Uncertainty, externalities and collective action problems: correcting the short-term bias through a multi-stakeholder approach.

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Abstract

In this paper, we examine the extent to which changes in the rules of corporate governance, imposed by law, might allow greater weight to be given, in the decision making of actors in financial markets, to longer term objectives such as the protection of the environment and inequalities in the distribution of wealth. We believe that the relevance of, and the growing concern with, short-termism in contemporary financial markets is due to certain identifiable factors, that we explore and discuss. Our thesis is that the involvement of a wider range of stakeholders in the decision-making of financial market actors (including professional investors and investee companies) can mitigate the negative effects of these factors.

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1. *Introduction.*

The European Commission ([1]) and a wide range of scholars ([2]) are currently addressing issues of corporate governance and the discipline of financial markets using a conceptual framework based on the contrast between short and long term, where – in simplified terms – a number of problems arise as a result of a short-term bias affecting market actors. We believe that this conceptual framework is able to capture the importance of the weight given to future (dis) utilities by actors in financial markets and, as such, serves as a useful analytical tool to frame the problems above.

In this paper, we examine the extent to which changes in the rules of corporate governance, imposed by law, might allow greater weight to be given, in the decision making of actors in financial markets, to longer term objectives such as the protection of the environment and inequalities in the distribution of wealth.

As a starting point, we believe that it is possible to identify, in the abstract, the factors capable of encouraging the take up of visions in which the weight of future (dis) utility is undervalued, and that of present (dis) utility is correspondingly overestimated, as well as the objectives and programmes most vulnerable to short-termism.

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([1]) See for example: European Comission, *Green Paper - The EU corporate governance framework* Brussels, 5.4.2011, COM (2011), 164 final ("Corporate governance is one means to curb harmful short- termism and excessive risk-taking"); European Commission, *Communication From The Commission To The European Parliament, The Council, The European Economic And Social Committee And The Committee Of The Regions - Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies*, Strasbourg, 12.12.2012, COM (2012), 740 final ("the importance of avoiding too much focus on short-term horizons only"). More recently, *Study on Directors' Duties and Sustainable Corporate Governance Final Report,* 20 – 07 – 2020; *Inception Impact Assessment for Sustainable Corporate Governance*, 30/07/2020.

([2]) A simple search in the internet shows the impressive list of scholars who use this conceptual scheme and detect the existence of phenomena that can be framed as short-term oriented behaviours. For an extensive bibliography, see in any case K. Willey, *Stock Market Short-Termism*, Springer International Publishing, 2019. Even critics who deny the existence of dysfunctions, or the usefulness of framing them in the long-short scheme, admit that they are an absolute minority, and (rightly) feel the need to explain why such a proportionately small number of people (they) are right and so many people (the others) are mistaken. They do so by appealing to the existence of a narrative that is (in their opinion) wrong, but nevertheless able to be convincing for reasons that, despite the efforts to evoke sophisticated explanations (M. Roe - R. Shapira, *The Power of the Narrative in Corporate Lawmaking,* available at SSRN 3703882, 2020, refer to three causes indicated as connotation, confusion and confirmation) remain substantially mysterious.

In particular, objectives and programmes are all the more subject to the risk of being distorted by phenomena of inappropriate distribution of weights between the present and the future, the more uncertain (in the results and their distribution) and vague (in the various stages) they are.

In this perspective, we believe that the recently growing concern with short-termism in contemporary markets, is explained, and may be justified, by factors connected with the expansion of the social role of financial markets.

First of all, it is a well-known, observable fact that financial markets have, over time, been entrusted with multiple tasks and objectives that used to be entrusted mainly to States. Examples include the achievement of very long-term objectives, such as the payment of pensions and other socially relevant goals ([3]), which today depend mainly on the functioning of financial markets.

Another factor justifying the growing concern with short-termism is the increased importance of financial markets in financing business corporations. Given that corporations govern our lives and "… determine what we eat, what we watch, what we wear, where we work and what we do" ([4]), the attention to the possibility of distortions in the functioning of their main financing mechanism cannot come as a surprise.

Other areas of concern, of a structural nature, are the ways in which markets are organized ([5]), something we will return to later.

We therefore share the widespread, but not undisputed ([6]), opinion that reference to short-termism is ultimately able to frame many current problems and that a number of factors fuelling short-termism are at work in contemporary financial markets ([7]). Our thesis is that the involvement of a wider range

([3]) On the "… wide-ranging retreat of the state from its role in guaranteeing and providing a wide range of social functions…" see P. Zumbansen - D. Katelouzou, *The Transnationalization of Corporate Governance: Law, Institutional Arrangements and Corporate Power*. *TLI Think*, 2020, https://ssrn.com/abstract=3536488

([4]) J. Bakan, *The Corporation: The Pathological Pursuit of Profit and Power*, Constable and Robinson Publishing, 2005, 5.

([5]) Especially the fact that the most important part of investments is no longer decided by retail investors but by professional investors subject to strong competitive pressure. On the relevance of this factor, see F. Denozza - A. Stabilini, *Principals vs Principals: The Twilight of the Agency Theory*, *Italian LJ*, 2017, 3: 511.

([6]) See for example some critical reactions [Feedback to Inception impact assessment Ares (2020) 4034032, www.ec.europa.eu]. to recent European Union documents (especially the *Study on Directors' Duties and Sustainable Corporate Governance Final Report,* and *Inception Impact Assessment* on Sustainable *Corporate Governance*, 20 July 2020) largely reasoning within an analytical long v. short framework

([7]) In addition to what has already been observed in note 1 above, it seems to us that the impact of short-termism on the final crisis of 2007-2008 is difficult to contest. As is well known, the main proximate cause of the crisis was immediately identified in excessive risk taking: Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report: Final Report of The National Commission On The Causes Of The Financial And Economic Crisis In The United States* (2011), p. xviii f.: "Too many of these institutions acted recklessly, taking on too much risk…. Like Icarus, they never feared flying ever closer to the sun"; High Level group on Financial Supervision in the EU, *Report* (2009), 8-9; Financial Stability Forum, *FSF Principles for Sound Compensation* Practices 1 (2009): "Perverse incentives amplified the excessive risk-taking that severely threatened the global financial system ...."; Basel Committee on Banking Supervision, of stakeholders in the decision-making of financial market actors (including professional investors and investee companies) can mitigate the negative effects of these factors.

To be clear from the outset, we do not intend to claim that stakeholder involvement is capable of directly reducing the short-term bias of market actors, or to neutralize the structural factors conducive to short-termism – above all, uncertainty. Nor do we assume that all stakeholders are long-term oriented (or more long-term oriented than investors) by definition. Our claim is rather that stakeholder involvement can lead to decision-making processes that are less vulnerable to short-term bias.

In this paper, we first (in part 2) specify the peculiar features of financial markets which frame the context in which distorted behaviour occurs (including that caused by an unbalanced vision of the relationship between short- and long-term objectives). We emphasise one feature, inherent in the process of price formation of financial products, making financial markets particularly sensitive to the effects of the diffusion of short-term or long-term visions (part 3). The elementary scheme of reasoning implied by the adoption of a short - long analytical framework is examined in part 4.

In general, there are goals and programmes that are more vulnerable to short-termism and we examine (in part 5) some factors usually able to transform the potential vulnerability in actual distortion and in incorrect evaluations of the weights of present utilities compared to future ones. We examine the operation of these factors in contemporary financial markets (part 6).

Finally (part 7) we indicate the reasons that, in our opinion, can link an enhancement of stakeholder intervention with reduced severity of the negative factors indicated.

2. *Individual choices and market responses: the peculiarities of financial markets and the case for corrective interventions.*

Any dialogue starting from different, unclear, and unexplained assumptions is often useless.

Compensation Principles and Standards Assessment Methodology 1 (2009) where it is recommended that "…excessive risk-taking is avoided"; Press Release, Bd. of Governors of the Fed. Reserve, *Fed. Reserve Issues Proposed Guidance on Incentive Comp*. (Oct. 22, 2009); Press Release, U.S. Dep't of the Treasury, *Statement by Treasury Sec'y Tim Geithner on Comp*. (June 10, 2009): "At many firms, compensation design unintentionally encouraged excessive risk-taking…"; K. FRENCH, et al. *The Squam Lake report: fixing the financial system*, 22 *Journal of Applied Corporate Finance*, 2010, 8, "…at the core of the problem is a potential conflict between the risk-taking proclivity of financial institutions and the interests of the economy at large that must be managed at least in part through more effective regulation". More recently, see, e.g., S. Schwarcz - M. Peihani, *Addressing Excessive Risk-Taking in the Financial Sector: A Corporate Governance Approach,* 2020, available at https://www.g20-insights.org/policy_briefs/addressing-excessive-risk-taking-in-the-financial-sector-a-corporate-governance-approach/: "Excessive corporate risk-taking … is widely seen as one of the primary causes of the global financial crisis".

Having established this, it seems difficult to deny that excessive risk-taking is a typical manifestation of short-termism (in the *Response to the Study on Directors' Duties and Sustainable Corporate Governance by Nordic Company Law Scholars,* Nordic & European Company Law, Lsn Research Paper Series No. 20-12, p. 7 it is emphasized that "… even where a decision has an undesirable or unintended effect, this is not necessarily proof that the directors were influenced by short-termism, it may just be an honest failure to gauge the many risks involved"; this observation may be true for occasional errors, but not for a *systematic* underestimation of risks, akin to that which occurred before the crisis).

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We are obviously well aware that our vision of financial markets is very different from that shared by many scholars([8]), and especially from the vision of steadfast believers in the tendency of all markets towards equilibrium and efficient valuation of financial assets.

A general discussion on this point cannot be started here, but a preliminary explanation of one's convictions in this regard is in our opinion indispensable.

We therefore start by clarifying the assumptions on which the arguments we are going to develop are based.

We believe that financial markets are exposed to the risk of not reaching optimal equilibria [or even just "transient orders" ([9])], not only due to the presence of market failures, but for structural reasons, inherent in the normal functioning of these markets.

Prices for financial products, determined on the basis of the returns they will generate in the future, follow processes different from those that determine the prices of the goods purchased where there is a utility to be obtained from their consumption. The differences between these price setting processes means that the main market regulation mechanism, namely the law of supply and demand, does not necessarily function for financial products.

It is well known that increases in the price of financial products can be seen as a correction of a previous (erroneous) undervaluation, and that an increase in the price may produce boost in demand rather than a decrease. It is also well known that the reverse is also true and that a decrease in the price of a financial product does not necessarily lead to an increase in the relative demand ([10]).

Another peculiarity of financial markets is the magnitude of the phenomenon whereby the choices made by each market player affect not only the well-being of the person making the choice, but also the well-being of the other market participants. This phenomenon, which is generally not taken into consideration, or even concealed ([11]), occurs, to varying degrees, in every market. Since the

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([8]) E.F. FAMA, *Efficient capital markets: A review of theory and empirical work*, 25 *Journal of Finance,* 970, 853–873, is probably the most prominent article outlining a different opinion.

([9]) R. R. Nelson (2013), 'Demand, Supply and Their Interaction on Markets, As Seen from the Perspective of Evolutionary Economic Theory', *Journal of Evolutionary Economics*, 23 (1): 17-38.

([10]) D. Harrison, *Price and Financial Stability: Rethinking Financial Markets*, Routledge, 2018. Pretcher, R.; Parker, W., The financial/economy dichotomy in social behavioural dynamics: The social perspective, *Journal of Behavioral Finance*, 2007, 8.2: 84-108.

([11]) This embarrassing (for market apologists) fact is usually concealed thanks to the distinction between pecuniary and non-pecuniary externalities (on which see E. J. Mishan, *The Postwar Literature on Externalities: An Interpretative Essay,*

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preference of a consumer for a certain product *x* not only affects the price of that product, but also the price of the competing product *y*, which happens to be the favorite of another consumer, the choice made by the former also affects the latter.

If we are dealing with consumer goods of relatively limited importance, it is rather obvious that the externality that each consumer produces on the well-being of others is of limited importance. It seems indisputable that the interest in preserving the freedom to choose the product that best satisfies the tastes of each individual should prevail over the protection against the negative consequences for others.

In the case of financial markets and financial products, the situation is somewhat different. First of all, the possibility of establishing that a certain choice is objectively wrong, an almost non-existent possibility with reference to many consumer goods, is present here to a significant extent. The immediate need for people to buy financial products is ultimately the same for everyone and concerns the production of income. If a financial product does not produce income, or even produces the loss of the invested capital, it can be safely said that the choice of that product has certainly proved wrong, without the need to carry out any inadmissible investigation into the tastes of the people who made the choice.

It is therefore evident that, in the context of financial markets, the external effects of the choices of each market actor are much more relevant for other market actors, than the external effects of the choices related to consumer goods. Systematic errors in the investment choices made by actors on financial markets can obviously have deleterious effects on society as a whole.

In short, in financial markets, the reasons for not interfering or not limiting individual choice are less pronounced than for consumer markets, and the reasons for acting to address the negative external effects of these choices are, correspondingly, strengthened.

On the issue of freedom of choice, we are convinced that the choices an actor makes depend not only on her or his preferences but on the context in which the choices are made and on the way in which the choices are presented. The same individual can give priority to different preferences depending on how the choice is presented, and therefore a different order of priority can be given if the same

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9 *Journal of Economic Literature,* 1971, 1) and the assumed irrelevance of pecuniary externalities. The alleged irrelevance of pecuniary externalities is totally unwarranted. As it has been noted (D. Hausman, *When Jack and Jill Make a Deal*, 9 *Soc. Phil. & Pol'y*, 1992, 95) "… why should only non-pecuniary externalities be of moral concern? For pecuniary externalities can totally transform people's lives". R. Posner, *Overcoming Law*, Harvard University Press, Cambridge, MA, 1995, 24, underlines the arbitrariness of the exclusion from the notion of damage of pecuniary and mental externalities (see also p. 305: "Each of us is harmed every day by the actions of unknown others and harms unknown others by our own actions, if only through the operation of competition in economic and other marketplaces"). From a general philosophical viewpoint, see S. Olsaretti, *Liberty, desert and the market: A philosophical study*, Cambridge University Press, 2004.

choice is presented in different circumstances. This clarification is important. While there are obvious reasons for respecting people's preferences, there are no equally obvious reasons for preferring (and respecting) certain contexts of choice (for example, that "spontaneously" created by the market) and for not interfering in the various contexts in which preferences are translated into choices ([12]).

Ultimately, it cannot be taken for granted that an individual will apply the same hierarchy of preferences in all contexts, or that the hierarchy operated in a certain context leads to necessarily more "genuine" choices. Changing the contexts in which financial market actors make their choices cannot therefore be considered, a priori, an illegitimate interference in the freedom of choice (we'll come back to this at the end of section 6).

3. *The value of financial products and the expectations on future returns: where short-termism comes from and why it is not simply a question of individual preferences.*

We now need to underline another peculiar feature of financial markets, namely the way financial assets are valued.

Let's go back to the law of supply and demand. The phenomenon according to which, all other things being equal, a decrease in prices causes an increase in demand (and vice versa), is a consequence of the fact that buyers base their decisions on the utility they will derive from the purchases they make. If the price of an otherwise identical good decreases, and the good is able to provide the same utility as before, it is evident that the buyer will derive a greater utility from the purchase (i.e., the same utility from the purchase but less loss of utility because the disbursement is less). Consumers may be induced to dismiss other alternatives and prefer the purchase of the asset in question.

This reasoning assumes that the utility provided by a certain good to a given subject is an objective, in the sense of *subjectively* certain, datum. All other conditions being equal, a definite unit (the first, the second, the third, etc.) of a given good, procures a given utility to a given subject. People are normally able to evaluate the utility that they will get from the purchase of a particular good.

The assumption does not hold in the case of financial products ([13]). The value of assets purchased in order to realise future returns, depends on uncertain estimates about expected yields and on the

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([12]) A "choice architecture" in the language of theories of nudging, s. C. Sunstein, *Nudging: a very short guide* in *The Handbook of Privacy Studies*, Amsterdam University Press, 2018. p. 173. It is worth emphasizing that that we do not think that individuals have fixed preferences ordered in a fixed scheme, and that contexts (or choice architectures) can be analysed on the basis of whether they induce, or do not induce, an individual to make the best choices, more responding to his "genuine" preferences. In our opinion, there are no "genuine", "unencumbered" individuals and preferences pre-existing society, to which the latter must offer the conditions to express at their best. Our opinion is that the preferences of individuals, and the way in which they are ordered, are continuously reshaped by the different social situations in which individuals are embedded.

([13]) P. Woolley, Why are Financial Markets so Inefficient and Exploitative, And a Suggested Remedy, in A. Turner, A. Haldane, P. Woolley, S. Wadhwani, C. Goodhart, A. Smithers, A. Large, J. Kay, M. Wolf, P. Boone, S. Johnson and R.

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probability that an asset will appreciate over time. It is therefore a value that may change, even if the preferences of the decision maker remain the same ([14]).

It follows that the valuation of a financial product is rarely reducible to a simple means-ends calculation in a context of given and unchanging (at least in the short period) preferences. The value of financial products generally depends on complex judgments relating to unpredictable and often absolutely incalculable [uncertain, in the sense of Keynes and Knight ([15])] future events. That is, it depends not only on preferences, not only on "technical" calculations (calculations which, in any case, are never purely objective and outside the actor's prejudices) but, above all, on a "political" evaluation that must give a "weight" to two distinct factors (immediate sacrifice of liquidity / future returns) which, as they are not in the same homogeneous space or timeframe (one is present, the other is future), cannot be properly compared. It is in this peculiarity of financial products that the contrast between short and long termism comes into play.

It is clear that the idea of short-termism is used (in EU documents and elsewhere) to come up with a conceptual scheme rather than to simply describe facts. A scheme in which the actors' behaviour is explained based on the "weight" that actors attribute to immediate (dis) utilities, compared to the "weight" actors attribute to possible future (dis) utilities.

The conceptual framework provided by the reference to short (long) - termism is therefore an appropriate approach to analyse situations in which the time factor (and the uncertainty that it brings with it) has a high impact on the actor's evaluations, due to the way in which the actor distributes the weight. Situations, it is worth underlining strongly from now on, whose frequency, importance and danger is not an invention of the Union, but has long been known to all economists ([16]) (a little less,

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Layard (eds.): The LSE Report, London School of Economics and Political Science, 2010, notes that the demand for most goods and services is limited by the physical capacity of consumers to consume whilst demand for financial services has no such boundaries.

([14]) Harrison (nt. 6), 173: "Unlike real economy prices, rooted in the real goods and services produced and exchanged, financial prices attempt to value future income flows from financial and capital assets. These valuations fluctuate erratically because expectations of the future fluctuate – and large liquid financial markets can amplify, rather than correct, these effects."

([15]) Y. Sakai, *JM Keynes on probability versus FH Knight on uncertainty: reflections on the miracle year of 1921,* in *JM Keynes Versus FH Knight*, Springer, Singapore, 2019, 39.

([16]) We exemplify with an illustrious quotation (often mentioned, although mostly in a different translation from the one that follows): "It is one of the most pregnant facts of experience that we attach a less importance to future pleasures and pains simply because they are future, and in the measure that they are future. Thus, it is that, to goods which are destined to meet the wants of the future, we ascribe a value which is really less than the true in- tensity of their future marginal utility. We systematically under-estimate future wants, and the goods which are to satisfy them." Cfr. E. Bohm – Bawerk, *The positive theory of capital*, translated by W. Smart, reproduction of 1891 edition, New York, 1930. The sentence reproduced above is at the beginning of chap. 3 of Book V, here at p. 254.

of course, to those blinded by the ideological prejudice that markets are always able to balance for the best and correctly steer actors' choices).

4. *The short-long framework: comparisons and evaluations.*

We now turn to look at what short-termism means. In a widespread view, it is the use of too high a rate of discount of future returns. Market actors using a higher discount rate are more short-term oriented while those using a lower rate are more long-term oriented. This is a simple comparative observation.

From another viewpoint, one can try to establish what the generally appropriate rate should be in the given circumstances, and qualify (at this point not as a simple observation, but as an evaluation with an implicit negative judgment) short-termism as the use of a higher rate and long-termism as the use of a lower rate.

The short / long term framework can ground judgments which are non-evaluative if they are limited to ascertaining that a behaviour is more oriented to the short (or long) term than another behaviour. They become evaluative when they claim that a behaviour is too short (or long) – term oriented, in the sense that actors use an excessively high (or low) discount rate for future returns.

In order to decide what is, and what is not, excessive, a parameter is obviously needed, one that is able to define the rate appropriate in a given situation. In this perspective, reference to short and long termism, states that a given behaviour differs significantly from the normal. Given that 'normal' cannot be defined in a manner that is valid in absolute terms for all situations, it is natural that, in any given situation, there can be a reasonable discussion as to what the 'normal' is, and what level of deviation from that normal should be considered as excessive.

In conclusion, the judgment (the judgment not limited to ascertaining that a certain behaviour is more less short-term oriented than another) is always relative, depending on the chosen purposes and on the programmes developed to achieve them.

5. *Main factors possibly leading to short-term oriented visions in general…*

The usefulness of an analytical framework based on the contrast between the short / long term depends on the nature of the situation and especially on the objectives pursued by the actors.

A conceptual scheme based on a comparison between the weight given to present utilities and the weight given to future utilities is obviously more useful in the analysis of certain situations and less in the analysis of others. It depends particularly on the distance into the future of the utility pursued (or of the impending disutility), on the uncertainty of the objective, on the linearity of the programmes that can be developed, etc.

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There are purposes and programmes that, in a given circumstance, require a very high immediate sacrifice, the rejection of which can be considered as short-termism, and purposes and programmes that, again in a given circumstance, have opposite implications. The evaluations of short or long-termism, and the very usefulness of resorting to the scheme that contrasts them, depend on the nature of objectives and programmes.

Given that the problem of short-termism is ultimately a problem of possible distorted evaluations of the costs and benefits of objectives and programmes the implementation of which takes place over a time span that is not short, it may be important to understand what factors may affect, and possibly alter, this evaluation.

Going over the list of factors contained in a classic treatment of the subject, and trying to condense its most useful ideas for our purposes, it seems to us that four macro factors deserve to be especially considered: uncertainty, herd behaviour, possible conflict between immediate preferences and second order preferences, possible externalization and the resulting misalignment of relevant interests ([17]). Let us briefly examine how these factors generally work.

Uncertainty (both that relating to the evolution of the context and that relating to the actor's future conditions) is perhaps the main factor that can cause errors in the evaluation of the weights that are attributed to costs and benefits.

An explanation of the contemporary spreading of short-termism and the related concern can then be sought in the greater uncertainty that currently hangs over our future in a situation in which Keynesian ordered markets no longer exist, in which no public body (let alone nation states) is able to carry out significant planning (and thus offer reference points to operators) and in which even firms (not to mention families) have difficulty in elaborating serious plans for their future business.

For some time, the current epoch has been defined as the age of risk ([18]), and perhaps better put as the age of uncertainty (in the sense, clarified by the works of Keynes and Knight, of absolute uncertainty, not susceptible of measurement even if only probabilistic), given that growing complexity made probabilities of future events less and less calculable and, therefore, increasingly difficult to translate into quotations and prices ([19]).

([17]) I. Fisher, *The theory of interest,* New York, The Macmillan Company, 1930, p. 81, lists the following factors: (1) foresight, (2) self-control, (3) habit, (4) expectation of life, *(5)* concern for the lives of other persons, (6) fashion.

([18]) Beck, U. *Risk Society,* London; Orig. *Risikogesellschaft. Auf dem Weg in eine andere Gesellschaft, Frankfurt a. M*, 1986.

([19]) With specific reference to financial markets, it is also worth mentioning the impact that the diffusion of particularly opaque financial products had in increasing the overall level of risk. Obviously, the risk grows not only for people (buyers of these products) eager to run it, but also for competing professional intermediaries (and their clients), unable of giving

In a situation of widespread uncertainty, the adoption of high and, perhaps, excessively future discount rates, does not come as a surprise. Short-termism in financial markets does not appear as an isolated anomaly, but as the expression of a much more complex phenomenon ([20]).

Other factors that can produce an incorrect evaluation of the weights to be attributed to future (dis) utilities can be traced back to the tendency to repeat one's previous behaviours or to repeat the behaviours of others. On financial markets this phenomenon has the specific name of herd behaviour. We will address this phenomenon in greater detail later on.

The third factor could be referred to as the contrast between immediate preferences and second-order preferences ([21]).

In a large number of situations, the actor has an immediate preference that favours a certain choice, possibly inconsistent with the more general preferences of the actor himself. This phenomenon can occur when an instinctive reaction leads to behaviour that the actor considers reprehensible, or when he/she does not manage to correctly evaluate the negative consequences that his/her immediate choice may produce on him/her in the future. It is also, and perhaps even more often, possible that the conflict between immediate preferences and second-order preferences reflects a different consideration for the interest of others, a consideration which may remain at a low level in immediate calculations guided by pure instrumental rationality and may perhaps be higher in more in depth reflections, not necessarily inspired by pure altruism, but simply by the awareness of the importance of offering others terms of cooperation appreciable and acceptable to them ([22]).

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up buying risky but profitable products, and in the end for any market participant, all being exposed to the risk of entering in dangerous relationships with other market participants in turn exposed to large and opaque risks.

([20]) The phenomena that feed the sentiment, named by J.M. Keynes, *The general theory of employment, interest, and money*, Harcourt, 1953, Ch 13, II, 70, "desire for security", which explains, among other things, the preference for liquidity.

([21]) As is known, the case considered typical is the one, obviously different from the one we are dealing with here, of intoxication and addiction: see A. Carballo, *Rationality and second-order preferences*, in *Noûs*, 2018, 196; D. Bruckner, *Second-order preferences and instrumental rationality*, in *Acta Analytica*, 2011, 367-385. In Fisher's presentation, in a more intimate vein, of the same factors, this goes by the name of self-control or weak will. Bohm-Bawerk (nt. 11) gives the example of the worker who gives in to the temptation to spend his wages to get drunk on Saturday nights, thus forcing himself and his family to face a week of deprivation.

([22]) J. Rawls, *Political Liberalism*, Columbia University Press, 2005; a summary of the question in L. Krasnoff, *The reasonable and the rational*, in J. Mandle, D. Reidy (ed.), The Cambridge Rawls Lexicon, Cambridge University Press, 2014). In this debate, the importance of the altruistic component has often assumed a central role (at least in the sense of awareness of the importance of offering others terms of cooperation that are appreciable and acceptable to them) that a reasonable attitude is able to incorporate much more than an attitude of pure instrumental rationality (see for example among the most recent, I. Grossmann- P. Eibach, *Reasonable bounds on rationality, Mind & Society*, 2020, 1, 6).

The last factor concerns the configuration of the interests at stake, and especially the possibility that the effects of the actor's choices are, in whole or in part, transferred to others, or the possibility that the actor, in making his/her choices, takes into account the interests of others as well ([23]).

In the context of financial markets, dominated by uncertainty, the possibility that the actor may not be able to align his choices with the interests (whatever they are) he intends to satisfy are very high. Equally high are the chances that the actor's actions have (knowingly or unknowingly) effects on interests, other than those appreciated by the actor himself. Besides, the complexity of the chains of intermediaries operating on contemporary markets is capable of further exacerbating these problems, by multiplying the opportunities for misalignment between the interests of the various market players.

6. *…and in financial markets: issuers, professional investors, and retailers facing uncertainty, externalities and collective action problems.*

Setting objectives for complex and long-lasting social processes, such as the reduction of inequalities, a higher level of respect for human rights and the protection of the environment, immediately raises the problem of the weight to be given to present and future (dis) utilities. It is clear to anyone that the pursuit of these and other long-term objectives may require immediate and significant sacrifices in the short term. Willingness to bear these sacrifices depends on the evaluation of the cost of the short-term sacrifice and on the importance attributed to the objectives in question. Which brings us back to the question of "weights" and the impact that myopic short-term views can have on the overestimation of immediate (dis) utilities and the correlative underestimation of future (dis) utilities.

People believing that the markets already ensure the best possible balance between all needs, have no reason to worry about short-termism, and probably not even about anything else. Those, in turn, who believe that these goals (reduction of inequalities, protection of human rights and defence of the environment) are not universal objectives concerning us all, have no reason to worry about anything, or maybe better put, will only be concerned from the possible negative consequences of the phenomena in question that could reverberate on them.

Even people believing that these problems do exist may still be unconcerned with the functioning of financial markets if they think that these markets already perform at their best, or that the task of coping with problems connected with long term objectives should be better tackled by law through

([23]) Fisher (nt. 16) 86, evokes the "the love of one's children and the desire to provide for their good" and notes that "Wherever these sentiments decay, as they did at the time of the decline and fall of the Roman Empire, and it becomes the fashion to exhaust wealth in self-indulgence and leave little or nothing to offspring, impatience and the rate of interest will tend to be high. At such times the motto, 'After us the *deluge*,' indicates the feverish desire to squander in the present, at whatever cost to the future".

explicit and specific rules ([24]). These actors have little reason to worry about short-termism in financial markets but might instead ask themselves the extent to which states, weakened by decades of neoliberalism, can succeed in imposing unwelcomely strict rules on economic actors that control resources greater than the gross domestic product of the states themselves, and whether it is really possible to solve this kind of problem resorting only to specific mandatory rules ([25]).

People believing that these social and environmental objectives are in everyone's interest, that the functioning of financial markets can undermine them, and that poorly rational behaviour ([26]) incompatible with these goals may easily occur in contemporary financial markets, have good reason to carefully consider the possibility that one or more of the factors we have outlined that can give rise to short-termism in fact occur in financial markets.

Such an analysis would require very complex investigations. We limit ourselves here to briefly indicating some phenomena that seem worthy of attention in relation to the three main players, namely investee corporations, professional intermediaries and retail final investors.

The managers of the investee corporations would have, in the abstract, the possibility of orienting the exercise of their wide discretionary power towards the pursuit of long-term objectives. There are however many reasons why it does not seem likely that investee corporations' managers can play a driving role in inducing the whole system to increasing the weight given to long-term benefits.

First of all, it should be noted that the power of managers is limited by the control that investors exercise over them (directly, if they are organized as shareholders in a stable majority, or indirectly, through the market) ([27]). If we add the influence of almost half a century of domination of the ideology of shareholder value, and the private advantages that the spread of this ideology has delivered to the managers, both in terms of earnings and in terms of power, it does not seem very likely that managers

([24]) This is one of the most frequently raised objections against proposals aimed at changing the rules of corporate governance, see e.g., M. Roe-H. Spamann - J.M. Fried - C.C.Y. Wang - J.M. Ramseyer - A. Farrel - R. Kraakman - L. Bebchuk - R. Clark, *The European Commission's Sustainable Corporate Governance Report: A Critique,* European Corporate Governance Institute - Law Working Paper 553/2020.

([25]) Significant limits to the steering capacity of law (and agreements) derive, as it is well known, from the inevitable incompleteness of rules (see in general *The Impact of incomplete contracts on economics*, P. Aghion, M. Dewatripont, P Legros, L. Zingales, Oxford University Press, 2016). This phenomenon seems to be particularly incisive in this case for various reasons relating to the general difficulty of predicting and prohibiting in advance all the specific behaviours that can hinder the achievement of long-term objectives, and also to the difficulty of constraining the discretion of managers beyond certain limits.

([26]) Actors do not correctly assess the weight of the negative consequences that their choices will have not only for others but for themselves as well.

([27]) The difficulty for managers to escape the pressure of the financial markets is also evidenced by the events connected with the financial crisis of 2007-2008. Notwithstanding the fact that managers of the investee corporations were the category most likely to be considered legally responsible for the excessive risk taking that characterized that period, the perspective of possible legal liability did not succeed in refraining managers from behaving in the way that market pressures (and their personal, immediate, interest) prompted them to behave.

will be at the forefront in activating mechanisms leading to a greater consideration of long-term objectives.

They would obviously oppose mechanisms based on the introduction of specific obligations (which moreover are likely to be difficult to implement).

As for mechanisms based on non-binding indications (alike those used in the US Constituency Statutes, for example), they would increase directors' and managers' discretion giving them better chance of always having arguments for justifying their choices. Everything would eventually depend on the interest of directors and managers in pursuing, from time to time, one or the other of the possible objectives ([28]).

It is true that something is probably changing and that even managers show impatience with a rigid interpretation of the shareholder value constraint ([29]). At present, however, it seems difficult to say whether this rethinking is the result of the actual appreciation for objectives other than maximizing shareholder value, or is the result of the managers' desire to free themselves from obligations towards shareholders, obligations to which they willingly declared they wanted to submit several decades ago, when shareholders were predominantly a scattered mass of retail investors ([30]). Obligations, however, which have become more troublesome today, when many investors are able to exert concentrated and direct pressure on the managers of investee corporations.

It is possible, then, that managers are beginning to consider it more convenient to declare themselves at the service of a mass of dispersed stakeholders, than of a mass of no-longer-so-dispersed shareholders.

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([28]) A not insignificant aspect that we are not able to investigate here concerns the issue of turnover. In fact, it does not seem likely that executive directors with an average term of office in (almost) continuous decline (according to a survey conducted by Korn Ferry, *Age and tenure in the C-Suite*, the average term of office of a CEO has dropped from 8 years in 2016 to 6.9 in 2020) may be willing to establish long-term relationships with the environment that (temporarily) surrounds them.

([29]) For a review and comment on the various positions taken in this regard, see. J. Fisch - S. Davidoff, *Should Corporations Have a Purpose?*, *U. of Penn., Inst. for Law & Econ. Research Paper*, 2020, 20-22. See also M. Lipton - S. Rosenblum - K. Cain - S. Niles, A. Blackett, K. Iannone, *It's Time To Adopt The New Paradigm*, in *Post on: Harvard Law School Forum on Corporate Governance and Financial Regulation*, 2019, February. In the Italian doctrine, see the debate contained in AaVv, *Lo* statement *della* Business Roundtable *sugli scopi della società. Un dialogo a più voci*, edited by A. PERRONE, in ODC Magazine, 2019, 589 ff.

([30]) For a critical view, see L. A. Bebchuck, R. Tallarita, *The Illusory Promise of Stakeholder Governance*, Johm M. Olin Center for Law, Economics, and Business, Discussion Paper No. 1052, 12/2020, available at https://papers.ssrn.com/abstract=3544978, arguing that "[r]ecognizing the shortcomings and perils of stakeholderism is especially important due to the increasing support for it among corporate leaders, management advisors, and many others" (p. 1) and that "some of the corporate support for stakeholderism might be partly motivated by the prospects that acceptance of stakeholderism would advance a managerialist agenda …" (p. 8). As we will explain further in the text, we believe our perspective does not suffer from the flaws highlighted by the authors with regard to stakeholder corporate governance (that we largely agree on).

In any case, we think it is difficult to believe that managers can systematically adopt policies that collide with market expectations. The core referents for the managers of any investee corporation are still limited to people who have invested, or who have a concrete intention to invest, in the company that they manage. These (current and potential) investors, however numerous they may be, still represent a small, clearly separated fraction of the global population. A fraction composed of individuals who pursue very different ultimate purposes (31) and who, with reference to a given specific company, could well be reasonably interested only to the short-term results (32).

Potentially more promising is the idea, pursued by the European Union, of not focusing on managers and directors of investee corporations, but on professional intermediaries, the today masters of the financial markets. In fact, it should be considered that the biggest segment of these intermediaries (pension funds, insurance corporations, but also partly mutual funds and passive funds) is committed to the satisfaction of a need (protection and enhancement of savings) which is at the same time less generic and more general (it equally concerns a vast community of people which tends to coincide with the whole community) than the maximization of shareholder welfare.
Comparing the situation of the managers of investee corporation with that of the managers of these intermediaries from the viewpoint of the ultimate beneficiaries, it seems to us that they are very different. The decision of the shareholders of a given corporation, and of the managers appointed by them, to maximize immediate gains even at the cost of increasing the risks of future losses, which will be borne by whoever will happen to be shareholder when the losses occur, is not irrational and probably, within given limits that distinguish it from fraud, also lawful.

The situation of the managers of professional intermediaries seems to us rather different. Decisions of managers of pension funds, insurance companies and most mutual funds exchanging immediate gains with future disproportionate risks, should not be considered as legitimate. The task of the managers of these organizations could never become that of maximizing the returns for current

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(31) The desire to maximize the value of the shares - assuming it is really a unifying common trait - plays the role of a means, not that of an ultimate end. A shared ultimate end could be, rather, the maximization not of shareholder value, but of shareholder welfare. But if we understand welfare as the satisfaction of preferences, welfare maximization appears immediately as an end only nominally common, given the obvious differences existing between the preferences of the different shareholders (for example, between selfish investor interested only in the amount of their dividends and altruistic investors also interested in the way value is produced, see F. Denozza, *Nonfinancial Disclosure between "Shareholder Value" and "Socially responsible Investing",* in G. Ferrarini – E. Wymeersch, *Investor Protection in Europe*, OUP, 2006, 365).

(32) The reasoning in the text and in the previous note explains also the unconference of the discussion on the long - short nature of the objective of maximizing the shareholder value and of the arguments used to affirm that it is a long term objective (see e.g. *Response to the Study on Directors' Duties and Sustainable Corporate Governance by Nordic Company Law Scholars ,* Nordic & European Company Law LSN Research Paper Series No. 20-12; A. Edmans, Resp*onse to the European Commission Study on Sustainable Corporate Governance*). The simple truth is that shareholders are free to decide what should count as maximization of their welfare and therefor of choosing, from time to time, the specific – long or short – perspective better satisfying their preferences.

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members, at the potential detriment of the interests of future members. The careful assessment of the long-term consequences of their choices should figure among their natural duties to a much greater extent than can generally be expected for investee corporations' managers ([33]).

There are however factors able to affect the choices of professional intermediaries and push them towards behaviour that can be considered short termism and not in compliance with the duty to assess the long-term consequences of their choices.

One factor is connected to the so-called herd behaviour. The point is that the choices of professional intermediaries are governed by mechanisms different from those influencing the decisions of people directly investing their savings. For professional managers, acting in situations of fierce competition, it can often be better to make the wrong decisions together with all other managers, than to make the right decision alone ([34]).

The most relevant example regards probably the decisions taken in the awareness of being in a speculative bubble. In situations of this kind, participation in the speculative game tends to be, as long as the bubble is growing, on the whole, very profitable, and the exit from the game tends, in the short term, to strongly penalize people who stop participating in the dance.

A saver directly investing his/her money, convinced that there is a bubble which could burst and induce losses greater than the gain, may consider the decision to withdraw as perfectly rational. An investment manager, on the other hand, also convinced that there is a bubble, but not knowing when the bubble will burst, may consider it more rational to continue in the dance. Exiting the bubble will cause, immediately and for an unpredictable time, a decrease in the returns achieved, while competitors continue to benefit from the bubble gains. In this situation, a manager who, unlike competitors, decides to exit the bubble, not only will suffer an immediate decrease in his/her earnings while the bubble continues, but will also put his/her very job at risk before the time comes when the bubble eventually bursts proving him/her finally right.

([33]) From this viewpoint the European Union project aimed at promoting (and creating the conditions favouring) a greater commitment of professional intermediaries to steering long term policies of the investee corporation (Recital 14 SRD II: "greater involvement of shareholders in corporate governance is one of the levers that can help improve the financial and non-financial performance of companies, including as regards environmental, social and governance factors…") could be considered as well founded. However, its effectiveness seems significantly limited by the collective action problems illustrated in the text.

([34]) J.M. Keynes, *The General Theory of Employment, Interest and Money*, Ch. 12, V, 4 "Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally"; J. Tirole, *Theory of Corporate Finance*, p. 22, n. 34: "it is sometimes better to be wrong with the rest of the pack than to be right alone".

Another factor able to induce a distorted behaviour may arise from a possible gap between immediate preferences and second-order preferences ([35]).

Corporate governance rules can provide an example. All (or almost all) investors are likely to be interested in the game running smoothly, and therefore in the fact that the corporations in which they invest comply with rules relating to many aspects of corporate governance ([36]) and especially with rules ensuring equal, appropriate information for all investors, thereby preventing the risk of sudden nasty surprises (this reasoning could be obviously generalized and referred to other even more important issues, such as the protection for the environment). We could therefore presume that professional intermediaries should be interested in imposing to investee corporations the compliance with rules preventing not only risks of degeneration of intermediation service into a gamble ([37]), but also financial, environmental and other risks able to have systemic effects. In other words, we should presume that investors are spontaneously interested in (or manifest a preference for) the adoption by investee corporations of a set of governance practices that are, on their face, to the benefit of all. In fact, many investors even openly advocate for governance rules of this kind.

However, it seems that something in this reasoning does not function.

A specific example of the difficulties that investors encounter in imposing behaviour complying with what they consider the most appropriate policies, is provided by the ambiguous attitude of investors towards the dual class stock, which is widely opposed officially ([38]), but does not seem to invoke a widespread refusal to subscribe the shares of companies that have issued multiple voting shares. This ends up supporting the share prices of companies that make use of this tool([39])(.

The hypothesis, in conclusion, is that professional intermediaries may be really convinced of the need of preventing systemic risks and of pursuing (and of imposing on investee corporations the obligation to pursue) long term objectives (not only in the general but in their own interest as well) but where it

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([35]) See nt 20.

([36]) As one of us noted elsewhere, see F. Denozza, *Quale quadro per lo sviluppo della corporate governance?*, in *Rivista ODC*, 1, 2015, 1-14. Similarly, M. Maugeri, *Informazione non finanziaria e interesse sociale*, in *Riv. soc.,* 2019, 992, ss., who underlines the existence of an interest, potentially common to all investors, in preventing systemic risks.

([37]) Based on pure fate, or in any case less on the ability to choose the best investments and more on that of discovering cheats.

([38]) See Council of Institutional Investors, *Dual Class Stock,* https://www.cii.org/dualclass_stock, and therein a list of official initiatives aimed at obtaining the elimination, or at least the limitation, of the possibility for companies that are listed on the stock exchange to issue multiple voting shares.

([39]) Firms with multiple voting shares now account for about 10% of the global equity market capitalization, MATOS, Jinhee Kim Pedro; XU, Ting. Multi-Class Shares Around the World: The Role of Institutional Investors. 2018, p. 3.

comes to making single choices, be unable to resist the strong temptation to profit from good short term business opportunities ([40]). In other words, it may be argued that for professional intermediaries, however aware of the existence of systemic interests common to all of them (and to society as a whole), it is difficult to fully coordinate this second order preference with the immediate preference induced by the need to prevail in the competitive mechanism. It seems very likely that awareness may indeed emerge at the level of general reflections, but it may then prove unable to adequately steer the choices made in specific situations where opportunities for profit arise.

An empirical evidence of the fact that a collective action problem might be at work in this context is that corporations have not typically adopted corporate governance principles a result of the pressure exerted by their investors, but rather out of compliance with codes of conduct or even mandatory rules of law. Constraints imposed from the outside seemed, and seem, indispensable to achieve goals that intermediaries would also have had the interest and the possibility of achieving on their own, but have not.
As to the goal, pursued by the European Union, of creating a well-functioning market in which well-informed investors can consciously choose between intermediaries whose practices reflect recognized different levels of concern for long-term objectives ([41]), in our opinion it is to be welcomed. However, it remains to be seen whether pure market mechanisms are, in this case, able to deliver results.

Even if we can assume some presence of "prosocial preferences" ([42]) among ultimate beneficiaries, we cannot ignore that no reasonable saver can disregard the issue of the profitability of the investments he/she makes. So, if the happy hypothesis immediately occurs in which investments considering long-term objectives turn out to be immediately more profitable than the others, it is clear that no problem arises. The lawmaker is in this case entrusted with the rather simple task of unblocking a situation in which psychological and cognitive deficits favour the permanence of sub-optimal equilibria.

([40]) The theme of herd behaviour, which we have already mentioned, is re-proposed here from a different viewpoint. The individual investor might well be personally convinced that prices do not adequately reflect the value of companies making significant investments, and yet continue to buy shares that he knows are overvalued, at least as long as he can hope that following the flow, he will still be able to realize, and secure, some immediate gain. See M. Petrin - B. Choudhoury, *Corporate Purpose and Short-Termism, Research Handbook on Comparative Corporate Governance*, Afra Afsharipour & Martin Gelter eds., Edward Elgar Publishing, 2020, 16.

([41]) A sort of stewardship market, v. D. Katelouzou – E. Micheler, *The Market for Stewardship and the Role of the Government*, *Global Shareholder Stewardship: Complexities, Challenges and Possibilities,* D. Katelouzou & D. Puchniak eds, Cambridge University Press, 2020.

([42]) See e.g., A. Pacces, *Sustainable Corporate Governance: The Role of the Law. European Corporate Governance Institute-Law Working Paper*, 550/ 2020. It remains to be seen how deep-rooted and clear these preferences are and whether the market context is the most suitable for making them adequately emerge.

However, if the happy situation does not occur, or if it is slow to come about, a delicate problem arises. The immediate financial performance of the various intermediaries will continue to influence the choices of investors and consequently the behaviour of the intermediaries (with all the problems described above).

It is also likely that, lacking appropriate corrections of the context in which all market actors make their choices, the immediate financial performance of the intermediaries is able to influence the investors' choices to an extent disproportionate in respect to their real hierarchy of preferences, since the moment in which individuals are reflecting on the economic consequences of their old age, or death, is not likely to be the best time to ask them to worry actively about the fate of the planet and of the community that inhabits it.

The peculiar (and, in that sense, disproportionate) sensitivity of savers will then end up influencing the behaviour of intermediaries who, pressured by competition, will try to concentrate their effort in enhancing the index most immediately perceptible and assessable by their potential customers, namely their ability to guarantee high returns on the savings entrusted to them. With all the reported consequences on the mechanisms governing the behaviour of intermediaries.

In our opinion, the choices of the final investors should therefore shift from a "solipsistic" context in which each chooses thinking only of himself, to a context in which there is also a confrontation with other subjects – the stakeholders – capable of presenting different visions of other interests that could prove to be common and important for everyone.

The last part of this work will now be devoted to the delineation of this context.

7. *A missing (and potentially decisive) actor: stakeholder involvement as a mitigant to short-term oriented behaviour.*

Our thesis is that active involvement of stakeholders could contribute to overcoming some of the problems indicated and to improving the effectiveness of the European Union's policies.
First of all, we reiterate that our thesis is not based on the unsustainable hypothesis that stakeholders other than shareholders are necessarily carriers of altruistically oriented long-term visions. The thrust of our thesis is that the obligation to dialogue with stakeholders and, ultimately, to define programs including fixed points of agreement with them (or some of them), is in itself (regardless of the subjective orientations of the various subjects involved) able to incentivize a greater consideration of the longer term, even if only because this orientation makes possible agreements and compensations between the various conflicting interests, which would be impossible to propose in a short time horizon.

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Obviously our thesis has nothing to do and should not be confused with the "*stakeholderism*" aiming at obliging or incentivizing boards of directors to take into account the interests of other stakeholders in addition to that of the shareholders – as for example via the definition [by mandatory rules or by shareholders' choice ([43])] of a "corporate purpose" including stakeholder interests. Rather, we are thinking of giving stakeholders a channel of access to directors and managers, enabling them to make their voice heard and therefore to enter the decision-making process (even without granting them any decision or veto power).

In fact, in regulatory contexts in which directors are appointed by the shareholders, and where only shareholders are entitled to take legal action against directors and managers, manipulating the definition of the corporate purpose seems a rhetorical exercise and, in some respects, useless and in others harmful.

It is useless, where shareholders strictly control the directors and are therefore able to force directors to respect their will despite formal rules to the contrary. It is harmful, where directors and managers, not directly controlled by a group of shareholders, by exploiting generic references to possible duties towards stakeholders other than shareholders, break free from any legal constraint, and can decide, from time to time, and almost at their discretion, which interests to protect and which to disregard at any one time ([44]).

Instead, we are proposing the institutionalization of a new channel of communication that would allow stakeholders to present directly to boards what they consider to be their interests, and to support their views, so that the decisions of the boards can protect (or refuse to protect) these actual stakeholder interests, and not the interests that the corporate directors and managers think the stakeholders should have.

This proposal raises many problems that we cannot address here (how to identify the stakeholders most involved in any given situation, how to select the subjects entitled to represent them, which rights can be exercised by the stakeholders and their representatives, within which procedures, etc.). At this stage, we want to underline that a greater direct empowerment of stakeholders can be achieved

([43]) The proposal of introducing a provision allowing the shareholders to choose the company's "function" (to pursue exclusively profit-making purposes; to reconcile shareholder value maximization and common benefit; to pursue only nonprofit purposes) has been advanced in Italy by U. Tombari, *Corporate Power and Conflicting Interests,* Giuffrè, Milano, 2021, 93.

([44]) According to L. Bebchuk - K. Kastiel - R. Tallarita, *For whom corporate leaders bargain*, 2020, available at *SSRN* 3677155, stakeholderist vision: "…advocates giving corporate leaders the discretionary power to serve all stakeholders and not just shareholders". The main criticism raised against all the "stakeholderist" theses generally concern precisely the dangerous increase in the mangers' discretion that their implementation could entail (see e.g., M. Gatti – C. Ondersma, *Can a Broader Corporate Purpose Redress Inequality? The Stakeholder Approach Chimera*. *J. Corp. L.*, 2020, 46: 1). This criticism cannot certainly be raised against the thesis supported in the text which, if anything, tends to reduce the discretion of directors and managers and certainly not to broaden it.

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in many different ways, that do not necessarily imply the presence of stakeholder representatives as members of boards of directors, and, even less, question the power of the shareholders, and of the directors appointed by them, to take the final decisions they deem most appropriate.

It is therefore not a matter of "*balkanizing*" boards of directors, as has also been said in the past by evoking the dystopian image of boards transformed into places of continuous and sterile battles between opposing and factious groups ([45]). As we have already said, the first and yet essential step is simply to ensure that boards of directors take their decisions after a serious examination of the interests as clearly expressed by the relevant stakeholders. An examination not of the interests as imagined by the directors themselves, but as presented by all the stakeholders involved.

It seems to us that the outlined type of stakeholder involvement should not elicit insuperable resistance on the part of managers and shareholders. Basically, it is a matter of regulating and institutionalizing a confrontation with the relevant stakeholders that no large firm can reasonably think it can systematically avoid.

Without going into the details of the institutional innovations that may be necessary to move in this direction, it seems to us that we can nevertheless indicate a trend that should inspire the necessarily gradual process of transformation ([46]). In our opinion, it is a question of envisaging a further evolution of the board of directors of large corporations.

A board that is no longer just a managing body (although the management function has not been entrusted to boards of large corporations for a long time), no longer just a monitoring body ([47]), but a place for the development of policies expressly aimed at creating mediations potentially acceptable for all the stakeholders from time to time involved, and in any case mediations able to be justified on the basis of considerations that no stakeholder can *a priori* refuse.

Returning to the issue of the contrast between short and long termism, we are convinced that the mere fact of taking into account all the relevant interests involved can be an important factor in widening the time horizon. The consideration of the different interests involved, often suggesting possible

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([45]) Among others, see M. Lipton- S. Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come* (March 9, 2012), Business Lawyer, Vol. 59, 2003, available at SSRN: https://ssrn.com/abstract=2017092, esp. p. 82 f.

([46]) From an operational point of view, shareholder engagement practices and policies might be considered in imagining institutional options. See for example the SDX Protocol of 2014, http://www.sdxprotocol.com/download-pdf/; the UK Stewardship Code 2020, https://www.frc.org.uk/investors/uk-stewardship-code. In the literature, see G. Strampelli, *Knocking at the Boardroom Door: A Transatlantic Overview of Director-Institutional Investor Engagement in Law and Practice*, 12 Va. L. & Bus. Rev. 187 (2017-2018), available at https://heinonline.org/HOL/LandingPage?handle=hein.journals/valbr12&div=9&id=&page=.

([47]) On the evolution of the board' functions, M. Eisenberg, *The board of directors and internal control*, *Cardozo L. Rev.*, 1997, 19: 237.

different policies and possible conflicting decisions, naturally pushes decision makers towards the elaboration of balances and of compromise solutions. The lengthening of the time horizon becomes almost inevitable, given its usefulness as a tool for mitigating the harshness of immediately irreconcilable clashes and for making possible compromises that would otherwise not be accepted.

Once again, the point is not based on the assumption that stakeholders necessarily bring a long-term perspective (although some of them arguably do). The point is the adoption of a decision-making process that, because it involves stakeholders, benefit from a richer set of information and from the consideration of all the relevant interests involved in corporate choices, possibly finding equilibria or compromises able to prevent the consequences of non-explicit conflicts.

It seems to us that creating a situation in which all companies (of a certain size) are forced, in formulating their plans, to take into consideration the point of view of their stakeholders, could guarantee greater homogeneity among the companies themselves, increasing, as it were, the levelling of the playing field, and thus mitigating the problem of short termism that excessive competition gives rise to.

Clear business plans formulated, if not with the consent, at least with some participation of stakeholders, could then favour a decrease in overall uncertainty, and a rebalancing of the weights in favour of greater consideration of long-term objectives, projected into a less uncertain future.

If we then consider that the alternative between the long and short terms is not only a matter of technical problems of measurement, but above all a matter of political and distributive choices, excluding from the related decision- making processes a significant part of people bearing the consequences of the decisions eventually taken, could favour (the persistence of) externalization phenomena to the detriment of the weakest stakeholders. This seems to us an incorrect path for both practical and ethical reasons.

A final consideration, less connected to the themes of short-termism, should not be ignored. A colossal concentration is occurring for some time on the financial intermediation market ([48]).

Given that overcoming collective action problems hindering the putting into practice of long-term orientations, could require greater coordination in the behaviour of professional intermediaries ([49])

([48]) See the 2020 edition of the Willis Towers Watson's and Thinking Ahead Institute's study on the "The world's largest 500 Asset Managers", available at https://www.thinkingaheadinstitute.org/research-papers/the-worlds-largest-asset-managers-2020/, reporting that, as of the end of 2019, "The top 20 managers' share of the total assets increased from 42.1% in 2018 to 43% in 2019". The figure was 38% in 2000 and 29% in 1995. The study also shows that, in the past decade, 232 asset manager names have dropped out of the ranking, indicating a steady concentration process in the market.

([49]) On the associated dangers, see E. Elhauge, (2018), *How horizontal shareholding harms our economy—and why antitrust law can fix it, Harv. Bus. L. Rev.*, *10*, 207; F. Morton – H. Hovenkamp, *Horizontal Shareholding and Antitrust Policy*, 127 Yale L.J. 2026 (2018); D. Gilo, *The Anticompetitive Effect of Passive Investment,* 99 Mich. L. Rev. 1, 29-33

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the question arises whether it is appropriate that the unavoidable balances among the weights of the various objectives, are entrusted exclusively to the managers of that limited number of entities that are now able to influence the performance of the markets. We believe the answer must be radically negative.

Balancing short- and long-term objectives is not a technical, but a political problem, and in a democratic system political decision should be taken with the widest participation, possibly of all the people concerned[50].

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(2000); E. Rock – D. Rubinfeld, *Defusing the Antitrust Threat to Institutional Investor Involvement in Corporate Governance,* Working Paper (Mar. 1, 2017), available at https://ssrn.com/abstract=2925855. See also J. Coates IV (2018), *The Future of corporate governance Part I: The problem of twelve.* Harvard Public Law Working Paper No. 19-07, Available at SSRN: https://ssrn.com/abstract=3247337 or http://dx.doi.org/10.2139/ssrn.3247337 .

[50] "Democratic equality entails a principle that everyone whose basic interests are affected by policies should be included in the process of making them." YOUNG, Iris Marion. *Inclusion and democracy*. Oxford University press on demand, 2002.