studies, 2003–2007, and media analyst at Cision since 2007. Her main research interest concerns the relationship between media and corporations and how media participate in creating conditions for corporations. More specifically, the development and organisation of business newspapers, content and production of business news, and how management models, such as CSR, are created and spread via the media.

Jaan Grünberg
Dr., Department of Business Studies, Uppsala University, Sweden. Grünberg's research deals with management and governance in large complex organizations. Issues that deal with corporate governance are a particular focus, for example concerning the relations between owners and executives. In his research both informal processes and the influence of formal regulation corporate governance are dealt with. His studies cover both private enterprises a public administration.

Gregory Jackson
Gregory Jackson is Professor of Business and Society, University of Bath, School of Management, UK. He received his PhD from Columbia University, USA. Gregory Jackson has published widely on the topic of corporate governance, particularly cross-national comparisons of Germany, Japan, the UK and USA. His research centres on how employment relations are influenced by diverse organizational and institutional contexts. His research compares the 'shareholder' and 'stakeholder' models of corporate governance in different countries, and explores the impact of global capital market and M&A activity on employment stability, skill formation, and employee participation. His previous positions were at the King's College in London, the Max-Planck-Institute for the Study of Societies in Germany and the Research Institute of Economy, Trade and Industry in Japan, and currently he is a member of International Advisory Board of the British Journal of Industrial Relations.

Johanna Laurin
Johanna Laurin is Head of Glasshouse Forum and Head of Research and Communication at the private investment company Proventus. Before joining Proventus and starting Glasshouse Forum, she was Research Director and Project Manager at the Swedish think tank Centre for Business and Policy Studies (SNS) where she ran research projects on media and democracy, journalism and PR, and women on top positions in business, as well as initiated and managed Swedish and European networks for young leaders. Prior to that she finished her MSc in Comparative Politics at the London School of Economics and worked as Arts Officer and Public Affairs Officer at The British Council in Stockholm.

Lars Magnusson
Lars Magnusson is Professor in Economic history and Vice-rector of Uppsala University. His research interests include three main fields: 1. History of economic thought in Sweden and Europe, mainly 18th and 19th century. 2. Regulation and Political Economy in a historical perspective. 3. Swedish Model of labour market relations in a comparative perspective (1930–2005). Lars Magnusson is a Member of the prize committee for the Swedish national bank's economy prize in honour of Alfred Nobel, Member of the Royal Academy of Sciences, Sweden, Member of the Scientific Committé of Observatoire social europeienne, Brussels, Editor (with J Ottosson) of Economic and Industrial Democracy (Sage) and Chairman of the SALTSA programme on European Research concerning working life issues.

Geny Piotti
Geny Piotti is since 2005 Research Fellow at the Max Planck Institute for the Study of Societies, Cologne, Germany. Her research interests include internationalization of markets, social capital, comparative industrial organization and restructuring processes, and local economic development.

Xavier Ragot
Xavier Ragot is Associate Professor at the Paris School of Economics and researcher at the CNRS. His fields of interest are macroeconomic finance and macroeconomics, and he is now working on the macroeconomic implications of financial imperfections. He has been chief economist at the French Agency for Industrial Innovation and is economic adviser at the Compagnie de Saint-Gobain. He graduated at the French Ecole Polytechnique, completed a PhD at CEPREMAP and he made post-doctoral studies at MIT Economic Department.

Shiva Rajgopal
Shiva Rajgopal is the Herbert O. Whitten Professor in Accounting at the University of Washington. He has published extensively in top tier finance and accounting journals. He is an Associate Editor at *Contemporary Accounting Research*. In 2006–7, he received the American Accounting Association's Notable Contribution to the Accounting Literature Award, the Financial Accounting and Research Section's Best Paper Award and the Graham and Dodd Scroll Award given by the Financial Analyst Journal. He was recently appointed to the Financial Accounting Standards Board's Research Initiative in their Survey Research Program.

Daniel Sachs
Daniel Sachs is the CEO of Proventus AB, a private company based in Sweden that invests internationally in companies in need of change and which provides growth and restructuring capital to mid-sized companies. He is Chairman of the Board of Design Research Ltd, BRIO AB, J.Lindeberg AB and Nordic Broadcasting Oy, as well as Member of the Board of Artek Oy and Proventus AB. Daniel Sachs is also Member of the Board of Dramaten (The Swedish Royal Theatre) and Umeå University and, through Proventus' involvement in the Jewish Theatre and Magasin 3 Stockholm Konsthall, engaged in the arts. Daniel Sachs was nominated Young Global Leader by the World Economic Forum in 2007. He is a member of the European Council on Foreign Relations and is the Chairman of the Concerned Capitalists Foundation, the foundation behind Glasshouse Forum.

He holds an MBA from the Stockholm School of Economics and The Wharton School at the University of Pennsylvania.

Lennart Schön
Lennart Schön is Professor in Economic History at Lund University and Vice Dean at the Lund University School of Economics and Management. His research is mainly devoted to the analysis of technological change and long term economic growth. He has, inter alia, constructed models of long cyclical processes. Publications in English include "Electricity, Technological Change and Productivity in Swedish Industry 1890–1990", *European Review of Economic History*, Vol 4:2 (2000); "Swedish Industrialization 1870–1930 and the Heckscher-Ohlin Theory", in Findlay, R. et.al. (eds.) *Eli Heckscher, International Trade and Economic History*, MIT Press (2006); "Technological shifts and convergence in Europe since 1950", *Scandinavian Economic History Review* Vol 5 (2007).

Paul Windolf
Paul Windolf is Professor of Sociology at the University of Trier, Germany. He was a fellow at Wissenschaftskolleg in Berlin 2005/2006. His area of research is corporate networks and comparative structural analysis of economical systems. Publications include: *Corporate Networks in Europe and the United States*, Oxford 2002; "Korruption, Betrug und 'corporate governance' in den USA: Anmerkungen zu Enron", *Leviathan* 31, 2003; "Was ist Finanzmarktkapitalismus?" in: P. Windolf (Ed.), *Finanzmarkt-Kapitalismus. Sonderheft 45 der Kölner Zeitschrift für Soziologie und Sozialpsychologie*. Wiesbaden: VS Verlag, 2005.

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