Short-Termism, Shareholder Payouts and Investment in the EU

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November 2020
EY’s “evidence” of short-termism, examining listed EU firms 1992-2019

(1) Sh’holder payouts (dividends + repurchases) increasing & high

**Fact**: EY ignores equity issuances which far exceed repurchases; *net* sh’holder payouts moderate; small EU firms are net equity issuers.

(2) CAPEX & R&D intensity has declined

**Fact**: Investment intensity has increased (EY uses flawed sample).

(3) Shareholder payouts deprive firms of resources for future investment

**Fact**: Cash balances increasing.

Facts should matter
William Lazonick:

“Corporate profitability is not translating into widespread economic prosperity. The allocation of corporate profits to stock buybacks deserves much of the blame. Consider the 449 companies in the S&P 500 index that were publicly listed from 2003 through 2012. During that period those companies used 54% of their net income—a total of $2.4 trillion—to buy back their own stock, almost all through purchases on the open market. Dividends absorbed an additional 37% of their net income. That left very little for investments in productive capabilities or higher incomes for employees.”
(1) Measuring Sh’holder-Firm Capital Flows

• EY looks at *gross* sh’holder payouts (dividends + buybacks)
  • ignoring equity issuances
• But including equity issuances dramatically changes picture
Need to Account for Equity Issuances

• Buybacks & dividends = capital moving from firm to shareholders

• Must account for capital moving to firm from shareholders via equity issuances

• **Direct equity issuances to shareholders**
  o E.g., rights offering

• **Indirect equity issuances to shareholders**
  o E.g., employee-paying

• **All** equity issuances functionally equivalent from sh’holder-firm capital-flow perspective  *(Fried & Wang, RCFS 2019)*
Sh’holder payouts by EU public firms (1992-2019)

65% of net income during 2010-2019 (like EY finding)
Repurchases, dividends, and equity issuances by EU public firms (1992-2019)
65% of net income during 2010-2019

38% of net income during 2010-2019, (similar to U.S.)
Cumulative excess income available for investment by EU public firms (1992-2019)

- Cum. R&D
- Adjusted Net Income
- Cum. Net Shareholder Payouts

Graph showing the cumulative shareholder payouts, adjusted net income, and net shareholder payouts from 1992 to 2019.
(2) Properly Measuring Investment

• EY “finds” investment intensity has fallen
  • by arbitrarily and inconsistently dropping firms from its samples

• Looking at all EU public firms, we show that
  • CAPEX, R&D levels each increased over 1992-2019, and over 2010-2019
  • Combined CAPEX+R&D intensity increased over these periods
    • CAPEX intensity fell over 2010-2019, but R&D intensity increased by higher amount
EU public firm investment levels (1992-2019)

- Data unreliable
- Most recent decade: CAPEX + R&D up 23%
- R&D up 75%
Investment intensity at EU public firms (1992-2019)

Most recent decade: CAPEX+R&D intensity slightly up R&D intensity up 30%
(3) Properly Measuring Remaining Investment Capacity

• EY Study, at 9
  • “Increasing payments to shareholders will decrease the available resources to invest in R&D, human capital, or other kinds of capital expenditures, thus jeopardizing future productivity growth”

• But cash balances in EU public firms are rising.
Cash balances at EU public firms (1992-2019)

Plus, firms can always issue more equity—as many do.
Conclusion

- Contrary to EY,
  - actual capital flows to shareholders, net of equity issuances, are modest
  - investment intensity is not declining, but rather rising
  - firms not starved of cash for future investment—cash balances are rising

- EU policymakers should not rely on the EY Study
Thank you!