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The missing role of controlling shareholders in the short-termism debate

Law Working Paper N° 728/2023
July 2023

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I want to thank participants in the Young Corporate Law Scholars Workshop, the ACLE-YSI Young Talents in Law & Finance Conference (and especially Suren Gomtsian, the discussant), the Midterm Meeting of the European Master in Law and Economics in Hamburg, as well as Luca Enriques and Jeroen Delvoie for helpful comments on previous drafts of this paper.

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Abstract

Corporate short-termism, i.e., corporations sacrificing long-term value for short-term profits, has received a lot of attention in the corporate governance literature. However, the role of controlling shareholders in the short-termism debate has remained understudied, possibly because of a focus on US and UK governance systems. This paper addresses this by comprehensively analyzing the impact of controlling shareholders on the short-termism problem. Two conceptual models of short-termism are presented, one where short-termism originates with asset managers and institutional investors, and one where it originates with managers and directors. The paper then shows how controlling shareholders can eliminate short-termism in both models, but only if controlling shareholders themselves are not excessively short-term oriented, which depends on the type of controlling shareholder. The paper concludes with some policy implications, including with regards to loyalty voting rights and dual class share structures.

Keywords: Short-termism, controlling shareholders, agency problems, private benefits of control, family firms, loyalty voting rights

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The missing role of controlling shareholders in the short-termism debate

Tom Vos[1]

Abstract

Corporate short-termism, i.e., corporations sacrificing long-term value for short-term profits, has received a lot of attention in the corporate governance literature. However, the role of controlling shareholders in the short-termism debate has remained understudied, possibly because of a focus on US and UK governance systems. This paper addresses this by comprehensively analyzing the impact of controlling shareholders on the short-termism problem. Two conceptual models of short-termism are presented, one where short-termism originates with asset managers and institutional investors, and one where it originates with managers and directors. The paper then shows how controlling shareholders can eliminate short-termism in both models, but only if controlling shareholders themselves are not excessively short-term oriented, which depends on the type of controlling shareholder. The paper concludes with some policy implications, including with regards to loyalty voting rights and dual class share structures.

Keywords

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[1] Visiting professor at the Jean-Pierre Blumberg Chair (University of Antwerp, Belgium) and part-time lawyer at Linklaters LLP. The Jean-Pierre Blumberg Chair is funded by donations by private partners, including some listed corporations (the topic of this paper). A list of the partners can be found here. I want to thank participants in the Young Corporate Law Scholars Workshop, the ACLE-YSI Young Talents in Law & Finance Conference (and especially Suren Gomtsian, the discussant), the Midterm Meeting of the European Master in Law and Economics in Hamburg, as well as Luca Enriques and Jeroen Delvoie for helpful comments on previous drafts of this paper.

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1. Introduction

Corporate short-termism is often seen as a large societal problem. For example, Joe Biden, then still vice-president of the United States, wrote in a 2016 op-ed for the Wall Street Journal: *"[s]hort-termism [...] is one of the greatest threats to America's enduring prosperity"*.[2] Sasja Beslik said at the World Economic Forum that *"[t]he finance world's short-termism will destroy our communities, economies and the planet"*.[3] The EY Study on directors' duties and sustainable corporate governance also stressed the negative impact of short-termism: "*[s]hort-term time horizons that fail to capture the full extent of long-term sustainability risks and impacts could amount to overwhelming environmental, social and economic consequences for companies, shareholders, investors, and society at large"*.[4]

Corporate short-termism can be defined as the idea that *"corporate directors and managers [...] favor immediate but lower-value results over more profitable long-term results"*.[5] This problem is essentially about sacrificing long-term shareholder value, and should be distinguished from the sacrifice of stakeholder value for (short-term) shareholder value. The latter is a separate problem that requires a separate analysis,[6] even though short-termism will often harm not only shareholders, but also stakeholders. The problem of short-termism has received a lot of attention in the corporate governance literature, with at least two recent books on the topic,[7] as well as too many articles to cite. However, almost all of the studies focus on short-termism in the US or the UK, and very few of the studies discuss to what extent short-termism could be a problem in other corporate governance systems, such as in continental Europe.[8] Perhaps this can explain why the impact of controlling shareholders on corporate short-termism has so far received little attention in the short-termism debate, as controlling shareholders are relatively rare in the US and the UK, but common in many other countries,

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[2] Joe Biden, 'How Short-Termism Saps the Economy' *Wall Street Journal* (New York, 27 September 2016).

[3] Sasja Beslik, 'The finance world's short-termism will destroy our communities, economies and the planet' (*World Economic Forum,* 10 March 2017) <https://www.weforum.org/agenda/2017/03/the-finance-world-s-short-termism-will-destroy-our-communities-economies-and-the-planet/>.

[4] EY, 'Study on directors' duties and sustainable corporate governance' (July 2020), 45 <https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en> (hereinafter the "EY Study").

[5] Mark Roe, 'Corporate short-termism – in the boardroom and in the courtroom' [2013] Business Lawyer 977, 981.

[6] Mark Roe, *Missing the target. Why stock-market short-termism is not the problem* (OUP, 2022) 52-64.

[7] Mark Roe, *Missing the target. Why stock-market short-termism is not the problem* (OUP, 2022); Kim Willey, *Stock-market short-termism. Law, regulation, and reform* (Palgrave MacMillan, 2019).

[8] A notable exception is the EY Study, which studies short-termism in the EU. However, the empirical study of this study suffers from serious methodological flaws and the literature review is extremely one-sided, as discussed further below. The report also does not discuss the specific governance structure in European countries, including the role of controlling shareholders, which could have a strong impact on short-termism, as discussed in this paper.

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including continental European ones.[9] Some papers have mentioned the possibility that certain (types of) controlling shareholders are more long-term oriented,[10] but none of these papers presents a comprehensive analysis of this issue. A paper by Choi argues that controlling shareholders generally have a long-term horizon, because they are incentivized to stay with the firm to retain their non-transferable private benefits of control.[11] This paper builds on the framework developed by Choi, but also goes further by incorporating factors that could make controlling shareholders short-term oriented.

This paper first presents two simple models of how corporate short-termism could originate (part 2). In the first model, institutional investors and asset managers are short-termist oriented, and this short-termism is transmitted to managers and directors through a shareholder-oriented corporate governance system. I call this the "investor short-termism model". In the second model, it is managers who are inherently short-termist oriented, which leads to corporate short-termism. In this model, investors (including institutional investors) may be long-term oriented, but they lack the incentives to hold short-termist managers accountable. I call this the "managerial short-termism model". Which model reflects reality is important, because the policy implications are different.

In part 3, I investigate the empirical evidence that could support these models of short-termism. I conclude that while some studies find some evidence for each model of short-termism, the evidence that this is a systematic and economy-wide problem is much weaker.

Next, I analyze the impact of the presence of a controlling shareholder on corporate short-termism in both models of the short-termism problem (part 4). I conclude that controlling shareholders cut the transmission of short-termism in both models. However, it is unclear

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[9] See the evidence presented in: Gur Aminadav and Elias Papaioannou, 'Corporate Control around the World' [2020] Journal of Finance 1191, 1205.

[10] See, for example: Mark Roe, 'Some differences in corporate structure in Germany, Japan and the United States' [1993] Yale Law Journal 1927, 1987 (noting that a concentrated shareholder structure could alleviate a short-termism problem, but not further analyzing this issue); Kim Willey, *Stock-market short-termism. Law, regulation, and reform* (Palgrave MacMillan, 2019) 5 (noting that *"short-termism may be more or less pronounced depending on the corporate structure, and particularly, the presence of a dominant shareholder*", but not fully analyzing the impact of controlling shareholders on short-termism); Joern Block, *Long-term orientation of family firms. An investigation of R&D investments, downsizing practices, and executive pay* (Gabler 2009) 54 (focusing only on the long-term incentives of family firms); Steen Thomsen, Thomas Poulsen, Christa Børsting and Johan. Kuhn, 'Industrial foundations as long-term owners' [2018] Corporate Governance: An International Review 180 (focusing only on the long-term incentives of industrial foundations).

[11] Albert Choi, 'Concentrated ownership and long-term shareholder value' [2018] Harvard Business Law Review 53.

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whether controlling shareholders are themselves more long-term or short-term oriented than other shareholders. Some characteristics of a controlling participation (including the size and the difficulties of transferring some private benefits of control) lock in controlling shareholders, giving them exposure to the long-term performance of the corporation. On the other hand, controlling shareholders may also have short-term incentives due to the possibility to extract private benefits of control. It is not clear which of these factors dominates, as the empirical evidence on the impact of controlling shareholders is not conclusive. However, it is likely that the answer depends on the type of controlling shareholder.

In part 5, I discuss the policy implications of the analysis. I argue that many of the reforms that have been proposed to combat short-termism will not be effective in corporations with a controlling shareholder. This includes proposals to reformulate directors' duties to account for the long-term interests of shareholders and stakeholders, to encourage long-term ownership through loyalty voting rights, to discourage shareholder activism, to encourage long-term stewardship, to ban quarterly reporting, or to introduce sustainability reporting. Nevertheless, if the legislator believes that controlling shareholders are more long-term oriented than other shareholders, it could allow loyalty voting rights and dual class share structures to facilitate the creation of controlling shareholders. However, by creating a wedge between cash flow rights and control, this solution also increases the risk of private benefits extraction. This implies that minority shareholder protection becomes more important, if controlling shareholders are to serve long-term shareholder value. Part 6 concludes.

2. Two models for corporate short-termism

2.1 Investor short-termism model

Corporate short-termism could originate in various ways. Probably the most common theory of short-termism is that it originates with institutional investors and asset managers, who are assumed to be excessively focused on the short term in this model.[12] These short-term preferences of investors are transmitted to the managers and directors of listed corporations through various channels. First, asset managers can pass on their preference for short-term results by advocating and voting for a remuneration policy that remunerates managers and

[12] This model was inspired by: Kim Willey, *Stock-market short-termism. Law, regulation, and reform* (Palgrave MacMillan, 2019) 155 and following. See also: Martijn Cremers, Ankur Pareek and Zacharias Sautner, 'Short-Term Investors, Long-Term Investments, and Firm Value: Evidence from Russell 2000 Index Inclusions' [2022] Management Science 4535; Lynne Dallas, 'Short-termism, the financial crisis and corporate governance' [2011] Journal of Corporation Law 265.

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directors on the basis of short-term results and the short-term share price, instead of long-term value creation. A second channel of transmission for short-termism is that asset managers may engage with the corporation or support other shareholder activists in order to replace managers when they do not sufficiently focus on the short-term results. As a result, managers are pressured to eliminate value-creating long-term investments in order to realize higher short-term profits, which can then be distributed to shareholders through dividends or share repurchases. In the long run, however, this harms the corporation's profitability, as well as economic growth for society. Figure 1 summarizes this first model of short-termism, which I call the "investor short-termism model".

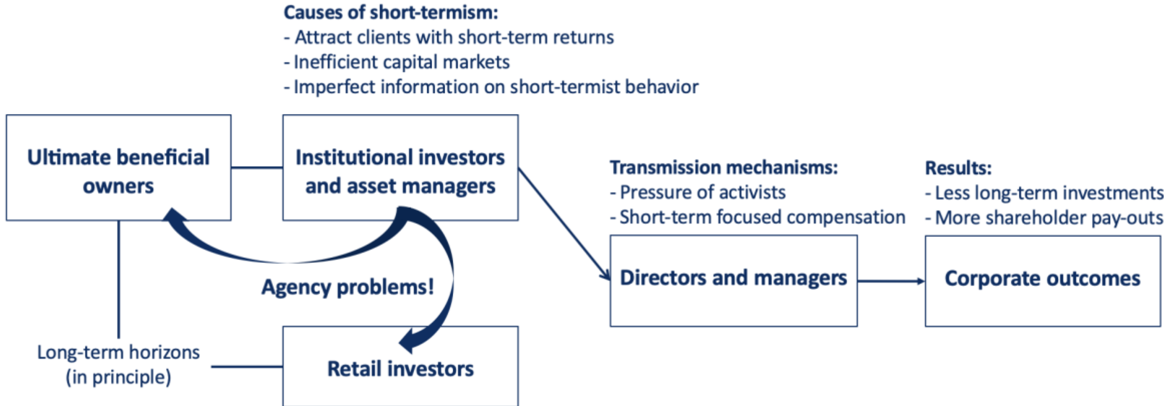

Figure 1: first model of short-termism: investor short-termism.

The investor short-termism model generally assumes that an agency problem exists between (some) institutional investors and asset managers (the agents), on the one hand, and retail investors and the ultimate beneficial owners (the principals), on the other hand.[13] The latter are thought to have a long-term horizon, for example because they save for their retirement, but they have little or no influence on the governance of corporations. In contrast, asset managers and institutional investors are assumed to have an influence on the corporate policy, but are excessively short-termist, according to the investor short-termism model.

The question arises why institutional investors and asset managers would be excessively short-termist. Answering this question is not the primary goal of this paper, as the primary argument of the paper is that controlling shareholders can help to solve the investor short-termism

[13] See for a description of the agency costs associated with asset managers: Ronald Gilson and Jeffrey Gordon, 'The agency costs of agency capitalism: activist investors and the revaluation of governance rights' [2013] Columbia Law Review 863.

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problem (see further in part 4.1). However, it is useful to briefly list a few of the theories for why (some) institutional investors and asset managers may be short-termist. One explanation is that the clients of asset managers are irrationally focused on short-term returns, even if this is not in their long-term interests.[14] Alternatively, the short-term returns may be the only thing that the clients of asset manager can easily monitor when picking an asset manager.[15] Either way, this focus of clients on short-term results induces asset managers to deliver good short-term results, even at the expense of long-term shareholder value, because they want to attract new clients by presenting a profitable investment portfolio. Such an argument assumes that capital markets are to some extent inefficient: if the capital market were perfectly efficient, then long-term results should already be incorporated in the current share price.[16] Another explanation of investor short-termism could be that while some institutional investors and asset managers (especially passive ones) are not short-termist (because they cater to clients with long-term interests), those institutional investors and asset managers that are short-termist (because they cater to clients with shorter time horizons) are unfortunately also more influential with regards to the governance of the corporation. For example, it could be that index funds are generally long-term oriented but passive, while hedge funds are generally short-termist but more active and therefore more influential.[17] The net effect could be excessive investor short-termism. A final explanation of excessive investor short-termism is the "signal-jamming model" developed by Stein, which can explain corporate short-termism even when investors are rational.[18] In the signal-jamming model, the managers of the corporation can take an action that influences what investors perceive to be the value of the firm, in this case by boosting short-term profits at the expense of long-term value. In the model, rational investors are imperfectly informed about whether the short-term profits are in line with the long-term value of the firm, although the investors anticipate that some of the managers will engage in short-termist behavior. Stein shows that, even though the investors bear the costs of short-termism, they will push the managers to engage in short-termist behavior, because some investors will have to sell their shares in the short term. The reason is that the investors would be even worse off if the

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[14] See, for example: Lynne Dallas, 'Short-termism, the financial crisis and corporate governance' [2011] Journal of Corporation Law 265, 270-271 (arguing that behavioral biases, such as hyperbolic discounting and herding, may cause short-termism).

[15] Lynne Dallas, 'Short-termism, the financial crisis and corporate governance' [2011] Journal of Corporation Law 265, 295-296.

[16] Kim Willey, *Stock-market short-termism. Law, regulation, and reform* (Palgrave MacMillan, 2019) 140.

[17] Part 3 will examine the empirical evidence, which does not seem to support the claim that hedge funds are excessively short-termist.

[18] Jeremy Stein, 'Takeover Threats and Managerial Myopia' [1988] Journal of Political Economy 61; Jeremy Stein, 'Efficient capital markets, inefficient firms: a model of myopic corporate behavior' [1989] Quarterly Journal of Economics 656.

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managers did not engage in short-termist behavior, given that the market anticipates short-termist behavior.[19] The optimal outcome for investors would be that managers agree not to engage in short-termism and that investors do not assume that managers engage in short-termism, but Stein shows that this is not a stable equilibrium in the model, as managers can then fool investors through short-termist behavior. In other words, the model of Stein shows under certain reasonable assumptions that if managers are able to "jam" the signal of their performance through actions that boost short-term profits at the expense of long-term value, the level of corporate short-termism will be positive in equilibrium, even though investors correctly anticipate the short-termist behavior.

2.2 Managerial short-termism model

There is also an alternative model for how corporate short-termism could arise. In this second model, short-termism originates from managers and directors, who are assumed to be inherently short-term-oriented.[20] One possible reason for this is the managerial labor market: if managers can demonstrate good results during their tenure at the corporation, they have a higher chance of obtaining a better paid and/or more prestigious position at another corporation. The long-term results of the first corporation are less important in that scenario, because the managers will have left by that time anyway. A second possible reason is (again) remuneration based on short-term results and the short-term share price. If remuneration is based on short-term results, it may be easier for managers to manipulate short-term results (for example by postponing investments) or to exercise stock options when the share price is temporarily high, rather than to create real long-term shareholder value.

Figure 2 summarizes this second model, which I call the managerial short-termism model. In this model, in contrast to the investor short-termism model, the problem does not originate with institutional investor and asset managers, who may be long-term oriented. In this model, managerial short-termism can persist because of a lack of accountability of management

[19] This is sometimes called the "Red Queen logic": Benjamin Hermalin and Michael Weisbach, 'Assessing Managerial Ability: Implications for Corporate Governance' in *Handbook of the Economics of Corporate Governance* (Elsevier 2017) 111 ("*the manager is like the Red Queen in Lewis Carroll's Through the Looking Glass: she must run as fast as possible just to stay still*") and 130.

[20] See for a few arguments of why managers and directors could be excessively focused on the short term: Mark Roe, *Missing the target. Why stock-market short-termism is not the problem* (OUP, 2022) 117-118; L Lynne Dallas, 'Short-termism, the financial crisis and corporate governance' [2011] Journal of Corporation Law 265, 272.

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towards shareholders. In other words, the managerial short-termism model is simply an example of the traditional managerial agency problem.[21]

Consider, for example, an index fund such as BlackRock, which has repeatedly emphasized that it takes a long-term approach with respect to investments.[22] However, the law and economics literature has shown that such index funds have few incentives to intensively monitor the corporations in which they invest.[23] In the managerial short-termism model, it is this lack of monitoring that allows the inherent short-termist preferences of managers and directors to have free rein. This is in contrast to the first model, which assumed short-term preferences of institutional investors that could be easily transmitted to managers. The outcome of the second model is the same as in the first model: a lack of long-term investment, allowing management to generate short-term profits and dividends for shareholders, at the cost of long-term shareholder value.

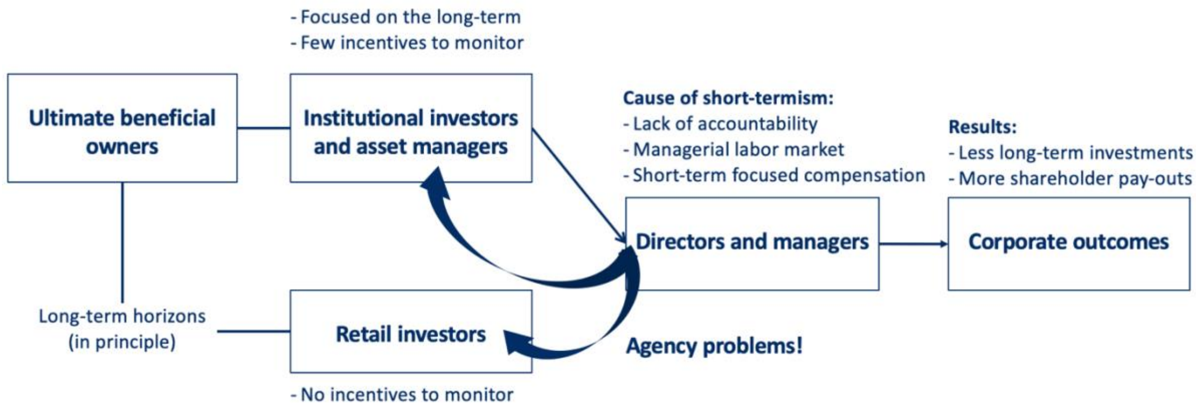

Figure 2: second model of short-termism: managerial short-termism.

2.3 The short-termism policy proposals matrix

Which of these two models better reflects reality is important, because the policy conclusions are quite different. In addition, it is also possible that both institutional investors and managers are short-termist, which calls for yet another policy approach. This leads to the 2-by-2 matrix in the table below.

[21] See for a discussion of the different agency problems in corporate law: Reinier Kraakman et al., *The Anatomy of Corporate Law* (OUP, 2017) 29-30.

[22] See for example: Larry Fink, '2022 Letter to CEOs' <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>.

[23] Lucian Bebchuk and Scott Hirst, 'Index funds and the future of corporate governance: theory, evidence, and policy' [2019] Columbia Law Review 2029.

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First, it is possible that neither institutional investors nor managers are short-termist (bottom right cell of the matrix). In this case, there is no short-termism problem and no solutions are needed.

	Managers short-termist	**Managers not short-termist**
Institutional investors and asset managers short-termist	(1) Lengthen horizons of investors; (2) Make managers more accountable to shareholders (if (1) is successful)	(1) Lengthen horizons of investors; (2) insulate managers from shareholders
Institutional investors and asset managers not short-termist	Make managers more accountable to shareholders	No problem, no policy implications

Table 1: the short-termism policy proposals matrix.

Secondly, it is possible that institutional investors and asset managers are short-termist, but that managers are not short-termist (upper right cell of the matrix). This is the pure investor short-termism model. In that case, the policy proposals are clear: try to lengthen the horizons of the institutional investors and insulate managers from the influence of shareholders (especially from short-termist institutional investors and asset managers, to the extent that these investors can be distinguished). Several proposals have been formulated to accomplish the first objective. One proposal is that long-term share ownership could be encouraged by rewarding long-term shareholders, for example through additional voting rights – so-called "loyalty voting rights". Loyalty voting rights have been suggested by the EY Study,[24] and several European countries have already allowed loyalty voting rights to combat short-termism, including France, Belgium, Italy, Spain and the Netherlands.[25] Another possible reform is to encourage institutional

[24] EY Study, 91-93 (although the study in the end does not recommend that the EU adopts binding legislation on this topic).

[25] Article L22-10-46 Code de commerce (France); article 7:53 Code des sociétés et des associations (Belgium) ; Article 27quinquies "Decreto Legislativo" nr. 58 of 24 February 1998 "Testo unico delle disposizioni in materia di intermediazione finanziaria, ai sensi degli articoli 8 e 21 della legge 6 febbraio 1996, n. 52" (Italy); Titiaan Keijzer, *Vote and Value. An economic, historical and legal-comparative study on dual class equity structures* (Kluwer 2020) 464-469 (describing the legality of loyalty voting rights in the Netherlands, based on several court decisions, such as: Dutch Supreme Court 14 December 2007, ECLI:NL:HR:2007:BB3523 (*DSM*) (upholding the validity of loyalty dividend rights); Amsterdam Court of Appeals 1 September 2020, ECLI:NL:GHAMS:2020:2379 (*Mediaset*) (upholding in principle the validity of loyalty voting rights, although the structure in this specific case was invalid).

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investors and asset managers to think more in the long-term by banning quarterly reporting by corporations,[26] and/or by requiring more long-term oriented reporting.[27] Institutional investors and asset managers could also be forced to disclose how their engagement policy relates to the corporation's long-term performance, which could lead to a stronger long-term orientation.[28] Finally, to address the investor short-termism problem, managers could be insulated from (short-termist) shareholders, for example by erecting barriers to shareholder activism, by reformulating directors' duties to make them less shareholder-friendly, or by allowing corporations to adopt takeover defenses and dual class share structures.[29] An example is the proposal by the European Commission for the Corporate Sustainability Due Diligence Directive, which included a provision that directors should take into account *"the consequences of their decisions for sustainability matters, including, where applicable, human rights, climate change and environmental consequences, including in the short, medium and long term"*.[30] However, this provision was deleted in the position taken by the Council.[31]

Thirdly, it is possible that managers are short-termist, but institutional investors are not (lower left cell of the matrix). This is the pure managerial short-termism model. In that case, the solution would be to make managers more accountable to shareholders – the opposite of what was recommended for the investor short-termism model. For example, shareholder activism

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[26] Kim Willey, *Stock-market short-termism. Law, regulation, and reform* (Palgrave MacMillan, 2019) 231-234 (arguing that abolishing quarterly reporting could encourage asset managers and institutional investors to think more in the long term); EY Study, 91-93 (although the study in the end does not recommend that the EU adopts binding legislation on this topic).

[27] It can be argued that recent legislative initiatives regarding sustainability reporting also require the disclosure of information that will be relevant for long-term oriented investors. See: European Parliament and Council Directive 2022/2464 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting [2022] OJ L 322/15 (especially recital 2).

[28] Such an obligation is included in article 3g of the revised Shareholder Rights Directive in the EU, with the goal of facilitating long-term engagement (see recital 2 and 14-17). See: European Parliament and Council Directive 2017/828 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement [2017] OJ L 132/1.

[29] See, for example: Kim Willey, *Stock-market short-termism. Law, regulation, and reform* (Palgrave MacMillan, 2019) 231-234 (recommending isolation of the board from shareholders to a larger extent as a solution against short-termism); EY, 'Study on directors' duties and sustainable corporate governance' (July 2020), 73-79 <https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en> (recommending a reformulation of directors' duties towards the long term and towards stakeholders as a solution against short-termism); Martin Lipton and Steven Rosenblum, 'A New System of Corporate Governance: The Quinquennial Election of Directors' [1991] University of Chicago Law Review 187.

[30] Article 25 Commission Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937, 23 February 2022, COM(2022) 71 final.

[31] Permanent Representatives Committee, Proposal for a directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 - General Approach, 30 November 2022, 2022/0051 (COD).

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and shareholder stewardship could be encouraged, dual class share structures could be banned, shareholders could be given a "say on pay", …

Finally, both managers and institutional investors could be short-termist (upper left cell of the matrix). In that case, the policy implications are more complex. If policymakers could succeed in lengthening the horizons of institutional investors and asset managers (for example through the proposals mentioned above), they would also have to ensure that managers become accountable to the (now long-term) shareholders (for example through the proposals mentioned in the previous paragraph) to solve managerial short-termism. However, if policymakers cannot ensure that institutional investors and asset managers are forced to focus on the long term, making managers more accountable to shareholders may make things worse. Policymakers could try to make managers think more in the long term, without making them accountable to shareholders, but it is difficult to see how this could be accomplished without excessive legislative intervention into the governance of corporations. In any case, the policy conclusion would be to shift power to those actors (shareholders or managers) whose short-termism is the easiest to solve.

The analysis above illustrates that the policy proposals above are sometimes conflicting. For example, depending on which model of short-termism one believes in, shareholders are either the problem and the solution is to isolate the board from the shareholders, or shareholders are the solution and the accountability of managers towards shareholders should be strengthened. In addition, questions can be raised with regards to the effectiveness of these proposals in combatting short-termism, and with regards to their disadvantages. For example, insulating managers from shareholders to combat investor short-termism would likely also increase managerial agency costs.[32] This paper is not the place to evaluate the costs and benefits of these policy proposals. The focus of this paper is on analyzing whether these policy proposals still make sense when corporations have a controlling shareholder, as will be done in part 5 of this paper.

[32] Lucian Bebchuk, 'The myth that insulating boards serves long-term value' [2013] Columbia Law Review 1637, 1679-1681.

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3. Empirical evidence for corporate short-termism

Of course, the models discussed above are only theoretical possibilities of how short-termism could originate. The question of whether short-termism really exists and how it may originate must be answered with empirical evidence.

A first type of empirical study of short-termism looks at macroeconomic trends to examine whether the increased financialization of the corporate landscape in recent years has led to increased short-termist behavior by corporations. A well-known example is the EY Study, which claimed to find empirical evidence that shareholder pay-outs (the sum of dividends and share buybacks) as a percentage of net income show a growing trend in Europe in recent years.[33] In contrast, capital expenditures ("capex") and research and development ("R&D") expenditures, also measured as a percentage of net income, show a declining trend, according to the EY Study. The EY Study sees this as evidence of short-termism: corporations feel obliged to distribute more and more cash to shareholders, leaving nothing for long-term investments. This can be evidence of either investor short-termism and managerial short-termism (or both).

However, the EY Study has been heavily criticized for its flawed empirical methodology.[34] For example, corporations with negative net income were excluded from the sample without good reason. In addition, net income already includes R&D expenditures, so it is not a good measure of the income available for investment. Also, the EY Study looked only at shareholder pay-outs, without taking into account the capital that shareholders injected into corporations through capital increases over the same period. Fried and Wang conducted an empirical study on European listed corporations in which they looked at net shareholder pay-outs (shareholder pay-outs minus share issuances) as a percentage of net income (which was adjusted by adding back R&D expenditures).[35] This resulted in much lower and less alarming figures than in the EY Study. While there is indeed an upward trend in (net) shareholder pay-outs, this can be explained by the fact that there was a need to compensate for the period between 1998 and 2010, when more cash was injected into corporations than was paid out to shareholders, which is not a sustainable situation from a shareholder perspective. In addition, Fried and Wang show

[33] EY Study, 9-22.

[34] See, for example: Mark Roe, Holger Spamann, Jesse Fried and Charles Wang, 'The Sustainable Corporate Governance Initiative in Europe' [2021] Yale Journal on Regulation Bulletin 133; Alex Edmans, 'Response to the EU Commission Study on Sustainable Corporate Governance' (2020) <https://alexedmans.com/wp-content/uploads/2020/10/European-Commission-Sustainable-Corporate-Governance.pdf>.

[35] Jesse Fried and Charles Wang, 'Short-termism, shareholder payouts and investment in the EU' [2021] European Financial Management 389.

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that long-term investments have actually remained stable over the last twenty years, and that corporations overall have more cash on their balance sheets than ever. This suggests that shareholder pay-outs have not reduced opportunities to invest for the long term. It is likelier that the rising shareholder pay-outs were part of a trend to substitute debt for equity, due to the low interest rates after the financial crisis.[36]

In addition, there is a more fundamental problem with such macro-economic studies. Even if there was a rising trend in shareholder pay-outs and a declining trend in investment, it is not clear why the initial levels should be considered optimal .[37] Indeed, it is also possible that there used to be too few shareholder pay-outs and too many investments, or that the trend for listed corporations was offset by an increase in investments in unlisted corporations, which are generally younger and more dynamic.[38] In any case, the currently available macro-economic studies do not offer evidence that short-termism impacts the economy as a whole.

Nevertheless, it is possible that short-termism poses a problem for some corporations. Therefore, it is worth looking at some micro-economic studies as well. One of the best known and most cited studies in the short-termism debate is the study by Graham, Harvey and Rajgopal, who surveyed 312 CFOs of listed corporations.[39] 78% of these CFOs responded that they would sacrifice long-term value to meet short-term profit targets. This result can be interpreted as evidence of the presence of short-termist behavior. However, Roe has criticized this interpretation of the survey: 52% of CFOs had answered that they would make only a small economic sacrifice to meet their profit goals, but they were grouped together for the conclusion by the authors with the 24% who would make a moderate sacrifice and the 2% who would make a large sacrifice. The data could also be aggregated differently: 74% of respondents would not make more than a small sacrifice, showing that if short-termism exists, it is not a big problem, according to Roe.[40]

[36] See for this argument: Mark Roe, *Missing the target. Why stock-market short-termism is not the problem* (OUP, 2022) 34.
[37] Mark Roe, Holger Spamann, Jesse Fried and Charles Wang, 'The Sustainable Corporate Governance Initiative in Europe' [2021] Yale Journal on Regulation Bulletin 133, 139.
[38] Mark Roe, Holger Spamann, Jesse Fried and Charles Wang, 'The Sustainable Corporate Governance Initiative in Europe' [2021] Yale Journal on Regulation Bulletin 133, 139-140.
[39] John Graham, Campbell Harvey and Shiva Rajgopal, 'The economic implications of corporate financial reporting' [2005] Journal of Accounting and Economics 3.
[40] Mark Roe, *Missing the target. Why stock-market short-termism is not the problem* (OUP, 2022) 95-96.

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Another well-known study is the study by Asker, Farre-Mensa and Ljungqvist.[41] This study concludes that listed corporations invest less than comparable unlisted corporations. The authors explain this result by arguing that unlisted corporations are not subject to short-termist pressures by investors. One problem with this study, however, is that truly successful and fast-growing listed corporations are not included in the comparison, because their size makes them incomparable to even the largest unlisted corporations.[42] Another study attempts to control for this effect with a more sophisticated matching methodology, by comparing only unlisted corporations that were already comparable to listed corporations at their inception.[43] This study finds no significant difference between comparable listed and unlisted corporations in terms of investments. Yet another study relies on a more detailed dataset with corporate investments and concludes that listed corporations even invest more than comparable unlisted corporations.[44] In conclusion, the idea that listed firms invest less because of short-termist pressures is not supported by the empirical evidence.

More convincing evidence of short-termism is a study by Cremers, Pareek and Sautner.[45] This study finds evidence that an increase in the number of short-termist investors leads to a decrease in R&D investment. This seems strong evidence for the first model of short-termism, where short-term behavior is caused by short-term investors. However, this conclusion also needs to be qualified: the study only examines corporations in the Russell 2000, which is limited to small-cap corporations. In addition, the impact on investment is economically speaking fairly small, which can be explained by the fact that only a minority of investors (about 13% according to the study) can be qualified as short-termist. Therefore, this study does not support the conclusion that short-termism is a major problem.

In the investor short-termism model, an important part of the theory is how short-termism is transmitted from investors to managers and directors. One of the possible transmission channels is shareholder activism, mainly by hedge funds. The idea is that activists pressure managers to

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[41] John Asker, Joan Farre-Mensa and Alexander Ljungqvist, 'Corporate Investment and Stock Market Listing: A Puzzle?' [2015] Review of Financial Studies 342.

[42] Mark Roe, *Missing the target. Why stock-market short-termism is not the problem* (OUP, 2022) 99-101.

[43] Vojislav Maksimovic, Gordon Philips and Liu Yang, 'Do Public Firms Respond to Industry Opportunities More than Private Firms? The Impact of Initial Firm Quality' (December 2017) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3093125>.

[44] Naomi Feldman, Laura Kawano, Elena Patel, Nirupama Rao, Michael Stevens and Jesse Edgerton, 'Investment Differences Between Public and Private Firms: Evidence from U.S. Tax Returns' [2021] Journal of Public Economics 104370.

[45] Martijn Cremers, Ankur Pareek and Zacharias Sautner, 'Short-Term Investors, Long-Term Investments, and Firm Value: Evidence from Russell 2000 Index Inclusions' [2022] Management Science 4535.

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increase the short-term profits and the short-term stock price, after which the activists sell their shares and do not suffer when the stock price later plummets.[46] However, the problem with this theory is that the empirical evidence suggests that hedge fund activism on average increases shareholder value, even in the long run and both in the US and in other countries.[47] That said, it is possible that some activists may be short-term oriented, although there is no evidence that this is a systematic problem. On top of that, even if shareholder activism were a transmission channel for short-termism, shareholder activism is relatively rare in continental Europe, even when viewed proportionally to the number of listed corporations.[48] This casts further doubt on the idea that shareholder activism is a major contributor to short-termism in continental Europe.

A second transmission channel of short-termism is short-termist compensation of managers and directors. Here, the empirical evidence for a causal link with corporate short-termism is the strongest. Indeed, several studies in the US conclude that if the CEO of a corporation has more short-term compensation incentives (such as "vested equity"[49]), this is associated with short-term behavior by the corporation, such as scaling back investments.[50] These papers show that short-term incentives contribute to short-termist corporate behavior, although it has not been shown that this is a large and systemic problem, as these studies focus on corporations with vested equity compensation. These studies also do not show which model of short-termism is

[46] See for this idea: Leo Strine, 'One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?' [2010] Business Lawyer 1; Martin Lipton, 'Empiricism and Experience; Activism and Short-Termism; the Real World of Business' (28 October 2013) Harvard Law School Forum on Corporate Governance <https://corpgov.law.harvard.edu/2013/10/28/empiricism-and-experience-activism-and-short-termism-the-real-world-of-business/>.

[47] See, for example: Lucian Bebchuk, Alon Brav and Wei Jiang, 'The long-term effects of hedge fund activism' [2015] Columbia Law Review 1085 (with regards to the US); Marco Becht, Julian Franks, Jeremy Grant and Hannes Wagner, 'Returns to Hedge Fund Activism: An International Study' [2017] Review of Financial Studies 2933 (with regards to other countries than the US); Alon Brav, Wei Jiang and Rongcheng Li, 'Governance by Persuasion: Hedge Fund Activism and the Market for Corporate Influence' (November 2021) ECGI Finance Working Paper N° 797/2021 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3955116> (a recent literature review with updated evidence on the US).

[48] Marco Becht, Julian Franks, Jeremy Grant and Hannes Wagner, 'Returns to Hedge Fund Activism: An International Study' [2017] Review of Financial Studies 2933, 2939; Mark Maffett, Anya Nakhmurina and Douglas Skinner, 'Importing Activists: Determinants and Consequences of Increased Cross-border Shareholder Activism' (September 2021) 37 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3721680>.

[49] "Vested equity" includes shares and options that can be sold or exercised immediately by the CEO.

[50] Alex Edmans, Vivian Fang and Katharina Lewellen, 'Equity Vesting and Investment' [2017] Review of Financial Studies 2230 (having more vested equity is associated with a reduction in investments, which is in turn associated with positive earnings guidance, after which CEOs sell their shares); Alex Edmans, Vivian Fang and Allen Huang, 'The Long-Term Consequences of Short-Term Incentives' [2021] Journal of Accounting Research 1 (more vested equity leads to more takeovers and share buybacks, after which CEOs sell their shares and the long-term stock prices goes down); Tomislav Ladika and Zacharias Sautner, 'Managerial Short-Termism and Investment: Evidence from Accelerated Option Vesting' [2020] Review of Finance 305 (vesting of stock options leads to the elimination of investments, which boosts the stock price in the short term, after which CEOs sell their shares).

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at the root of the problem: is the excessively short-term focused executive compensation caused by demands for such a compensation structure by shareholders, or by a lack of accountability towards shareholders with regards to executive compensation? A study by Flammer and Bansal suggests that the latter may be more likely.[51] The authors find that shareholder proposals to the general meeting to make remuneration more long-term oriented are associated with an increase in the number of investments and better corporation performance. This suggests that the problem of short-term executive compensation could be addressed by stronger accountability to shareholders. It is also important to note that outside the US, and especially in continental Europe, the problem of short-term focused executive compensation may be less important. Indeed, shares and stock options make up a smaller proportion of total compensation outside the US (19%) than in the US (42%). Short-term variable compensation also seems to be less important outside the US, as a larger percentage of compensation is fixed (53% outside the US versus 30% in the US).[52]

Finally, there is empirical evidence that managers are inherently focused on the short term, as assumed in the second model of short-termism.[53] For example, the assumption that managers are eager to achieve good results during their tenure is supported by a study that finds that CEOs invest more in research and development during their first years at the corporation than during their later years (when they arguably have shorter time horizons).[54] There is also empirical evidence that older CEOs (who arguably have shorter time horizons) invest less than younger CEOs.[55] However, these studies do not necessarily support the conclusion that short-termism is a widespread problem, as accountability to shareholders may limit the impact of these problems in practice.

[51] Caroline Flammer and Pratima Bansal, 'Does a long-term orientation create value? Evidence from a regression discontinuity' [2017] Strategic Management Journal 1827.
[52] Alex Edmans, Xavier Gabaix and Dirk Jenter, 'Executive Compensation: A Survey of Theory and Evidence' (July 2017) ECGI Finance Working Paper nr. 524/2017, 167 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2992287> (the study presents data on executive compensation in the US and compares it with data from Belgium, France, Germany, Ireland, Italy, the Netherlands, Norway, Sweden, Switzerland and the UK).
[53] See for a similar conclusion: Mark Roe, *Missing the target. Why stock-market short-termism is not the problem* (OUP, 2022) 117-118.
[54] Patricia Dechow and Richard Sloan, 'Executive Incentives and the Horizon Problem: An Empirical Investigation' [1991] Journal of Accounting and Economics 51.
[55] Jon Garfinkel, Jaewoo Kim and Kyeong Lee, 'The Interactive Influence of External and Internal Governance on Risk Taking and Outcomes: The Importance of CEO Career Concerns' (November 2012) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2171005>; Xiaoyang Li, Angie Low and Anil Makhija, 'Career Concerns and the Busy Life of the Young CEO' [2017] Journal of Corporate Finance 88.

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The conclusion of the above review of the empirical evidence is nuanced. While some studies find evidence of short-termism, many studies can also be criticized, and most studies do not necessarily show that there is a large and systemic problem of short-termism among listed corporations. Roe has also argued that even if certain corporations are affected by short-termism, this would not necessarily have negative consequences for the economy as a whole, because it is perfectly possible that other (e.g., unlisted) corporations compensate for this, for example, by exploiting the investment opportunities that were ignored by the short-termist corporations.[56] In any case, the macro-economic evidence does not support the conclusion that the economy in Europe suffers from widespread short-termism. In addition, it is not clear which of the two models of short-termism would be the cause of the short-termism problem, should there be one. Finally, short-termism is less likely to be a problem in Europe than in the US, as the two main transmission channels of short-termism, short-termist activists and short-term focused executive compensation, are less likely to be present.

4. The impact of controlling shareholders on corporate short-termism

Many of the studies discussed above involved US corporations. This may explain why these studies have largely ignored the impact of controlling shareholders on corporate short-termism, as controlling shareholders are relatively uncommon in the US, especially compared to continental Europe.[57] This is an important omission, as the presence of a controlling shareholder can have a significant impact on whether short-termism can exist, and this for both the investor short-termism model and the managerial short-termism model.

4.1 Controlling shareholders in the two models of short-termism

In the investor short-termism model, controlling shareholders can block the transmission channels. For example, shareholder activism becomes more difficult in a controlled corporation, because an activist hedge fund is unlikely to win a vote in the general meeting if the controlling shareholder supports the board.[58] In addition, because of their (generally) large financial stake and high percentage of voting rights, controlling shareholders also have the

[56] Mark Roe, *Missing the target. Why stock-market short-termism is not the problem* (OUP, 2022) 105-109.
[57] Gur Aminadav and Elias Papaioannou, 'Corporate Control around the World' [2020] Journal of Finance 1191, 1205.
[58] Kobi Kastiel, 'Against all odds: hedge fund activism in controlled corporations' [2016] Columbia Business Law Review 60, 65 (*"engagements with controlled companies should be rare, at least according to the conventional theory, since the presence of a controlling shareholder dramatically reduces the chances of a successful activist campaign"*). Kastiel also nuances this idea, however, arguing that *"although controlled companies are more insulated from activism than widely held companies, they are not fully immune to it"* (p. 67).

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incentives and ability to monitor executive compensation, which should prevent executive compensation from incentivizing short-term behavior.[59]

Controlling shareholders also have an important impact in the managerial short-termism model. In this model, the problem of short-termism arises from a lack of accountability to shareholders, i.e., the classic agency problem between shareholders and managers. Controlling shareholders reduce that agency problem, because their large ownership stake gives them the incentives and ability to monitor management.[60] For example, controlling shareholders can use their voting rights to nominate directors who will stay with the corporation for the long term and commit to evaluating these directors' performance on a long-term basis only. Controlling shareholders can also monitor that executive compensation is calculated on the basis of long-term performance, in order to discourage short-termist behavior by executives. In short, controlling shareholders can prevent that the short-termism problem arises among managers and directors by influencing their incentives. Controlling shareholders can also eliminate the short-termism induced by the signal-jamming actions of managers, in the model developed by Stein, if they can commit themselves to the firm for the long term.[61] In addition, controlling shareholders will generally be more informed about the true performance of the corporation, making signal-jamming actions by managers more difficult.

4.2 Controlling shareholders' long-term and short-term incentives

In both models of short-termism, controlling shareholders can solve the short-termism problem. A condition for this, however, is that the controlling shareholder is not part of the problem. In other words, the question is whether controlling shareholders themselves are long-term oriented or also suffer from a short-termist mindset.

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[59] Lucian Bebchuk and Assaf Hamdani, 'The Elusive Quest for Global Governance Standards' [2009] University of Pennsylvania Law Review 1263, 1284 (*"Diversion of value through executive compensation, however, is a concern of lesser importance in [controlled] companies than in [non-controlled] companies"*); Kobi Kastiel, 'Executive compensation in controlled companies' [2015] Indiana Law Journal 1131, 1134 (*"Controlling shareholders, the theory suggests, have both the ability and the incentive to monitor executive pay"*). Kastiel qualifies this conclusion, however, by arguing that controlling shareholders may have an incentive to extract private benefits of control through executive compensation. This issue is discussed further below.

[60] Ronald Gilson and Jeffrey Gordon, 'Controlling Controlling Shareholders' [2003] University of Pennsylvania Law Review 785, 785 (*"the presence of a large shareholder may better police management than the standard panoply of market-oriented techniques"*); Lucian Bebchuk and Assaf Hamdani, 'The Elusive Quest for Global Governance Standards' [2009] University of Pennsylvania Law Review 1263, 1281 (*"controlling shareholders commonly have both the effective means to monitor management and the incentives to do so"*).

[61] Benjamin Hermalin and Michael Weisbach, 'Assessing Managerial Ability: Implications for Corporate Governance' in *Handbook of the Economics of Corporate Governance* (Elsevier 2017) 130 (making this point).

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A first reason why controlling shareholders may be more inclined to think in the long term is the size and illiquidity of their financial participation in the corporation. Controlling shareholders typically hold a relatively large financial stake in a corporation,[62] and are therefore to a large extent exposed to the long-term value that the corporation can generate. A controlling shareholder could try to improve short-term results, for example by delaying value-creating investments, and try to sell their stake before the long-term decline in value becomes apparent to the buying shareholders. However, a large participation would probably be too illiquid to sell on the open market, so a controlling shareholder will likely have to sell the participation to sophisticated buyer in a block trade, in which case the buyers will normally conduct some due diligence on the corporation.[63] To the extent that this is apparent from the due diligence, the buyers will probably not want to pay for an improvement in short-term performance that is accompanied by a reduction in long-term value, unless the buyer itself believes that it will only hold the stake for a short term and can somehow resell it to someone who will not see through the short-termist trick.

In some situations, controlling shareholders may care more about the short-term stock price than about the long-term cash flows of the corporation, causing the controlling shareholder to engage in short-termism. For example, controlling shareholders may have short-term preferences regarding the stock price if they want to sell a part of their participation on the stock market. Controlling shareholders may also care about the short-term stock price if they use their shares as collateral for debt and they are facing a margin call. However, their remaining participation will also expose them to a large extent to the long-term cash flows of the corporation, which limits the harm they would be willing to inflict on the long-term performance of the corporation in order to boost the short-term stock price.

A second argument for the long-term perspective of controlling shareholders is the existence of non-transferable private benefits of control. According to standard definition, private benefits of control encompass the value enjoyed by the persons in control that is not shared with the

[62] This may not be the case if the cash flow rights are separated from the voting rights, for example through a dual class share structure or a pyramid structure. In that case, the controlling shareholder is less exposed to the long-term value of the corporation. However, in practice, the controlling shareholder would probably still hold a significant part of his wealth in shares in the corporation. He would likely also be locked in for the long term, due to the need to sell to a sophisticated buyer if the controlling shareholder wants to monetize their control premium and due to the presence of non-transferable private benefits of control (see below).

[63] This is especially true when the sale of the controlling participation triggers the mandatory bid rule, forcing the buyer to buy all the other shares in the corporation at the same price. See article 5 of the Takeover Bid Directive: European Parliament and Council Directive 2004/25/EC on takeover bids [2004] OJ L 142/12.

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other shareholders in proportion to their share percentage.[64] Several types of private benefits of control can be distinguished: "diversionary" private benefits of control, which follow from the diversion of corporate assets to the controller; "distortionary" private benefits of control, which follow from the management of the corporate assets in the controller's personal interest instead of in the shareholders' interest generally, including empire building and extravagant perquisites; and "idiosyncratic" private benefits of control, which is the value needed to induce the controller to undertake firm-specific investments, and which includes the pride and psychological satisfaction the controller enjoys from controlling the corporation.[65] Choi has developed an economic model in which private benefits of control are non-transferable, which makes it less interesting for controlling shareholders to transfer their participation, as they will not be able to monetize the private benefits of control.[66] Choi argues that this reduced liquidity of the participation also reduces corporate short-termism: because controlling shareholders cannot sell their participation without losing the private benefits of control, they are forced to take a long-term perspective.

However, Choi's assumption that private benefits of control cannot be transferred is too restrictive: certain types of private benefits of control, such as the diversionary and distortionary private benefits of control, can be transferred by transferring control. Even certain idiosyncratic private benefits can be transferred, as the buyer may also enjoy pride from owning a corporation. Such private benefits can still be monetized by the controlling shareholder if the buyer is willing to pay a control premium. However, there may still be positive impact on the long-term orientation of the existing controlling shareholder, as the buyer of a controlling stake in a listed corporation will likely be a sophisticated actor, who will conduct due diligence and be able to protect himself against short-termist manipulations of the existing controlling shareholder. In the EU, private benefits of control are also harder to monetize for controlling shareholders, because the mandatory bid rule prohibits the transfer of a controlling participation without offering the same bid price to all shareholders. This again locks in the controlling shareholder, giving them a long-term view.

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[64] Alexander Dyck and Luigi Zingales, 'Private Benefits of Control: An International Comparison' [2004] Journal of Finance 537, 541.

[65] Alessio Pacces, *Rethinking Corporate Governance. The Law and Economics of Control Powers* (Routledge, 2012) 83-115.

[66] Albert Choi, 'Concentrated ownership and long-term shareholder value' [2018] Harvard Business Law Review 53.

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In addition, certain types of private benefits of control are indeed hard to transfer, because they are so closely associated with the person of the controlling shareholder. Consider, for example, the value that a family shareholder places on maintaining the family control over the corporation across generations.[67] The value attached to control over the corporation cannot easily be monetized in the event of a sale of the participation, so the controlling shareholder is to some extent locked in with regards to the corporation and must therefore take a long-term perspective. Another example is a state-owned corporation where the government attaches some form of national pride to the control over the corporation, which may be (historically) important for the national socio-economic fabric, or where the government may pursue some public interest objectives through control over the corporation. These de facto non-transferable private benefits of control reduce the liquidity of the controlling shareholder's participation and therefore encourage long-term behavior.

Finally, Choi's model assumes that as a controlling shareholder's share ownership increases, private benefits of control decrease.[68] That may be true for certain types of private benefits of control, in particular diversionary private benefits of control (as there are fewer minority shareholders from whom value can be diverted) and distortionary private benefits of control (as the larger financial stake ensures that controlling shareholders' incentives are less distorted). However, idiosyncratic private benefits of control will probably not decrease as a controller's share ownership increases, and may even increase, as controllers more closely associate themselves with the corporation. In addition, at very high levels of ownership, a controlling shareholder will be unlikely to be able to liquidate their whole participation by simply selling in the market, making a block trade with a sophisticated buyer necessary. Again, this reduces the scope for short-termist behavior. For this reason, Choi's claim that corporate short-termism will re-emerge at high levels of concentrated share ownership seems implausible.

The conclusion from the analysis above is that the size of the participation of the controlling shareholder and the presence of private benefits of control that can only be transferred by

[67] Ronald Anderson and David Reeb, 'Founding-Family Ownership and Firm Performance: Evidence from the S&P 500' [2003] Journal of Finance 1301, 1302–1303 *("[F]ounding families have concerns and interests of their own, such as stability and capital preservation, that may not align with the interests of other investors or the firm")*.
[68] Albert Choi, 'Concentrated ownership and long-term shareholder value' [2018] Harvard Business Law Review 53, 89.

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transferring a control block, “lock” in controlling shareholders and give them a long-term perspective.

However, private benefits of control may also give controlling shareholders incentives that deviate from long-term value creation, for example by “stealing” (diversionary private benefits of control) or “shirking” (distortionary private benefits of control). Some private benefits of control may also specifically lead to short-termist behavior.[69] For example, a controlling shareholder who is also the CEO might choose to link their compensation as CEO to a larger extent to short-term results, because these results are easier to manipulate. If their remuneration is criticized, the controlling shareholder-CEO can defend themselves by arguing that the remuneration is in line with the (short-term) results. This hypothesis has support in the empirical evidence: some empirical studies have already concluded that remuneration in controlled corporations is higher and less sensitive to performance,[70] although to my knowledge no research has been done specifically on the short-term orientation of remuneration. Another typical example of a private benefit of control derives from the control over shareholder pay-outs. For example, a controlling shareholder in need of cash might cause the corporation to pay a dividend even if the corporation actually needs the money to realize valuable investment opportunities and the dividend is therefore value-destroying. Consider, for example, the case of a family shareholder who urgently needs money for private expenses, such as the purchase of a (new) family home. Or think of a listed state-owned corporation where the state could use an extra dividend to balance its budget and where the politicians controlling the corporation have a relatively short time horizon due to regular elections.

Another situation that can cause a corporation to miss out on valuable long-term investments occurs when the controlling shareholder wants to maintain control over the corporation (and the associated private benefits of control), but does not have sufficient resources to participate in a capital increase that is necessary to finance the investments. This could lead to the

[69] See for the argument that private benefits of control can lead to short-termism in family-controlled corporations: Joern Block, *Long-term orientation of family firms. An investigation of R&D investments, downsizing practices, and executive pay* (Gabler 2009) 52.

[70] See for an overview of the evidence and new empirical evidence: Kobi Kastiel, ‘Executive compensation in controlled companies’ [2015] Indiana Law Journal 1131. However, other studies find that family controlling shareholders have a negative impact on CEO compensation: Ettore Croci, Halit Gonenc and Neslihan Ozkan, ‘CEO compensation, family control, and institutional investors in Continental Europe’ [2012] Journal of Banking & Finance 3318.

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controlling shareholder blocking capital increases that are necessary for the corporation to expand, harming long-term shareholder value.

Of course, these examples of extraction of private benefits of control are only beneficial for the controlling shareholder to the extent that the private benefits exceed the damage suffered by the controlling shareholder as a (long-term) shareholder. The incentive to extract private benefits of control therefore increases as the controlling shareholder holds a smaller financial participation in the corporation, for example because of a dual class share structure.[71] In addition, the distortionary and diversionary private benefits of control may also be limited by rules that protect minority shareholders (as I discuss further in part 5), as well as by market forces, such as product market competition or capital markets if the corporation needs to raise additional capital, although none of these constraints can eliminate all such private benefits of control.[72]

Finally, for the sake of completeness, controlling shareholders may also be inefficiently long-term oriented, which is known as "hyperopia".[73] In this case, a controlling shareholder erroneously applies too low a discount rate to future cash flows, for example, due to behavioral biases. On the other hand, behavioral biases can also cause an excessive focus on the short term ("myopia"),[74] so few systematic conclusions can be drawn from this.

The conclusion of the analysis above is that controlling shareholders have stronger incentives to think in the long term than other shareholders due to the size and illiquidity of their holdings. However, that mechanism does not necessarily guarantee a long-term orientation because controlling shareholders may also enjoy private benefits of control, which may have a positive or negative impact on their long-term orientation, depending on the situation. Therefore, the net

[71] Kobi Kastiel, 'Executive compensation in controlled companies' [2015] Indiana Law Journal 1131, 1148-1151.
[72] Lucian Bebchuk, 'Limiting Contractual Freedom in Corporate Law: The Desirable Constraints on Charter Amendments' [1989] Harvard Law Review 1820, 1844-1846 (discussing the limits of the disciplinary effect of the market for additional capital and of product market competition) and 1847 (arguing that the managerial labor market and the market for corporate control cannot discipline the management of the corporation in the presence of a controlling shareholder).
[73] Luca Enriques, Alessandro Pacces and Ronald Gilson, 'The case for an unbiased takeover law (with an application to the European Union' [2014] Harvard Business Law Review 85, 92 and 94. See also: Michal Barzuza and Eric Talley, 'Long-term bias' [2020] Columbia Business Law Review 104 (arguing that corporate managers are often biased towards the long-term).
[74] See, for example: Richard Thaler, Amos Tversky, Daniel Kahneman and Alan Schwartz, 'The Effect of Myopia and Loss Aversion on Risk Taking: An Experimental Test' [1997] Quarterly Journal of Economics 647.

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impact of the presence of a controlling shareholder on corporate short-termism is an empirical one.

4.3 Empirical evidence on controlling shareholder short-termism

Unfortunately, the impact of controlling shareholders on corporate short-termism has received little attention in empirical studies, although there are a few relevant studies. For example, Puca and Vatiero find that shareholder concentration leads to more innovation (as measured by the number of patents and patent citations) in Swiss corporations.[75] If we assume that innovation is a good proxy for long-term behavior, this is evidence that controlling shareholders have a net negative impact on short-termism.

Other studies do not directly study the link between controlling shareholders and long-term corporate behavior, but rather between controlling shareholders and financial performance (as measured, for example, by "Tobin's Q"), which also provides some indication of the net positive impact of controlling shareholders. Here, the empirical evidence is inconclusive. For example, a study by Morck, Shleifer and Vishny finds that shareholding by managers in the US is positively associated with corporation value below 5%, negatively associated between 5% and 25%, and positively associated again above 25%.[76] A more recent study confirms these results for large corporations in the US, but finds an overall negative association between managerial ownership and firm value when the sample is extended to smaller corporations.[77] In contrast, another study, this time of East Asian corporations, finds that the size of the largest shareholder's participation is positively correlated with firm value.[78] Another paper points out that shareholder concentration is endogenous: it is determined by several factors that may also have an impact on the value of the corporation, which makes establishing a causal relationship

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[75] Marcello Puca and Massimiliano Vatiero, 'Ownership and Innovation: Evidence from Switzerland' (September 2017) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2739880>. The authors use the introduction of takeover law as an exogenous shock that led to a less concentrated ownership structure, making causality at least plausible.

[76] Randall Morck, Andrei Shleifer and Robert Vishny, 'Management ownership and market valuation. An empirical analysis' [1988] Journal of Financial Economics 293. Another study in the US with a larger sample finds a positive association between managerial ownership and firm value up to a threshold of 40-50%, but a slight negative association afterwards. See: John Mcconnell and Henri Servaes, 'Additional evidence on equity ownership and corporate value' [1990] Journal of Financial Economics 595.

[77] Kornelia Fabisik, Rüdiger Fahlenbrach, René Stulz and Jérôme Taillard, 'Why are firms with more managerial ownership worth less?' [2021] Journal of Financial Economics 699. It should be noted, however, that this study does not argue for a causal link, but argues that the liquidity of the shares has a negative impact on managerial ownership, and that liquidity is positively associated with financial performance.

[78] Stijn Claessens, Simeon Djankov, Joseph Fan and Larry Lang, 'Disentangling the Incentive and Entrenchment Effects of Large Shareholdings' [2002] Journal of Finance 2741.

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difficult. Once this study has taken endogeneity into account, the association between shareholder concentration and corporation value seems to disappear.[79] This finding is consistent with the idea that controlling shareholders have both advantages and disadvantages and that the optimal shareholder structure may vary from corporation to corporation. Other research has suggested that firm value impacts ownership concentration, but not the reverse.[80] This highlights the issue with existing research on the impact of controlling ownership: research has not yet found many good external shocks that allow us to understand the causal impact of controlling ownership.[81]

It also seems likely that the type of controlling shareholder has an impact on the extent to which the controlling shareholder has a long-term perspective. As suggested above, family shareholders might have a long-term perspective due to the desire to transfer the family business to the next generation. This could explain why family ownership is generally associated with stronger financial performance in listed corporations.[82] However, it seems that this link mainly exists in corporations where the CEO or chairman of the board belongs to the first generation of the founding family – in descendant-led family firms underperform non-family firms.[83] One possible explanation is that later generations of the founding family and non-founding families are less concerned with the long-term vision. However, it is also possible that founders are simply more competent, and that the association has nothing to do with long-term vision. Other studies examine the impact of family firms on R&D investment, which can be seen as a more

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[79] Harold Demsetz and Belén Villalonga, ‘Ownership structure and corporate performance’ [2001] Journal of Corporate Finance 209.
[80] Myeong-Hyeon Cho, ‘Ownership structure, investment, and the corporate value: an empirical analysis’ [1998] Journal of Financial Economics 103.
[81] Cfr. Alex Edmans and Clifford Holderness, ‘Blockholders: A Survey of Theory and Evidence’ in Ben Hermalin and Mike Weisbach (eds.), *Handbook of the Economics of Corporate Governance* (Elsevier, 2017) 587-588 *(“Our point is that it would be powerful to use natural experiments (or instruments, as considered in the previous section) to study blockholders, but we simply do not know of any”*).
[82] See, for example: Ronald Anderson and David Reeb, ‘Founding-Family Ownership and Firm Performance: Evidence from the S&P 500’ [2003] Journal of Finance 1301 (regarding the US); Belen Villalonga and Raphael Amit, ‘How do family ownership, control and management affect firm value?’ [2006] Journal of Financial Economics 385 (regarding the US); Joern Block, *Long-term orientation of family firms. An investigation of R&D investments, downsizing practices, and executive pay* (Gabler 2009) 81-88 (regarding the US); Roberto Barontini and Lorenzo Caprio, ‘The Effect of Family Control on Firm Value and Performance: Evidence from continental Europe’ [2006] European Financial Management 689 (regarding continental Europe). See for an excellent literature review: Belen Villalonga, Raphael Amit, Maria-Andrea Trujillo and Alexander Guzmán, ‘Governance of Family Firms’ [2015] Annual Review of Financial Economics 635.
[83] Belen Villalonga, Raphael Amit, Maria-Andrea Trujillo and Alexander Guzmán, ‘Governance of Family Firms’ [2015] Annual Review of Financial Economics 635, 638 (concluding on the basis of a review of the empirical evidence that *“founder-led firms outperform, whereas descendant-led firms underperform […]. Within family firms, founding families are particularly likely to be dedicated and effective owners because their emotional ties to the firm give them an additional source of motivation”*).

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direct measure of long-term orientation. One study finds that listed family firms generally invest less in R&D, compared to other listed corporations.[84] However, family firms where later generations remain involved in the management on average invest more in R&D, which could be explained by the stronger long-term orientation of these firms, due to the presence of a potential family successor. Another study also finds an overall negative effect of family ownership on R&D investment, but a positive effect on R&D investment if the family owns more than 30% of the shares in a listed company.[85] Therefore, whether family controlling shareholders are more focused on the long term seems to depend on the circumstances.[86]

There is also empirical evidence that industrial foundations, a type of controlling shareholder common in the Nordic countries, take a long-term approach to governing corporations.[87] Empirical studies also find that this long-term approach is associated with a financial performance that is at least as good (although not necessarily better) as that of corporations with a different shareholder structure.[88] One possible explanation for the stronger long-term perspective is that industrial foundations are required by their charter to hold their shares for the long term and to promote the survival of the company.[89] This constitutes a stronger commitment than most other types of controlling shareholder that the shares will not be

[84] James Chrisman and Pankaj Patel, 'Variations in R&D investments of family and nonfamily firms: behavioral agency and myopic loss aversion perspectives' [2012] The Academy of Management Journal 976.
[85] Joern Block, *Long-term orientation of family firms. An investigation of R&D investments, downsizing practices, and executive pay* (Gabler 2009) 109-121.
[86] See for an overview of the theoretical arguments of why family firms may be more or less short-termist: Joern Block, *Long-term orientation of family firms. An investigation of R&D investments, downsizing practices, and executive pay* (Gabler 2009) 54.
[87] Steen Thomsen, Thomas Poulsen, Christa Børsting and Johan. Kuhn, 'Industrial foundations as long-term owners' [2018] Corporate Governance: An International Review 180 (concluding on the basis of a data set of Danish corporations that *"foundation ownership is highly stable compared to other ownership structures. Foundation-owned companies replace managers less frequently. They have conservative capital structures with low financial leverage. They score higher on an index of long-termism in finance, investment, and employment. They survive longer"*).
[88] Markus Herrmann and Günter Franke, 'Performance and Policy of Foundation- owned Firms in Germany' [2002] European Financial Management 261 (*"The empirical findings show a slightly better performance of foundation-owned firms compared to corporations"*); Steen Thomsen, 'Foundation Ownership and Economic Performance' [1996] Corporate Governance: An International Review 212; Steen Thomsen and Caspar Rose, 'Foundation Ownership and Financial Performance: Do Companies Need Owners?' [2004] European Journal of Law and Economics 343 (finding that *"foundation-owned companies listed on the Copenhagen Stock Exchange are at least as efficient as other listed companies in terms of risk adjusted stock returns, accounting returns and Tobin's Q"*); Steen Thomsen and Henry Hansmann, 'The Performance of Foundation-Owned Companies' (11 October 2013 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2406055> 1 (*"We find that, overall, foundation-owned companies have similar accounting profitability, take less risk, and grow more slowly than listed investor-owned companies*").
[89] Steen Thomsen, Thomas Poulsen, Christa Børsting and Johan. Kuhn, 'Industrial foundations as long-term owners' [2018] Corporate Governance: An International Review 180, 183; Markus Herrmann and Günter Franke, 'Performance and Policy of Foundation-owned Firms in Germany' [2002] European Financial Management 261, 263.

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transferred. In addition, foundations do not normally have their own operational activity, so the potential for increasing diversionary private benefits of control by engaging in related party transactions is lower, reducing one source of short-termism. Unlike other controlling shareholders, a foundation also has no shareholders or natural persons who can demand pay-outs to meet their personal consumption needs, eliminating another source of short-termism.[90]

A final example where the type of controlling shareholder may make a difference concerns the state as controlling shareholder. As suggested above, there is a risk that the state may be short-termist, for example, by sacrificing long-term investments to ensure large dividends to balance its budget. The empirical evidence suggests that listed state-owned enterprises in generally perform less well financially.[91] However, it is possible that this has nothing to do with short-termism, but rather with the pursuit of non-financial goals by public corporations. This last hypothesis is confirmed by empirical evidence that state-owned enterprises perform better on environmental metrics.[92]

5. Policy implications

What are the policy implications from the analysis above? A first conclusion is that some of the solutions for the investor short-termism or the managerial short-termism model (discussed above in part 2.3) will not be effective in corporations with a controlling shareholder.

For example, it can be doubted whether the proposals to reformulate directors' duties to make less shareholder-oriented will be effective in combatting investor short-termism in corporations with a controlling shareholder. In all corporations, forcing directors to take a more long-term view by suing them for a breach of directors' duties is difficult, because of the presence of the business judgment rule (or similar legal doctrines) and barriers to bringing shareholder

[90] Steen Thomsen, Thomas Poulsen, Christa Børsting and Johan. Kuhn, 'Industrial foundations as long-term owners' [2018] Corporate Governance: An International Review 180, 183. A nuance is that a foundation can also have as its purpose to financially support family members. See: Markus Herrmann and Günter Franke, 'Performance and Policy of Foundation- owned Firms in Germany' [2002] European Financial Management 261, 263; Steen Thomsen, 'Corporate Ownership by Industrial Foundations' [1999] European Journal of Law and Economics 117, 119.

[91] See for example: Steen Thomsen and Torben Pedersen, 'Ownership Structure and Economic Performance in the Largest European Companies' [2000] Strategic Management Journal 689.

[92] Belén Villalonga, Peter Tufano and Boya Wang, 'Corporate Ownership and ESG Performance' (9 September 2022) working paper, 15.

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litigation.[93] In corporations with a controlling shareholder, the low-powered incentives of directors' duties are likely to be less effective in combatting short-termism than monitoring by the controlling shareholder. In addition, if the controlling shareholder is short-termist itself, the low-powered incentives of directors' duties are likely dominated by the high-powered incentives for directors to serve the interests of the controlling shareholder, as the controlling shareholder can simply fire the directors that do not implement the desired policy and/or reward directors that do implement the desired policy with higher pay. It could be argued that imposing a fiduciary duty on the controlling shareholder to act in the long term could discourage controlling shareholder short-termism. However, such a duty would be hard to enforce and therefore unlikely to be effective if the business judgment rule would be applied, and would probably be too intrusive if a business judgment rule would not be applied.

In addition, proposals to solve the investor short-termism problem by insulating the board of directors from allegedly short-termist activist shareholders will likely not make a difference if there is a controlling shareholder, as the controlling shareholder already insulates the board from activists to a large extent.[94] Conversely, trying to encourage long-term oriented investors to engage in long-term oriented stewardship to combat managerial short-termism will not matter much if a controlling shareholder dominates the general meeting. If the controlling shareholder has a long-term perspective, the stewardship is unnecessary; if the controlling shareholder is short-termist, long-term oriented stewardship will likely not be effective.[95]

Some scholars have argued short-termism can be reduced by banning quarterly reporting and/or introducing more long-term oriented reporting, based on the idea that this will help shareholders focus on information that is relevant for the corporation's long-term performance.[96] However, controlling shareholders already have the incentives and the ability to gather exactly the information that they need from corporations, making changes to mandatory disclosure rules largely irrelevant. Nevertheless, disclosures (especially together with shareholder activism and

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[93] Reinier Kraakman et al., *The Anatomy of Corporate Law* (OUP, 2017) 69-70 (regarding the business judgment rule); Martin Gelter, 'Why do shareholder derivative suits remain rare in Europe?' [2012] Brooklyn Journal of International Law 843.

[94] However, Kastiel discusses some options for shareholder activism in controlled corporations: Kobi Kastiel, 'Against all odds: hedge fund activism in controlled corporations' [2016] Columbia Business Law Review 60, 67

[95] See for a similar argument that investor stewardship is unlikely to be effective in controlled corporations: Dan Puchniak, 'The False Hope of Stewardship in the Context of Controlling Shareholders: Making Sense Out of the Global Transplant of a Legal Misfit' (August 2021), https://ssrn.com/abstract=3858339.

[96] Lynne Dallas, 'Short-termism, the financial crisis and corporate governance' [2011] Journal of Corporation Law 265, 324-329.

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shareholder stewardship) could still be relevant for short-termism in controlled corporations, to the extent that they impact the reputation of a controlling shareholder.

The analysis in part 4 also shows that if one fears that controlling shareholders are short-termist, the best solution would be to address the private benefits of control, since they are the primary reason for why controlling shareholders may be short-termist. One example is to provide strong procedural safeguards in case of related party transactions involving the controlling shareholder. In addition, as argued above in part 4, the remuneration of a controlling shareholder who is also a director is a possible source of short-termism. Therefore, the executive compensation for directors with ties to the controlling shareholders could be made subject to the approval of a majority of the minority shareholders. Such a rule has been found effective in Israel in protecting shareholders against the extraction by controlling shareholders of private benefits through remuneration.[97] Finally, minority-appointed directors could help monitor the extraction of private benefits by controlling shareholders.[98] However, the problem with all these policy proposals is that they can only be effective in reducing short-termism if the minority shareholders that are empowered by these proposals are less short-termist than the controlling shareholders; otherwise the policy proposals could exacerbate short-termism.

If one believes that controlling shareholders are the solution to the short-termism problem because they are more long-term oriented, then policymakers could facilitate the creation of control. One obstacle to holding a controlling stake in a listed corporation is that it ties up a large portion of the controlling shareholder's wealth in a single corporation, making diversification more difficult and thus holding a controlling stake less attractive.[99] In addition, it is also possible that a controlling shareholder's wealth is simply limited, so that the controlling shareholder can no longer finance further expansion of the corporation without

[97] Jesse Fried, Ehud Kamar and Yishay Yafeh, 'The effect of minority veto rights on controller pay tunneling' [2020] Journal of Financial Economics 777.

[98] Such directors have been proposed by: Lucian Bebchuk and Assaf Hamdani, 'Independent directors and controlling shareholders' [2017] University of Pennsylvania Law Review 1271, 1295-1304; Maria Gutiérrez and Maribel Sáez, 'Deconstructing independent directors' [2013] Journal of Corporate Law Studies 63, 93-94; Alessio Pacces, 'Procedural and Substantive Review of Related Party Transactions. The Case for Noncontrolling Shareholder-Dependent Directors' in Luca Enriques and Tobias Tröger (eds.), *The Law and Finance of Related Party Transactions* (Cambridge University Press, 2019) 209-212.

[99] Ronald Gilson, 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' [2006] Harvard Law Review 1641, 1652 and 1664; Andrei Shleifer and Robert Vishny, 'A survey of corporate governance' [1997] Journal of Finance 737, 758.

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losing their control.[100] The classic answer to these problems is to decouple the financial participation of the controlling shareholder from the voting rights associated with the participation, for example through a dual class share structure or a pyramid structure.[101]

Alternatively, the creation of controlling shareholders can be encouraged by introducing loyalty voting rights. Loyalty voting rights grant shareholders multiple voting rights (typically double voting rights) if they have their shares for an uninterrupted period of time (typically two years).[102] The original idea behind loyalty voting rights was that they would encourage shareholders to hold their shares for a longer period of time and therefore discourage short-termism among shareholders.[103] However, that rationale has also been criticized, because a long holding period in the past does not necessarily equate to a long-term vision for the future. In practice, loyalty voting right are almost exclusively used by insiders and controlling shareholders to enhance their existing control.[104] This implies that loyalty voting rights are not effective in lengthening the horizons of institutional investors and asset managers, for example. However, loyalty voting rights can still help to combat short-termism by encouraging the creation of controlling shareholders, who may be more long-term oriented than other shareholders (see above in part 4).

However, encouraging the creation of controlling shareholders through dual class share structures and loyalty voting rights also comes with a drawback: the "wedge" between cash flow rights and voting rights strengthens the incentive for the controlling shareholder to extract private benefits of control from the corporation, because the controlling shareholder bears a

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[100] Koen Geens and Carl Clottens, 'One share one vote: fairness, efficiency and EU harmonization revisited' in Klaus Hopt and Koen Geens (eds.), *The European Company Law Action Plan revisited: reassessment of the 2003 priorities of the European Commission* (Leuven University Press, 2010) 151.

[101] See for a thorough analysis of the advantages and disadvantages of dual class share structures: Titiaan Keijzer, *Vote and Value. An economic, historical and legal-comparative study on dual class equity structures* (Kluwer 2020).

[102] Chiara Mosca, 'Should shareholders be rewarded for loyalty? European experiments on the wedge between tenured voting and takeover law' [2019] Michigan Business & Entrepreneurial Law Review 245.

[103] Jeroen Delvoie and Carl Clottens, 'Accountability and short-termism: some notes on loyalty shares' [2015] Law and Financial Markets Review 19, 19-20. This rationale was also explicitly mentioned by the Belgian legislator in the parliamentary documents. See: Explanatory Statement Law 4 June 2018 regarding the introduction of the Companies and Associations Code, *Parliamentary Proceedings* Chamber of representatives 2017-2018, nr. 54-3119/001, 208.

[104] Mark Roe and Federico Cenzi Venezze, 'Will Loyalty Shares Do Much for Corporate Short-Termism?' [2021] Business Lawyer 467, 487-496. See for empirical evidence: Marco Becht, Yuliya Kamisarenka and Anete Pajuste, 'Loyalty Shares with Tenure Voting: Does the Default Rule Matter? Evidence from the *Loi Florange* Experiment' [2020] Journal of Law and Economics 473 (with regards to France); Emanuele Bajo, Massimiliano Barbi, Marco Bigelli and Ettore Croci, 'Bolstering family control: Evidence from loyalty shares' [2020] Journal of Corporate Finance 101755 (with regards to Italy).

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smaller fraction of the financial consequences.[105] As discussed in part 4, these private benefits of control can be the cause of short-termism among controlling shareholders. Ironically, it is precisely the tool that aims to encourage more long-term oriented controlling shareholders that can cause controlling shareholders to become more short-term oriented. One advantage that loyalty voting rights have over dual class share structures, however, is that the multiple voting rights are limited to double voting rights. Therefore, in order to maintain control, controlling shareholders still need to hold a significant financial participation in the corporation and are still exposed to a large extent to the corporation's long-term performance.

Whether loyalty voting rights and dual class share structures have a net positive or negative impact on short-termism remains to be seen. In any case, this analysis shows that one has to be very vigilant with the introduction of multiple voting rights, which can have both advantages and disadvantages. This is especially true when multiple voting rights are introduced during the life of the corporation (in the "midstream"), as this causes a sudden shift of power from minority shareholders to controlling shareholders.[106] Lowering the majority required for introducing loyalty voting rights, as has been done in Belgium and Italy,[107] or making loyalty voting rights the default rule, as has been done in France with the Loi Florange,[108] therefore seems misguided, even if one agrees with the goal of combatting short-termism. If loyalty voting rights have a role to play in combatting short-termism, and not merely serve to increase the power of controlling shareholders, legislators should provide stronger protection for minority shareholders when loyalty voting rights are introduced in the midstream phase, for example by requiring approval by a majority of the minority shareholders or by granting minority shareholders appraisal right.

The table below summarizes the policy implications of adding controlling shareholders to the short-termism models. In the presence of a controlling shareholder, whether managers are short-

[105] See for an economic analysis of this issue: Lucian Bebchuk, Reinier Kraakman and George Triantis, 'Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights' in Randall Morck (ed.), *Concentrated Corporate Ownership* (University of Chicago Press, 2000).
[106] See for a discussion of the greater risks for shareholders in the midstream phase: Lucian Bebchuk, 'The Debate on Contractual Freedom in Corporate Law' [1989] Columbia Law Review 1395.
[107] For Belgium: article 7:53 Belgian Companies and Associations Code; for Italy, see: Emanuele Bajo, Massimiliano Barbi, Marco Bigelli and Ettore Croci, 'Bolstering family control: Evidence from loyalty shares' [2020] Journal of Corporate Finance 101755.
[108] See about the Loi Florange: Marco Becht, Yuliya Kamisarenka and Anete Pajuste, 'Loyalty Shares with Tenure Voting: Does the Default Rule Matter? Evidence from the *Loi Florange* Experiment' [2020] Journal of Law and Economics 473.

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termist is largely irrelevant, as the long-term or short-term orientation of managers will normally be an emanation of the orientation of the controlling shareholder, who appoints the managers. For this reason, managers are left out of the table. The table illustrates that the policy implications differ depending on whether controlling shareholders are long-term or short-term oriented. If controlling shareholders are long-term oriented, and other investors are short-termist, creating control should be facilitated by making loyalty voting rights and/or dual class share structures available, and minority rights should be limited. On the other hand, if controlling shareholders are short-termist, and other investors are not short-termist (or less short-termist), policymakers should try to reduce the extraction of private benefits of control (a source of short-termism) by empowering minority shareholders (as discussed above). In addition, if controlling shareholders are short-termist, policymakers can try to lengthen the horizon of controlling shareholders, for example by introducing fiduciary duties for the controlling shareholders and the company to act in the long term, making disclosures more long-term oriented, and/or encouraging long-term activism and stewardship. However, as discussed above, the effectiveness of these policy proposals is likely to be limited (hence the question mark).

	Controlling shareholder short-termist	**Controlling shareholder not short-termist**
Institutional investors and asset managers short-termist	(1) Lengthen horizon of controlling shareholders (?) (2) reduce extraction of private benefits of control by empowering minority shareholders (only if minority shareholders are less short-termist than controlling shareholders)	(1) Encourage the creation of control (for example through dual class share structures and loyalty voting rights) (2) insulate controlling shareholder (even more) from minority shareholders
Institutional investors and asset managers not short-termist	(1) Lengthen horizon of controlling shareholders (?) (2) reduce extraction of private benefits of control by empowering minority shareholders (for example through minority-appointed directors, strong rules regarding related party transactions and executive compensation and strong protections when dual class share structures and loyalty voting rights are introduced)	No problem, no policy implications

Table 2: the short-termism policy proposals matrix adapted to controlling shareholders.

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6. Conclusion

The goal of this paper was to move the short-termism debate forward by adding the role of controlling shareholders to the analysis. It is clear that controlling shareholders could play an important role in solving the short-termism problem (should one exist), both in the investor short-termism model and in the managerial short-termism model. However, controlling shareholders can only help with combatting short-termism if they themselves are not excessively focused on the short term. Further empirical research, especially employing external shocks to insider ownership, is necessary to determine which controlling shareholders can have a positive impact on the long-term firm performance, and under what conditions. In any case, the theoretical analysis suggests that the protection of minority shareholders against the extraction of private benefits of control is important for preventing short-termism. Initiatives to facilitate controlling shareholders through multiple voting rights must therefore be accompanied by mechanisms that protect minority shareholders. Only in this way can we arrive at a corporate governance system that truly facilitates long-term value creation.

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