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The short long - Paper by Andrew Haldane and Richard Davies

In a paper to be presented at the 29th SUERF (Société Universitaire Européene de Recherches Financières) Colloquium in Brussels on 11th May, Andrew Haldane – Executive Director for Financial Stability – and Richard Davies discuss the effects of short-termism in investment decision-making. Drawing on evidence across time and industrial sectors, they argue that short-term behaviour is significant among investors in capital markets and is rising over time. They examine the adverse implications of short-termism for investment choice and outline policy options to counteract it.

Andrew Haldane and Richard Davies first chart the history of empirical and quantitative evidence on short-termism, from the Classical economists of the 19th century to the present day. This evidence has tended to be consistent with short-termism. They conclude: "This evidence – anecdotal, survey, quantitative – is broadly consistent with popular perceptions. Capital market myopia is real. It may be rising. For at least some of the jury, however, it remains inconclusive".

They proceed to construct a variety of quantitative tests to assess the significance and scale of short-termism in equity markets. This draws on a sample of over 600 firms in the UK and US over the period 1980-2009. The tests assess whether expected future cash-flows paid by a company are discounted "excessively" in the determination of their share price today. The empirical tests suggest there is significant evidence of short-termism, or "excess discounting", among UK and US companies over the past few decades. For example, one year ahead cash-flows are discounted 5-10% more than would be rational. These effects are more significant in the latter part of the sample, suggesting myopia is increasing over time. And these effects are consistent across all industrial sectors.

These quantitative estimates of short-termism can be used to determine the potential implications for investment. Two are key. First, some projects with a positive net present value might be rejected because future cash-flows are discounted too heavily, reducing investment and ultimately growth. Second, long-duration cash-flows and projects are penalised particularly severely by excess discounting. Under rational discounting, cash-flows even 50 years ahead retain more than 1% of their face value. Under myopia, cash-flows have lost more than 99% of their value within 25 years. The long is dramatically shortened.

This is a market failure. Andrew Haldane and Richard Davies discuss a number of policy proposals to reduce the effects of short-termism, including greater transparency about long-term performance, improved governance, better contract design and tax / subsidy measures. In tackling short-termism, they conclude: “It might be time to increase the level of policy ambition. Without intervention, the long could become shorter still.”

Key Resources

The short long – Full speech