

Due date: 11th / January / 2021.

Word upper limit: 2000 words

ESSAY TOPIC

Incentives, Short-termism & Investment decisions

Exchange students can write up to 1000 words more.

One of the most fundamental concerns with corporations is that they focus on short-term profit rather than investing for the long-term. This is a particular concern in the 21st century, where innovation is particularly critical for competitive success. Moreover, allegations of short-termism have serious social repercussions. Long-term investments, such as developing blockbuster drugs, or training workers, typically benefit stakeholders as well as shareholders, but short-term profit only goes to shareholders. Short-termism can reduce a firm's growth opportunities and give rise to failure.

Incentives shape top managers' corporate decisions, including investment decisions. Poor incentives can worsen corporate short-termism while right incentives can drive top managers towards long term investments that expand the growth potential of the firm and increase its market value. Investment decisions are though risky and frequently fail, which can impact the firm's market value negatively. An optimal incentive system should equally lower the chance of imprudent investment decisions.

Given this background, your task in the coursework is to:

- 1) Explain the short-termism hypothesis, critically explain whether principal-agent issues may contribute to short-termism, and explore its consequences for firm performance;
- 2) Analyse how modern firms seek to deal with the principal-agent problem. Your analysis should explicitly distinguish between the *level* and *structure* of pay.
- 3) Explain how firms may design a compensation scheme to reduce short-termism by combining reward instruments such as stocks, stock options, restricted stocks and inside debt. Justify your proposal by referring to the academic literature.
- 4) Explain how your proposal can strengthen firm resilience and enable firms to better deal with deep recessions such as the Covid-19 recession.

A number of notes will be placed on the course webpage to guide you through your research and help you with the literature on the short-termism hypothesis and CEO's pay. A note will specify marking guidelines in details. You should follow the guidelines.

Coursework should be submitted online by **3pm on Monday 11th January 2020** onto Blackboard and the marks and comments will be released online via Blackboard on Monday 1st February 2021.

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