European Commission Study on Sustainable Corporate Governance

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THE QUEEN OF HEARTS.

The Queen of Hearts, ——
— She made some tarts,
All on a summer's day: —
— The Knave of Hearts,
He stole those tarts, ——
And took them clean away.


"Let the jury consider their verdict," the King said, for about the twentieth time that day.
"No, no!" said the Queen. "Sentence first – verdict afterwards!"

The Approach

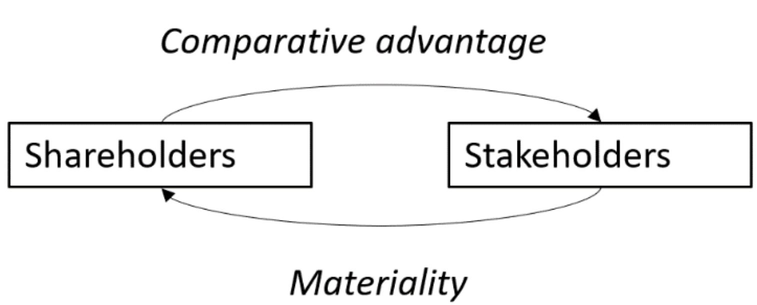
- EC should be commended for undertaking a study on such an important topic: diagnosis precedes treatment
- Data is not evidence
  - Data is a collection of facts
  - Evidence supports one particular conclusion and rules out others. See TED talk, "What to Trust in a Post-Truth World"
- > 95% of papers are rejected by top journals
- Evidence quoted is one-sided, as if authors have decided on a conclusion and reverse-engineered evidence to support it

1. Short-Term Shareholder Value

- Finance 101: $P_0 = \sum_{t=1}^{\infty} \frac{D_t}{(1+r)^t}$
- "Maximising shareholder value" / "shareholder capitalism" does *not* mean maximising the short-term stock price or short-term profits
  - Mixes up *horizons* (LT vs. ST) with *objectives* (shareholders vs. stakeholders). See Harvard response
- The solution is *more* shareholder capitalism
  - Von Lilienfeld-Toal and Ruenzi (2014): CEO equity incentives improve long-term shareholder returns
  - Flammer and Bansal (2017): long-term CEO pay improves profitability, innovation, and stakeholder value
  - Edmans et al. (2017), Ladika and Sautner (2020): short-term incentives lead to investment cuts

2. Shareholders vs. Stakeholders

- Study assumes a fixed-pie mentality
  - Shareholder value is at the expense of stakeholder value
  - Stakeholder capitalism should be anti-shareholder capitalism
- But the pie is not fixed (Ch 4, 6 of "Grow the Pie")
  - CEOs can increase it by innovation and excellence; decrease it through coasting or pursuing own pet projects
  - Reducing shareholder accountability won't move from shareholder capitalism to stakeholder capitalism, but to <u>managerial capitalism</u>
- Say-on-purpose



3. Shareholder Payouts

- "Upward trend in shareholder pay-outs" is evidence of a "focus on short-term benefits of shareholders rather than on the long-term interests of the company"
- Lazonick (2014): 91% of net income went to investors, which "left very little investments in productive capabilities or higher incomes for employees"
- Ch 7: positive ST *and LT* returns to payouts
  - Michaely, Thaler, and Womack (1995) for dividends
  - Ikenberry, Lakonishok, and Vermaelen (1995), Manconi, Peyer, and Vermaelen (2019) for repurchases
- Bennett et al. (2017) and PwC/Edmans (2019): buybacks don't inflate CEO pay

3. Shareholder Payouts

- Finance 101: invest if and only if NPV > 0. Investment is not always good for society
- Partial equilibrium thinking: Fried and Wang (2019), Chen (2018)

4. Loyalty Shares

- Arguments for "long-term shareholders" confuses the *holding period* of a shareholder with the *horizon*
  - ST selling could be based on LT information: Edmans (2009)
  - Trades of blocks improve firm value: Holderness and Sheehan (1988), Barclay and Holderness (1991)
  - Loyalty schemes reward doing nothing (VW)
  - "ST" shareholders help companies adapt to changes in competitive environment: Giannetti and Yu (2020)