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HARVARD LAW SCHOOL

Short-Termism in European Corporate Governance

Conference Summary

Supported By

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Prepared by

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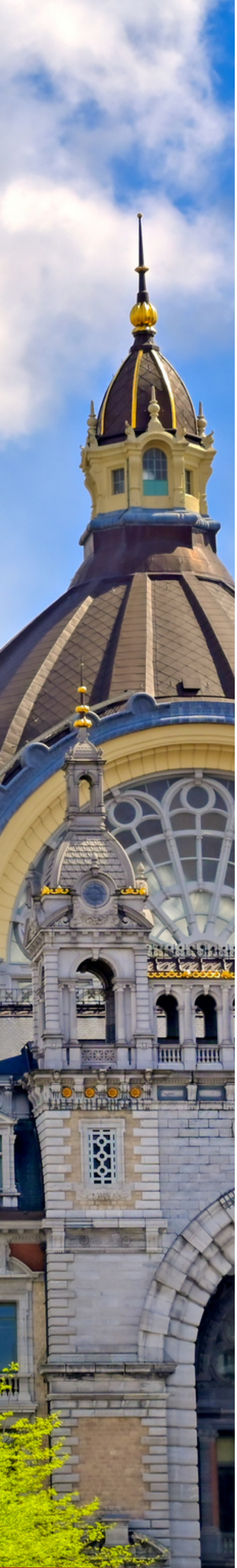

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EXECUTIVE SUMMARY

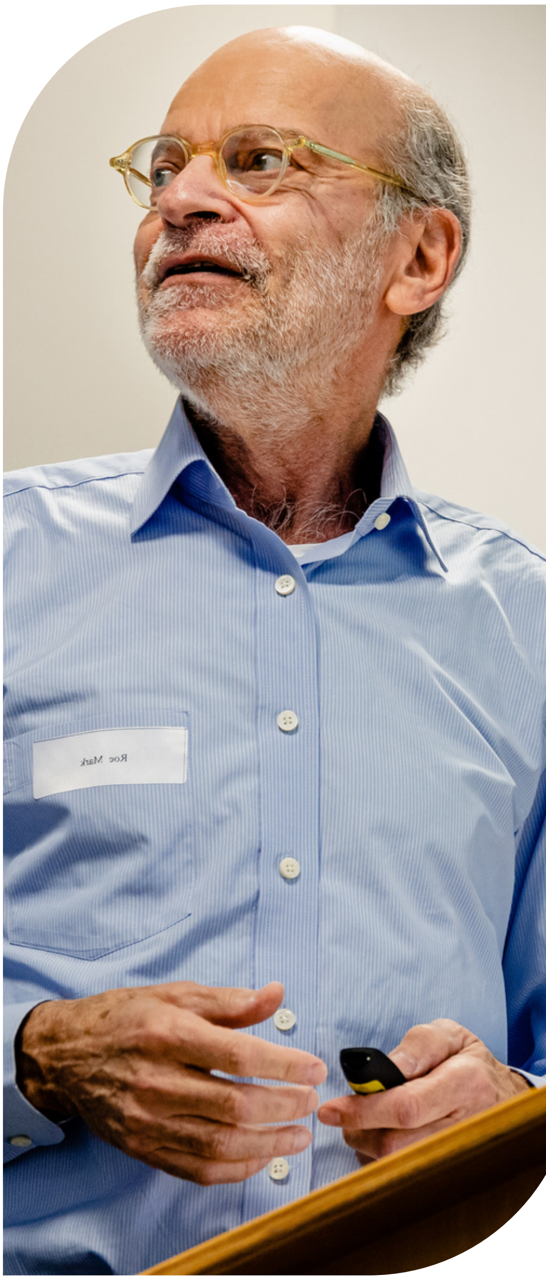
On 30 May 2023, the Jean-Pierre Blumberg Chair at the University of Antwerp, Harvard Law School, and the European Corporate Governance Institute (ECGI) organised a conference on short-termism in European Corporate Governance, with the financial support of Gimv. The conference's main goal was to improve the understanding in Europe of short-termism in corporate governance, as much of the current academic and societal debate on short-termism has focused on the US and UK. Focusing on European corporate governance is important, given that it differs in a few fundamental respects from corporate governance in the US and the UK, including the important role that large reference shareholders typically play in European corporate governance.

The conference started with a keynote from Mark Roe in which the issue of stock market short-termism was introduced. Roe argued that the problem of short-termism is inflated due to policymakers who conflate corporate short-termism with corporate social problems and that the empirical evidence on short-termism remains inconclusive. In addition, Roe briefly commented on the cures for short-termism and their costs and presented different arguments which could explain the fixation of the public discourse on the phenomenon.

During the different presentations afterwards, speakers and discussants commented on different aspects of corporate governance and their positive or negative impact on short-termism. First, Xavier Baeten and Holger Spamann discussed the topic of executive compensation and presented some empirical evidence that illustrates the complex relation between different remuneration schemes and the financial and ESG performance of a company. Tom Vos and Federico Cenzi Venezze then analysed the missing role of controlling shareholders in the short-termism debate. Vos presented two conceptual models that can explain short-termism and argued that controlling shareholders can have a positive impact on short-termism depending on the circumstances and type of controlling shareholders. Their discussion was followed by a panel discussion on loyalty shares. The panellists presented empirical evidence on the use of loyalty shares in Italy and Belgium and agreed that loyalty shares are in practice mainly a control-enhancing mechanism that serves controlling shareholders.

For the second keynote, Zacharias Sautner gave an overview of the empirical evidence on short-termism and concluded that although some indicators hint at a short-termism issue, there is no conclusive evidence of a systematic problem. Next, Sofie Cools and Anne Lafarre analysed the role of shareholder activism in short-termism and corporate ESG performance. Jesse Fried and Theo Vermaelen then critiqued the fixation of policymakers on shareholder payouts as proof of short-termism, before Kim Willey and Roy Shapira questioned the efficiency of quarterly reporting reforms in the fight against short-termism. In a final panel discussion, some prominent Belgian practitioners were invited to share their views on short-termism. The panellists discussed, among other things, the tension between investors' short-term focus and companies' long-term vision, the role of controlling (family) shareholders and the impact of ESG parameters on corporate decision-making.

KEYNOTE: SHORT-TERMISM: WHAT IS IT? AND HOW BIG A PROBLEM IS IT?



After a welcome by Tom Vos, Mark Roe started the conference with a keynote on four major issues about stock market short-termism. First, Roe focused on the lack of a clear understanding of the boundaries of short-termism in the public discourse. Issues that relate to the sustainability of companies are often misdiagnosed as short-termism, while in fact they follow a different logic. Corporate short-termism can be defined as favouring current profits over long-term profits and it originates from a distorted time horizon of investors.

Typical examples in this instance are low levels of investment, declining R&D and more stock buybacks. In contrast, corporate social problems, such as companies damaging the environment and planet or mistreating stakeholders, are not primarily due to time horizon failures but are rather due to the ability of companies to externalise the social cost of their actions. Given that policymakers often conflate both problems when proposing policy changes, Roe reiterated the importance of not over-aggregating the issue of short-termism.

Second, Roe discussed some of the macro and firm-level evidence on short-termism. Concerning the macro-level evidence, empirical studies are divided on the severity of the problem. Moreover, Roe emphasised that policymakers should mainly focus on economy-wide data and not on the short-term behaviour of some individual companies in order to overcome the so-called "partial equilibrium" problem. The firm-level evidence also appears to be divided and sometimes even ambiguous. Overall, Roe concluded that policymakers should not assume that there is a severe case of short-termism as the evidence remains inconclusive.

Third, the cures for short-termism and their costs were briefly analysed. Typical policy solutions propose to weaken the power of shareholders inside a company in order to insulate management from the short-term pressure of the stock market. Other cures also focus on dampening trading with, for example, tax incentives or lowering the reporting frequency of companies. However, given the inconclusiveness of the empirical evidence on short-termism and the questionable assumption that managers are more long-term than the stock market, Roe argued that these cures should be carefully balanced against their costs.

Fourth, Roe discussed the potential reasons why the public discourse excessively focuses on short-termism. One explanation is that executives and boards benefit from an inflated narrative as the cures for short-termism often involve a shift of power from shareholders to managers. Also, employees and social critics of the large corporation find in short-termism a more appropriate rhetoric to tackle social problems and externalities rather than directly targeting (American) capitalism as such. Other explanations can be found in psychology, given that in ordinary discourse "long-term" has a better connotation than "short-term". However, Roe argued that this is not necessarily true in a business context, where flexibility and adaptability are important qualities.

EXECUTIVE COMPENSATION AND SHORT-TERMISM

After Roe's keynote, Xavier Baeten analysed the role of executive compensation in short-termism. The presentation started with a theoretical analysis of executive compensation on three different levels (i.e. optimal contracting, rent extraction and institutional theory) and continued with a discussion of some empirical evidence on three different aspects of executive compensation (remuneration level, structure and criteria).

With respect to the remuneration level, an empirical study by Graham, Kim and Leary (2017) on the CEO-board dynamics shows that CEO tenure is positively correlated with CEO power which in turn is associated with an increase in annual remuneration and a decrease in the percentage of independent directors. However, Baeten argued that an increased level of CEO remuneration is not necessarily problematic for the long-term orientation of a company.

In addition, a study by Jeong (2020) finds that CEO internal overcompensation (i.e. CEO remuneration vs. remuneration of other executives within the company) is negatively correlated with CSR performance, while CEO external overcompensation (i.e. CEO remuneration vs. industry average CEO remuneration) has a positive effect on CSR performance. To the extent that a company's CSR performance is linked to its long-term orientation, this study illustrates the impact of CEO overcompensation on short-termism.

For the second perspective, Baeten discussed the impact of the remuneration structure. A study by Lee, Park and Folta (2018) shows among other things that the myopic behaviour of CEOs (proxied by real options investments) with shorter career horizons is mitigated by the presence of long-term incentives (LTI). Other empirical evidence from the Vlerick Executive Remuneration Research Centre, based on panel data of STOXX Europe 600 companies, finds that there is a negative relation between the proportion of LTI in CEO remuneration and the long-term financial performance of a company and that a higher proportion of LTI in CEO remuneration is associated with a lower ESG performance (measured with Refinitiv data).

On the other hand, the study shows that the use of performance shares in combination with a long(er) vesting period does have a positive effect on ESG performance. Although that some of these results seem counterintuitive, Baeten argued that LTI do not perfectly align with the long-term focus of a company and that it is important to consider both the proportion and design structure of LTI.

Regarding the remuneration criteria, Baeten highlighted the evolution of CEO compensation over time (i.e. later in the career of the CEO, financial incentives arise more from equity-based pay instead of cash-based pay) and discussed a study that shows that CEO power is positively correlated with the practice of rigging (i.e. CEOs influence their incentive pay by shifting the weight towards better-performing measures).

In addition, empirical evidence from the Vlerick Executive Remuneration Research Centre indicates that the long-term financial performance of a company is negatively correlated with LTI that are driven by return-based KPIs and by total shareholder return (TSR) and positively correlated with accounting-based incentives. It was also shown that TSR-based LTI have a negative impact on ESG performance, while accounting-based LTI have a positive impact.

For the discussion, Holger Spamann first argued that, in contrast to Baeten's findings, other empirical studies (such as Edmans, Gabaix and Jenter (2017)) are more positive about stock-based long-term compensation and sceptical about accounting-based incentives as they can be manipulated by managers.

It was also pointed out that one of the presented studies used Refinitiv data, which were rewritten over time and thus proved to be less reliable for empirical research. In general, different sustainability datasets lead to different empirical results which illustrates the difficulty of finding generalisable results.

As for a second (conceptual) point, Spamann indicated that executive compensation is an incentive scheme that tries to align the interests of managers and shareholders and that this, as with any other incentive scheme, will inevitably lead to some negative side effects. Indeed, some managers might behave myopically as they try to increase their short-term remuneration. This, however, does not mean that executive compensation is overall inefficient; the focus should rather be on balancing the cure and its cost.

In the discussion afterwards, participants questioned the need for legal restrictions on executive compensation (e.g. cap on executive pay) in order to combat short-termism. Baeten replied that legal restrictions are imperfect and might lead to overcomplexity. It was also indicated by the participants that the incorporation of ESG targets in the evaluation of firm performance adds to the complexity of executive compensation.

> **Pay of powerful CEOs has greater sensitivity to the better performing of stock returns and return on assets in a given period.**

CONTROLLING SHAREHOLDERS AND SHORT-TERMISM

Tom Vos then started the discussion on the missing role of controlling shareholders in the short-termism debate by presenting two conceptual models that can explain the myopic behaviour of corporate managers.

In the first model, short-termism is caused by short-termist institutional investors and asset managers who are able to influence management via activism or short-term focused executive compensation. In the second model, short-termism originates from the fact that managers and directors are inherently short-termist (e.g. they want to demonstrate good results during their tenure at the company) and that long-term shareholders are unable or unwilling to hold them accountable.

Upon considering the presence of controlling shareholders, Vos argued that in both models controlling shareholders could alleviate the short-termism problem: in the first model, controlling shareholders can block the transmission mechanism from short-termist investors to managers, and in the second model, controlling shareholders have the incentives and ability to monitor management.

Both models thus show that controlling shareholders could assist with combatting short-termism, provided that they themselves are not short-termist. Theoretical arguments in this regard go both ways: some arguments state that controlling shareholders have more long-term incentives (e.g. due to the size and illiquidity of their ownership stake) while others disagree (e.g. they push for excessive dividends to fund their personal liquidity needs). In addition, the empirical evidence is divided which leads Vos to the conclusion that the long-term incentives of controlling shareholders depend on the circumstances and the type of controlling shareholders.

With respect to the policy conclusions, Vos highlighted the importance of considering the role of controlling shareholders. Some commonly proposed remedies to short-termism, such as discouraging shareholder activism, will not be effective in companies with a controlling shareholder.

Vos also argued that if one believes that controlling shareholders are more long-term oriented, a policy option might be to facilitate the creation of control by allowing the separation of ownership and control (e.g. through loyalty shares). However, the creation of a wedge between the cash flow rights and voting rights increases the risk of private benefit extraction, which in turn might be a source of short-termism.

During the discussion, Federico Cenzi Venezze stated that in Europe convincing empirical evidence on the existence of short-termism is missing and questioned the degree to which policymakers can rely on the few studies in the US and UK that do provide some evidence, given the presence of controlling shareholders in Europe.

Cenzi Venezze continued by discussing some policy implications following the hypothesis that controlled companies might reduce short-termism. With respect to loyalty shares, it was argued that financially constrained controlling shareholders might raise new capital to fund long-term investments given that they can remain in control due to the voting bonus. However, there is also the risk that controlling shareholders use loyalty shares to keep control while selling some shares, which increases their incentives to behave opportunistically.

Finally, Cenzi Venezze emphasised the need to keep the benefits of the (supposed) long-term view of controlling shareholders, without reducing the power of minority shareholders and activists to intervene when controlling shareholders act opportunistically.

PANEL DISCUSSION: LOYALTY SHARES

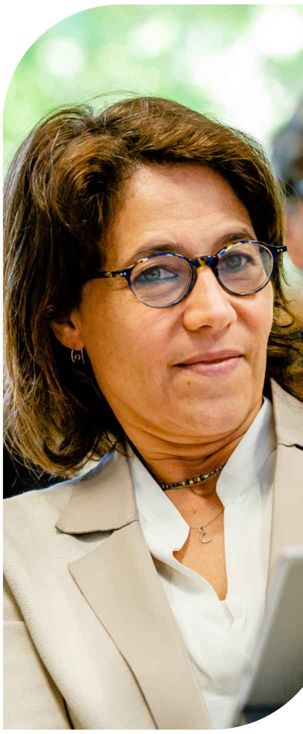
Moderator: Marieke Wyckaert, KU Leuven
Panellists: Chiara Mosca, Università Bocconi, Marco Becht, Solvay Brussels School for Economics and Management and Université libre de Bruxelles and Jeroen Delvoie, Vrije Universiteit Brussel

The panel discussion on loyalty shares began with a brief opening statement from each panellist. Chiara Mosca started by discussing the main reasons why loyalty shares were adopted in Italy in 2014. Although the main official goal was to combat short-termism, it was pointed out that the Italian legislator also wanted to increase the attractiveness of its corporate legal system and prevent national companies from migrating to other European member states with a more flexible corporate law regime.

In addition, Mosca highlighted the role of loyalty shares (and multiple voting rights) in promoting the number of IPOs. Mosca presented empirical evidence that, currently, about 69 Italian companies (which represent about 18% of the total market value) use loyalty shares, and that the controlling shareholders that were already present before the adoption are the main beneficiaries of the voting bonus.

In general, Mosca questioned the effect of loyalty shares on the long-term orientation of a company and concluded that loyalty shares give controlling shareholders the opportunity to reach a position of absolute dominance in all corporate decisions.

Marco Becht then critiqued the theoretical arguments in favour of loyalty shares. Proponents often argue that loyalty shares are more appropriate than dual-class shares given that in theory all shareholders are treated equally.



Loyalty shares would also promote long-term shareholders which in turn could enhance the long-term vision and sustainability of a company. However, Becht argued that loyalty shares are worse than dual-class shares given that they are in fact “stealth” dual-class shares. Loyalty shares constitute in practice two separate classes of shares (registered vs. dematerialised shares) and are inaccessible to institutional investors given the restrictive registration requirement.

Although technology could improve the illiquidity of registered shares, Becht argued that it is a deliberative choice of legislators to exclude institutional shareholders from loyalty shares. Loyalty shares are also less transparent than dual-class shares, as the exact number of votes varies from month to month.

Jeroen Delvoie continued the discussion by analysing the theory and practice of loyalty shares in Belgium. Delvoie first explained that the Belgian legal framework favoured controlling shareholders as the threshold for adopting loyalty shares was lowered from 75% to two-thirds and the possibility to immediately benefit from the extra votes (i.e. grandfather past holding periods) was allowed.

In addition, some empirical evidence was presented: in Belgium, loyalty shares are mainly adopted by companies with a concentrated ownership structure and the votes of the controlling shareholders were often sufficient ex-ante to reach the two-third threshold. These controlling shareholders benefit almost exclusively from loyalty shares and create on average a wedge of 11 percentage points. Some controlling shareholders use loyalty shares to decrease their equity participation. It was also said that none of the IPOs since the legislative reform made use of loyalty shares, which contradicts the idea that loyalty shares boost the number of IPOs.

In general, Delvoie concluded that loyalty shares in Belgium function mainly as a control-enhancing mechanism and strongly resemble dual-class shares (but with less protection for minority shareholders).

For the first discussion point, Becht argued that a deviation from the traditional one-share-one-vote rule is not necessarily problematic. For instance, dual-class shares can facilitate IPOs of family-controlled companies as they allow the controlling shareholders to keep control after the IPO. Delvoie added that it would be more appropriate in Belgium to also allow for dual-class shares and let the market decide on the usefulness of both instruments. However, the lack of sufficient minority protection in the current Belgian regime on loyalty shares was critiqued.

Furthermore, Mosca noted that some empirical evidence in Italy shows that the use of control-enhancing mechanisms is positively correlated with the ESG performance of a company, which illustrates the potential usefulness of deviations from the one-share-one-vote rule.

For the second discussion point, Mosca highlighted the fact that there is a large divergence between the level of EU harmonisation on corporate law and financial law. In this regard, a recent draft directive of the European Commission that would mandate member states to allow multiple-vote share structures for companies who seek admission to trading on a SME growth market was discussed. Becht wondered if the EU legislator would want to further intervene with the market for corporate mobility and restrict the freedom of the individual member states.

For the last discussion point, the panellists commented on the relation between loyalty shares and the mandatory bid rule. Mosca stated that in line with theoretical expectations – Italian takeover law requires shareholders to launch a mandatory takeover bid when they cross the threshold as a result of the maturing of loyalty shares – only controlling shareholders that already exceeded the threshold benefited from loyalty shares. Although in Belgium shareholders that cross the threshold due to the extra voting rights of loyalty shares are exempt from a takeover bid, Delvoie argued that the impact in practice was limited.

Participants also pointed out that the Belgian legal regime could be in violation of EU law and that it is clearly designed to favour controlling shareholders.

KEYNOTE: AN OVERVIEW OF THE EVIDENCE ON CORPORATE SHORT-TERMISM

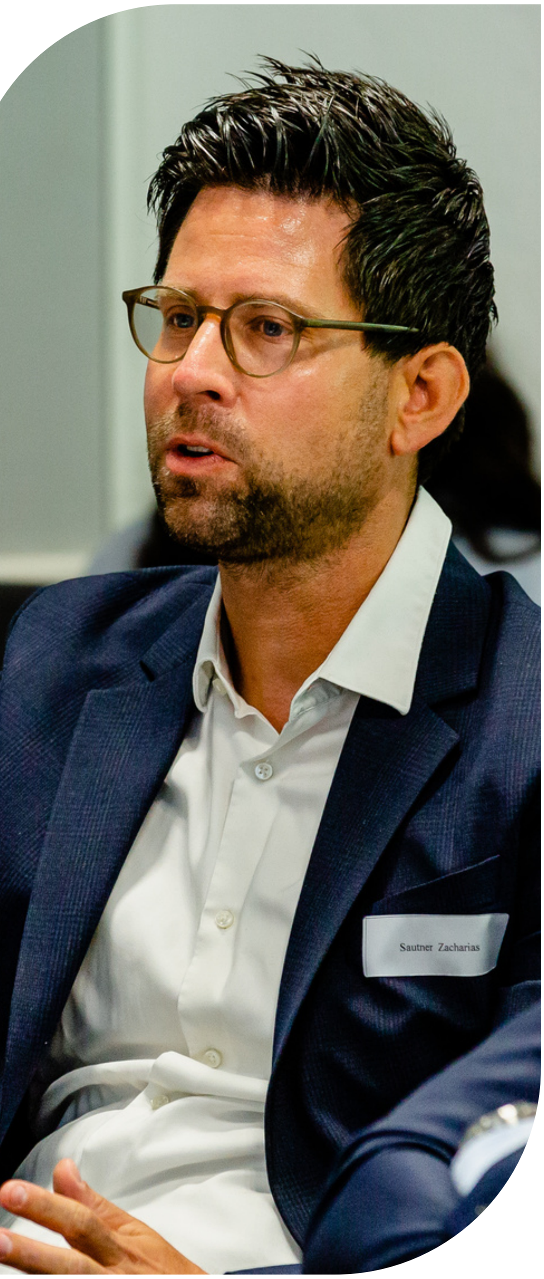
Zacharias Sautner, University of Zurich and Swiss Finance Institute

For the second keynote, Zacharias Sautner presented an overview of the evidence on short-termism with a specific focus on climate change. To start with the "generic" finance evidence, Sautner argued that the financial system as a whole is not broken because of short-termism, but rather that specific parts of the financial system suffer from short-termism.

Most of the empirical studies that find evidence of corporate short-termism identify a so-called "local (average) treatment effect" which indicates that there might be a short-termism issue under specific circumstances. The provided firm-level evidence focused on three potential drivers of short-termism: executive compensation, financial reporting and ownership.

The causal evidence is the strongest when considering executive compensation. For instance, a study from Edmans, Fang and Lewellen (2017) shows for a sample of US companies that short-term compensation incentives (i.e. "vested equity") induce CEOs to reduce investments in long-term projects (e.g. investments in Capex and R&D) and increase short-term earnings.

A similar study from Ladika and Sautner (2020) also finds that accelerated option vesting (which leads to a shift from long-term to short-term incentives) induces CEOs to cut long-term investments and boost the short-term stock price, after which CEOs sell their shares. However, Sautner reiterated that these studies do not provide evidence for a systematic short-termism problem, but rather show that there can be a short-termism issue under certain circumstances.



One of the participants also pointed out that cutting R&D investments is not necessarily harmful depending on the type of projects that were cut. Sautner replied that although project-level evidence is further needed to counter such a claim, the discussed studies do illustrate that the short-term stock price increase was reversed in the long term.

With respect to the role of financial reporting and ownership, the evidence is less distinctive. Sautner discussed some evidence that shows that increased reporting frequency is associated with less investment and that the presence of short-term investors is correlated with more managerial myopic behaviour. However, the empirical studies on ownership do not provide a clear causal relationship.

For the second part, some “specific” climate finance evidence was discussed. First, Sautner focused on the role of investors in tackling climate change. Although research shows that a significant part of institutional investors are pessimistic about reaching the targets of the Paris Agreement on climate change, they on average do not act accordingly. Other studies on climate risk disclosure and investor horizons find that long-term or climate-conscious institutional investors are positively correlated with the climate risk disclosure of companies. However, companies on average do not seem to take appropriate actions to effectively reach their climate ambitions.

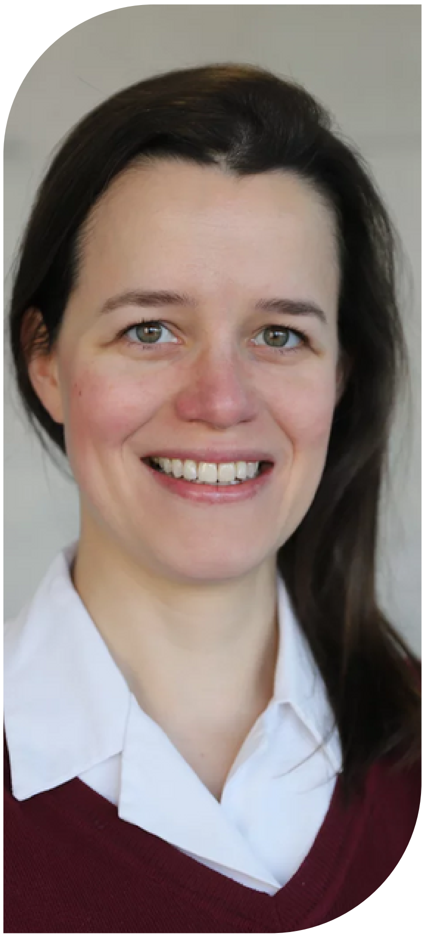
Second, Sautner highlighted the risk of greenwashing by some investment funds that try in the short term to exploit the willingness of investors to invest in ESG funds. As a result, investors might start to distrust ESG products which in turn jeopardises the long-term capital reallocation that is required for the green transition.

In conclusion, Sautner emphasised the importance of efficient incentive structures to tackle both short-termism and climate change-related issues.

Distrust in ESG products may lead to large ESG fund outflows, which can have large real effects on green firms.

STEWARDSHIP, ACTIVISM AND SHORT-TERMISM

After Sautner's keynote, Sofie Cools analysed the interplay between shareholder activism, which can be defined as attempts by shareholders to formally or informally influence corporate decision-making, and short-termism. Following up on the previous presentations, Cools argued that the conceptual link between both concepts is two-directional: shareholder activism can be a channel for investor short-termism as well as a strategy to overcome managerial short-termism. However, the empirical evidence on the role of shareholder activism mainly focuses on activism as a cause of short-termism and remains inconclusive.



Participants also pointed out that the mere presence of aggressive activist investors can put pressure on managers and thus be another cause of short-termism. In addition, Cools added the agency perspective to the discussion. (Short-term) investors see activism as a cure to overcome the first agency conflict, as they, for instance, want to decrease the financial resources in the hands of managers by demanding more dividends instead of investments. Although shareholders might behave rationally (cf. free cash flow hypothesis from Jensen), more dividends and fewer investments are typically considered to be indicators of investor short-termism.

On the other hand, the myopic behaviour of managers might be induced by agency strategies that aim to align their incentives with the shareholders' incentives (e.g. stock-based compensation). These reward strategies in turn cause a new agency conflict (i.e. long-term investors vs. short-term managers), whereby shareholder activism could serve as a potential cure.

Cools continued by discussing the differences in corporate governance between the US and Europe which influence the levels of activism. For instance, the ownership disclosure requirements in the EU are more restrictive than in the US, which limits the possibility of stakebuilding and in turn, hinders activist campaigns. Other differences, such as the thresholds for submission of shareholders proposals and the authority to declare a dividend and appoint or remove directors, also affect the choice and impact of activist tools.

As a final point, Cools compared the ability of the board to exclude shareholders' proposals with respect to the board's strategic competence in the US and the EU. Cools concluded that the presented differences indicate that some forms of shareholder activism in the EU are more difficult than in the US, but that the effect on short-termism is unclear given that activism can be both a cure and a cause of short-termism.

During the discussion, Anne Lafarre focused on the role of shareholder activism in fostering corporate sustainability. Although professional investors often claim to contribute to the ESG performance of the companies in their portfolio, doubts exist whether this is the case in practice.

Some evidence shows that European (including Dutch) investors seem to be acting more sustainable than their US counterparts and that some ESG proposals by investors can have a (significant) impact in Europe. However, Lafarre argued that the existing sentiment in Europe and especially in the Netherlands is that managers should be legally and contractually protected against the short-term pressure of activist shareholders.

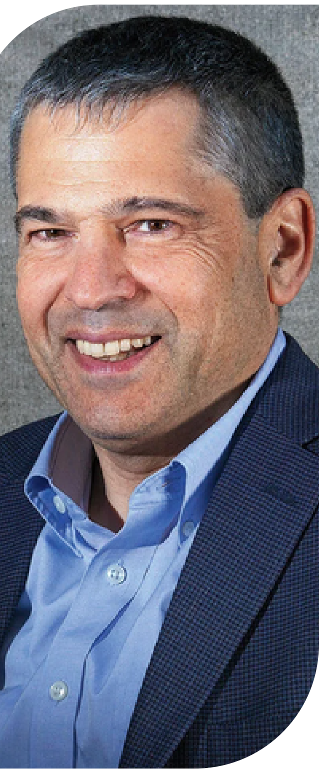
To conclude, Lafarre argued that although investor-led sustainability is unlikely to solve all sustainability problems, legislators should take the role of shareholders more seriously. In addition, board autonomy remains an important part of a potential solution: shareholders should set broader lines and boundaries for sustainability issues using their tools while granting the board enough flexibility. Participants further debated the necessity to strengthen shareholder rights and to increase the level of EU harmonisation in this regard.

SHAREHOLDER PAYOUTS AND SHORT-TERMISM

Speaker: Jesse Fried, Harvard Law School
Discussant: Theo Vermaelen, INSEAD

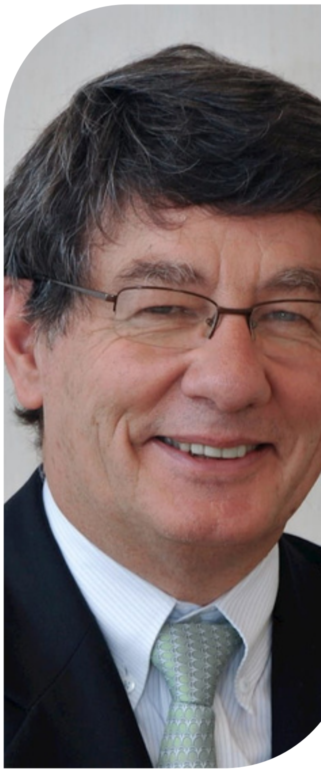
Next, Jesse Fried continued the discussion on short-termism with a presentation on the role of shareholder payouts. In the policy debate, much attention goes to the magnitude of shareholder payouts (i.e. dividends and stock buybacks) as evidence of pervasive and harmful market-induced short-termism. The narrative goes that companies are pressured by activists to distribute too much cash, leaving the company with insufficient funds for innovation, wages and long-term investment.

Fried discussed the evolution of shareholder payouts of S&P 500 companies between 2007 and 2016. According to the data, the level of shareholder payouts in a given company has risen to about 96% of its total net income, which induced policymakers to propose restrictions on stock buybacks. However, Fried pointed out that the presented evidence only provides half of the story as capital flows moving to the company from shareholders via direct or indirect equity issuances are ignored. A better estimate of the shareholder-company capital-flow should include both shareholder payouts and equity issuances and thus look at net shareholder payouts. Taking into account these considerations, a revision of the initial data shows that the net shareholder payouts were only about 50% of the total net income. There is also no evidence that the levels of corporate investments have drastically decreased during this period or that companies have starved of capital.



Not only in the US but also in Europe have policymakers focused on excessive shareholder payouts as proof of short-termism. For Europe, the empirical evidence was provided by the infamous EY report on directors' duties and sustainable corporate governance. However, similar to the US data, Fried argued that the report failed to take into account the net shareholder payouts and that more accurate data indicate that over time investment intensity and cash balances have increased rather than decreased. This again shows that the empirical evidence does not support the view that excessive shareholder payouts are causing short-termism.

Following up on the presentation of Fried, Theo Vermaelen continued the discussion on stock buybacks as a driver of corporate underinvestment, by arguing that some projects are more efficiently financed with debt and that cutting inefficient investments as a result of stock buybacks is not necessarily problematic.



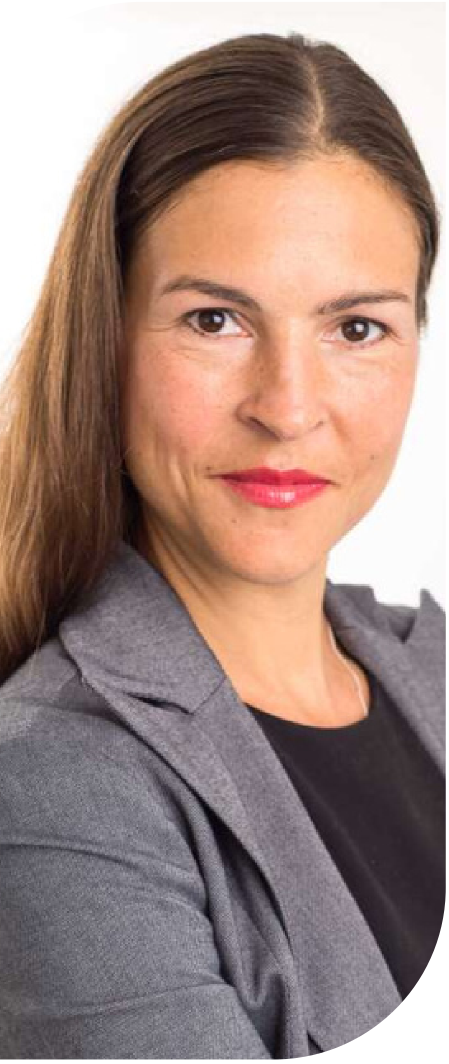
Vermaelen then focused on stock buybacks as a stock price manipulation scheme that could benefit insiders. In theory, managers could benefit from stock buybacks as it allows them to influence EPS management, increase the value of stock options by lowering dividends and sell their shares after the buyback announcement. However, Vermaelen argued that potential problems are not necessarily caused by stock buybacks as such, but rather by poor corporate governance.

In addition, the presented empirical evidence does not support the stock price manipulation hypothesis: global evidence shows that a stock price increase caused by a stock buyback announcement is on average not reversed in the weeks/months following the announcement. Participants pointed out that the evidence would be even more convincing if it only included the data of companies that have effectively engaged in stock buybacks after the announcement.

In conclusion, Vermaelen emphasised that although markets may have a short-term view when they attach too much weight to poor short-term earnings, managers with a long-term view can exploit this form of short-termism by buying back undervalued shares to the benefit of current long-term shareholders.

“Managers with a long-term view exploit this short-termism to benefit long-term shareholders by buying back undervalued shares.

QUARTERLY REPORTING AND SHORT-TERMISM



After the discussion on stock buybacks, Kim Willey analysed the impact of quarterly reporting on short-termism. Quarterly reporting, or the obligation of listed companies to publicly file a summary of unaudited financial statements each quarter, is allegedly causing companies to prioritise positive short-term results at the expense of long-term investments as impatient investors may unduly react to “quarterly reports”.

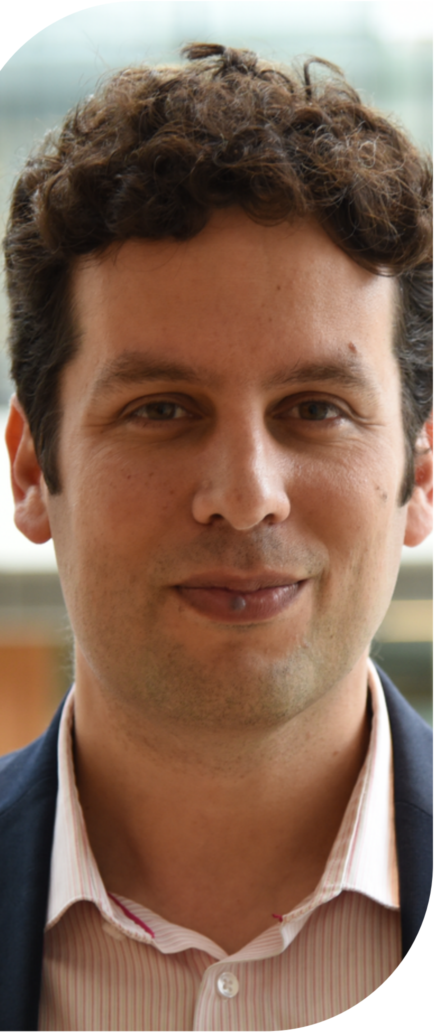
As a result, policymakers have considered reforming the requirements on financial reporting to combat short-termism. Both the UK and the EU, with the exception of some national stock exchanges, have ended mandatory quarterly reporting and only require listed companies to publish annual and half-annual financial reports. Although the US has not (yet) adjusted the quarterly reporting requirements, there seems to be a continued interest in the public discourse to extend reporting periods.

Following up on the previous presentations, Willey argued that the evidence on short-termism is inconclusive and that even if short-termism would be harmful, the reforms to quarterly reporting are unlikely to be effective. One policy pathway is that ending quarterly reporting could improve or enlighten investors by forcing a longer-term approach.

However, given that the reforms are voluntary (i.e. companies can still decide to report on a quarterly basis), and not in place in the US and certain EU stock exchanges, the impact seems to be minimal. Participants also pointed out that the market might perceive the decision of a company to only report on a half-annual basis as a negative signal, thereby reducing the incentives for companies to change their reporting behaviour.

The second policy pathway presented by Willey would be that ending quarterly reporting could insulate managers from the short-term market pressure. However, insulating managers is not effective given that executive compensation might still be tied to quarterly results.

Willey concluded that restrictions on quarterly reporting will not solve short-termism concerns, although they might be justified for other reasons such as reducing the administrative burden on companies or improving the quality of information.



During the discussion, Roy Shapira focused on the political economy dimension. Shapira argued that the (over)attention from the public discourse on quarterly reporting is due to the large coalition of actors that have an interest in reducing quarterly reporting.

For instance, it might be more politically feasible to reform the frequency of reporting instead of dealing with the quality of reporting or executive compensation. In addition, managers or consultants who want to advocate for less managerial accountability are more likely to succeed when they use an anti-short-termist rhetoric. Reducing the frequency of reporting might also benefit professional investors as they have other channels to receive information about the performance of a company.

However, Shapira concluded that given the increased tendency of real-time reporting by companies, reducing the frequency of financial reporting is not well suited to combat short-termism or sustainability-related issues.

In the discussion afterwards, the participants emphasised the role of financial forecasts of analysts that might pressure management to behave myopically. Furthermore, it was pointed out that lowering the reporting frequency could aggravate short-termism as the gap between the actual performance of a company and the projected performance could increase when the company escapes the public eye for a longer period of time.

It was also mentioned that analysts could still assess the performance of companies with half-annual reporting by studying the results of similar companies that do report on a quarterly basis and that a harmonisation of the reporting requirements might be warranted.

PANEL OF PRACTITIONERS

Moderator: Charles-Antoine Leunen, Linklaters
Panellists: Hilde Laga, Gimv; Rika Coppens, House of HR and Harold Boël, Sofina

In the final discussion of the day, a panel of practitioners was invited to present their perspectives on the short-term versus long-term debate. To start the panel discussion, Hilde Laga, chairman of Gimv (European private equity company listed on Euronext Brussels) and board member in other (listed) companies, stated that Gimv typically divests after a period of 3 to 7 years in order to reward both shareholders and managers (in the form of carried interest). This can create short-term pressure to sell a portfolio company while the long-term potential value of the company has not yet been fully realised.

To balance this pressure, Laga argued that the interest of the portfolio company always prevails and that Gimv as an evergreen fund, can (to some extent) be patient. Following up on the discussion on activist investors, Laga mentioned that in her experience activist investors are not necessarily short-termist as they are willing to embrace the more long-term nature of a business.

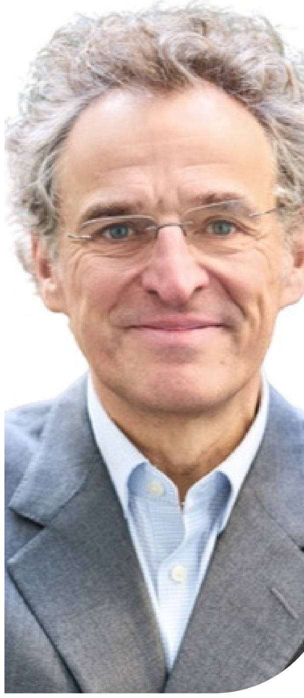
Then Rika Coppens, CEO of the House of HR and non-executive board member in several listed companies, spoke about her experience as a CEO of a private equity-backed company. Coppens argued that there can be tensions between the long-term vision of the company and the exit date of a private equity company.

To achieve a long-term perspective, a strong management team and an active involvement of employees as shareholders can be useful. In addition, Coppens noted that the tension between the interest of the company and the interest of investors is often driven by a lack of clear understanding of the specific business by the latter.

Harold Boël, CEO of Sofina (listed on Euronext Brussels) and non-executive board member in several companies, argued that in his experience the main tensions concern issues of alignment rather than issues of long-term versus short-term.

Boël added that Sofina as a long-term, growth-oriented minority investor also faces the challenge of when to sell its participation. To align the interests of managers and shareholders in this regard, Sofina has set up long-term incentive schemes that allow managers to benefit from the net asset value of the portfolio (regardless of realisations), which in turn lowers the pressure to sell certain participations. More in general, it was pointed out that the investors themselves present a variety of investing horizons and that in order to align the interests of the company and the shareholders, the company should provide sufficient strategic information to the market.

For the second discussion point, the panellists were invited to comment on the influence of controlling family shareholders on the governance of a company. Laga argued that the long-term orientation of a company will prevail as long as the founder is at the helm of the company. Boël, however, disagreed and gave a few counterexamples of founders who were unable to build a legacy. Boël also stressed the importance of a family company to adequately manage the tension between the different generations within the family and the tension between active and inactive family members. For instance, the controlling family shareholder of Sofina has over time institutionalised the decision-making process to address these tensions. Coppens agreed with the importance of institutionalising family foundations and stated that a clear dividend policy helps to avoid yearly discussions among family members.



The third discussion focused on the importance of ESG parameters on the long-term orientation of a company. Coppens stated that in practice ESG is highly important, given that companies are active in an ecosystem and need to take into account their impact on society. In addition, Coppens argued that ESG objectives should be specified in the context of an individual company in order to define realistic and achievable goals.

Laga also pointed out that shareholders are more and more focused on ESG and specifically on climate change-related concerns. However, Laga questioned the extent to which companies can be held accountable for all social problems and advocated for a better balance between the role of companies and the role of the government.

To conclude, Boël commented on the importance of a clear understanding by managers of the specific corporate ESG objectives and on the future role of the Corporate Sustainability Reporting Directive in practice. To conclude the discussion, the panellists gave their perspectives on the role of independent directors. Laga argued that the relatively recent tendency in Belgium to reward independent directors partly with shares is not necessarily problematic: it can be useful to enhance the motivation of independent directors without compromising their independence and their long-term vision.

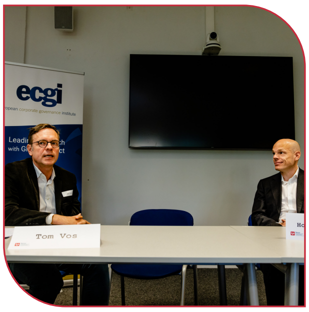
Boël agreed with Laga and shared some practical insights on his experience with the remuneration of independent directors. In contrast, Coppens disagreed and questioned the divergence from the remuneration policy of, for instance, independent auditors who cannot be rewarded with shares. Coppens argued that a balance on the board between directors that have an interest in the share price and directors that do not, is in the best interest of the company.














About the European Corporate Governance Institute (ECGI)

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The ECGI is an international scientific non-profit association which provides a forum for debate and dialogue focusing on major corporate governance issues and thereby promoting best practice. It is the home for all those with an interest in corporate governance offering membership categories for academics, practitioners, patrons and institutions.

Its primary role is to undertake, commission and disseminate research on corporate governance. Based upon impartial and objective research and the collective knowledge and wisdom of its members, it can advise on the formulation of corporate governance policy and development of best practice. In seeking to achieve the aim of improving corporate governance, ECGI acts as a focal point for academics working on corporate governance in Europe and elsewhere, encouraging the interaction between the different disciplines, such as economics, law, finance and management.

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