

**Explaining Sacrifice of Long-Term Investments for Short-Term Earnings:  
Spiral of Silence in Financial Markets**

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## **ABSTRACT**

Despite the increasingly observed tendency of company managers to sacrifice long-term value-maximizing investments to meet short-term earnings forecasts and the ostensible pressure by financial market in encouraging this tendency, earlier research has lacked a systemic perspective to the emergence of the pressure and its effects. Based on the spiral of silence theory, the authors provide a theoretical system-level explanation to the emergence of the pressure in the financial market and its effects on company managers. It is proposed that a dynamic, system-level, self-reinforcing process among the investing public may lead to a status quo in which the orientation of a minority of (institutional) investors and investment analysts towards short-term earnings, vociferously expressed in media and certain stock price and analyst reactions, is biasedly perceived as the orientation of the majority. This will further make company managers orient themselves excessively for the short-term – even if the silent majority of investors currently and/or inherently had quite long-term earnings/investment orientation.

### **Keywords:**

long-term vs. short-term, long-term investments, earnings management, institutional investors, individual investors, managerial myopia

## **Explaining Sacrifice of Long-Term Investments for Short-Term Earnings: Spiral of Silence in Financial Markets**

Albeit not a completely new concern (see e.g., Hayes & Abernathy 1980; Hill, Hitt, & Hoskisson 1988), researchers have recently started to more strongly share the concern widely lamented in popular press: that companies', and hence societies', long-term development and innovation may be compromised by the tendency of company managers to excessively concentrate on managing for short-term earnings instead of investing in company development and innovation for the long-term (e.g., Bauman & Shaw 2006; Bhojraj & Libby 2005; Brown & Caylor 2005; Dobbs, Leslie, & Mendonca 2005; Graham, Harvey, & Rajgopal 2005; Lavery 2004; Porter, Wayland, & Wayland 1992). This "myopic" tendency is seen to have become increasingly evident since the 1990s due to a growing pressure by the financial market: i.e. a complex system of (institutional) investors, investment analysts, and business media (Brown & Caylor 2005; Lavery 2004; Porter, Wayland, & Wayland 1992; Zorn, Dobbin, Dierkes, & Kwok 2004). For instance, in a recent survey, Graham, Harvey, and Rajgopal (2005) found that the majority of executives admit to sacrificing long-term value-maximizing investments to smooth short-term earnings and meet short-term earnings forecasts; the executives also pointed out the role of financial market pressures encouraging this kind of behavior. In a similar vein, Brav et al.

(2005) found that stock market reactions drive executives to avoid cutting dividends even if this means bypassing positive net-present-value investments.

Historical explanations for the growing pressure by financial market and its effects on company managers have been sought from the growing number of investment analysts, advising (institutional) investors about earnings to be expected from companies; the increasing number of companies followed by these analysts; and the increasing amount of media attention paid to analyst forecasts (Brown & Caylor 2005; Zorn, Dobbin, Dierkes, & Kwok 2004). Consistently, using a cross-country sample, Degeorge et al. (2005) recently found that ‘analyst following’ encourages subtle, short-term forms of earnings management to reach the analyst consensus.

Also, a growing share of investments being made (indirectly) by institutional investors, as opposed to individuals, has been seen as an explanation (Edwards & Hubbard 2000; Grinstein & Michaely 2005; Hotchkiss & Strickland 2003; Khan, Dharwadkar, & Brandes 2005; Sundaramurthy, Rhoades, & Rechner 2005; Zorn, Dobbin, Dierkes, & Kwok 2004). Institutional investors have been viewed to make their investment decisions excessively on the basis of companies’ short-term earnings prospects rather than long-term prospects, pressuring company managers to make corresponding compromises (Drucker 1986; Graves 1988; Graves & Waddock 1990; Hill, Hitt, & Hoskisson 1988; Hoskisson, Hitt, Johnson, & Grossman 2002; Hotchkiss & Strickland 2003; Jacobs 1991; Khorana 1996; Lavery 1996; Porter, Wayland, & Wayland 1992). Indeed, the concentration of capital under institutions’ control means that single institutional investors have generally far more significant role in companies’ financing and stock price formation in the market than single individual investors. As actual shareowners, institutions can have, as owners of large blocks, significant legal and legitimate power on company

managers and are often also willing to exert this power through monitoring and activism (e.g., Bushee 1998; David, Hitt, & Gimeno 2001; Kochhar & David 1996).

Thus, emergent explanations exist that hint about the role of e.g. analysts and (institutional) investors in how the growing pressure by financial market leads to the tendency of company managers to excessively concentrate on managing for short-term earnings. However, despite seemingly short-term orientation of analysts and investors, there is no unequivocal (empirical) evidence ascertaining that analysts or institutional investors would, in majority, have adopted the short-term earnings orientation in reality (cf., Abarbanell & Bernard 2000; Bushee 1998; Bushee 2001; Hansen & Hill 1991; Johnson & Greening 1999; Kochhar & David 1996; Lee & O'Neill 2003). Importantly, earlier research has lacked systemic perspectives to the emergence of the financial market pressure, which may also have led to the equivocal evidence mentioned above. In this article, we address this research gap. Specifically, we seek to provide a system-level explanation to the emergence of the pressure in the financial market and its effects on company managers, based on spiral of silence theory developed by Noelle-Neumann (1985; 1974; 1991) in the research on public opinion formation. Building on this theory, we show how a dynamic, system-level, self-reinforcing process among the financial public – i.e. (institutional) investors, analysts, company managers – may have led to a status quo in which the orientation of a vociferous minority of analysts and (institutional) investors towards short-term earnings (STE) is perceived as the orientation of the majority, making company managers orient themselves accordingly – even if the silent majority of investors actually had quite long-term earnings/investment (LTE/I) orientation in reality.

## **THE SPIRAL OF SILENCE**

The ‘spiral of silence’ theory, developed by Noelle-Neumann (1985; 1974; 1991) in the field of public opinion research, suggests a dynamic process, in which people increasingly adopt, due to fear of isolation and often contrary to their own judgment, an opinion which seems to be the majority opinion in the public – and behave accordingly. Over time, this leads to one opinion becoming seemingly predominant at the public or societal level (Scheufele, Shanahan, & Lee 2001). The theory assumes that to avoid (social) isolation, people try to find out both what the majority opinion is and whether various opinions are decreasing or increasing in popularity (Noelle-Neumann 1974). Here, individuals use “an innate ability” or “quasi-statistical organ” to gauge the public opinion: “by observing his social environment, by assessing the distribution of opinions for and against his ideas, but above all by evaluating the strength (commitment), the urgency, and the changes of success of certain proposals and viewpoints” (Noelle-Neumann 1974: 44)

Individuals who think their opinion conflicts with the dominant or increasingly popular opinion of others tend to remain silent on an issue. When they are not sure that they agree with the majority, people are reluctant to express their opinions. In other words, individuals tend to publicly express their opinions and attitudes when they perceive their view to be dominant or on the rise, but when people sense their view is in the minority or on the decline, they become cautious and silent (Scheufele & Moy 2000). Thus, when people perceive that they share the dominant opinion they will speak out, strengthening this position, whilst those who perceive that they hold the minority opinion will become more silent, diminishing their position (Gonzenbach, King, & Jablonski 1999). This is the dynamic, self-enforcing, system-level process of spiraling – the spiral of silence.

The spiral of silence theory suggests a phenomenon referred to as “the silent majority”, where the majority of people actually agree on an issue, but do not individually perceive social support for the opinion. As a result, their enduring silence and inactivity leads to an erroneous conclusion about what the opinion of the majority is. Indeed, the self-reinforcing process may lead to a situation whereby an opinion which is expressed by a “vociferous minority” comes to be a public opinion and to direct much of the public behavior, even if the majority – silent majority – would personally disagree with the opinion.

Moreover, as Cutlip et al. (2000: 260-267) elaborate, (mass) media exposure can reflect, enforce, or challenge this spiral of silence effect of public opinion. Messages conveyed by media provide individuals pictures of their social environment, of whether there is social approval or disapproval of their views or actions. In essence, public opinion reflects a dynamic process of media and interpersonal communication on issues among groups and collectivities of people who have the capacity to act in similar ways – “thinking together” leads to “acting together”. This suggests that media message may, from an individual’s perspective, provide the appearance of consensus regarding common orientation and action with respect to a given issue (DeFleur & Ball-Rokeach 1982: 225-226).

## **THE FINANCIAL MARKET AND THE SPIRAL OF SILENCE**

The spiral of silence theory was developed through public opinion and mass media research at the societal level. Even if this research may generally seem to be somewhat distant from management or financial market research, our application of the theory is quite justified considering that the financial market is essentially a society-level phenomenon and involves

public issues as well as media. The theory is also generally applied to issues that are somewhat controversial and have a moral or value-laden component – as opposed to issues that can be definitively proven “right” or “wrong” by using facts (Bowen & Blackmon 2003; Miller 2005). Accordingly, we see that the spiral of silence provides an applicable theoretical perspective for the consideration of the somewhat controversial and value-laden question of whether companies should prefer STE orientation or LTE/I orientation. Moreover, the theory is particularly appropriate to circumstances in which individuals witness a struggle between conflicting positions and have to consider where they stand (Noelle-Neumann 1974: 44), but they do not have strong inherent preference for one position over another. Also this seems to be the case with our issue.

The financial domain of the society includes institutional investors, investment analysts, investment bankers, other finance/investment professionals, company managers, and wealthy and ordinary citizens engaging in saving/investing (individual investors). Note that even the organizational actors, e.g. institutional investors, are eventually represented by individuals such as professional money managers. Like assumed in public opinion research, each individual involved, while taking up a certain role on the financial society, is interpersonally connected to and can observe other individuals to varying extent – but always only a fraction of the whole population of individuals at the global level. For instance, company managers may have interpersonal contacts with multiple investment analysts and representatives of multiple institutional investors, but still only a fraction of all investment analysts and institutional investors at the global level. The same applies to interpersonal contacts between investment analysts and institutional investors. Even more evident, company managers and investment

analysts can have interpersonal contacts with only “one in a million” ordinary citizens engaging in saving/investing in their countries, let alone the whole world.

Furthermore, since individuals’ interpersonal contacts and direct observation is limited to a small fraction of the population, media can play a significant part in the spiral of silence by dramatically impacting individuals’ perceptions of where the public opinion lies, whether or not that portrayal is factual (Scheufele & Moy 2000). In financial society, the role of the media is, indeed, likely to have been significant, as media have in recent years become increasingly globalized and paid increasing attention to investment analysis and business/company news in general (Brown & Caylor 2005; Marcus 2005).

In the following sections we provide a set of propositions that explicate how the fear of isolation in the financial society may lead to biases in the behavior of investors and managers relative to inherent preferences. We elaborate how the spiral of silence produces a status quo in which the orientation of a vociferous minority of analysts and (institutional) investors towards STE is perceived as the orientation of the majority, even if the silent majority of investors had LTE/I orientation in reality – inherently and even currently. And, finally, how these biased perceptions push company managers to orient their management accordingly. The dynamic, system-level, and self-reinforcing process elaborated on below is portrayed in Figure 1.

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## **Fear of Isolation in Financial Society**

As implied above, for the spiraling of silence to occur, people have to perceive a threat of (social) isolation *and* they must fear isolation (Noelle-Neumann 1991). In the financial society, the fear of isolation is related to the fear of losing money or wealth and/or not gaining it. Most importantly for the present arguments, all the involved individuals are more or less aware of that the market values of companies' stocks are dependent on the dominant valuation criteria among the financial society, rather than any isolated criterion of any single individual or even any fundamental value of companies. This is actually the basic argument in the Keynesian beauty contest view (Keynes 1936), where much of investment is seen to be driven by expectations about what other investors think, rather than expectations about the fundamental profitability of a particular investment.

Keynes observed that investment strategies resembled a contest in a London newspaper featuring pictures of about a hundred young women. The winner of the contest would be the newspaper reader who submitted a list of the top five women that would best match the consensus of all other contest entries. A naïve strategy for an entrant would be to rely on his or her own concepts of beauty to establish rankings. Rather, each contest entrant would try to second guess the other entrants' reactions, and most sophisticated entrants would even attempt to second guess the other entrants' second guessing. Similarly, each potential investor will somewhat ignore the fundamental values and try to predict "what the market will do". Thus, if individuals in the financial society witness a struggle between the conflicting positions of STE orientation and LTE/I orientation, they are likely to fear being isolated for choosing the stand which is not the dominant stand. As expected by the spiral of silence theory, this is particularly the case with individuals who are uncertain of which stand to choose, due to their lack of strong inherent preferences for one over another.

*Proposition 1: Witnessing a struggle between the conflicting preferences of STE orientation vs. LTE/I orientation, individuals in the financial society fear being isolated for behaving according to the preference stand which is not currently the dominant one.*

Should an investor, whether institutional or individual, inherently value long-term earnings/investment and on this basis invest in a company in which he/she sees worthy long-term earnings/investment potential, he/she must fear that other investors dominantly value short-term earnings, making the company's valuation and company managers' orientation reflect short-term earnings and, hence, his/her own investment decision sub-optimal. Particularly the fear of isolation of professional money managers of *institutional* investors is likely to be emphasized by their being reviewed and rewarded not only on the basis of their individual decisions but also on the basis of their decisions relative to the decisions of other money managers – i.e. the professional reputation in relative terms.

Indeed, institutional money managers have been suggested to herd together with peers even to make sub-optimal decisions, since “an unprofitable decision is not as bad for reputation when others make the same mistake (Dennis & Strickland 2002; Froot, Scharfstein, & Stein 1992; Scharfstein & Stein 1990; see also Hirshleifer & Hong Teoh 2003). In Keynes' words, “wordly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally” (Keynes 1936: 158). Note also that institutional money managers are usually reviewed and rewarded on the basis of quarterly, or at most, annual performance measures (Graves 1988; Graves & Waddock 1990; Kochhar & David 1996).

Similarly, should an investment analyst see worthy long-term earnings/investment potential in a company and recommend the company to investors, he/she must fear that investors

value and other investment analysts give recommendations based on short-term earnings, rendering the company's valuation and company managers' orientation reflect short-term earnings and, hence, his/her own recommendations bad. Also analysts' fear of isolation is likely to be further emphasized by their being reviewed and rewarded on the basis of their recommendations relative to other analysts' recommendations, and they have been suggested to herd together with peers and institutional money managers (Chansog Kim & Pantzalis 2003; Clement & Tse 2005; De Bondt & Forbes 1999; Hirshleifer & Hong Teoh 2003). In addition, also they are usually reviewed and rewarded on the basis of quarterly, or at most, annual performance measures.

With respect to individuals' fear of being isolated for orienting or behaving according to a preference stand which is not the currently dominant stand, the spiral of silence theory predicts increasingly large proportion of individuals shifting to behave according to the stand perceived dominant. Correspondingly, the theory predicts decreasingly large proportion of individuals behaving according to the stand perceived not dominant. Note that a central assumption of the theory is that this way the proportion of individuals that comes to behave according to a stand (perceived dominant) may not correspond to any inherent preference stand of those individuals. Thus, applying the theory to a situation where STE is perceived to be the currently dominant stand among the investing public leads to the following propositions.

*Proposition 2a: Fear of being isolated for behaving according to the preference stand which is not the currently dominant stand among investing public, combined with the perception that STE is the currently dominant stand, leads to greater proportion of investing public behaving currently with STE orientation.*

*Proposition 2b: The proportion of individuals in investing public that prefer STE orientation vs. LTE/I orientation in their behavior does not follow the distribution of inherent investor preferences for STE vs. LTE/I.*

### **Vociferous Public Expressions and Managerial Biases**

In the situation described above, company managers may also make the conclusion that the majority of the financial society or investing public prefers STE orientation even if it would inherently and/or currently prefer LTE/I orientation. The distinction between inherent and current preferences here reflects the fact pointed out above in propositions 2a and 2b, i.e. spiral of silence may lead to greater proportion of individuals/investors behaving with STE orientation than the distribution of inherent preferences would suggest. Further, as elaborated below, managers may orient for STE even more strongly than the proportion – potentially only a minority – of investors currently preferring STE orientation would call for. According to the spiral of silence theory, this is likely to be the case especially if there is a minority orientation towards STE which is expressed relatively vociferously in media or other ways, or which gets emphasized in vociferous expressions.

First, it has to be noted that the proportion of investing public currently preferring STE orientation will be increased due to STE orientation becoming emphasized in vociferous public expressions. Namely, even if not inherently preferring STE orientation out of their own judgment, individuals in the investing public may come to embrace more of such orientation in their behavior, since they perceive it as being the majority orientation in the public and since they fear isolation – the spiral of silence.

*Proposition 3: The emphasis on preference for STE in vociferous public expressions leads to perception of STE orientation being increasingly dominant stand among the investing public.*

Second, and even more importantly, to the extent that managers perceive, especially judging by the vociferous expressions, that STE orientation dominates among the investing publics, their perception of the dominant current preference will be biased toward STE, as will their perception of the distribution of inherent investor preferences. The vociferous expressions on which managers are likely to base their perceptions are dealt with in the next section. With respect to bias in the managers' perception of the dominant current preference stand of investors, the spiral of silence theory can actually commensurate the reports about managers' perception/feeling of pressure by financial market towards STE orientation with the seemingly equivocal evidence that a great part of investors would not prefer or encourage this orientation (Bushee 1998; Koh 2007). That is, the managers perceive and act according to certain preference stand that may not exist as such in reality. With respect to bias in the managers' perception of the distribution of inherent investor preferences, the spiral of silence theory assumes that the preference stand perceived dominant may not correspond to any inherent preference distribution of the publics. These considerations lead to following propositions.

*Proposition 4a: The emphasis on preference for STE orientation in vociferous public expressions leads to managerial perception of STE orientation dominating among the investing public.*

*Proposition 4b: Managerial perception of STE dominating among the investing public, judged by the vociferous expressions, leads the managerial perception of the preference that is currently dominating to be biased towards STE.*

*Proposition 4c: Managerial perception of STE dominating among the investing public, judged by the vociferous expressions, leads the managerial perception of the distribution of inherent investor preferences to be biased towards STE.*

Furthermore, since managers in the prevailing financial capital system are likely to manage their firms according to their perceptions of the dominant preferences of the investing public, the biases lead to status quo whereby firms are managed (a) with excessive STE orientation relative to *current* investor preferences as well as (b) excessive STE orientation relative to *inherent* investor preference distribution. As a result, we propose:

*Proposition 5a: Managerial perception of dominant current (investor) preference being biased towards STE leads to firms being managed with excessive STE relative to dominant current (investor) preference.*

*Proposition 5b: Managerial perception of distribution of inherent (investor) preferences being biased towards STE leads to firms being managed with excessive STE relative to inherent (investor) preference distribution.*

### **Vociferous Public Expressions vs. Orientations in Practice**

The questions that remain are what are vociferous public expressions among the financial society, emphasizing STE orientation, and how likely it is that they reflect only a minority

orientation. As mentioned in the introduction of this article, (a) the media have in recent years widely reported about the tendency of investors and investment analysts (and company managers) to prefer short-term earnings over long-term investments. Note that regardless of the fact that the reports have often expressed their worry or concern about potentially detrimental consequences of the short-term tendency instead of merely describing the tendency, the tendency has nonetheless been widely described or reported about – expressed vociferously. In other words, preference for STE as the dominant stand among the financial society has been reported about and emphasized in the vociferous expressions of media. A good example of an expression of media is a report by *New York Times* about a survey by researchers in *February 2004*: “About 80 percent [of surveyed executives] said they would cut spending on research and development, advertising or maintenance that would not hurt them in the short run but could hurt them over time.” Interestingly, this particular report shows that also management researchers may have role in sustaining the vociferous media expressions.

Also (b) immediate reactions in stock prices and analyst recommendations to news about companies’ current or near-term earnings are expressions that are highly vociferous and that can be interpreted as preference for and valuing of STE orientation over LTE/I orientation by (certain) investors or the investing public in general. Although this interpretation is by no means a logical necessity or without controversy (e.g., Abarbanell & Bernard 2000; Dobbs, Leslie, & Mendonca 2005), it is an interpretation or judgment easily and often made by e.g. company managers observing the market reactions to the earnings news of their own or other companies – either (b<sub>1</sub>) on their own or (b<sub>2</sub>) with the help of the media pointing the interpretation out, as frequently happens. Thus, we propose that:

*Proposition 6: Among the most vociferous public expressions emphasizing STE orientation are (a) the media reports about the tendency of investors and investment analysts to prefer short-term earnings over long-term investments and (b) the immediate reactions in stock prices and analyst recommendations to news about companies' current or near-term earnings.*

Despite these vociferous expressions through media and stock price and analyst reactions, it remains highly possible, however, that the majority of investors do not actually (inherently) prefer short-term earnings orientation over LTE/I orientation.

First of all, there is plausible evidence suggesting that *not* all – or *not* even the majority of – institutional investors actually prefer short-term earnings orientation over LTE/I orientation (Abarbanell & Bernard 2000; Bushee 1998; Bushee 2001; Hansen & Hill 1991; Johnson & Greening 1999; Kochhar & David 1996; Lee & O'Neill 2003). The vociferous stock market reactions to news about companies' current or near-term earnings on a daily level, for instance, may well stem from the behavior of vociferous minority investors having near-term earnings orientation, even if the majority of investors, analysts or stock market in general did not overweight near-term earnings over long-term earnings/investments in their valuation (see Abarbanell & Bernard 2000). Even more evidently, *individual* investors in general are likely to tend to make investment decisions with and prefer long-term earnings/investment orientation than short-term earnings orientation (Aspara 2007; Dennis & Strickland 2002; Markowitz 1991). Thus, the silent majority of institutional investors and, particularly, individual investors may or are even likely not to prefer STE orientation over LTE/I orientation – rather the opposite.

Second, even if the long-term earnings/investment orientation rather short-term earnings orientation would (still) be true about the silent majority of investors, the spiral of silence in the financial society may of course have generated an increase in the proportion of investors with STE orientation over LTE/I orientation. In accordance with the theory, many investors, even if not inherently preferring STE orientation out of their own judgment may have adopted more of such orientation in their behavior, since it *seems* to them as being the majority orientation in the public and since they fear isolation.

## DISCUSSION

Despite the increasingly observed tendency of company managers to sacrifice long-term value-maximizing investments to smooth short-term earnings and meet short-term earnings forecasts and the ostensible pressure by financial market in encouraging this tendency, earlier research has lacked a systemic perspective to the emergence of the pressure and its effects. Based on the spiral of silence theory (Noelle-Neumann 1985; 1974; 1991), we provided in this article a theoretical system-level explanation to the emergence of the pressure in the financial market and its effects on company managers. We showed how a dynamic, system-level, self-reinforcing process among the financial society or investing public may lead to a status quo in which the orientation of a minority of (institutional) investors and investment analysts towards short-term earnings, vociferously expressed in media and certain stock price and analyst reactions, is biasedly perceived as the orientation of the majority, making company managers orient themselves accordingly – even if the silent majority of investors currently and/or inherently had quite long-term earnings/investment orientation.

Yet, it must be noted that the spiral of silence may have led many investors, even if not inherently preferring short-term earnings orientation out of their own judgment, to adopt more of such orientation, since it *seems* to them as being the dominant majority orientation in the financial society and since they fear isolation therein. After all, investors are more or less aware of the fact that the market values of companies' stocks are dependent on the dominant orientation and valuation criteria among investors, rather than any isolated criterion of a single investor or even any fundamental value of companies, which makes fear of isolation associate to fear of losing money or wealth and/or not gaining it.

In any case, company managers may, in the current status quo, make an erroneous conclusion about what the (inherent) orientation of the majority of financial society, notably investors, is. They may make the conclusion that the majority prefers short-term earnings orientation even if it would inherently prefer long-term earnings/investment orientation. Thus, it would be partly an illusion of the managers that the financial market pressures (cf. Graham, Harvey, & Rajgopal 2005) them to sacrifice long-term value-maximizing investments to smooth short-term earnings and meet short-term earnings forecasts.

What is worth noting is also the media's role in the spiral of silence: the media reports that have been concerned about potentially detrimental consequences of the tendency of investors and investment analysts (and company managers) to prefer short-term earnings orientation over long-term earnings/investment orientation. Paradoxically, even if these reports have likely been made to turn the tendency, they may have actually enforced the spiral of silence causing the tendency by being highly vocal reports of the increasing (minority) orientation towards short-term earnings.

In broad terms, the spiral of silence explanation to the emergence of the ostensible pressure to sacrifice long-term investments for short-term earnings has also aspects that could be interpreted in terms of neo-institutional theory. Parallel can be drawn between, on one hand, the proposition that individuals in the financial society will, in the lack of strong inherent or “right” stand, choose the stand concerning STE vs. LTE/I perceived as currently dominant and, on the other hand, the institutional theory prediction that in the presence of environmental uncertainty, agents/organizations will tend to adopt ideas by mimicking others. In addition, parallel can be drawn between, on one hand, the general proposition that particularly managers manage their firms with (excessive) STE orientation due to the (perceived) pressure from investing public and, on the other hand, the institutional theory’s prescription that firms are managed so as to gain legitimacy by conforming to institutional forces rather than to rationally and efficiently serve the real interests/preferences of the firm or its specific stakeholders.

Nevertheless, the spiral of silence explanation is also quite distinct from possible institutional ones and has its own contributions. First, institutional theory explanations usually assume the mimetic forces (isomorphism) to occur between firms/organizations and their managers. In contrast, in our spiral of silence explanation the mimetic force is considered to occur widely among the individual agents in the financial society and further, not only company managers but importantly money managers of institutional investors, investment analysts, investment bankers, other finance/investment professionals, and individual investors. Second, while institutional theory suggests no individual level explanation for acquiescence to institutional forces, the spiral of silence explanation centrally points out individual’s fear of isolation in combination with the perception of the dominant opinion/stance.

Third, while institutional theory pays little attention to managers' or others' perceptions (about the institutions), managers' perceptions of the investing public's preferences, as well as biases therein due to judgments based on vociferous public expressions, are central in the spiral of silence explanation. Finally, institutional theory could readily accept the claim that managers manage their firms with STE orientation due to the pressure – e.g. coercive and/or normative – from investing public. In contrast, the spiral of silence explanation implies that firms get managed with STE orientation partly due to an *illusion* of the pressure by the managers, resulting from their erroneous perceptual judgment, based on the vociferous public expressions, that the majority of investing public prefers STE orientation. Moreover, to the extent that this judgment is biased towards STE orientation, firms actually get managed with *excessive* STE relative to actual – inherent and/or current preferences – of the investing public. In other words, an information asymmetry may exist between the investing public's knowledge of their own inherent and current preferences concerning STE vs. LTE/I and managers knowledge of those preferences.

### **IMPLICATIONS**

If, indeed, company managers live in the illusion that the financial market pressures them to sacrifice long-term value-maximizing investments to smooth short-term earnings and meet short-term earnings forecasts, managers should recognize this. Managers should have more “spiral of silence awareness”: be more sensitive to the possibility – or probability – that the silent majority of investors have quite long-term earnings/investment orientation and that short-term reactions in stock prices and analyst recommendations, for instance, to news about companies' current or near-term earnings will only be vociferous expressions of a minority.

Accordingly, managers should feel less pressured to sacrifice long-term value-maximizing investments to smooth short-term earnings and meet short-term earnings forecasts.

Investors and company shareholders preferring long-term earnings/investment orientation should, in turn, attempt to vociferously express this orientation in media, as well as go strongly to the buy-side after news about investments with long-term orientation in e.g. R&D or marketing. This kind of “spiral of silence engineering” – analogous to institutional engineering – could break or even reverse the current spiral of silence that leads to company managers sacrificing long-term investments to smooth short-term earnings and meet short-term earnings forecasts.

To the extent that public policy is concerned about that society’s long-term development and innovation may be compromised by the tendency of company managers to excessively concentrate on managing for short-term earnings instead of investing in company development and innovation for the long-term, breaking of the spiral of silence should be pursued.

First, media could be educated and encouraged to vociferously report about the majority or increasing proportion of investors and financial society preferring long-term earnings/investment orientation again, instead of continuing to emphasize the tendency of investors and investment analysts (and company managers) to prefer short-term earnings orientation, which enforces the spiral of silence. For instance, positive stock price and analyst reactions to news about long-term-oriented investments in e.g. R&D could be vociferously reported, instead of reactions to news about changes in short-term earnings prospects.

Second, individual investment should be favored over institutional investment substantially more than is currently the case, since even more evidently than institutions, individuals are likely to prefer long-term earnings/investment orientation as investors. This can

be achieved e.g. by (1) including individual accounts to public (national) and occupational pension schemes, (2) encouraging individuals to invest their savings directly to companies in the stock market rather than in e.g. mutual funds by education and favorable tax treatment, (3) supporting the creation of alternative marketplaces for small companies, (4) encouraging wealthy citizens to invest their wealth as private placements in growth companies by education and favorable tax treatment.

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**FIGURE 1\***

**Dynamic, system-level, and self-reinforcing process among the financial public leading to biases towards short-term orientation**

