Organizational antecedents of managerial short-termism
Kleinknecht, R.H.

Citation for published version (APA):
Kleinknecht, R. H. (2018). Organizational antecedents of managerial short-termism

General rights
It is not permitted to download or to forward/distribute the text or part of it without the consent of the author(s) and/or copyright holder(s), other than for strictly personal, individual use, unless the work is under an open content license (like Creative Commons).

Disclaimer/Complaints regulations
If you believe that digital publication of certain material infringes any of your rights or (privacy) interests, please let the Library know, stating your reasons. In case of a legitimate complaint, the Library will make the material inaccessible and/or remove it from the website. Please Ask the Library: http://uba.uva.nl/en/contact, or a letter to: Library of the University of Amsterdam, Secretariat, Singel 425, 1012 WP Amsterdam, The Netherlands. You will be contacted as soon as possible.
CHAPTER 1
INTRODUCTION

While many regarded business as the engine behind technological progress and macroeconomic growth in the past decades, the financial crisis of 2007–2008 triggered the deepest recession since the 1930s (IMF, 2009) and indicated that the efforts of firms to increase performance do not necessarily benefit society. In particular, concerns have arisen that corporate leaders tend to focus too much on quarterly earnings while neglecting value creation for the long term (Barton, 2011; Barton & Wiseman, 2014; Christensen & Van Bever, 2014; Ignatius, 2014; Lazonick, 2014). For example, in 2014 Blackrock, the world’s largest asset manager, observed that “many companies have shied away from investing in future growth of their companies” (Fink, 2014: 1), an observation supported, amongst others, by a global survey in 2013 that revealed that many business leaders perceived increased pressures to deliver short-term financial performance (Bailey & Godsall, 2013).

One of the major concerns is that a focus on short-term results does not only influence the strategies of individual firms but may also affect society at large. Observers, for instance, have warned that “companies are less able to invest and build value for the long term, undermining broad economic growth and lowering returns on investment for savers” (Barton & Wiseman, 2014: 50). In addition to such macroeconomic effects, a short-term focus of business leaders may also reduce their ability to address long-term societal issues such as climate change (Jackson & Petraki, 2011; Slawinski, Pinkse, Busch & Banerjee, 2017). As such, worries about corporate short-termism, i.e. “a preference for actions in the near term that have detrimental consequences for the long term” (Marginson & McAulay, 2008: 274), also figure prominently in public debates. During the U.S. presidential campaign in 2016, for example, the Democratic candidate Hillary Clinton (2015: 2), decried “quarterly capitalism”, a term first coined in 2011 to refer to the “short-term approaches to running and investing in companies” (Barton, 2011: 87). Though these discussions are most prevalent in the Anglo-Saxon context (Kay, 2012), short-termism is also debated in other institutional environments (Brunzell, Liljeblom & Vaihekovski, 2015; Suto & Toshino, 2005; The Economist, 2015), including in the Netherlands (Boot, 2017; Hermes, 2017).

While concerns about short-termism have risen during the last decade, it is not the first time that the issue has been under scrutiny. Already in the beginning of the 1980s, Hayes and Abernathy (1980: 70) argued that U.S. corporations had lost ground against European and Japanese competitors because “maximum short-term financial returns have become the overriding criteria for many companies.” More than a decade later, Jacobs (1991) and Porter (1992) joined in, arguing that the short-term investment approaches of capital providers reduced the competitiveness of American companies by inducing corporate short-termism. It is probably no coincidence that all these pessimistic analyses were published during or shortly after contractions of the U.S. economy: the article of Hayes and Abernathy was published right after the (at the time) second-worst post-World War II contraction of the U.S. economy (–7.9% in the second quarter of 1980), while the
other two pieces were published in the early 1990s, shortly after the only two quarters of negative growth since 1982 (–3.4% and –1.9% in the second and third quarters of 1991 respectively). In retrospect, these fears about declining competitiveness may have been exaggerated: 35 years after the seminal article by Hayes and Abernathy (1980), the U.S. still belongs to the richest countries of the world in terms of GDP (per capita), U.S. firms such as Apple, Exxon Mobile and Microsoft rank among the most profitable of the world, and about one third of the Global Fortune 500—the largest firms in the world—is of U.S. origin, although that share has been on the decline for years.

In spite of these observations, scholars have continued raising the issue of short-termism from time to time. For instance, at the turn of the century, even though the dot-com bubble reached its height, Lazonick and O’Sullivan (2000) expressed concerns that the U.S. were living off their past. They argued that the successes in the information and communication technology were mainly based on historical accumulations of resources in districts such as Silicon Valley, but doubted “whether the American economy is currently generating the new technological infrastructure that can provide foundations for sustainable prosperity in the twenty-first century” (Lazonick & O’Sullivan, 2000: 31). Also after the wave of accounting scandals in the early 2000s, international scholars and business observers have expressed concerns about short-termism in business (e.g. Tonello, 2006; Krehmeyer, Orsagh & Schacht, 2006). Despite this periodic attention, however, short-termism has never been a central issue in academic scholarship, in particular since the economic upturn of the late 1990s.

This changed after the financial crisis in the late 2000s. During the past decade, the phenomenon of short-termism and its societal and business consequences issue have increasingly gained attention among both practitioners and scholars, as well as in the international media (e.g. Barton, 2011; Barton & Wiseman, 2014; Christensen & Van Bever, 2014; Curran & Chapple, 2009; Jackson & Petraki, 2011; Jarsulic, Duke & Madowitz, 2015; Kay, 2012; Lazonick, 2014; Rappaport, 2011; Summers, 2015; The Aspen Institute, 2009). Moreover, given that more and more analyses indicate that short-termism is not only quite prevalent (Asker, Farre-Mensa & Ljungqvist, 2015; Graham, Harvey & Rajgopal, 2005; Souder, Reilly, Bromiley & Mitchell, 2016), but may also have important macroeconomic implications (Gutiérrez & Philippon, 2016; Terry, 2015), scholarly attention for short-termism may be here to stay.

1.1 SHORT-TERMISM AND INTERTEMPORAL CHOICES

The problem of short-termism arises from managers’ need to make intertemporal choices (Laverty, 1996), i.e. “decisions in which the timing of costs and benefits are spread out over time” (Loewenstein & Thaler, 1989: 181). The in-depth study of relevant bodies of literatures from different (sub)disciplines in Chapter 2 of this dissertation shows that these intertemporal choices are related to various antecedents of managers’ temporal orientations at the individual, organizational and macro levels. While scholars have mostly focused on antecedents at the macro level (Laverty, 1996; Marginson & McAulay, 2008), and individual-level antecedents have been increasingly analyzed in recent years (e.g. Antia, Pantzalis & Park, 2010; Crilly, 2017; Nadkarni & Chen, 2014), relatively limited attention has been paid to the role of organizational antecedents.
CHAPTER 1: INTRODUCTION

This PhD thesis, therefore, aims to contribute to filling this gap in the literature by asking as an overall research question: *Which organizational factors influence the temporal orientations of managers?*

As indicated, Chapter 2 reviews how a wide variety of research streams has addressed managers’ intertemporal choices, paying specific attention to the causes and consequences of short-termism. It starts with discussing how theoretical approaches touch upon the subject, with particular focus on the capital budgeting literature, neoclassical economics, agency theory, the behavioral theory of the firm, and real options theory. Next, it summarizes the various constructs related to intertemporal choices (including short-termism, myopia, investment horizon, temporal orientation and temporal focus), as well as the measurement methods that have been used to capture intertemporal choices (i.e. interviews and surveys, analyses of financial statements or managers’ strategic actions, and studies of managers’ cognition by means of text analyses). Subsequently, it organizes and discusses the various antecedents of intertemporal choices identified in empirical research at the individual, organizational, and macro levels, before reviewing the empirical evidence of the consequences of intertemporal choices. The literature review is completed by discussing the overarching themes that emerge and the implications for further research.

It is recommended that future research makes use of constructs that disconnect antecedents from (suboptimal) consequences, as well as of measures that enable the isolation of temporal orientations from other aspects that may influence long-term decisions, such as risk-taking. Several promising areas for research are identified, including further analysis of the role of organizational antecedents of intertemporal choices, studies of interactions among antecedents of intertemporal choices, comparative research of intertemporal choices across different institutional contexts and examinations of the relationship between intertemporal choices and firm performance in different industry settings. The remainder of this PhD thesis focuses on the role of organizational antecedents, which so far has gained limited attention among scholars.

This limited attention for the organizational antecedents of temporal orientation is unfortunate as a better understanding of the organizational dimensions that shape managers’ temporal orientation may potentially help firms to devise institutions that could counterbalance macro-level and individual-level factors that tend to be beyond the control of the firm. In order to fill this gap in the literature with respect to the organizational antecedents of managers’ temporal orientations, three sub-questions were identified, which are addressed in the empirical chapters:

a) Do institutional ownership and managerial entrenchment interact in affecting managers’ temporal orientation?

b) Does the structure of the organization affect the short-term performance pressures perceived by managers?

c) Does participation in corporate decision-making by employees, which tend to have an interest in the long-term survival of the firm, affect firm value?

In addition to shedding light on organizational factors, the research to answer the first sub-question contributes further to the literature by addressing interactions among two different antecedents of
intertemporal choices, based on an analysis of U.S. data as explained below. The second and third sub-questions are addressed by using data of firms operating in the European context. They thus expand the analyses of the antecedents of managers’ intertemporal choices to institutional environments that are different from the U.S., which may help spur comparative research.

In view of the nature of these sub-questions, the three chapters use different theoretical approaches, as well as a variety of constructs and measurements (see Table 1.1). All chapters are based on the behavioral theory of the firm in the sense that they analyze factors that may affect the process of decision-making in the firm given cognitive limits of decision-makers. Specifically, Chapter 3 draws on behavioral agency theory (Pepper & Gore, 2015; Wiseman & Gomez-Mejia, 1998), arguing that the temporal orientation of managers depends on the type of control executed by shareholders. Chapter 4 adopts an attention-based view of the firm (Ocasio, 1997; 2011) to explain how structural elements of the organizations determine the cognitive distance of management from operations, shaping managers’ perceptions of short-term performance pressures. Finally, Chapter 5 employs arguments from behavioral decision theory (Hambrick & Mason, 1984), in addition to classical agency theory logic (Jensen & Meckling, 1979), to explain why employee participation in corporate decision-making lengthens managers’ temporal orientation.

Table 1.1: Overview of the empirical papers

<table>
<thead>
<tr>
<th>Research question</th>
<th>Theory</th>
<th>Construct</th>
<th>Measurement method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chapter 3</td>
<td>Do institutional ownership and managerial entrenchment interact in affecting managers’ temporal orientation?</td>
<td>Behavioral theory of the firm (i.e. behavioral agency theory)</td>
<td>Temporal orientation</td>
</tr>
<tr>
<td>Chapter 4</td>
<td>Does the structure of the organization affect the short-term performance pressures perceived by managers?</td>
<td>Behavioral theory of the firm (i.e. attention-based view of the firm)</td>
<td>Perceived short-term pressures (self-reported temporal orientation)</td>
</tr>
<tr>
<td>Chapter 5</td>
<td>Does participation in corporate decision-making by employees, which tend to have an interest in the long-term survival of the firm, affect firm value?</td>
<td>Agency theory and behavioral theory of the firm</td>
<td>Short-termism</td>
</tr>
</tbody>
</table>

In addition, the three chapters use different constructs, resulting from the variety of measurement methods used. Chapter 3 analyzes managers’ temporal orientation as reflected in quarterly earnings conference calls; Chapter 4 captures the perceived short-term pressures as indicated in a survey and Chapter 5 examines managers’ short-termism by means of retro-active inference of financial statements. Taken collectively, the three empirical studies in this PhD thesis enhance our understanding of the organizational antecedents of managers’ temporal orientations.
1.2 INTRODUCTION TO THE EMPIRICAL STUDIES

At the organizational level, intertemporal choices may be affected both by the process of decision making and by the corporate goals pursued by managers. As the latter is influenced by corporate governance characteristics that determine the type of stakeholder interests salient to managers (Aguilera & Jackson, 2003; Kacperczyk, 2009; Mitchell, Agle & Wood, 1997), scholars have, for instance, analyzed whether the power and types of a firm’s shareholders affect managers’ intertemporal choices (Reilly, Souder & Ranucci, 2015). In particular, the effects of management entrenchment and institutional ownership have been analyzed as both are likely to shape the corporate goals that managers pursue by determining the salience of specific stakeholders (Hill, Hitt & Hoskisson, 1988; Jensen, 1988; Stein, 1988). Yet, so far, the empirical analyses of both the effects of shareholder type and management entrenchment have delivered mixed results (e.g. Aghion, Van Reenen & Zingales, 2013; Atanassov, 2013; Shi, Connelly & Hoskisson, 2017; Wang, Zhao & He, 2016).

Chapter 3 of this thesis contributes to the literature by proposing that both factors may interact in determining the intertemporal choices of managers, which potentially explains the mixed findings in previous studies. A database over 18,000 quarterly earnings conference calls of more than 1,100 publicly-listed, non-financial U.S. companies over the period 2007–2014 was developed to analyze the effects of shareholder type and management entrenchment on managers’ temporal orientation as reflected in these calls. The results provide support for a crossover interaction between institutional ownership and entrenchment, such that each may contribute to longer temporal orientations of management in isolation, but that in conjunction they push managers’ temporal orientation to the short term. The findings suggest that future research should pay more attention to such interactions.

Besides the corporate goals that managers pursue, intertemporal choices may also be shaped by organizational factors that affect the process of decision making. For instance, the role of the specific performance measurement techniques used and the effect of the availability of financial resources have drawn the attention of researchers (Aberethy, Bouwens & Lent, 2012; Marginson, McAulay, Roush & Van Zijl, 2010; Martin, Wiseman & Gomez-Mejia, 2016; Souder & Shaver, 2010). Yet, in addition to these financial elements, there may be more factors that could affect the way corporate choices are perceived and to what extent alternatives are critically evaluated (Laverty, 1996).

In Chapter 4, it is argued that structural elements of the organization (i.e. its size, hierarchy, bureaucracy, and flexibility) are likely to shape the distribution of attention within the organization in ways that affect intertemporal choices. In particular, aspects of organizational structure that increase the cognitive distance of managers from operations reduce their understanding of the crucial resources and capabilities on which these operations depend in the long term. As a result, managers are inclined to shift their attention to shorter-term issues and answers that are more easily understood and managed. Hence, factors that increase managers’ cognitive distance to operations, such as firm size and hierarchy, may make short-term issues more salient to managers. A large-scale survey among more than 3,200 managers of non-listed companies from the Netherlands provides support for the hypothesized effects.
One further organizational factor that may influence both the process of decision-making and the corporate goals pursued is employee participation in corporate decision-making by means of works councils or representation in the board of directors. This is a common feature of corporate governance among larger firms in several European countries. As employees in the European context tend to have an interest in the long-term survival of the firm, they are likely to play a conservative role in the decision-making process, increasing the salience of long-term corporate objectives that contribute to chances of survival over short-run goals such as quarterly earnings targets (Jensen & Meckling, 1979). Chapter 5, therefore, analyzes the effects of employee participation during the financial crisis of 2007–2008. Data from a sample of over 700 European firms show that while firms with employee representation at the level of the board of directors were valued lower than firms without such representation before the start of the financial crisis, they also lost less value during the financial crisis.

Chapter 5 does not directly measure temporal orientation. Yet, the finding that employee participation increases the resilience of firms during a crisis suggests that employees, who have an interest in the long-term survival of the firm, push for corporate strategies that are less risky in the short term and focus more on long-term value creation. Rather than directly observed, the role of intertemporal choices is thus based on ex post interpretation resulting from retro-active inference of financial statements. The fact that intertemporal choices are not directly measured, results from the process underlying this thesis: the PhD trajectory started with this project and its research findings, which have been published in the *European Journal of Industrial Relations* in the meantime, formed the inspiration to take a more in-depth look at the antecedents of managers’ intertemporal choices in the rest of the thesis.\(^1\)

Jointly, the empirical analyses within this thesis contribute to the literature on the antecedents of intertemporal choices by examining their organizational-level antecedents. In the conclusion of this PhD thesis, it is explained how the various chapters contribute to answering the overall research question. The results of the analyses are reviewed, including a discussion of the limitations and the implications for future research, and for management and policy.

\(^1\) Although this article was the first study, in the final set-up of the dissertation it seemed to fit best as a last empirical chapter (see also the discussion in the concluding Chapter 6).