Organizational antecedents of managerial short-termism
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CHAPTER 6
DISCUSSION AND CONCLUSIONS

This final chapter reflects and concludes, taking a chronological perspective on the studies included in this PhD thesis. It first sketches the broader context of the research and its underlying inspiration, followed by a discussion of key foci and contents of the four chapters (a literature review and three empirical studies) in sections 6.1, 6.2, 6.3 and 6.4. Subsequently, the overall contribution of the PhD thesis is explicated, together with its limitations and possible areas for further research. The final section, 6.6, provides implications for management practice and policy.

Overall, this dissertation aimed to explore organization-level antecedents of short-termism, inspired by a growing interest in corporate governance issues that emerged after the financial crisis of 2007–2008 in particular. In this period, it became clear that excessive risks had been taken in order to maximize corporate profits (and bonuses, i.e. individual rewards), especially in the financial services industry. This raised doubt about the contribution of business to society at large, also in view of the deep recession that followed. Observers especially questioned the effectiveness of the systems of corporate governance, given that supervisory boards often seemed unaware of the risks that had been taken by the companies that they were supposed to control. Moreover, reports at the time suggested that these governance problems were not limited to the financial services industry, but symptomatic of a more general failure of corporate governance (Kirkpatrick, 2009). In many firms, the pursuit of short-term profits seemed to have gained priority over the creation of value for the long term (Barton, 2011; Kay, 2012). This background formed the inspiration for the first project of this PhD thesis (included as Chapter 5), concentrating on the role of employee participation in relation to corporate governance and firm value.

6.1 THE ROLE OF EMPLOYEE PARTICIPATION IN DECISION-MAKING

The motivation to look into the effects of employee participation in corporate decision-making was, at least, twofold. First, the literature suggested that such participation could strengthen the flow of information from the work floor to the level of the board of directors, which could improve the supervisory control exerted by boards (Fauver & Fuerst, 2006; Freeman & Lazear, 1995). Second, agency theory holds that employees are more long-term oriented and risk averse than managers and shareholders as they cannot diversify their risk of being fired (Jensen & Meckling, 1979), implying that employee participation could possibly mitigate short-termism and excessive risk-taking in firms. Hence, the research question of the first project was: *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?*

This question was addressed by analyzing a sample of European companies, as employee participation is common in many European countries and employees in Europe tend to have long-term contracts, increasing their interest in the long-term survival of the firm. Hence, we expected that employees 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. In good times, given that risk-taking and profits are correlated, this conservative influence may come at the cost of shareholder value. In bad times, however, employee participation may enhance firms’ resilience as firms took less risks during the boom period and employees may be more cooperative in adapting to the new circumstances. The analysis revealed that, in the period 2006–2008, firms with employee board-level representation were valued lower before the crisis, but also lost less value when financial markets crashed. These results suggest that employee participation indeed affects managers’ temporal orientations such that more value is attached to the long-term.

While this interpretation was based on indirect evidence, during the process of the research project it was discovered that few studies directly measured managers’ temporal orientations. Scholars frequently referred to concepts such as ‘managers’ time horizons’, but often these references were based on widely-held assumptions rather than on empirical analysis. In fact, studies that actually tried to measure managers’ temporal orientations seemed to be limited, both in terms of quantity and quality. In a review of the literature on short-termism, Laverty (1996), for instance, argued that intertemporal choices could not be reliably measured by means of R&D investments, an approach typically followed by the few researchers that actually tried to capture managers’ temporal orientations. This was due to the fact that such investments do not necessarily represent long-run investments and may also be affected by risk preferences. This apparent lack of research formed the motivation to dig deeper into the literature on intertemporal choices, ultimately resulting in the literature review included as Chapter 2 in this PhD thesis.

6.2 REVIEW OF THE LITERATURE ON INTERTEMPORAL CHOICES
The review of the literature from a broad range of disciplines showed that researchers in different areas have conducted empirical studies related to intertemporal choices. Yet, as these studies were fragmented over different research fields, connections between the studies were often lacking, resulting in the use of a broad variety of constructs and measurements and limiting the extent to which scholars build on the work of others. Consequently, different, and sometimes conflicting, ex-ante assumptions were made about the phenomenon, hindering the broader generalizability of individual examinations. This results in the curious phenomenon that some researchers, in line with, for instance, Hayes and Abernathy (1980), worry about the ubiquity of short-termism in management practice (Barton, 2011; Barton & Wiseman, 2014; Christensen & Van Bever, 2014), whereas others, following Jensen (1986b), assumed that such suboptimal managerial behavior cannot exist on a large scale given control from financial markets (Dent, 2010).

Fortunately, in recent years, both the quantity and quality of research has increased, encouraged, amongst others, by the development of new measures reflecting the intertemporal choices of managers (e.g. Brochet, Loumioti & Serafeim, 2015; Souder & Shaver, 2010). As such, recent studies have provided empirical evidence of the pervasiveness of the tendency of managers to prioritize short-term results over long-term goals, especially in publicly-listed firms (Asker, Farre-Mensa & Ljungqvist, 2015; Souder, Reilly, Bromiley & Mitchell, 2016). In addition, some
studies indicate that such short-termism may come at the expense of corporate financial performance (Flammer & Bansal, 2017; Reilly, Bromiley & Mitchell, 2016) and of social and environmental performance (Slawinski, Pinkse, Busch & Banerjee, 2017). Moreover, there is evidence suggesting that a focus of managers on the short term also negatively affects macroeconomic growth, amongst others by reducing corporate investment levels (Gutiérrez & Philippon, 2016; Kahle & Stulz, 2017; Terry, 2015). Similarly, it could potentially explain why corporate investments in scientific research have declined even though they remain valuable for corporate innovation (Arora, Belenzon & Patacconi, 2018).

In view of the potentially dire consequences of a focus on short-term results, it is important to understand what factors drive the intertemporal choices of managers. The literature review organized the antecedents of intertemporal choices, as identified in several different areas of research, at the individual, organizational and macro levels. It found that while macro-level antecedents, such as earnings pressures from financial markets, have received relatively much attention in the literature, and scholars have increasingly analyzed the role of individual-level factors, such as behavioral biases and personality traits, our understanding of the role of organizational-level antecedents is still limited (Laverty, 1996; Marginson & McAulay, 2008).

In particular, the effects of the power of shareholders on intertemporal choices remain ambiguous. On the one hand, managers’ entrenchment by means of takeover protection is argued to enhance managers’ power relative to shareholders, relieving short-term earnings pressures and enabling them to focus on long-term value creation (Kacperczyk, 2009; Stein, 1988). On the other hand, monitoring and control by institutional owners could press managers towards serving long-term value creation, meaning that increased power of shareholders could enhance the attention for the long term (Atanassov, 2013; Jensen, 1988). The second empirical project of this thesis, therefore, concentrated on the effects of institutional ownership and takeover protection on managers’ temporal orientation.

6.3 THE ROLE OF SHAREHOLDERS

While both institutional ownership and managers’ entrenchment are argued to enhance managers’ attention to the long term, empirical studies into the effects of both factors have delivered mixed results (Aghion, Van Reenen & Zingales, 2013; Atanassov, 2013; Shi, Connelly & Hoskisson, 2017; Wang, Zhao & He, 2016). These different outcomes may result from both factors interacting in shaping temporal orientation. Entrenchment of managers reduces the ability of institutional shareholders to influence managers’ temporal orientation through the exercise of voice, which could lead them to invest less in monitoring of management when entrenchment is high. Instead they are likely to behave more like minority shareholders in this case, selling their stocks when short-term earnings are expected to disappoint, which increases the pressures on management to deliver short-term results. As such, the occurrence of either entrenchment or institutional ownership may lengthen temporal orientation, while the combination of both shortens it. Hence, the research question of the second empirical project (in Chapter 3) was: Do institutional ownership and managerial entrenchment interact in affecting managers’ temporal orientation?
In order to capture managers’ temporal orientation, a novel measure was used, based on content analysis of quarterly earnings calls. Pioneered by Brochet, Loumioti and Serafeim (2015) and DesJardine and Bansal (2015), content analysis of earnings conference calls allows us to capture managers’ temporal orientation by means of data that is widely available and may better reflect managers’ cognition than accounting-based methods. In addition, it is likely to be less susceptible to socially-desirable answers than alternative methods such as surveys or interviews. We gathered data for stock-market listed companies in the U.S., as these companies were among the first of which (same-language) quarterly earnings conference calls were transcribed, which made it possible to do a longitudinal analysis.

Analyzing the temporal orientation of managers as exposed in quarterly earnings conference calls, we found a crossover interaction of institutional ownership and entrenchment. In other words, managers’ temporal orientation tends to become longer when either institutional ownership or managers’ entrenchment is high. However, when institutional ownership increases while managers’ entrenchment is already high, or entrenchment increases while institutional ownership is already high, this shortens managers’ temporal orientation. This crossover interaction could explain why previous research into the effects of entrenchment and institutional ownership delivered inconsistent results.

In addition, the study contributes to the literature by further investigating the potential of the measurement of temporal orientation based on content analysis of quarterly earnings calls. Brochet, Loumioti and Serafeim (2015) and DesJardine and Bansal (2015) show that temporal orientation as measured in earnings conference calls relate to other measures of temporal orientation, as well as to pressures from financial markets. They, however, do not analyze how the measure is influenced by the particular context, i.e. quarterly earnings conference calls. In our project, we do control for this context, by controlling for the temporal orientation of analysts, the length of the call and whether the call addresses only the results of the last quarter or the results of the entire year. The results indicated that these variables also significantly explain managers’ temporal orientation, implying that analyses of temporal orientation by means of quarterly earnings conference calls may be improved by controlling for such contextual factors. In line with Brochet, Loumioti and Serafeim (2015), our results with respect to institutional ownership and entrenchment also indicate that these transcripts provide more general insights beyond the specific earnings calls context.

6.4 THE ROLE OF ORGANIZATIONAL STRUCTURE
While the evidence of the effects of institutional ownership and managers’ entrenchment on intertemporal choices was mixed, the review of the literature also showed that other organizational-level antecedents have been largely neglected. Most surprisingly perhaps was the lack of research into the effects of basic elements of organizational structure, such as firm size. Chapter 4 of this thesis therefore, addressed the following question: *Does the structure of the organization affect the short-term performance pressures perceived by managers?*
CHAPTER 6: DISCUSSION AND CONCLUSIONS

Drawing on the attention-based view of the firm, it is argued that the short-term pressures perceived by managers depend on the information they pay attention to. Specifically, the more managers are cognitively detached from operations, the more they rely on middle management to provide key information on daily operations and on issues that affect these operations, and the less strategically relevant information reaches them because some of the operational knowledge is tacit. As top managers are, thus, less likely to fully comprehend the operational resources and capabilities that underlie the firm’s long-term competitive advantage, investments in the firm’s long-term competitive advantage becomes less salient and seem more uncertain to managers than investments that ‘fix’ performance in the short term. In a survey among more than 3,200 managers of firms in the Netherlands, we find that structural elements that increase managers’ distance to operations (i.e. size, hierarchy, bureaucracy and flexibility) are indeed related to greater perceptions of short-term pressures among managers.

As such, this chapter contributes to the literature by providing the first empirical evidence of the role of structural aspects of the organization in shaping managers’ intertemporal choices. Determining managers’ perceptions, the structure of the organization affects their response to internal and external attention triggers. As such, although the analysis in Chapter 4 focused on private firms, the extent to which managers of publicly-listed firms perceive short-term performance pressures exerted by financial markets may also be moderated by structural aspects of organizations. In view of the results found in Chapter 5, the effects of employee participation in decision-making would be of specific interest in this regard: one could imagine that employee participation in decision-making may reduce managers’ cognitive distance to operations as the input from employees helps managers to better understand the resources and capabilities involved in operations. This could lengthen managers’ temporal orientation as it increases their confidence in the benefits of long-term investments, reducing their susceptibility to turn to short-term strategies to increase performance. As such, the results of Chapter 4 provide interesting possibilities for future research with respect to the effects of organizational structure on managers’ intertemporal choices.

6.5 LIMITATIONS AND FUTURE RESEARCH

Jointly, the empirical analyses within this PhD thesis contribute to answering its overall research question: Which organizational factors influence the intertemporal choices of managers? Table 6.1 gives an overview of these three chapters’ research questions, empirical bases and main results. The results indicate that employee participation in corporate decision-making, institutional ownership, managerial entrenchment and organizational structure affect managers’ intertemporal choices. As such, the thesis advances the literature on managers’ intertemporal choices by showing empirically that, in addition to macro-level factors such as earnings pressures from financial markets, or individual-level factors such as personality traits or behavioral biases, organizational factors shape the cognition underlying managers’ intertemporal choices and thus are key underemphasized elements in the debate surrounding short-termism. Furthermore, by empirically analyzing the antecedents of intertemporal choices in different contexts – including European and
U.S. firms, listed and non-listed, and large versus small and medium-sized companies – the thesis contributes to the literature by showing empirically that intertemporal choices are a common theme in management practices across different settings. This indicates that short-termism is a broader phenomenon than is suggested in the current debate, which focuses on large listed companies in the U.S.

Table 6.1: Overview of the results of the empirical chapters

<table>
<thead>
<tr>
<th>Research question</th>
<th>Sample and data</th>
<th>Main results</th>
<th>Study included in</th>
</tr>
</thead>
<tbody>
<tr>
<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>726 firms in 17 European countries, 2006–2008</td>
<td>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, but also lost less value during the financial crisis.</td>
<td>Chapter 5</td>
</tr>
<tr>
<td>Do institutional ownership and managerial entrenchment interact in affecting managers’ temporal orientation?</td>
<td>1,118 publicly-listed, non-financial firms in the U.S., 2007-2014</td>
<td>Managers talk more about the long term when either institutional ownership or entrenchment is high, but are more focused on the short term when both are absent or when they are jointly present.</td>
<td>Chapter 3</td>
</tr>
<tr>
<td>Does the structure of the organization affect the short-term performance pressures perceived by managers?</td>
<td>3,221 private firms in the Netherlands, 2014</td>
<td>Firm size, hierarchy and workforce flexibility increase managers’ focus on the short term, although the effects of workforce flexibility are only marginally significant.</td>
<td>Chapter 4</td>
</tr>
</tbody>
</table>

Another contribution of this PhD thesis is that it uses a variety of measurement methods. Chapter 3 uses content analysis of conference calls in order to analyze the interaction among institutional ownership and entrenchment, Chapter 4 relies on a survey to examine the effects of organizational structure, and Chapter 5 on retro-active inference from financial statements to assess the effects of employee participation. As indicated in the literature review, all these measures have their weaknesses. Retro-active inference based on financial statements does not directly relate to managerial behavior, surveys tend to be limited in scale (although this scale issue was circumvented in Chapter 4 by making use of an existing large-scale survey in the Netherlands) and, although the first results are promising, the extent to which content analysis reflects the behavior of managers in other settings is still an open question. By using a variety of measures, this thesis provides some evidence suggesting that the results of the various methods are largely consistent. In line with the results in Chapter 5, for instance, exploratory analyses of the data used in Chapter 4 did not indicate any significant effects of the presence of works councils on the short-term pressures perceived by managers.12 As such, this contributes to overcoming the measurement

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12 These results were not included in the chapter as the results for works councils were insignificant and, moreover, inclusion of the variable was found to lead to a rejection of the proportional odds test of ordinal regression. This was
problems that long held back our understanding of intertemporal choices in management practice (Laverty, 1996).

At the same time, however, the variety of contexts analyzed and measurement methods used, limits the extent to which the results of this PhD thesis can be generalized. For instance, Chapter 5 found that firm value during the crisis was affected by employee participation in decision-making at the level of the board of directors, but not by the presence of European works councils. Yet, as Dutch firms do not know employee participation in the board of directors, we could not validate the results of Chapter 5 in the data collected for Chapter 4. Similarly, the results of Chapter 5 suggest that the financial crisis increased short-term pressure on firms, which were mitigated by employee participation. In line with this, the conference calls data used in Chapter 3 indicated (although not reported in the chapter) that managers’ temporal orientation on average lengthened from 2011 onwards. While this could be viewed as validating our suggestion in Chapter 5, such generalizations should be treated with care as both studies use different samples and partly different time periods.

Future research, therefore, is needed to further clarify how the crisis affected managers’ temporal orientation, as well as more directly analyzing the effects of employee participation on managers’ intertemporal choices. The latter could be done, for instance, by conducting a survey among large firms in a set of European countries, including questions comparable to the ones used in Chapter 4. Yet, as such data collection may be problematic given low response rates, a more promising approach for the future would be using earnings conference call transcripts as we have done in Chapter 3. These transcripts are not yet as widely available in Europe as in the U.S., but the numbers seem to be increasing. Alternatively, investment-based measures of time horizons, such as developed by Souder and Shaver (2010), may provide further scrutiny of the results in Chapter 5.

More generally, future research is recommended to avoid making a priori presumptions about intertemporal choices, such as the assumption that managers’ decision horizons are shorter than shareholders’ investment horizons. The literature review in Chapter 2 reveals a variety of antecedents of intertemporal choices. One of the key questions for future research is how these antecedents, including interactions among different levels, interact in shaping intertemporal choices. Can specific organizational features or individual characteristics, for instance, mitigate or aggravate the effects of shareholder pressures? Are the effects of individual biases affected by organizational structures? In order to address such questions, it is probably most productive to avoid making a priori assumptions about the nature of the phenomenon, and rather to take a behavioral, actor-centered perspective. Given the upsurge of high-quality research in recent years, the analysis of intertemporal choices is expected to shortly be an important area of research among management scholars and that our understanding of the phenomenon will keep improving in the coming years.

probably caused by the high correlation with firm size, which also affected the short-term pressures perceived by managers.
6.6 IMPLICATIONS FOR MANAGEMENT PRACTICE AND POLICY

The findings of this dissertation have several implications for both management practice and policymaking. With regards to management practice, the evidence that value creation may suffer from a focus on the short term (Flammer & Bansal, 2017; Souder, Reilly, Bromiley & Mitchell, 2016) urges firms to increase the attention for long-term strategy. Shareholders, for instance, increasingly realize that quarterly earnings that come at the cost of future value are not in their interest (Fink, 2014; The Aspen Institute, 2009). As a result, supervisory boards, which are supposed to monitor managers’ behavior, are likely to increasingly see it as their duty to address short-termism within their company. One way to reduce the pressures for short-term results would be to delist the company, which frees managers from the pressures exerted by financial markets (Asker, Farre-Mensa & Ljungqvist, 2015). Yet, such a drastic decision may not always be desirable. The results of this PhD thesis suggest that boards may consider alternatives that are less radical, such as increasing managers’ entrenchment, depending on the level of ownership, reducing hierarchy or introducing employee participation in decision-making.

With regards to policymaking, the evidence indicating that managers’ intertemporal choices have implications for society, amongst others through influencing corporate action on investment decisions, implies that the tendency of firms to focus more on the short term than would be optimal (Flammer & Bansal, 2017; Souder, Reilly, Bromiley & Mitchell, 2016), may also of concern to policymakers (e.g. Clinton, 2015). However, it is heavily debated what the optimal policy answer to short-termism may be. In 2014, France introduced the ‘Florange law’, which reduced the rights of short-term shareholders relative to those of long-term shareholders in an attempt to reduce short-term pressures on managers. This law sharply contrasts with the tendency of many countries, and in particular the U.S., to extend shareholder rights since the 1980s, which was motivated, amongst others, by the agency theory-based expectation that increased shareholder control would enhance value creation (Jensen, 1988; Lazonick & O’Sullivan, 2000). Hence, while some praised the initiative of the French government against short-termism, the law also received criticism for restricting the rights of shareholders. Similarly, the entrenchment of managers by means of takeover protection is subject to fierce debate (Bebchuk, 2013).

This PhD thesis contributes to this debate in several ways. First, the literature review in Chapter 2 shows that there are several, sometimes conflicting factors that affect short-termism. For instance, earnings pressures from financial markets may contribute to short-term horizons, but such short-term horizons may also result from adverse incentives from managers, which control from financial markets may actually help to mitigate. Second, it is shown that antecedents may interact in shaping intertemporal choices, indicating that one should be careful with one-size-fits-all solutions. Rather, short-termism is likely to be reduced by balancing corporate governance such that sufficient numbers of stakeholders are committed to stimulating managers to take care about long-term value creation. In this regard, Chapter 5 suggests that, in addition to shareholder engagement, also employee participation may be useful in reducing short-termism. Given this fine balance, policymakers should be aware that policies that aim at extending or limiting shareholder rights may have differential effects.