

*Moving Beyond “Short-termism”*

*Bill George*

## The Danger of Short-termism

*In the summer of 2008, Lehman Brothers and AIG were renowned power-players and titans of finance.*

*They were innovative, profitable... nearly untouchable. Now, they are insolvent.*

*These are just two in a long line of now-clichéd Wall Street stories: successful company—under pressure to earn bigger profits faster—succumbs to appeal of short-term gains, makes bad bets, and goes bust.*

Negligent and cavalier investment strategies created overly-leveraged balance sheets, causing these companies, and many others, to place incredible strain on investors, the financial system, the U.S. government, and American taxpayers. Their collapse was monumental and the aftershocks are continuing; worldwide, no one has been unaffected by the ramifications of this collective short-term profit seeking.

Where were the CEOs with plans for the long-term viability of these companies? Where were the board members who were supposed to be minding the store? Where were the shareholders with the knowledge and foresight to shout “STOP?”

The truth is, the “should-be” supervisors allowed greed to engross their attention and distract them from leadership responsibilities. As I’ve asserted before, the economic collapse of 2008-2009 was not caused by subprime mortgages, credit-default swaps, or even excessive greed.

These are only symptoms of the real problem. The root cause of the problem was failed leadership.

And the shared mentality that created an atmosphere where leadership was so easily seduced? “Short-termism,” the act of seeking quick profit at the expense of strategic growth and sustainable profits.

Short-termism is the bane of long-term economic prosperity. It has put innumerable corporations in danger by derailing growth strategies, hindering long-term gains, and sowing the seeds of the high-risk tactics that put the American economy into a tailspin a year ago this month. This phenomenon continues to encapsulate the American financial system and threaten hopes for sustainable reform.

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## Phasing Out Short-termism

Pension, mutual, and hedge fund managers have pursued quick profits by increasingly turning to higher risk strategies, all while simultaneously ignoring the inherent risks of those strategies. This short-sighted philosophy is detrimental to long-term market health because: 1) it hampers long-term gains by incurring too costly, too frequent trades fees; 2) it distracts policies that could lead to the creation of a responsible corporate culture and practices; and 3) it harms the interests of long-term-oriented investors.

It is imperative that we take these shareholders to task, but we cannot force-feed just any solution. Instead, we must incentivize the right one.

Only by refocusing incentives, rewards, and taxes on sustainable performance will we have an impact on the cultural impetuses which harvested the flawed leadership that ushered in the economic collapse.

That is why I recently joined 28 business, political, and social leaders as a signatory to the Aspen Institute's statement: "[Overcoming Short-termism: A Call for a More Responsible Approach to Investment and Business Management.](#)" Only by refocusing incentives, rewards, and taxes on sustainable performance will we have an impact on the cultural impetuses which harvested the flawed leadership that ushered in the economic collapse.

## Key Leverage Points

The “Overcoming Short-termism” statement encourages responsible investment behavior by adopting several important principles.

### **1 | Providing market-based incentives through restructured tax policy**

First, we can revise capital gains and excise taxes to encourage long-term share ownership. Second, we can remove limitations on capital loss deductibility so investors are not spooked by temporary stock shortfalls. Third, we can explore the adoption of minimum length share holding periods to bring stability and flexibility to companies.

### **2 | Aligning investor interest with company interests**

Investment decisions inconsistent with investors’ intent are rampant. For example, college savings accounts and 401(k)s can be easily leveraged in high-risk strategies that are not in concert with investors’ long-term growth strategy. To curb this practice, we can apply a higher degree of accountability to intermediaries and install regulations mandating that a fund manager’s compensation be tied to the long-term profitability of his/her fund.

### **3 | Increasing the transparency of shareholder/investor influence.**

Currently, investors can wield a great deal of unpredictable decision-making power through intermediaries or underhanded securities manipulation (ex: exerting shareholder voting privileges while “shorting” shares). We must update disclosure rules with enhancements that accommodate this evolution of masked behavior and further encourage long-term thinking.

With the proper motivating tools, we are capable of encouraging shareholders and companies, to “adopt long-term strategies for growth and sustainable earnings, and to rely on long-term, forward-looking metrics in the consideration of compensation and performance incentives.” [Aspen Institute, “Overcoming Short-termism”]

## Leaders Must Dig Deep and Prepare for the Long-Haul

At the end of the day, however, it comes down to the men and women in charge who will decide if “short-termism” pervades, or “long-termism” prevails.

Regulation will have little impact on markets unless our leaders take one another to task and voluntarily commit to upholding responsible practices like these. We’ve been reminded all-too-often of the business community’s propensity to over-leverage itself in the interest of short-term profit—circumventing the most strident of regulations along the way. So, one of the safest means of insuring responsible behavior is a mutually-enforced, preemptive commitment.

This is what the Aspen Institute signatories hope to begin. However, much more is needed if we are to usher America out of the financial crisis. Leaders must prepare themselves for two realizations:

Leaders must commit themselves to this cause, and bolster support to prepare for the inevitable short-term uproar.

First, our leaders must be ready to dig deep and find the specific root causes of our problems. The Aspen Institute has begun this work at a high-level, but each individual company and shareholder is unique. It is incumbent on the leaders of every organization to be their own watchdogs, to root out wrongdoing and discourage short-termist behavior. It is not sufficient to take a passive role in this process. To do so is to pave the way for a recurrence of economic collapse.

Second, leaders should prepare for the long-haul; curbing short-termism is not an overnight fix. Leaders must commit themselves to this cause, and bolster support to prepare for the inevitable short-term uproar. Simple shareholders and Wall Street will be angry over decreases in their quarterly profits. However, as time passes and long-term gains increase, along with the viability and respectability of the company, those concerns will subside.

If the past year has shown us anything, it's that a situation can easily worsen beyond expectation. Leaders should take a page out of the Goldman Sachs 2007 playbook. When the trading unit suffered a modest loss in subprime mortgages (a classic short-term investment), they realized that the situation could devolve into catastrophe if immediate action were not taken. Goldman Sachs removed itself from the subprime mortgage business entirely, cutting ties with businesses that remained, and saving itself from financial collapse when the bottom fell out in 2008.

The lesson here is two-fold. First: make the changes you need to make when you are still able to make them. Second: pursue profitable opportunities, but ensure that candid internal conversations are taking place as to the risks associated with those ventures.

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## Why I Became a Signatory

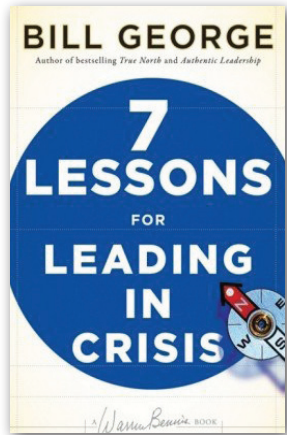
I am confident that putting these leverages into action will help insure that America does not suffer a similar financial collapse again. The only way we can truly reform the financial system to the point where we will not risk collapse is if we incentivize responsible behavior on Wall Street. The framework set forth by the Aspen Institute and my fellow signatories does that explicitly.

Furthermore, this plan encourages simple, sound, and profitable business-logic. Strategic, long-term investments reap considerable benefits without the unreasonable risk accompanying the short-term profit gimmicks leading to the economic collapse.

You only need look at Berkshire Hathaway, Goldman Sachs, or IBM for top tier examples of success by long-term investment. And you only need look at General Motors, Lehman Brothers, and AIG for examples of those who subscribed to short-terminism.

**You want smart investing? Make it long-term. **





## BUY THE BOOK

Get more details or buy a copy of Bill George's [\*7 Lessons for Leading in Crisis\*](#).

## ABOUT THE AUTHOR

Bill George is professor of management practice at Harvard Business School and author of *7 Lessons for Leading in Crisis*, *True North*, and *Authentic Leadership*. The former chair and CEO of Medtronic, he currently serves on the boards of ExxonMobil and Goldman Sachs and previously, Novartis and Target. Read more at [BillGeorge.org](http://BillGeorge.org), or follow him on Twitter [@Bill\\_George](https://twitter.com/Bill_George).

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