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PROMOTING THE LONG-TERM MANAGEMENT OF PUBLIC CORPORATIONS THROUGH A REFORM OF CANADIAN CORPORATE LAW

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ABSTRACT

Short-termism, a tendency to overemphasize strategies that generate immediate financial results at the expense of long-term profits, is a serious issue that the business community faces. Short-term market pressures and the responsive behaviour of corporate boards undermine long-term economic prosperity and social welfare. While select investors and executives may benefit financially from this short-termism, it largely runs counter to the interests of long-term investors and other stakeholders. Without concrete measures, it is unlikely that we will address the problem of short-termism.

This article makes recommendations directed at encouraging long-term oriented thinking in boardrooms. It proposes two regulatory measures that, if jointly implemented, would dissuade boards from managing corporations for the short-term and insulate them from market pressures: first, imposing a fiduciary duty upon directors to act in accordance with the corporation's long-term interests; and second, requiring executive compensation to be aligned with the corporation's long-term interests.

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INTRODUCTION

Short-termism has permeated corporate culture across the world, negatively affecting corporate behaviour.[1] In recent years, executives, investors, and other corporate leaders have all allowed short-term considerations to overwhelm the long-term growth objectives of the corporation.[2] While businesses were once managed with a view to prosper over time, they are now managed as if meeting quarterly expectations is their sole purpose. Under continuing pressure from financial markets to maximize short-term results, boards have become overly preoccupied with current earnings and shareholder returns, while neglecting long-term investments.[3]

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1 Eric Sigurdson, "Overcoming the Forces of 'Short-termism'—corporate governance, principled leadership, and long-term sustainable value creation", *Sigurdson Post* (19 February 2018), online: <www.sigurdsonpost.com/2018/02/19/overcoming-the-forces-of-short-termism-corporate-governance-principled-leadership-and-long-term-sustainable-value-creation/#_ftnref48> archived at <https://perma.cc/Y7PF-94XP>.

2 *Overcoming Short-termism: A Call for a More Responsible Approach to Investment and Business Management* (New York: Aspen Institute Business & Society Program, 2009) at 2, online: <assets.aspeninstitute.org/content/uploads/files/content/images/BSPonlineBroch.pdf> archived at <https://perma.cc/T93B-2LMR>.

3 Dominic Barton & Mark Wiseman, "Focusing Capital on the Long Term" (2014) January-February Harvard Business Review, online: <hbr.org/2014/01/focusing-capital-on-the-long-term> archived at <https://perma.cc/WLB3-W8E7>.

Despite growing evidence that short-termism is profoundly harmful to individual businesses, the economy, and society, no concrete measures have been implemented in Canada to alleviate this problem.[4] What is needed is a framework that deters excessive focus on short-term gains and encourages the pursuit of long-term business goals. This article attempts to fill that void by proposing reform to Canadian corporate law.

This article is divided into two parts. Part I provides an analysis of the short-termism phenomenon and the factors contributing to it. It also addresses the debate surrounding short-termism and its consequences. Part II offers two proposals for reducing short-term market pressures and encouraging sound long-term management. It suggests amending section 122(1)(a) of the *Canada Business Corporation Act*[5] ("*CBCA*"), which provides for directors' fiduciary duty, and amending section 125 of the *CBCA*, which provides for directors' power to set compensation. Although this article focuses on the *CBCA*, it also makes recommendations with respect to securities regulation that could be implemented concomitantly.

I. THE SHORT-TERMISM PHENOMENON

A. Short-Termism: Modern Corporate Culture

i. The Concept of "Short-Termism"

Over the last 30 years, legal scholars, lawyers, and business persons have been studying the concept of short-termism.[6] The Business Roundtable Institute defines short-termism as the excessive focus of corporate managers, asset managers, investors, and analysts on short-term results, whether quarterly earnings or short-term portfolio returns, and a repudiation of concern for long-term value creation and the fundamental value of firms.[7]

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4 Overcoming Short-termism, *supra* note 2 at 2.

5 *Canada Business Corporations Act*, RSC 1985, c C-44, s 122(1)(a) [*CBCA*].

6 See Dominic Barton et al, *Measuring the Economic Impact of Short-Termism*, Discussion Paper (New York: McKinsey Global Institute, 2017), online: <www.mckinsey.com/~/media/mckinsey/featured%20insights/Long%20term%20Capitalism/Where%20companies%20with%20a%20long%20term%20view%20outperform%20their%20peers/MGI-Measuring-the-economic-impact-of-short-termism.ashx> archived at <https://perma.cc/T52W-NMQ3>; Dominic Barton, Jonathan Bailey & Zoffer Joshua, *Rising to the challenge of short-termism*, Survey Findings (FLTC Gobal, 2015), online: <www.fcltglobal.org/docs/default-source/default-document-library/fclt-global-rising-to-the-challenge.pdf> archived at <https://perma.cc/GD8M-DVAV>; Donna Dabney et al, *Is Short-Term Behavior Jeopardizing the Future Prosperity of Business?* (The Conference Board, 2015), online: <www.wlrk.com/docs/IsShortTermBehaviorJeopardizingTheFutureProsperityOfBusiness_CEOStrategicImplications.pdf> archived at <https://perma.cc/9FPN-3LPN>; Lynne Dallas, "Short-Termism, the Financial Crisis, and Corporate Governance" (2012) 37 J Corp Law 264; Dean Krehmeyer, Matthew Orsagh & Kurt N Schacht, *Breaking the Short-Term Cycle*, Discussion and Recommendations (CFA Institute Centre for Financial Market Integrity and the Business Roundtable Institute for Corporate Ethics, 2006), online: <www.corporate-ethics.org/pdf/Short-termism_Report.pdf> archived at <https://perma.cc/5L4H-V32X>; Martin Lipton et al, *The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth*, Corporate Governance Framework (International Business Council of the World Economic Forum, 2016), online: <wlrk.com/docs/thenewparadigm.pdf> archived at <https://perma.cc/EE28-UY5B>; Lawrence Summers & Ed Balls, *Report of the Commission on Inclusive Prosperity* (Center for American Progress, 2015), online: <cdn.americanprogress.org/wp-content/uploads/2015/01/IPC-PDF-full.pdf> archived at <https://perma.cc/GR44-RZLH>; Overcoming Short-termism, *supra* note 2.

7 Krehmeyer, Orsagh & N. Schacht, *supra* note 6 at 7.

Short-termism is a mindset that has permeated modern corporate culture. It is not limited to the behaviour of a few actors in the corporate chain, but a system-wide issue that involves individual and organizational dimensions.[8] The focus of this article is, however, on the tendency of corporate boards to manage public corporations for the short-term.[9]

Short-termism is not a problem *per se*.[10] If a company is to survive, short-term results must be achieved to some extent.[11] What is crucial, however, is balancing the needs of both short and long-term objectives.[12] The problem of short-termism arises only when decisions are made at the expense of long-term values.[13] In other words, when business strategies favoured by boards undermine corporations' ability to create future value, generally over five years.[14] "Long-term value" not only refers to corporations' ability to maximize profits over the long-run, but also to their ability to innovate, to adapt to changes, to sustain operations, to meet stakeholder expectations, and to consider ecological and sociological impacts on society.[15]

Short-termism is seen by many as an indictment of the current corporate governance framework.[16] The current legal parameters allow corporate boards to manage firms for the short-term and externalize the costs of short-termism on the rest of society without being sufficiently held accountable to the long-term consequences of their decisions.[17] Without proper accountability, directors are able to take on excessive risks and sacrifice long-term investments in research and development ("R&D"), innovation, and human capital to increase current earnings and stock prices.[18] In the end, this pervasive mindset frustrates the ability of corporations to create long-term value.[19]

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8 David Marginson & Laurie McAulay, "Exploring the Debate on Short Termism: a Theoretical and Empirical Analysis" (2008) 29 Strategic Management J 273 at 273; Overcoming Short-termism, *supra* note 2 at 4.

9 Except for Section B of Part II, this article uses the terms "corporate boards," "boards" and "directors" are used as shorthand ways of referring collectively to the corporation's directors and officers.

10 Bartosz Olesiński et al, *Short-termism in business: causes, mechanisms, consequences* (Poland: EY Poland, 2014) at 7, online: <www.ey.com/Publication/vwLUAssets/EY_Poland_Report/$FILE/Short-termism_raport_EY.pdf> archived at <https://perma.cc/4KMY-GQQF>.

11 Marginson & McAulay, *supra* note 8 at 274.

12 *Ibid*; Olesiński et al, *supra* note 10 at 6.

13 Mark R DesJardine, "The Causes and Consequences of Corporate Short-Termism" (DCL Thesis, University of Western Ontario, 2016) Electronic Thesis and Dissertation Repository No 3784 at 18 [unpublished], online: <//ir.lib.uwo.ca/etd/3784/> archived at <https://perma.cc/2FYF-VW8M>; Marginson & McAulay, *supra* note 8 at 274.

14 Dominic Barton, "Capitalism for the Long Term" (2011) March 2011 Harvard Business Review, online: <hbr.org/2011/03/capitalism-for-the-long-term> archived at <https://perma.cc/D3JH-9EAC>.

15 Denise Valkering & Arlette Brouns, "What do we mean with 'long-term value creation'?" *Deloitte*, online: <www2.deloitte.com/nl/nl/pages/risk/articles/revised-corporate-governance-code-what-do-we-mean-with-long-term-value-creation.html> archived at <https://perma.cc/6LT8-ULEK>.

16 Sigurdson, *supra* note 1. See e.g. Barton et al, *supra* note 6; Lipton et al, *supra* note 6.

17 Lawrence E Mitchell, "The Board as a Path Toward Corporate Social Responsibility" in Doreen McBarnet, Aurora Voiculescu & Tom Campbell, eds, *The New Corporate Accountability: Corporate Social Responsibility and the Law*, (Cambridge: Cambridge University Press, 2007) 279 at 281.

18 John C Coffee Jr & Darius Palia, "The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance" (2015) 41:3 J Corp Law 545 at 550; Dallas, *supra* note 6 at 267.

19 Kelly Tang & Christopher Greenwald, *Long-Termism Versus Short-Termism: Time for the Pendulum to Shift?* (S&P Dow Jones Indices LLC, 2016) at 1–2, online: <integratedreporting.org/wp-content/uploads/2017/03/SPLong-TermismversusShort-termism.pdf> archived at <https://perma.cc/5FB3-SAUH>.

ii. How Short-Termism has permeated Corporate Culture

Short-term thinking has not always prevailed in corporate culture. In the early historical development of the corporate structure, the same individuals owned and controlled corporations.[20] Most corporations were small businesses in which shares were held by the founders and their close circle, who generally devoted their careers to running the businesses they owned.[21] Both shareholders and directors had an interest in ensuring sustainable success and long-term growth of the company.[22] Thus, the well-being of employees and other stakeholders was of primary importance for management.[23] Those views changed dramatically over the course of the 20th century.

During the 1900s, many closely-held corporations turned into significantly larger publicly traded corporations which, in turn, diluted high ownership concentrations. This dilution created a distancing effect between "ownership" and "control."[24] As a result, investors began selling and buying equity shares on the stock markets for speculation purposes rather than for the purpose of financing a particular business.[25] The increased popularity of speculative trading has largely contributed to short-termism.[26]

Moreover, new technologies, reduced trading times and transaction costs, market volatility, and media coverage have all encouraged speculation.[27] As transactions can be made via the Internet in a few seconds at low costs, many investors have adopted a "trading" rather than a "buy-and-hold" mentality.[28] Since the 1950s, the average holding period for a traded stock has decreased from almost eight years to a few months.[29] As explained by the Conference Board, a research association that promotes good governance and constructive solutions that support long-term corporate performance, "stock markets have largely become trading platforms in which capital is directed not to business but to traders."[30]

The substantial increase in activism by large institutional investors has also set the stage for short-termism to dominate. The rise of institutional investors during the 1980s led to an increased concentration of equity ownership in the hands of pension funds,

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20 Nadelle Grossman, "Turning a Short-Term Fling into a Long-Term Commitment: Board Duties in a New Era" (2010) 43:4 U Mich JL Ref 905 at 909; Steven A Rosenblum, "Hedge Fund Activism, Short-Termism, and a New Paradigm of Corporate Governance" (2017) 126 Yale LJ 538 at 540–41; Robert Yalden et al, *Business Organizations Practice, Theory and Emerging Challenges*, 2nd ed (Toronto: Emond Montgomery Publications, 2018) at 129–32.

21 Grossman, *supra* note 20 at 909; Rosenblum, *supra* note 20 at 540–41.

22 Rosenblum, *supra* note 20 at 540–41.

23 Joshua William Mason, *Understanding Short-Termism: Questions and Consequences* (New York: Roosevelt Institute, 2016) at 5 online: <rooseveltinstitute.org/wp-content/uploads/2015/11/Understanding-Short-Termism.pdf> archived at <https://perma.cc/PYV4-45Y4>.

24 Yvan Allaire & Stephane Rousseau, "To Govern in the Interest of the Corporation: What is the Board's Responsibility to Stakeholders other than Shareholders?" (2015) 5:3 J Management & Sustainability 1 at 8; Grossman, *supra* note 20 at 909; Rosenblum, *supra* note 20 at 540.

25 Grossman, *supra* note 20 at 909–10.

26 *Ibid* at 911.

27 Olesiński et al, *supra* note 10 at 12.

28 Tang & Greenwald, *supra* note 19 at 2–3.

29 Yvan Allaire, *Pay for Value: Cutting the Gordian knot of Executive Compensation*, Policy Paper (Working Group on Compensation of IGOPP, 2012) at 30, online: <igopp.org/wp-content/uploads/2014/04/pp_payforvalue_allaire_en_v4.pdf> archived at <https://perma.cc/93T7-42MF>; David Hunkar, "Average Stock Holding Period on NYSE 1929 To 2016", *Top Foreign Stocks* (1 October 2017), online: <topforeignstocks.com/2017/10/01/average-stock-holding-period-on-nyse-1929-to-2016/> archived at <https://perma.cc/MXR2-MLPM>.

30 Dabney et al, *supra* note 6.

insurance companies, and mutual funds.[31] Due to this concentration of share ownership, institutional investors were able to exert significant influence on corporate decision-making.[32] Instead of selling their shares when dissatisfied with the performance of a company, institutional investors became actively involved in management decisions in order to unlock value for shareholders.[33] These activist investors brought about important changes in governance practices, including the use of financial performance metrics and stock-based compensation.[34] Perhaps a less desirable result of investors' scrutiny over managerial decisions is that it directed boards' attention towards stock price and short-term financial performance.

The hostile takeover boom of the 1980s also exerted significant pressure on boards to pursue short-term gains.[35] During this period, corporate raiders took control of underperforming companies. Using their voting rights, raiders attempted to undermine the power and practices of these companies' management.[36] Once in control, they replaced select board members with individuals who were willing to take actions to maximize shareholder value.[37] Confronted by these newly empowered investors, boards became "shareholder-centered" and increasingly concerned about stock value.[38]

This activist movement intensified with the rise of hedge funds, a class of empowered shareholders who actively use governance levers to achieve high short-term returns.[39] In the United States and Canada, where the regulatory environment facilitates activism, hedge funds can easily "come in and shake up boards."[40] Through aggressive tactics, hedge funds force management to implement strategic changes to inflate stock value, at which point

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31 Allaire, *supra* note 29 at 29; Lucian A Bebchuk, Alma Cohen & Scott Hirst, "The Agency Problems of Institutional Investors" (2017) 31:3 J Economic Perspectives 89 at 89, 107.

32 See Craig Doidge et al, "Collective Action and Governance Activism" (2015) Rotman School of Management Working Paper No 2635662, online: <ssrn.com/abstract=2635662>; Patrick Jahnke, *Voice versus Exit: The Causes and Consequence of Increasing Shareholder Concentration* (DCL Thesis, University of Edinburgh School of Social and Political Science, 2017) [unpublished], online: <ssrn.com/abstract=3027058>.

33 See Stuart L Gillan & Laura T Starks, "The Evolution of Shareholder Activism in the United States" (2007) 19:1 J Applied Corp Finance 55.

34 Allaire, *supra* note 29 at 34. See also Gregg D Polsky & Andrew CW Lund, "Can Executive Compensation Reform Cure Short-Termism?" (2013) 58 Issues in Governance Studies 1, online: <www.brookings.edu/wp-content/uploads/2016/06/Download-the-full-paper.pdf> archived at <https://perma.cc/THE3-9783> at 4 (explaining that, "[w]ithout proper compensation incentives, managers were expected to shirk their responsibilities to shareholders by giving insufficient effort, making inefficient decisions, engaging in entrenchment strategies, or self-dealing").

35 Mitchell, *supra* note 17 at 300; Yalden et al, *supra* note 20 at 554.

36 Aaran Fronda, "The rebranding of corporate raiders", *World Finance* (9 March 2016), online: <www.worldfinance.com/strategy/the-rebranding-of-corporate-raiders> archived at <https://perma.cc/73SK-7YXQ>.

37 *Ibid*.

38 Mitchell, *supra* note 17 at 300.

39 Martijn Cremers, Saura Masconale & Simone M Sepe, "Activist Hedge Funds and the Corporation" (2017) 94:2 Wash U L Rev 261 at 272; Frank Partnoy & Randall Thomas, "Gap filling, hedge funds, and financial innovation" (2006) Vanderbilt Law and Economics Research Paper No 06-21 at 23, online: <ssrn.com/abstract=931254> (explaining that four characteristics usually identify hedge funds, "[1] they are pooled, privately organized investment vehicles; [2] they are administered by professional investment managers with performance-based compensation and significant investments in the fund; [3] they are not widely available to the public; and [4] they operate outside of securities regulation and registration requirements").

40 *CBCA*, *supra* note 5, ss 109, 143, 150, 241. See Brian R Cheffins, "Hedge Fund Activism Canadian Style" (2014) 47 UBC L Rev 1 at 32, 34, 42.

they sell their shares and pocket the added value.[41] These activist investors are generally motivated solely by short-term gains and not the corporations' long-term performance.[42]

Another consideration that has enriched this focus on quarterly earnings is the market communication and financial reporting practices.[43] In most jurisdictions, public corporations must issue quarterly financial statements.[44] Additionally, certain firms choose to issue quarterly earnings guidance, the official prediction of the company's future profits.[45] While such frequent disclosure improves transparency and information symmetry, it equally serves as an instrument for monitoring executives' short-term goals.[46] Investors and analysts over-rely on quarterly results to make their investment decisions and assess firms' performance.[47] When a company issues poor financial results or fails to meet earnings targets, it sends negative signals to the public and investors, which perceive the company as a failure.[48] Many investors may then exit the company, leading to a decline in share price.

The problem with quarterly reports is that they do not accurately reflect a firm's performance. As explained by Matteo Tonello, a leading expert on corporate governance, "[a]s these expenditures [investments on intangibles] increase, earnings per share typically decrease. In other words, current financial reporting principles operate as a disincentive to invest in research, innovation, and other future shareholder value drivers."[49] Current practices cause financial markets to place undue reliance on quarterly statements and to neglect the broader picture.[50] To avoid disappointing the market or spreading the image of an underperforming corporation, directors have little choice but to engage in strategies that increase current earnings.[51]

Long gone is the era where business decisions were made with a view towards creating long-term value. In today's mindset, corporations are governed as if maximizing short-term results is their sole purpose. As poignantly stated by Roosevelt Institute researchers, "the financial system is no longer an instrument for getting money into productive businesses, but has instead become an instrument for getting money out of them."[52]

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41 Errol P Mendes, "Short Termism and the Danger to the Canadian Economy and Companies", *Huffington Post* (27 May 2013), online: <www.huffingtonpost.ca/errol-p-mendes/short-termism-and-the-dan_b_2934721.html> archived at <https://perma.cc/D43K-NXCM>.

42 Overcoming Short-termism, *supra* note 2 at 3.

43 Olesiński et al, *supra* note 10 at 18.

44 See *Regulation 51-102 respecting Continuous Disclosure Obligations*, CQLR c V-1.1, r 24, pt 4 [Regulation 51-102].

45 Olesiński et al, *supra* note 10 at 18–19.

46 Krehmeyer, Orsagh & N. Schacht, *supra* note 6 at 5; Tonello Matteo, *Revisiting Stock Market Short-Termism*, Corporate/Investor Summit (The Conference Board, 2006) at 16, online: <ssrn.com/abstract=938466>.

47 Grossman, *supra* note 20 at 919.

48 See Alexander V Laskin, "Reputation or Financial Performance: Which Comes First?" in Craig E. Carroll, ed, *The Handbook of Communication and Corporate Reputation* (Wiley-Blackwell, 2013) at 376.

49 Matteo, *supra* note 46 at 29.

50 Grossman, *supra* note 20 at 916–17.

51 John R Graham, Harvey R Campbell & Shiva Rajgopal, "The Economic Implications of Corporate Financial Reporting" (2005) 40 J Accounting & Economics 3 at 12; Grossman, *supra* note 20 at 919.

52 Joshua William Mason, *Disgorge the Cash: The Disconnect Between Corporate Borrowing and Investment* (New York: Roosevelt Institute, 2015) at 3, online: <rooseveltinstitute.org/wp-content/uploads/2015/09/Disgorge-the-Cash.pdf> archived at <https://perma.cc/FJ7Q-4WPP>.

B. Is Short-Termism a Problem?

Whether short-termism is a problem has been an issue of long-standing debate, particularly in the wake of the financial crisis and recent corporate scandals.[53] This section explores some of the arguments that have been raised with respect to short-termism. It then argues that although the literature does not provide a definitive answer to the question of whether short-termism is a problem, real-world examples indicate that short-termism does indeed have negative impacts.

i. The Short-Termism Debate

While opinions on short-termism substantially diverge, most people would agree that two lines of thought emerge from the debate: those who dismiss the idea that short-termism is a problem, or at least that it is a managerial problem ("supporters"), and those who view short-termism as a threat to individual companies, the economy, and society ("opponents").[54]

There are a number of arguments in favour of short-termism. First, some supporters argue that long-term decisions bear a greater degree of risk and uncertainty than short-term decisions.[55] Under this view, it is therefore desirable to invest in the short-run.[56]

Second, many supporters maintain that temporal horizons are immaterial.[57] Building on the efficient capital markets hypothesis ("ECMH"), supporters believe that the present value of a company's long-term position is reflected in the short-term price of its stock.[58] Where a company's stock price does not fully reflect a proportion of the firm's true value represented by a share of that stock, investors will either buy or sell that firm's stock until the stock price reflects a proportionate share of the firm's true value.[59]

Third, some supporters contend that short-termism is a managerial problem and not a shareholder problem. They purport that the board itself, not shareholders, is the corporate sovereign and that it has absolute authority to run the corporation's business and affairs.[60] Therefore, the self-centered motivations of executives account for any short-termism problems that exist.[61] For example, directors might favour short-termism behavior because they believe that they can beat the market or that shareholders prefer short-term results. Another possibility is that they expect to retire or leave the company and are thus not motivated to pursue long-term goals.[62]

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53 Stephen I Erlichman, "Canadian Institutional Investor Activism in the 21st Century: the Sleeping Giants Awaken" in *Corp 21st Century*, 9th ed (Kingston, Ontario: Queen's Annual Business Law Symposium, 2003) 199 at 204 (noting that, "concern about corporate governance issues has become endemic in the United States with such high profile disasters as Enron and WorldCom. Although Canada has not recently had such corporate failures, we have had our share in the past with names such as Bre-X Minerals, YBM Magnex International, Livent and Cinar").

54 Emeka Duruigbo, "Tackling Shareholder Short-Termism and Managerial Myopia" (2011) 100:3 Ky LJ 531 at 540–41.

55 DesJardine, *supra* note 13 at 15.

56 Duruigbo, *supra* note 54 at 545–46; Julian Velasco, "Taking Shareholder Rights Seriously" (2007) 41:605 UC Davis Law Rev at 637.

57 Rebecca A Crawford, "Corporate Governance Reform: How to Promote the Long-Term Health and Value of U.S. Corporations" (2009) 5:2 NYU J LB 905 at 918; Duruigbo, *supra* note 54 at 544.

58 *Ibid*.

59 Grossman, *supra* note 20 at 914.

60 René Reich-Graefe, "Deconstructing Corporate Governance: Director Primacy Without Principle?" (2011) 16 Fordham J Corp & Fin L 465 at 471, online: <digitalcommons.law.wne.edu/cgi/viewcontent.cgi?article=1162&context=facschol> archived at <https://perma.cc/G3CJ-NUGG>.

61 George W Dent, "For Optional Federal Incorporation" (2010) 35 J Corp L 499 at 514.

62 George W Dent, "Academics in Wonderland: The Team Production and Director Primacy Models of Corporate Governance" (2008) 44 Hous L Rev 1213 at 1238; Masako N Narayanan, "Managerial incentives for short-term results" (1985) 40:5 J Finance 1469; David I Walker, "The Challenge of Improving the Long-Term Focus of Executive Pay" (2010) 51:2 Boston Coll Law Rev 435 at 441.

Fourth, other supporters claim there is insufficient evidence to support that short-termism is a problem. They argue that if companies were really too focused on the short-term, there would have already been a collapse in their profitability.[63] According to this line of reasoning, there is no evidence that short-termism is detrimental to companies, thus short-termism is not harmful.[64]

Finally, some individuals recognize short-termism's existence but argue that it is desirable. They contend that activist investors, especially hedge funds, positively impact the financial health of underperforming companies.[65] Harvard Law professor Lucian Bebchuk maintains that investors' short-term pressures lead to better returns.[66] He claims that there is no empirical evidence that shareholder influence over corporate governance has harmed companies' long-term returns.[67] Hence, shareholders should have the power to intervene in decision-making even if they pursue short-term economic goals.[68]

Opponents of short-termism have heavily contested the foregoing views of supporters. First, there are strong arguments against the ECMH. Theorists and scholars suggest that assumptions underlying the ECMH are overly optimistic and that a perfectly efficient market is an unattainable ideal. They conclude that stock markets do not always reflect intrinsic value.[69] With compelling evidence that markets do not accurately value firms who are short-term oriented, the ECMH has lost substantial credibility and no longer presents a compelling argument that a distinction between short-termism and long-termism is irrelevant.[70]

Against Bebchuk's view, opponents maintain that activist investors encourage harmful short-termism.[71] Empirical studies have reached the conclusion that shareholder activism has not improved the profitability of firms,[72] and show that activist investor strategies are actually harmful in the long-term.[73] For instance, Yvan Dallaire from the Institute for

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63 Noah Smith, "Short-Termism Hasn't Hurt Companies Long Term", *Bloomberg* (14 June 2017), online: <www.bloomberg.com/view/articles/2017-06-14/short-termism-hasn-t-hurt-companies-long-term> archived at <https://perma.cc/D6DN-QWLE>.

64 Steven N. Kaplan, "Are U.S. Companies Too Short-Term Oriented? Some Thoughts" (2017) The National Bureau of Economic Research (NBER) Working Paper No 23464, online: <ssrn.com/abstract=2972117> (The paper finds little long-term evidence that is consistent with the predictions of the short-term critics); Mason, *supra* note 23 at 5; Mark J Roe, "The Imaginary Problem of Corporate Short-Termism", *Wall Stree Journal* (17 August 2015), online: <www.wsj.com/articles/the-imaginary-problem-of-corporate-short-termism-1439853276>.

65 Duruigbo, *supra* note 54 at 545.

66 Lucian A Bebchuk, "The Myth That Insulating Boards Serves Long-Term Value" (2013) 113 Colum Bus L Rev 1637.

67 *Ibid*; Lucian A Bebchuk, Alon Brav & Wei Jiang, "The Long-Term Effects of Hedge Fund Activism" (2015) 115 Colum L Rev 1085 at 59–61.

68 Bebchuk, *supra* note 66.

69 Cynthia A. Williams & John M. Conley, "An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct" (2005) 38 Cornell Int'l L.J. 493 at 502; Duruigbo, *supra* note 54 at 544; Lynn A. Stout, "The Mechanics of Market Inefficiency: An Introduction to the New Finance, (2003) 28 J Corp L 635 at 637; Michael L Watcher, "Takeover Defense When Financial Markets Are (Only) Relatively Efficient" (2003) 151 U Pa L Rev 787 at 792.

70 Iman Anabtawi & Lynn Stout, "Fiduciary Duties for Activist Shareholders" (2008) 60 Stan L Rev 1255 at 1291; Dallas, *supra* note 6 at 279–80; Duruigbo, *supra* note 54 at 544.

71 Yvan Allaire & François Dauphin, *Hedge Fund Activism: Preliminary Results and Some New Empirical Evidence* (Institute for Governance of Private and Public Organizations, 2015), online: <www.shareholderforum.com/access/Library/20150401_Allaire.pdf> archived at <https://perma.cc/S66R-ZMU3>; Martijn Cremers, Ankur Pareek & Zacharias Sautner, *Short-Term Investors, Long-Term Investments, and Firm Value* University of Notre Dame, 2018) [unpublished]; Coffee Jr & Palia, *supra* note 18; Dabney et al, *supra* note 6.

72 William W Bratton & Michael L Wachter, "The Case Against Shareholder Empowerment" (2010) 158 U Pa L Rev 653 at 702–03; Dallas, *supra* note 6 at 307–08.

73 Anabtawi & Stout, *supra* note 70; Cremers, Masconale & Sepe, *supra* note 39.

Governance of Private and Public Organizations ("IGPPO") concludes that, although hedge funds' interventions may create short-term value, this value does not last.[74]

Opponents of short-termism also argue that it has detrimental consequences on a variety of stakeholders.[75] They assert that short-termism destroys long-term value, decreases market efficiency, reduces investment returns, and impedes efforts to strengthen corporate governance.[76] In *The New Paradigm*, a corporate governance framework developed by Martin Lipton, he explains that:

> A short-term mindset in managing and investing in businesses has become pervasive and is profoundly destructive to the long-term health of the economy. Short-termism erodes the foundation for future innovation, ingenuity in product enhancements and the research and development that makes possible medical breakthroughs, technological progress and scientific advances. It undercuts investments in employees, factories and equipment, expansion into new markets and the pursuit of other long-term projects that require upfront costs but have the potential for sustainable value creation and social impact.[77]

Several academics and business people share Lipton's position. The CEO of the Canada Pension Plan Investment Board declared that short-termism has widespread negative consequences because "companies are less able to invest and build value for the long-term, undermining broad economic growth and lowering returns on investment for savers."[78] Using macroeconomic data, Pavlos Masouros, a corporate lawyer holding a PhD in Law and Economics, has further demonstrated a correlation between short-termism and economic decline.[79] Likewise, Dominic Barton, global managing partner of McKinsey, as well as Larry Fink, CEO of the world's largest asset manager, BlackRock, have made their case against short-termism.[80]

Academic research further supports the position that short-termism has harmful consequences. According to an empirical study, long-term management is linked to superior financial performance.[81] Additionally, another study shows that to meet quarterly earnings targets, many directors and executives would delay a new project, even with the

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74 Yvan Allaire & François Dauphin, *"Activist" hedge funds: creators of lasting wealth? What do the empirical studies really say?* (Institute for Governance of Private and Public Organizations, 2014) at 2, online: <www.wlrk.com/docs/IGOPP_Article_Template2014_Activism_EN_v6.pdf> archived at <https://perma.cc/6RYY-Z9EF>.

75 Mason, *supra* note 23 at 6."event-place":"New York","URL":"rooseveltinstitute.org/wp-content/uploads/2015/11/Understanding-Short-Termism.pdf","author":[{"family":"Mason","given":"Joshua William"}],"issued":{"date-parts":[["2016"]]},"locator":"6","label":"page"}],"schema":"https://github.com/citation-style-language/schema/raw/master/csl-citation.json"}

76 Barton & Wiseman, *supra* note 3; Krehmeyer, Orsagh & N. Schacht, *supra* note 6 at 1.

77 Lipton et al, *supra* note 6 at 5. See also Summers & Balls, *supra* note 6 at 35.

78 Barton & Wiseman, *supra* note 3.

79 Lipton et al, *supra* note 6 at 5; Pavlos Masouros, *Corporate Law and Economic Stagnation: How Shareholder Value and Short-Termism Contribute to the Decline of the Western Economies,* (The Hague: Eleven International Publishing, 2013).

80 Barton & Wiseman, *supra* note 3; Barton, *supra* note 14; Larry D Fink, "Larry Fink's Annual Letter to CEOs - A Sense of Purpose", online: *BlackRock* <www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter> archived at <https://perma.cc/79K4-Q7YC>; Walter Frick, "Worries About Short-Termism Are 40 Years Old, but Are They Overblown?" (2017) Harv Bus Rev, online: <hbr.org/2017/08/worries-about-short-termism-are-40-years-old-but-are-they-overblown> archived at <https://perma.cc/9NWS-287E>.

81 Dominic Barton, James Manyika & Sarah Keohane Williamson, "Finally, Evidence That Managing for the Long Term Pays Off" (2017) Harvard Business Review, online: <hbr.org/2017/02/finally-proof-that-managing-for-the-long-term-pays-off> archived at <https://perma.cc/P9B2-MWSW>.

stipulation that doing so would sacrifice some value.[82] Some scholars even point to real-world evidence that short-termism encourages reckless actions, excessive risk-taking, and unethical behaviour.[83] They contend that short-termism is the reason behind the Enron scandal, the 2008 financial crisis, and the 2010 Gulf Oil tragedy.[84]

In view of the above, there is clearly a disagreement about the causes and consequences of short-termism. With articles and statistical studies contradicting each other, it is difficult to draw definite conclusions. I will not pretend to have the expertise to confirm or refute any of the foregoing studies. Nevertheless, we cannot simply ignore the body of evidence suggesting that short-termism is harmful. Moreover, further investigation into current corporate governance practices, which is discussed in the next section, makes it increasingly difficult to claim that the short-term mindsets of boards are not damaging to economic prosperity and social welfare.

ii. Examples of Short-Termism's Ill-Effects

Statistically proving that short-termism has negative consequences is unequivocally difficult, and not the objective of this article. Instead, this article argues that real-world examples sufficiently corroborate the argument that short-termism is a serious issue that the business community faces.

First, short-termism encourages reckless risk-taking. Under short-term market pressures, boards tend to favour high-risk strategies designed to produce high returns rather than sustainable strategies. In turn, this raises the volatility of firms' cashflows and increases the risk of disruption.[85] The 2008 financial crisis, which has been described as the result of short-termism, demonstrates how boards take on excessive risk in the quest to increase profits.[86] Lynne Dallas, an internationally recognized corporate governance and interdisciplinary scholar, writes that "the financial crisis of 2007-2009 was preceded by a period of financial firms seeking short-term profit regardless of long-term consequences."[87] To boost immediate earnings and increase their compensation, executives of financial institutions invested in high-risk instruments such as mortgage-backed securities and collateralized debt obligations despite their longer-term risks.[88] Eventually, these risks materialized and national economies collapsed.[89]

Second, short-term thinking induces boards to manage firms based on quarterly results. To improve companies' short-term performance and keep earnings high, corporate boards sacrifice long-term investments and reduce operational expenses reported on the balance sheet. This means that to boost observable quarterly earnings, directors may jettison projects that optimize financial performance and reduce long-term investments.[90] A survey of over 1,000 executives and board members revealed that 71% of the respondents would

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82 Barton, Bailey & Joshua, *supra* note 6 at 8 (More than half of executives [55%] at companies where long-termism is not a major part of the culture said they would delay a new project).

83 Leo E Strine Jr, "Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law" (2014) 114 Colum L Rev 449 at 465.

84 Barton & Wiseman, *supra* note 3; Dallas, *supra* note 6 at 280–91; Duruigbo, *supra* note 54 at 532.

85 John Armour & Jeffrey N Gordon, "Systemic Harms and Shareholder Value" (2014) 6:1 J Legal Analysis 35 at 44.

86 See Dallas, *supra* note 6 at 279–80; Judith F Samuelson & Lynn A Stout, "Are Executives Paid Too Much?", *Wall Street Journal* (26 February 2009), online: <www.wsj.com/articles/SB123561746955678771> archived at <https://perma.cc/UQ4J-L7DA> at A13.

87 Dallas, *supra* note 6 at 266.

88 Grossman, *supra* note 20 at 935–36; Steven L Schwarcz, "Protecting Financial Markets: Lessons from the Subprime Mortgage Meltdown" (2008) 93 Minn L Rev 373 at 384–85.

89 Dallas, *supra* note 6 at 279–80.

90 Bratton & Wachter, *supra* note 72 at 702; Duruigbo, *supra* note 54 at 541–42.

reduce discretionary spending on R&D, advertising, maintenance, and hiring in order to meet earnings targets.[91] This data demonstrates that short-termism drives directors to manage earnings, not the business.[92] However, as explained in the next paragraphs, short-term gains made by cutting expenses in R&D and human capital or by selling off a company's assets are often outweighed by long-term costs.

R&D. Investing in R&D is fundamental to companies' long-term success because it allows them to develop new income-producing assets or cost-effective technologies.[93] New innovations not only bring benefits to the environment, the economy, and society, but also increase companies' long-term profitability. However, once companies go public, they invest fewer resources into R&D.[94] As these investments are expensive in the short-term and take time to materialize, neither investors nor boards are willing to wait for the long-term benefits of R&D.[95] Consequently, directors tend to prioritize strategies that maximize shareholder returns and current earnings rather than investing in new technologies or medicines.

While reducing investments in R&D may generate short-term results, it also raises serious concerns, especially for technology and biotechnology companies which largely depend on these investments to develop products. When firms invest for the long-term, "these investments show up immediately as expenses on the balance sheet and reduce profits in the current quarter but raise future productivity of the firm."[96] In contrast, incentivizing a short-term focus "lowers future output, reduces long-term competitiveness, and diminishes worker productivity and the higher wages that it can bring."[97]

The real-world example of Valeant Pharmaceutical ("Valeant") demonstrates the negative long-term effects of sacrificing R&D for short-term goals. Starting in 2010, Valeant's business model was to buy pharmaceutical companies with established products and cut back on their R&D efforts to maximize cash flow and boost stock prices.[98] To further increase profits, Valeant raised the price of lifesaving heart medications and other drugs by

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91 Barton, Bailey & Joshua, *supra* note 6 at 8. See also Graham, Campbell & Rajgopal, *supra* note 51 (a survey of more than 400 financial executives revealed that 80% of the respondents would decrease discretionary spending).

92 Lawrence E Mitchell, "The Sarbanes-Oxley Act and the Reinvention of Corporate Governance?" (2003) 48 Vill L Rev 1189 at 1210.

93 William T Allen & Leo E Strine Jr, "When the Existing Economic Order Deserves a Champion: The Enduring Relevance of Martin Lipton's Vision of the Corporate Law" (2005) 60:4 Bus Lawyer 1383 at 1388; Grossman, *supra* note 20 at 936–37.

94 Frick, *supra* note 80.

95 Grossman, *supra* note 20 at 936–37; Houman B Shadab, "Innovation and Corporate Governance: The Impact of Sarbanes-Oxley" (2008) 10 U Pa J Bus & Employment L 955 at 962.

96 Summers & Balls, *supra* note 6 at 32.

97 *Ibid*; Bill George, "Another View: Can Biotech Survive Icahn", *N Y Times Deal* (3 June 2010), online: <dealbook.blogs.nytimes.com/2oio/o6/o3/another-view-can-biotech-survive-icahn/> archived at <https://perma.cc/CFL2-WSK7>.

98 John C Coffee Jr & Darius Palia, "The Impact of Hedge Fund Activism: Evidence and Implications" (2014) European Corporate Governance Institute (ECGI) Working Paper No 2662014 at 44, online: <ssrn.com/abstract=2496518>; Linette Lopez, "American companies have developed a very particular disease — and CEOs hate the cure", *Business Insider* (14 June 2016), online: <www.businessinsider.com/american-companies-and-short-termism-2016-6> archived at <https://perma.cc/5YA7-PPAX>.

hundreds of percentages.[99] Between 2010 and 2015, Valeant's share price increased more than 1,000%.[100] Nevertheless, its business model was unsustainable in the long-term. By 2016, its stock price had lost 90% of its value.[101]

Layoffs. Beyond withdrawing R&D investment, companies frequently resort to layoffs as a method of increasing earnings and meeting market expectations.[102] There are several examples of this phenomenon. First, in 2017, Athenahealth, an electronic healthcare company, laid off 500 workers in the face of pressure from an activist hedge fund.[103] Second, the CEO of Cisco Systems raised $15.2 million in stock awards and a $4.7 million cash bonus after eliminating 4,000 jobs.[104] Finally, the CEO of ConocoPhillips made nearly $21 million US after laying off hundreds of employees in Calgary in 2015.[105]

These examples reveal an alarming trend: market pressures encourage boards to slash costs to perform in the short-run, while neglecting long-term investments and social value. However, laying off employees may turn out to be more expensive in the long-term. If a company wants to expand in the future, it would need to find and train new employees, which is both time-consuming and costly.[106] Cutting jobs can also limit a company's ability to seize new growth opportunities and its ability to adapt to new market challenges.[107] In the end, it not only destroys firms' long-term value, but also impacts the rest of society.

Asset Stripping. Furthermore, certain boards put their company's financial health at risk to maximize shareholder return, inflate stock prices, and trigger executive performance bonuses.[108] The case of Sears Canada demonstrates how this short-term thinking that drives business decision-making is problematic. Through the sale of some of its most important and profitable assets, Sears Canada paid more than $3 billion in dividends to shareholders between 2005 and 2013 even as its pension deficit mounted.[109] Despite the company's continued financial deterioration, the board repeatedly approved dividend

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99 Lopez, *supra* note 98.

100 Bartie Scott, "Valeant CEO Michael Pearson Lost $180 Million Yesterday, and $750 Million In Past Year", Forbes (16 March 2016), online: <www.forbes.com/sites/bartiescott1/2016/03/16/valeant-ceo-michael-pearson-lost-two-thirds-of-his-billion-dollar-fortune-in-a-year/#1f5146ab6c41> archived at <https://perma.cc/6PF4-3E4C>.

101 *Ibid*.

102 Olesiński et al, *supra* note 10 at 25.

103 Andy Rosen, "Watertown-based athenahealth laying off about 500 employees", *Boston Globe* (19 October 2017), online: <www.bostonglobe.com/business/2017/10/19/watertown-based-athenahealth-inc-begins-layoffs/Myo8aTnnDXCVKyIUjsYjCP/story.html#> archived at <https://perma.cc/7QT8-CWKN>.

104 Julianne Pepitone, "Cisco CEO John Chambers gets 80% raise", *CNN* (30 September 2013), online: <money.cnn.com/2013/09/30/technology/enterprise/cisco-john-chambers-raise/index.html> archived at <https://perma.cc/R342-ZLDC>.

105 Thomas Ross, "Column: With a tanking share price and layoffs, this energy executive still made $20 million", *Boe Rep* (14 February 2018), online: <boereport.com/2018/02/14/column-did-you-make-20000000-last-year/> archived at <https://perma.cc/LJZ6-CK4F>.

106 Olesiński et al, *supra* note 10 at 26.

107 *Ibid*.

108 Cole Eisen, "How a corporate focus on the short term drove Sears into the ground", *The Globe and Mail* (30 July 2017), online: <www.theglobeandmail.com/report-on-business/rob-commentary/how-a-corporate-focus-on-the-short-term-drove-sears-into-the-ground/article35839929/> archived at <https://perma.cc/GWA3-YBKG>.

109 *Ibid*; Francine Kopun, "Companies should have to pay pension funds before shareholders: Report", *Star Bus J* (21 November 2017), online: <www.thestar.com/business/2017/11/21/companies-should-have-to-pay-pension-funds-before-shareholders-report.html> archived at <https://perma.cc/DZ3H-MYSA>.

payments.[110] Today, Sears Canada has negative operating earnings and cash flow and is unable to meet its pension funding obligations.[111] These practices are not unique to Sears.[112] In today's short-term mindset, boards are ready to turn down projects expected to produce positive returns and sell off profitable divisions of their company to deliver strong shareholder returns.[113] After all, "pension funding obligations are just one item on corporate balance sheets."[114]

Even though "supporters" discredit short-termism's negative impacts, the above examples demonstrate that short-termism is a serious problem. These practices reflect an economy-wide embrace of attitudes that prefer short-term gains over sustained growth, job creation, and innovation.[115] Nobel prize-winning economist Jean Tirole summarizes the issue in the following manner:

> Managerial decisions do impact investors, but they also exert externalities on a number of—natural stakeholders who have an innate relationship with the firm: employees, customers, suppliers, communities where the firm's plants are located, potential pollutees, and so forth. There is no denying that such externalities may be substantial; for example, the closure of a plant by a major employer in a depressed area has dramatic consequences for its workers and for the local economy.[116]

Given the serious consequences associated with short-termism, it is important to find solutions to the problems it creates. However, to propose effective solutions, we must identify what causes short-termism in the first place.

C. Factors Contributing to Short-Termism

Although it is notoriously difficult to identify the exact factors contributing to short-termism, there is a consensus that the main source of the problem is the tremendous pressure that financial markets put on public corporations to maximize short-term results.[117] This pressure is generally attributed to two factors: first, activist investors, particularly activist hedge funds, who seek to profit by interfering in corporations' management; second, executives who are financially rewarded based on short-term performance regardless of the inherent long-term risks.[118] This article explains each of these two factors in turn.

i. Short-Term Activist Investors Interfering in Decision-Making

Short-term activist investors directly contribute to short-termism.[119] This new class of influential investors push for measures designed to boost stock prices and to maximize

110 Francine Kopun, "Will 16,000 Sears Canada retirees see their pensions?", *Star Bus J* (20 January 2018), online: <www.thestar.com/business/2018/01/20/will-16000-sears-canada-retirees-see-their-pensions.html> archived at <https://perma.cc/FM4S-XSHX>.

111 Eisen, *supra* note 108. See Kopun, *supra* note 110 (explaining that, "when Sears Canada applied for protection from creditors on June 22 last year [2017], the deficit in the defined benefit pension plan was $266.8 million").

112 See for example Carillion, a British multinational company that collapsed after prioritizing shareholder dividends over funding its pension scheme.

113 Eisen, *supra* note 108.

114 *Ibid*.

115 *Ibid*.

116 Jean Tirole, "Corporate Governance" (2001) 69 Econometrica 1 at 5.

117 Barton & Wiseman, *supra* note 3; Grossman, *supra* note 20 at 905; Kevin J Laverty, "Managerial myopia or systemic short-termism?: The importance of managerial systems in valuing the long term" (2004) 42:8 Management Decision 949; Tang & Greenwald, *supra* note 19 at 2.

118 Grossman, *supra* note 20.

119 Matteo, *supra* note 46 at 21.

profits at the expense of long-term value.[120] These investors interfere in decision-making to advance their own interests and divert boards' attention away from their primary mandate to act in the corporation's best interests.[121]

Under the *CBCA*, the formal authority to manage the business and affairs of the corporation is in the hands of the directors, not the shareholders.[122] Subject to the limits imposed by incorporating statutes, unanimous shareholder agreements, and the law, directors have complete discretion to exercise their powers as they deem appropriate.[123] In exercising their powers, they must act honestly and in good faith with a view to the best interests of the corporation.[124] As for shareholders, they may be entitled to certain rights, such as the right to vote or to receive any dividend declared, but they do not have any rights in the management of the corporation.[125]

In practice, however, shareholders have many tools at their disposal to influence decision-making and drive short-term changes.[126] Through their voting rights, shareholders can vote on directors' election and removal, important corporate transactions, and amendments to by-laws and articles of incorporation.[127] Moreover, investors can actively pressure directors through other mechanisms including open letters, shareholder proposals, solicitation through publicity campaigns, and proxy fights.[128] In recent years, this allocation of power to shareholders has proven to be a powerful weapon to influence how directors manage companies.[129] In Canada, among the 55 public activist campaigns launched in 2015, 30 activists succeeded in implementing their demands.[130]

Short-term activist investors usually target mismanaged or underperforming companies. When they acquire shares in a company, they exert pressure on the board to bring about changes that will increase immediate results, but are often not sustainable.[131] Their agenda typically involves issues related to corporate governance such as replacing management, dividend payout policy, new director appointments, executive compensation, and value-enhancing transactions.[132] To implement their demands, short-term activist investors usually threaten to start proxy fights to displace boards. Once these investors achieve

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120 Coffee Jr & Palia, *supra* note 18 at 573 (explaining why activist hedge funds are short-term oriented); Dallas, *supra* note 6 at 302–04 (explaining that transient institutional ownership affects managerial decision making and negatively impacts corporate governance).

121 Matteo, *supra* note 46 at 21.

122 *CBCA*, *supra* note 5, ss 102, 122.

123 *Automatic Self-Cleansing Filter Syndicate Co v Cunninghame*, [1906] 2 Ch 34 (CA) ("[directors] are given in express terms the full powers which the company has, except so far as they 'are not hereby or by statute expressly directed or required to be exercised or done by the company,' so that the directors have absolute power to do all things other than those that are expressly required to be done by the company..."); *Directors' Responsibilities in Canada* (Osler, Hoskin & Harcourt LLP and the Institute of Corporate Directors, 2014) at 4, online: <www.corporate-ethics.org/pdf/Short-termism_Report.pdf> archived at <https://perma.cc/G2Y7-VWTX>.

124 *CBCA*, *supra* note 5, s 122(1).

125 *Ibid*, s 24(3); Yalden et al, *supra* note 20 at 441.

126 Summers & Balls, *supra* note 6 at 36.

127 *CBCA*, *supra* note 5, ss 103, 106, 173.

128 *Ibid* ss 137, 150; Grossman, *supra* note 20 at 927.

129 Strine Jr, *supra* note 83 at 453–55.

130 *2017 Proxy Season Review*, Insight (Kingsdale Advisor, 2017) at 5, online: <www.kingsdaleadvisors.com/attachments/2017_Proxy_Season_Review.pdf> archived at <https://perma.cc/874H-V2TM>.

131 Allaire & Dauphin, *supra* note 74; Andrew MacDougall & Raphaël Amram, "Increased Shareholder Activism in Canada: A Potential Warning Sign for the Upcoming Meeting Season?" (2010) December Osler Corp Rev, online: <www.osler.com/en/resources/governance/2010/corporate-review-december-2010/increased-shareholder-activism-in-canada-a-potent> archived at <https://perma.cc/7HP2-5TXQ>; Tang & Greenwald, *supra* note 19 at 3.

132 Allaire & Dauphin, *supra* note 71; Proxy Season, *supra* note 130 at 6.

their short-term goals, they generally exit the company without being accountable for the long-term consequences of their interventions. Although properly incentivized activists can contribute to long-term wealth creation, short-term activists which advocate for unsustainable measures risk jeopardizing firms' futures.[133]

Given that activist investors hold significant power over management, directors can hardly expect to pursue long-term courses of action that are in the company's long-term interests without activist investors intervening.[134] If directors do not oblige investors' demands for short-term profits, they "risk lagging behind their competitors, thereby increasing their risk of termination."[135] Once firms sacrifice their future to boost current earnings, "executives at other firms will be compelled to follow suit lest their share price and, correspondingly, their career prospects suffer."[136] Under these pressures, it is not surprising that directors are themselves short-term oriented.[137] Instead of focusing on the corporation's long-term profitability, boards endeavour to boost earnings and stock prices to satisfy market expectations.

However, shareholder activism is not the sole cause of short-termism. Even though it is a significant contributing factor, shareholder activism alone does not explain why directors succumb to the pressure and divert their attention from their primary mandate.[138] There are other factors contributing to the short-termism phenomenon.[139] One of these factors is current executive compensation practices.

ii. Executive Compensation Inducing Short-Termist Behaviour

Current compensation packages incentivize executives to focus their efforts on delivering short-term results.[140] Many companies continue to tie a high percentage of execution compensation to short-term financial metrics such as earnings per share, total shareholder value, or one-year share price increase.[141] These short-term financial metrics are not reliably linked to long-term value creation. Instead, they encourage reckless risk taking, which may lead to value destruction when long-term consequences are ignored.[142] Furthermore, these short-term metrics induce executives to delay or forego long-term investments in order to achieve their short-term targets.[143]

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133 Overcoming Short-termism, *supra* note 2 at 3.

134 Summers & Balls, *supra* note 6 at 36.

135 Polsky & Lund, *supra* note 34 at 6; Grossman, *supra* note 20 at 922.

136 Polsky & Lund, *supra* note 34 at 6.

137 Daniel M Gallagher, *Activism, Short-Termism, and the SEC: Remarks at the 21st Annual Stanford Directors' College* (2015), online: <www.sec.gov/news/speech/activism-short-termism-and-the-sec.html#_edn61> archived at <https://perma.cc/BSX9-FV7K>.

138 Olesiński et al, *supra* note 10 at 17.

139 Grossman, *supra* note 20 at 921.

140 The term "executives" encompasses all directors and officers involved in the day-to-day operations of a company that receive compensation.

141 Holly J Gregory, "Corporate Governance Issues for 2015" (12 December, 2014) *Harvard Law School Forum on Corporate Governance and Financial Regulation*, online: <corpgov.law.harvard.edu/2014/12/12/corporate-governance-issues-for-2015/> archived at <https://perma.cc/Y8CP-QPHW>; Grossman, *supra* note 20 at 930.

142 Olesiński et al, *supra* note 10 at 17; GMI Ratings, "Interview: Alfred Rappaport of Saving Capitalism from Short-Termism", *Business Insider* (27 September 2011), online: <www.businessinsider.com/interview-alfred-rappaport-of-saving-capitalism-from-short-termism-2012-6> archived at <https://perma.cc/83X9-5453>.

143 GMI Ratings, *supra* note 142.

Stock-based remuneration is another aspect that influences executives to concentrate excessively on stock prices by "internalizing" the short-term focus of investors.[144] Executives may own stock options with short vesting periods, which allow them to make considerable gains from short-lasting spikes in a company's stock value before the long-term costs of their decisions materialize.[145] When the options are about to vest and executives can cash out, they may be tempted to take actions that fuel short-term stock price performance at the expense of long-term value.[146] As Bebchuk and Fried mention, directors, "may have incentives to jack up short-term stock prices by running the firm in a way that improves short-term results at the expense of long-term value."[147] Executives therefore have little to no incentive to adopt a long-term perspective.

Short-termism has become the order of the day.[148] Together, shareholder activism and executive compensation blind boards to the fact that a short-term mindset is counterproductive to corporations' long-term success. An FCLT Global report explains that, "the balance between short-term accountability and long-term value creation has fallen out of balance; it is time to reconsider what can be done to restore the long-term to its proper place in corporate planning and strategy."[149] Proactive steps must be taken to address the problem, starting with a reform of corporate law. Our legal system should promote sustained wealth creation, not simply for the benefit of shareholders and executives, but more generally for the benefit of all stakeholders.[150] The question that remains is how to adequately encourage the long-term management of public corporations.

II. SOLUTIONS TO DETER SHORT-TERMIST BEHAVIOURS & ENCOURAGE LONG-TERM MANAGEMENT

Part II, which is divided in two sections, proposes regulatory responses to alleviate the problem of short-termism and restore long-term focus. These propositions are not intended to completely solve the problem of short-termism, but constitute reasonable first steps towards combatting it. The proposed reforms target boards of publicly-held corporations but could potentially be tailored to privately-held corporations.[151] Section A focuses on directors' fiduciary duty to act in the best interests of a corporation under section 122(1)(a) of the *CBCA*. Section A proposes amendments to this provision to impose an obligation upon boards to manage companies with a focus on the long-term. Section B considers the possibility of reforming executive compensation under section 125 of the *CBCA*. Acknowledging the challenges of regulating executive compensation, this section offers possible reform to encourage long-term thinking in managerial decision-making.

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144 Dallas, *supra* note 6 at 320; Gregory Jackson & Anastasia Petraki, *Understanding Short-termism: the Role of Corporate Governance* (Stockholm, Sweden: Glasshouse Forum, 2011) at 51, online: <www.glasshouseforum.org/pdf/GF_jacksonpetraki_short-termism.pdf>; Olesiński et al, *supra* note 10 at 16.

145 Olesiński et al, *supra* note 10 at 16; Strine Jr, *supra* note 83 at 467–68; Summers & Balls, *supra* note 6 at 36.

146 Patrick Bolton, Jose Scheinkman & Wei Xiong, "Pay for Short-Term Performance: Executive Compensation in Speculative Markets" (2005) 30:4 J Corp L 721 at 724.

147 Lucian A Bebchuk & Jesse M Fried, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation* (Harvard University Press, 2009) at 184; Strine Jr, *supra* note 83 at 467–68.

148 Mitchell, *supra* note 17 at 302.

149 Barton, Bailey & Joshua, *supra* note 6 at 3.

150 Allen & Strine Jr, *supra* note 93 at 1385.

151 Unlike public corporations, privately-held corporations are not subject to continuous disclosure obligations. It would therefore be much more difficult to monitor whether they abide by the law. Furthermore, the problem of short-termism concerns much less privately-held corporations, which are not under continuous pressure to deliver short-term results.

A. Clarifying Directors' Fiduciary Duty under Section 122(1)(a) of the *CBCA*

i. State of Law and Shortcomings

The *CBCA*, which is the corporate governance framework for federally incorporated companies, imposes a number of duties on directors. Among them, directors owe a fiduciary duty to the corporation, as provided for under section 122(1)(a):

> **122(1)** Every director and officer of a corporation in exercising their powers and discharging their duties shall
>
> (a) act honestly and in good faith with a view to the best interests of the corporation; …[152]

The formulation of section 122(1)(a) of the *CBCA* does not shed much light on the details of board's fiduciary obligation. In 2004, the Supreme Court of Canada ("SCC") clarified the scope of directors' fiduciary duty in the decision of *Peoples Department Stores v Wise* ("*Peoples*").[153] The SCC specified that section 122(1)(a) of the *CBCA* imposes a legal obligation upon directors not to use their position for personal gain; to serve the corporation selflessly, honestly, and loyally; to avoid conflicts of interest with the corporation; to exercise independent judgment; and to maintain the confidentiality of information they acquire by virtue of their position.[154] The Court also confirmed that the "corporation's best interests" is not synonymous with "shareholders' best interests."[155] From an economic perspective, it should be interpreted as meaning the maximization of the corporation's value.[156] Nonetheless, the SCC held that "it may be legitimate, given all the circumstances of a given case, for the board of directors to consider, *inter alia*, the interests of shareholders, employees, suppliers, creditors, consumers, governments, and the environment," as long as they do not conflict with the corporation's best interests.[157] Finally, the SCC clearly stated that directors' fiduciary duty is owed to the corporation itself, not the shareholders.[158]

Four years later, the SCC rendered another decision with respect to directors' fiduciary duty: *BCE Inc. v 1976 Debentureholders* ("*BCE*").[159] The SCC held that directors are required to act in the corporation's best interests as a "good corporate citizen."[160] In introducing this notion, it is unclear whether the Court implied that corporations must have a socially oriented component.[161] It may be that the SCC referred to the growing influence of the

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152 *CBCA*, *supra* note 5, s 122(1)(a).

153 *Peoples Department Stores Inc (Trustee of) v Wise*, 2004 SCC 68 [*Peoples*].

154 *Ibid*, para 35; Kevin P McGuinness & William C V Johnson, *The Law and Practice of Canadian Business Corporations* (Toronto: Butterworths, 1999) at 715; Barry J Reiter, *Directors' Duties in Canada*, 3rd ed (CCH Canadian Limited, 2006) at 54.

155 *Peoples Department Stores Inc (Trustee of) v Wise*, 224 DLR (4th) 509, [2003] RJQ 796 (Qc CA) at paras 66–67. See also *Greenhalgh v Ardene Cinemas Ltd*, [1946] 1 All ER 512.

156 *Peoples*, *supra* note 153 at para 42; Edward M Iacobucci, "Directors' Duties in Insolvency: Clarifying What Is at Stake" (2003) 39 Can Bus Law J 398 at 400–01.

157 *Peoples*, *supra* note 153 at para 42.

158 *Ibid*; Allaire & Rousseau, *supra* note 24 at 14.

159 *BCE Inc v 1976 Debentureholders*, 2008 SCC 69 at para 66 [*BCE*].

160 *Ibid*.

161 Sarah P Bradley, "BCE Inc. v. 1976 Debentureholders: The New of Fair Treatment, Statutory Compliance and Good Corporate Citizenship?" (2009) 41 Ott L Rev 325 at 345–47 (noting that many questions arise from this statement: "Could a decision to operate exclusively for profit be consistent with such a duty?" or "What if the corporation's activities are inherently polluting or dangerous?").

corporate social responsibility movement in modern society and encouraged further reflection on the legal standards imposed on corporations.[162] The SCC also reiterated that the corporation is a legal entity with a perpetual existence, and therefore enjoined directors to consider its long-term interests:[163]

> [38] The fiduciary duty of the directors to the corporation is a broad, contextual concept. It is not confined to short-term profit or share value. Where the corporation is an ongoing concern, it looks to the long-term interests of the corporation. The content of this duty varies with the situation at hand...[164]

In *BCE,* the SCC also confirmed two principles from the *Peoples* decision. First, that directors' duties are to the corporation, not to a particular set of stakeholders.[165] Second, the Court affirmed that the board *may* look to the interests of shareholders and other stakeholders in considering what is in the best interests of the corporation.[166] However, in applying these principles, the SCC added that appropriate deference should be given to the business judgment of directors who take into account these ancillary interests.[167] They are not expected to make perfect decisions, but must act within a range of reasonableness.[168]

In light of Canadian case law, the duty to act in the corporation's best interests consists of maximizing the value of the corporation in a long-term perspective, and in the context of the corporation as an ongoing concern.[169] However, section 122(1)(a) of the *CBCA* does not impose an express obligation upon directors to manage for the long-term *per se*.[170] While the SCC enjoined directors to make decisions in the corporation's long-term interests, directors still have the discretion to determine the timelines for their decisions.[171] Because of this latitude, boards are more susceptible to be influenced by short-term activist investors.[172] Although some boards have managed to ignore short-term market pressures, a majority continue to make decisions that are primarily aimed at generating immediate profits.[173] By amending section 122(1)(a) of the *CBCA*, it is possible to address the pervasiveness of short-termism and to generate behavioural changes. The issue that remains is how to properly reform section 122(1)(a) of the *CBCA* to give priority to long-term management instead of short-term decisions designed to increase quarterly results.[174]

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162 *Ibid* at 347.
163 Allaire & Rousseau, *supra* note 24 at 5.
164 *BCE*, *supra* note 159 at para 38.
165 *Ibid*, at paras 38, 40.
166 *Ibid*, at para 40.
167 *Ibid*.
168 *Ibid*.
169 Allaire & Rousseau, *supra* note 24 at 22.
170 *Ibid* at 13.
171 *Ibid* at 5.
172 Grossman, *supra* note 20 at 956.
173 Barton & Wiseman, *supra* note 3.
174 Duruigbo, *supra* note 54 at 533.

ii. A Fiduciary Duty to Act in the Corporation's Long-Term Interests

This article recommends reform to section 122(1)(a) of the *CBCA* to clarify directors' fiduciary duty. Inspired by Professor Grossman's proposed legal reform of Delaware corporate law,[175] the Creating Shared Value approach,[176] and the Canadian Bar Association's recommendations,[177] this article suggests amending section 122(1)(a) to impose an obligation upon directors to:

> **122(1)** […] (a) act honestly and in good faith with a view to the best long-term interests of the corporation;

This article also proposes defining the meaning of the "corporation's best long-term interests." For instance, a paragraph could be added to section 122 to provide that:

> The "corporation's best long-term interests" referred to in section 122(1)(a) shall be interpreted to mean the maximization of the corporation's long-term value. In determining which course of action is in the corporation's best long-term interests, directors shall have regard to the interests of shareholders and stakeholders without giving priority to a particular interest over any other interest.

Under the amended provision, directors would breach their fiduciary duty when they implement substantial cost cutting programs to maintain high earnings at the expense of long-term profitability. For instance, if a board decided to reduce equipment maintenance expenses which resulted in a pollution scandal, directors could be held accountable for failing to act in the company's long-term interests, or for failing to consider the firm's reputation and long-term value.

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175 Grossman, *supra* note 20 at 956 (Professor Grossman suggests reforming Delaware corporate law to require directors, outside the context of a takeover proposal, to act in the best long-term interests of the corporation and its shareholders. This suggestion is, however, based on the premise that directors' fiduciary duty is owed to the corporation and its shareholders. While Grossman's proposal may have little impact from a director liability standpoint because of the business judgment rule, it would have an "expressive" function, or more specifically, an effect on beliefs regarding the value of long-term behaviour that may eventually become an internalized business norm).

176 Michael E Porter & Mark R Kramer, "Creating Shared Value" (2011) 89 Harv L Rev 62 (The Creating Shared Value (CSV) approach has been developed by Porter and Kramer at Harvard Business School. According to the CSV, the corporation's purpose is to maximize "shared value," not just profit *per se*. The CSV recognizes the interdependency between corporations and society; companies need successful communities for use of public assets, social licenses, and sustained demand, as much as communities need corporations for jobs, innovation, and improved living standards. Accordingly, it is fundamental to take into account stakeholders' interests to optimize economic value.); Evguenia Paramonova, "Steering Toward 'True North': Canadian Corporate Law, Corporate Social Responsibility, and Creating Shared Value" (2015) 12:1 MJSDL 27 (Evguenia Paramonova suggests amending section 122(1)(a) CBCA to redefine the purpose of the corporation, that is, to maximize long-term shared value for the corporation and its stakeholders).

177 *Submissions on the Canada Business Corporations Act*, Public Statement (The Canadian Bar Association, 2014) at 23, online: <www.ic.gc.ca/eic/site/cilp-pdci.nsf/vwapj/Canadian_Bar_Association.pdf/$FILE/Canadian_Bar_Association.pdf> [*Submissions*] archived at <https://perma.cc/78A9-YDRC>. (The Canadian Bar Association recommends amending section 122 CBCA to expressly state that directors are allowed to consider the corporation's short and long-term interests. Moreover, directors should be permitted to consider not only the interests of shareholders, but also other stakeholders in the decision-making process. The Association also proposes to clarify that directors need not give priority to a particular interest over any other interest, not even the shareholders).

Section 122 would also require boards to consider the impacts of their decisions on stakeholders, who play a fundamental role in the company's success. Skillful, productive, and committed employees are critical in creating innovative and growing companies.[178] Therefore, companies cannot realistically expect to optimize long-term value if stakeholders' interests are secondary.[179] Furthermore, it is erroneous to think that there are inherent tensions between creating value and serving the interests of employees, suppliers, customers, creditors, communities, and the environment.[180]

Under the reformed section 122, shareholders would have the same rights and power as before, but directors would be less susceptible to activist investor influences. Not only would the proposed reform prevent directors from making decisions in which the only metric that matters is stock price, but it would also empower them to resist market pressure.[181] Additionally, investors may become more reluctant to interfere in management knowing their short-term demands conflict with the board's fiduciary duty.[182]

To better monitor compliance with section 122, securities regulation could concomitantly require corporations to disclose a detailed long-term business plan, as well as information on environmental and social matters. In the case of important decisions, securities regulation could also require directors to disclose how the decisions they make promote the corporation's best long-term interests.

Law can play a crucial role in tackling short-termism.[183] Besides its coercive function, law can be used as a tool to facilitate and generate changes. As Kent Greenfield explains, "it is foolish and inefficient as a matter of public policy to leave corporate law as an untapped resource."[184] The proposed reform would help change the short-term mindset that characterizes modern corporate culture. By expressly forcing directors to consider the long-term consequences of their decisions, the proposed reform can eventually make the focus on long-term behaviour an internalized business norm.[185]

B. Reforming Executive Compensation under Section 125 of the CBCA

i. State of the Law, Current Practices, and Shortcomings

In Canadian corporate law, directors have the power to appoint and delegate management powers to officers.[186] Public corporations are typically managed by appointed officers, leaving the directors in a supervisory role.[187] Officers who are responsible for managing the day-to-day business of the corporation ("executives") generally receive compensation.

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178 Alberto Salazar & Muthana Mohamed, "The Duty of Corporate Directors to Tie Executive Compensation to the Long-Term Sustainability of the Firm" (2016) Osgoode Legal Studies Research Paper No 20/2016 at 32, online: <digitalcommons.osgoode.yorku.ca/olsrps/141> archived at <https://perma.cc/GYP2-3EM8>; Yalden et al, *supra* note 20 at 630.

179 *Ibid*.

180 Barton, *supra* note 14.

181 Yalden et al, *supra* note 20 at 639.

182 *Ibid* at 632.

183 Paramonova, *supra* note 176 at 46.

184 Kent Greenfield, "Reclaiming Corporate Law in a New Gilded Age" (2008) 2:1 Harvard L & Policy Rev 1 at 23.

185 Dallas, *supra* note 6 at 276, 356.

186 *CBCA*, *supra* note 5, s 121. In Section B of Part II, the terms "board of directors" or "directors" only refer to the directors elected in accordance with section 106 of the *CBCA*.

187 Yalden et al, *supra* note 20 at 708.

Pursuant to section 125 of the *CBCA*, the power to fix the remuneration of officers is in the hands of the directors:

> 125 Subject to the articles, the by-laws or any unanimous shareholder agreement, the directors of a corporation may fix the remuneration of the directors, officers and employees of the corporation.[188]

In practice, the majority of publicly traded corporations appoint an independent compensation committee that is responsible for overseeing compensation payable to executives.[189] There are also compensation consultants that may provide boards with insight into current practices and trends. As boards generally follow those practices and trends, most companies provide similar compensation packages that include salaries, bonuses, stock options, restricted shares, long-term incentive plans, and pension benefits. Generally, only the quantum of the compensation varies.[190] All public companies must annually disclose what compensation they provide to their executives.[191]

Apart from these disclosure requirements, directors have complete discretion to determine the amount, form, and terms of executive compensation. In exercising their discretion, directors must comply with their fiduciary duty to the company.[192] This means that directors must establish fair and reasonable compensation with a view to the corporation's best interests.[193] Nevertheless, left to the discretion of directors, compensation does not have to be structured in a way that considers the corporation's long-term future.

In recent times, company directors have applied their discretion to provide officers with increasingly complex compensation packages. There are a multitude of forms of compensation, including cash (e.g. salary, annual bonus, long-term non-equity plans and pensions) and stock-based compensation (e.g. stock options, restricted shares, and performance shares).[194] Today, stock-linked compensation is the largest component of overall executive compensation.[195]

Furthermore, each compensation package has its own incentives which generally depend on performance-based triggers (e.g. earnings per share, share price increases, and return on invested capital).[196] These compensation incentives are generally linked to short-term performance but not to long-term value creation. Although most compensation packages include what is labelled as "long-term incentive plans", these plans are not fundamentally long-term given that they are designed for a period of one to three years.[197] Thus, executives

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188 *CBCA*, *supra* note 5, s 125.

189 See *Policy Statement 58-201 to Corporate Governance Guidelines*, ss 3.15-3.17; John Valley, Andrew MacDougall & Robert Yalden, "Canada" in Willem J L Calkoen, ed, *The Corporate Governance Review*, 8th ed (London: Law Business Research Ltd., 2018) 64 at 68.

190 Allaire, *supra* note 29 at 42.

191 See Regulation 51-102, *supra* note 44, Form 51-102F6 - Statement of Executive Compensation; Valley, MacDougall & Yalden, *supra* note 189 at 66–68, 72.

192 *CBCA*, *supra* note 5, ss 102, 122, 125; *UPM-Kymmene Corp v UPM-Kymmene Miramichi Inc* (2002), 214 DLR (4th) 496, 2002 CarswellOnt 2096 (Ont Sup Ct) at paras 116–59.

193 Allaire, *supra* note 29 at 44.

194 Submissions, *supra* note 177 at 6.

195 Allaire, *supra* note 29 at 34.

196 Submissions, *supra* note 177 at 6.

197 Seymour Burchman & Blair Jones, *When Did Long-term Incentives Become So Short-term?,* Insight (Semler Brossy, 2016) at 1, online: <www.semlerbrossy.com/wp-content/uploads/When_Did_Long-term_Incentives_Become_So_Short-term.pdf> archived at <https://perma.cc/P3YX-8XL7>; Eric Hosken & Dan Laddin, "Are You Rewarding Short-Termism?" (2014) November-December Corp Board 6 at 6, online: <www.capartners.com/wp-content/uploads/news/id263/120114%20-%20CAP%20-%20The%20Corporate%20Board.pdf> archived at <https://perma.cc/HU7N-VVMW>.

have every incentive to base their business practices on profit-driven and primarily short-term oriented goals.[198]

Compensation packages reward short-term behaviours but fail to encourage long-term management. For instance, a CEO would receive a bonus payment for meeting quarterly earnings expectations even if it was achieved by laying off hundreds of employees, but would not be rewarded for implementing measures that reduce the company's carbon emissions. By overemphasizing financial performance, other important aspects of management such as employee and customer satisfaction, corporate reputation, and environmental impacts are neglected. As a result, executives are not sufficiently held accountable to the long-term outcomes of their decisions.[199]

Compensation packages should be structured in ways that reward executives for achieving business goals in furtherance of the corporation's long-term strategy and prevent excessive short-term focus[200] If appropriate measures are not implemented, directors are unlikely to depart from their current practices. In addition to amending section 122 of the *CBCA*, reforming executive pay is another important step towards tackling short-termism.

ii. A Duty to Align Compensation with the Corporation's Best Long-term Interests

While a comprehensive law reform proposal for executive compensation is beyond the scope of this article, it makes recommendations that policy makers should consider in reforming executive compensation. The recommendations are largely inspired by Germany's legal reform of the *German Stock Corporation Act,*[201] which now imposes an obligation upon boards to award compensation that is oriented towards the long-term sustainability of the firm and provides for clawback provisions.[202] Thus far, the reform has had a reasonable amount of success given that it has encouraged discussions about companies' long-term growth.[203]

This article suggests amending section 125 of the *CBCA* to restrict directors' discretion with respect to compensation. A paragraph could be added to section 125 of the *CBCA* to provide that:

> The remuneration of executives shall be aligned with the corporation's best long-term interests as defined in section 122 and should therefore extend over several years.

Requiring directors to design compensation packages that are aligned with the corporation's long-term interests will likely help alleviate the impacts of short-termism.[204] Such a requirement would prevent boards from using a substantial amount of short-term incentives and would promote the implementation of deferred compensation arrangements and risk-adjusted compensation measures.[205] To fulfil their duty, directors would need to align executive compensation with the company's long-term performance.[206] Under this proposition, directors would retain the authority to determine which forms of compensation are most effective for promoting the long-term success of the firm.

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198 Salazar & Mohamed, *supra* note 178 at 6.

199 *Ibid* at 5.

200 Lipton et al, *supra* note 6 at 8–9.

201 *German Stock Corporation Act*, 2013, BGBl P 1089 FNA 4121-1, s 87 [*Aktiengesetz*].

202 *Ibid*, s 87(2); Salazar & Mohamed, *supra* note 178 at 11.

203 Salazar & Mohamed, *supra* note 178 at 21-22.

204 Dallas, *supra* note 6 at 276.

205 *Ibid*.

206 Victoria Krivogorsky, *Law, Corporate Governance and Accounting: European Perspectives* (Routledge Studies in Accounting, 2001).

Nonetheless, compensation packages would have a requirement to disincentivize short-term behaviour and excessive risk taking that may undermine the corporation's future.

Similar to what Germany and other jurisdictions have implemented, policy makers should consider including claw backs to hold executives accountable for the long-term consequences of their decisions in certain circumstances. For example, the *Sarbanes-Oxley Act*[207] as well as the *Emergency Economic Stabilization Act of 2008*[208] both provide that executives must repay income awarded to them in specific circumstances. This would allow directors to claw back pay from executives if a business built on short-term risk-taking implodes.[209] Assuming that executives know that any negative long-term consequences of their actions may result in a claw back of their compensation, executives would likely engage in long-term minded behaviour.[210] Moreover, claw backs would dissuade executives from manipulating earnings or taking excessing risk.

To better monitor compliance with section 125, securities regulation could concomitantly require directors to explain in annual filings how executive compensation is aligned with the firm's long-term interests and how it promotes the achievement of long-term business goals.[211] Directors would be required to justify executive compensation in terms of long-term oriented thinking and would also be required to propose remuneration packages that are in line with long-term sustainability.[212]

Another recommendation would be to incorporate non-financial measures in compensation arrangements to promote the sustained growth of companies. Non-financial measures complement the company's financial measures by providing the ability to account for various factors such as customer and employee satisfaction, corporate reputation, health and safety, or environmental impacts.[213]

Contrary to financial measures, which may lead to cost-cutting and earning manipulation, non-financial measures tend to focus executives on the long-term.[214] For instance, BHP Biliton and the Commonwealth Bank use non-financial performance indicators such as the company's reputation, employee engagement outcomes, rate of injury, and level of GHG emissions to guide the compensation of executives.[215] Given that the measures that best link strategy and compensation are specific to each corporation, the *CBCA* might not be the best forum to promote the use of non-financial measures. However, securities

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207 *Sarbanes–Oxley Act of 2002*, Pub No 107-204 116 Stat 745, s 304.

208 *Emergency Economic Stabilization Act of 2008*, Pub No 110–343 122 Stat 3765, s 111(b)(3)(B).

209 Polsky & Lund, *supra* note 34 at 3–4.

210 Salazar & Mohamed, *supra* note 178 at 28.

211 Lipton et al, *supra* note 6 at 9.

212 Salazar & Mohamed, *supra* note 178 at 18.

213 *Getting What You Pay For: Linking Executive Remuneration to Responsible Long-Term Corporate Success*, Discussion Paper (Henderson Investors, 2005), online: <www.henderson.com>, cited in Matteo, *supra* note 46 at 21 (explaining that, "focusing just on financial objectives may sometimes mean that underlying extra-financial factors that are essential for long-term success do not receive adequate attention…").

214 Salma Ibrahima & Cynthia Lloyd, "The association between non-financial performance measures in executive compensation contracts and earnings management" (2011) 30:3 J Accounting & Public Policy 256 at 256.

215 *BHP Annual Report 2017*, Annual Report (BHP Billiton Limited, 2017), online: <www.bhp.com/-/media/documents/investors/annual-reports/2017/bhpannualreport2017.pdf> archived at <https://perma.cc/59SR-NT59>; *Annual Report 2017*, Annual Report (Common Wealth Bank of Australia, 2017), online: <www.commbank.com.au/content/dam/commbank/about-us/shareholders/pdfs/2017-asx/Annual_Report_2017_14_Aug_2017.pdf> archived at <https://perma.cc/PF6M-XTRF>.

regulators and other relevant authorities should work on incorporating non-financial measures into compensation packages. As for boards, they should endeavour to develop non-financial metrics that support a framework for long-term growth.[216]

Finally, this article acknowledges that further research is needed to understand the conditions under which long-term compensation is most effective. Discussions on reform should consider the potential conflict between deterring reckless short-term behaviours and encouraging sufficient risk-taking to maximize the corporation's value over the long run.[217] Moreover, these reform discussions should consider that every corporation has different needs and strategies, and that there is no one-size-fits-all solution.[218]

CONCLUSION

Short-termism is a troubling mindset that has permeated corporate culture.[219] Recent examples have shown that short-term market pressures not only encourage excessive risk-taking, but also induce corporate boards to sacrifice long-term investments that are fundamental to long-term growth. For reasonable first steps towards combatting short-termism, this article has proposed to clarify directors' fiduciary duty under section 122 of the *CBCA* and to reform executive compensation under section 125 of the *CBCA*. If implemented, this reform would not only hold boards accountable for long-term value creation, it would also encourage long-term oriented thinking and decision-making.

This article recognizes that although influencing corporate boards' behaviour is a key leverage point to tackling short-termism, effective change will result from a comprehensive rather than piecemeal approach.[220] As noted, short-termism is not limited to the behaviour of a few actors in the corporate chain.[221] Therefore, we cannot place the entire onus on corporate boards to focus on the long-term and resist short-term pressures.[222] The broader solution to short-termism requires greater engagement on the part of investors, especially institutional investors who own significant proportions of shares in public companies. Due to their significant influence on decision-making, institutional investors could prove to be key allies in in facilitating an eventual reform of corporate law.[223]

Investors must provide greater support for the efforts of the companies in which they invest to build sustainable, long-term, and successful businesses.[224] They must stop believing that "if companies allocate more profits to employees, or to communities, that necessarily means a loss for shareholders."[225] On the contrary, these factors contribute to firms' long-term profitability.

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216 Sigurdson, *supra* note 1.
217 Walker, *supra* note 62 at 437.
218 *Ibid* at 447.
219 Sigurdson, *supra* note 1.
220 Overcoming Short-termism, *supra* note 2 at 3.
221 *Ibid* at 4; Duruigbo, *supra* note 54 at 536.
222 Tang & Greenwald, *supra* note 19 at 5–6.
223 Doidge et al, *supra* note 32 at 6.
224 Rosenblum, *supra* note 20 at 539.
225 Lenore Palladino, "Why Corporate Social Responsibility Won't Be Enough", *Roosevelt Institute* (1 February 2018), online: <rooseveltinstitute.org/why-corporate-social-responsibility-wont-be-enough/> archived at <https://perma.cc/X22L-CXHP>.

Fortunately, there have been promising signs of change for the future. Prominent institutional investors such as BlackRock and Canada Pension Plan Investment Board have expressed their commitment to long-term investments as well as their desire to combat short-termism.[226] Furthermore, initiatives such as "Focusing Capital on the Long-Term" and "The New Paradigm" have been launched to develop practical tools that encourage long-term decision-making and to alleviate the pressures to maximize profits.[227]

To conclude, it is crucial to change the way our corporate system works and thinks. Short-termism undermines long-term economic prosperity and social welfare, and encourages opportunistic behaviours by a few to the detriment of the many.[228] In contrast, there is an emerging consensus that long-term focused companies that balance the interests of all its stakeholders outperform their shorter-term peers on a range of key economic and financial metrics.[229]

226 See e.g. "BlackRock's responsibility", *BlackRock* online: <www.blackrock.com/investing/investment-ideas/sustainable-investing> ("BlackRock is committed to sustainable outcomes and long-term value"); "Sustainable Investing", *CalPERS* online: <www.calpers.ca.gov/page/investments/governance/sustainable-investing> ("the goal of the CalPERS Investment Program is to achieve long-term, sustainable, risk-adjusted returns..."); "Our Investment Strategy", *CPP Invest Board* online: <www.cppib.com/en/how-we-invest/our-investment-strategy/> archived at <https://perma.cc/LU52RD42> ("[w]e developed our investment strategy with a long-term view in mind").

227 Barton, Bailey & Joshua, *supra* note 6; Lipton et al, *supra* note 6.

228 Matteo, *supra* note 46 at 5.

229 Sigurdson, *supra* note 1. See Barton et al, *supra* note 6; Martin Lipton, "Some Thoughts for Boards of Directors in 2018" (30 November, 2017), *Harvard Law School Forum on Corporate Governance and Financial Regulation,* online: <corpgov.law.harvard.edu/2017/11/30/some-thoughts-for-boards-of-directors-in-2018/> archived at <https://perma.cc/ZFJ2-QVBQ>.