Columbia Business School

Wei Jiang
Arthur F. Burns Professor of Free and Competitive Enterprise
3022 Broadway, Uris Hall 803
New York, NY 10027-6902
Tel: ([redacted]
Email: [redacted]

July 18, 2019

To Whom It May Concern:

Regarding the Securities and Exchange Commission's roundtable on July 18 on the subject of "Short-Term/Long-Term Management of Public Companies, Our Periodic Reporting System and Regulatory Requirements," I wanted to take the opportunity to submit two previously published documents for consideration as the SEC considers these important questions.

1) "Who Are the Short-Termists?"

In the fall of 2018, I gave a keynote address at the Financial Management Association (FMA) Conference in San Diego titled "Who Are the Short-Termists?" I have attached this speech in full for your review.

The key points I sought to make in the speech are as follows:

- Are markets too short-term focused? If we define "short-termism" as an "excessive focus on short-term results at the expense of long-term interests," then at least two pieces of evidence suggest that the answer is no:
  - Using dividends as a proxy, several recent studies have provided evidence that investors are relatively indifferent between receiving a dollar of dividends today and a dollar of dividends (or capital gains) tomorrow;
  - Using innovation as a proxy, a recent study found that highly innovative companies—as identified by high levels of R&D spending—are fairly or even favorably priced in the sense that their future stock returns are comparable to those earned by other companies in the same risk class.

- Is managerial short-termism a likely possibility in a market that has shown itself not only willing, but eager to take a long view of corporate performance? The answer is yes:
  - For one thing, most businesses are subject, at least to some degree, to "stakeholder runs." Creditors, suppliers, and employees often seek to flee at the first sign of trouble. And for this reason alone, just the perception, as possibly distinguished from the reality, of financial health is important. Hence managers will often take actions that favor current observable results—think earnings here—to convince (or in some cases mislead) the market about its fundamental health.
  - The market, however, is typically not fooled. Investors understand managers' incentives to set and then beat earnings targets, and they correctly suspect that there will be "short-termist" efforts to meet those targets—stuffing inventories into the supply chain, even cutting productive R&D if necessary.

- One possible solution to this problem is for companies to avoid providing earnings guidance—a step that a large number of companies have taken in recent years—and to focus their disclosures on other measures of performance than earnings per share.

The speech concludes: "Is short-termism a problem for our financial markets? Views from prominent business leaders and scholars have long ranged from 'it's really a problem' to 'it's imaginary.' The jury is still out on this. The long term is, of course, nothing more than a continuous series of short-terms. And it will be easier for companies and their managers to arrive at the right 'long-term' mark if they navigate their paths along the many 'short terms' in a way that ensures that they're always headed for that mark."

2) "How Does Hedge Fund Activism Reshape Corporate Innovation?"

I have also attached a paper I co-authored in the *Journal of Financial Economics* titled "How Does Hedge Fund Activism Reshape Corporate Innovation?" This paper was recently awarded First Prize for Best Paper at the *Journal*. The study on which our paper was based started by confirming the popular claim, made by certain critics of activism, that corporate spending on R&D does fall, in dollar terms, in the year following interventions by shareholder activists. But there are a number of reasons not to be surprised, or alarmed, by this finding.

First of all, we show that when scaled by total assets, the amount of corporate R&D remains unchanged. In other words, companies tend to become leaner after refocusing, and there is no disproportionate drop in R&D relative to the now reduced total scale of the firm. But more importantly, we also find that, although overall R&D spending goes down, the R&D that remains becomes more productive. The number of newly filed patents increases by about 15% during the three-to-five year period following the activist's intervention. And in some ways even more telling, the number of citations per patent—which is a widely accepted indicator of patent impact or quality—also increases by about 15%. Both of these pieces of evidence attest to increases in the efficiency of R&D and quality of corporate innovation.

I appreciate the opportunity to submit these documents for consideration, and regret that I could not attend the roundtable. Should anyone at the SEC have any questions about the research on which these documents are based, I would welcome the opportunity for further discussion. My contact information is below.

Wei Jiang
Arthur F. Burns Professor of Free and Competitive Enterprise
Columbia Business School
Phone: [redacted]
E-mail: [redacted]
Website: https://www8.gsb.columbia.edu/cbs-directory/detail/wj2006

Sincerely,

Weijiang

Copyrighted material redacted. Author cites:

Brav, Alon and Jiang, Wei and Ma, Song and Tian, Xuan, How Does Hedge Fund Activism Reshape Corporate Innovation? (July 3, 2017). Journal of Financial Economics (JFE), Forthcoming. Available at SSRN: https://ssrn.com/abstract=2409404 or http://dx.doi.org/10.2139/ssrn.2409404

Jiang, Wei. Who are the Short-termists? (February 14, 2019) Journal of Applied Corporate Finance. Available at https://onlinelibrary.wiley.com/doi/full/10.1111/jacf.12314.