



**FCLTGLOBAL**

**FOCUSING CAPITAL  
ON THE LONG TERM**

# **Rising to the challenge of short-termism**

Dominic Barton, Jonathan Bailey, and Joshua Zoffer

### **About FCLT Global**

FCLT Global is dedicated to developing practical tools and approaches that encourage long-term behaviors in business and investment decision-making.

It takes an active and market-based approach to achieve its goals. By conducting research and convening business leaders, FCLT Global develops tools and generates awareness of ways in which a longer-term focus can increase innovation, economic growth and future savings.

FCLT Global's membership encompasses asset owners, asset managers and corporations from around the world.

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# Rising to the challenge of short-termism

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## Introduction

Discussions of corporate short-termism are often a microcosm of the issue itself. On the short view—say, 2009 to the present—things are looking up. CEO tenures, the average holding period for S&P 500 shares, and the average duration of corporate bonds are all up. If one takes a longer view, however, the picture begins to darken. By some measures, U.S. business investment in fixed assets is at an all-time low, while the share of net income S&P 500 companies spend on buybacks is at an all-time high of 58%, nearly 30 times its share in 1981.

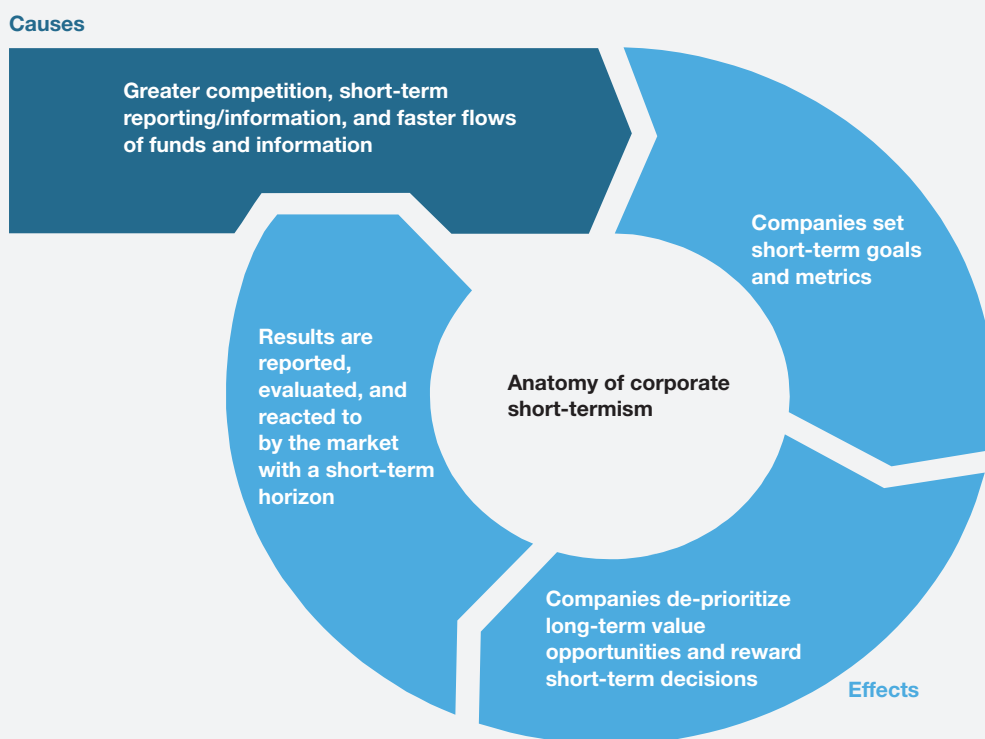
Advocacy against short-termism is not new—a slew of articles over the past 5 years in publications from the *Financial Times* to the *Harvard Business Review* have established the contours and scale of this problem. In 2013, BlackRock, the Canada Pension Plan Investment Board (CPPIB) and McKinsey & Company came together to create the Focusing Capital on the Long Term initiative with the aim of conducting research on long-termism and developing practical tools and solutions. This work was shared through roundtables with asset owners, asset managers, companies and other stakeholders in Brazil, Canada, Chile, the Netherlands, Singapore, the United Kingdom, the United States and beyond. The initiative has now grown into a not-for-profit organisation, FCLT Global, co-founded by BlackRock, CPPIB, the Dow Chemical Company, McKinsey and Tata Sons. We believe that there is still much to be done to secure the right balance between short- and long-term performance.

Unfortunately, according to corporate executives themselves, the pressure on companies to generate short-term financial performance shows no sign of letting up. In fact, the latest results from a *McKinsey Quarterly* survey panel of over a thousand C-level executives and board directors show that a majority of respondents perceive that short-term pressure is growing. Compared with survey results from 2013, even more of them report feeling most pressured to produce results in two years or less. The balance between short-term accountability and long-term value creation has fallen out of balance; it is time to reconsider what can be done to restore the long-term to its proper place in corporate planning and strategy.

The problem of corporate short-termism is a complex one. Its causes are multifaceted, ranging from activist investor pressure to the way management teams are incentivized and compensated. However, the

answers executives and board members give when asked directly about short-termism offer an opportunity to get to the heart of the matter. What emerges from these responses is a keen understanding that short-termism manifests through a negative feedback loop: while executives may feel that investor pressure forces their hand, the short-term objectives and metrics they set also push investors to shorten their horizons to match the data available to them. Indeed, when executives and directors are asked where they feel short-term pressure on them comes from, nearly 40% point to executive teams and boards of directors themselves! These business leaders know that they are affected by short-termism and freely admit that they would prefer to use longer strategic planning horizons. The problem is how to enable them to break the vicious cycle.

**Exhibit 1 Causes and effects of corporate short-termism**



While less robust than the empirical data used in academic studies of short-termism, survey results can offer a perspective from the frontline. From these answers, we can begin to paint a picture of the extent, causes, and effects of short-termism. And from this picture, hopefully, we can start working toward a solution.

## Evidence and findings

In late 2015 and early 2016, McKinsey & Company surveyed over 1,000 *McKinsey Quarterly* panelists on their perceptions of corporate short-termism and how it has evolved over time. The respondents represent over 1,000 C-level executives and board members from across the world, covering a full range of industries and functions. Many of the questions were a repeat of those asked in a 2013 survey of the same panel.

Overall, the survey has two critical implications for the battle against short-termism: first, that short-termism has shown no signs of abating and, second, that its causes are manifold and hard for individual companies and executives to combat alone.

These implications are supported by a diverse body of evidence, with four headline survey findings:

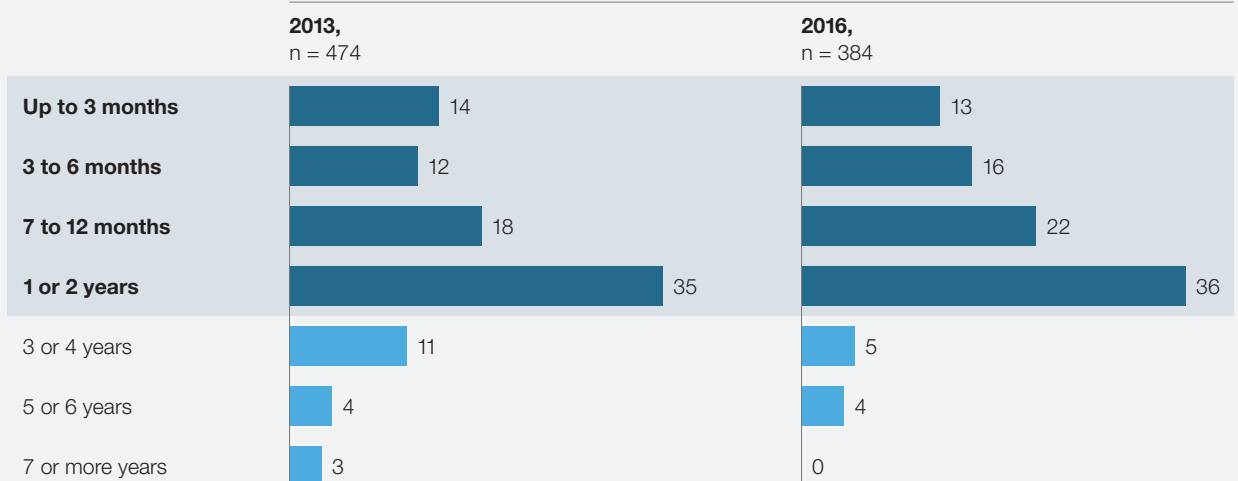
### 1. Short-term pressure on executives has increased since 2013

Board members and executives alike believe that short-term pressures continue to grow. Sixty-five percent of all respondents say the pressure on senior executives to deliver short-term results has increased in the past five years—roughly the same share who said so in 2013. And from 2013 to 2016, the share of respondents who reported feeling the most pressure to demonstrate strong financial performance within two years or less rose from 79% to 87%. Those who felt that pressure most acutely over 7 years or more fell to zero, while those who felt most pressure over a period of less than six months increased from 26% to 29%.

## Exhibit 2 'Short' is getting shorter.

% of respondents<sup>1</sup>

Time periods when respondents feel the most pressure to demonstrate strong financial performance



<sup>1</sup> Respondents who answered "don't know" are not shown.

When cut by company characteristics, these results yield additional insights on the state of short-termism. Public-company respondents are significantly more likely than their private-company peers to cite increasing pressure. So are respondents at companies with lower share prices than their competitors: 80 percent of those reporting lower share prices than peers say short-term pressure has increased, compared with 68 percent of those with higher share prices.

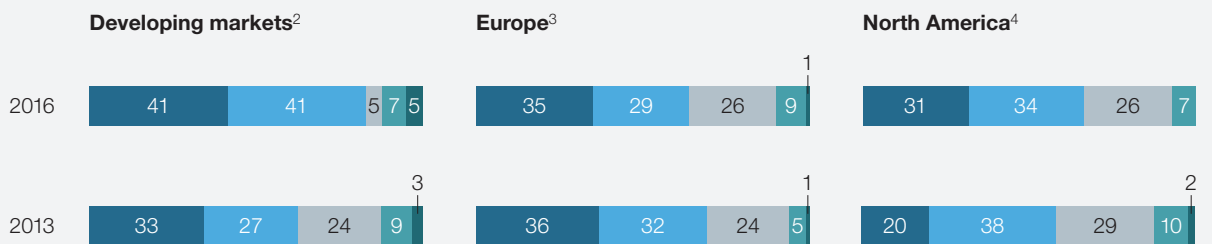
Across geographies, respondents from companies with headquarters in developing markets were significantly more likely to report increasing short-term pressure (82%) than their peers in Europe (64%) or North America (65%), a major jump from 2013 (Exhibit 3). In previous years, unique corporate structures and ownership models had made at least some developing markets a relative safe harbor from short-term pressures. It may be that today’s macroeconomic environment, characterized by depressed investment returns, has sent Western investors further afield seeking yield, bringing their shorter time horizons with them. This worrisome trend represents yet another sign that the battle is far from won. Indeed, emerging market companies with less established corporate governance procedures may be even more vulnerable to such pressure than their North American and European counterparts.

### Exhibit 3 Short-term pressure shows no signs of letting up.

% of respondents,<sup>1</sup> by office location

#### Change in pressure on senior executives to demonstrate strong short-term financial performance, past 5 years

■ Significant increase ■ Moderate increase ■ No change ■ Moderate decrease ■ Significant decrease



<sup>1</sup> Figures were calculated after removing respondents who selected “don’t know/not applicable”; figures may not sum to 100%, because of rounding.

<sup>2</sup> Includes China, India, and Latin America. In 2016, n = 94; in 2013, n = 132.

<sup>3</sup> In 2016, n = 164; in 2013, n = 159.

<sup>4</sup> In 2016, n = 88; in 2013, n = 126.

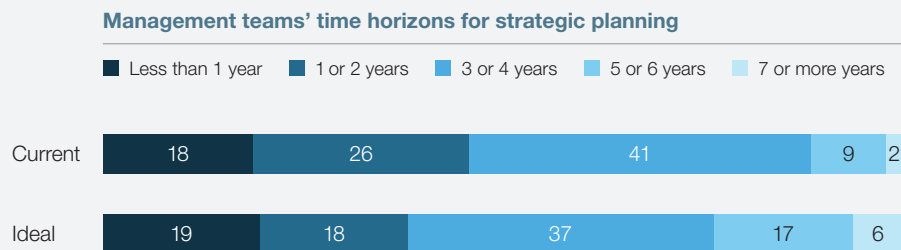
## 2. Companies have struggled to codify long-term plans and articulate critical elements of their long-term strategies

Given the prevalence of short-term pressures, it is not surprising that many executives believe their companies are using time horizons in their strategic planning that are too short. Sixty percent of respondents say their management teams should use a time horizon of at least three years for formal

strategic planning, while 52 percent report using this timeline already (Exhibit 4). Compared with earlier results, though, executives are now more likely to believe that they should be conducting strategic planning on a shorter time frame: 37 percent say their companies should use a planning horizon of two years or less, up from 27 percent who said so in 2013.

**Exhibit 4 Executives report that their strategic planning horizons are too short.**

% of respondents,<sup>1</sup> n = 384



<sup>1</sup> Respondents who answered “don’t know” are not shown, so figures do not sum to 100%.

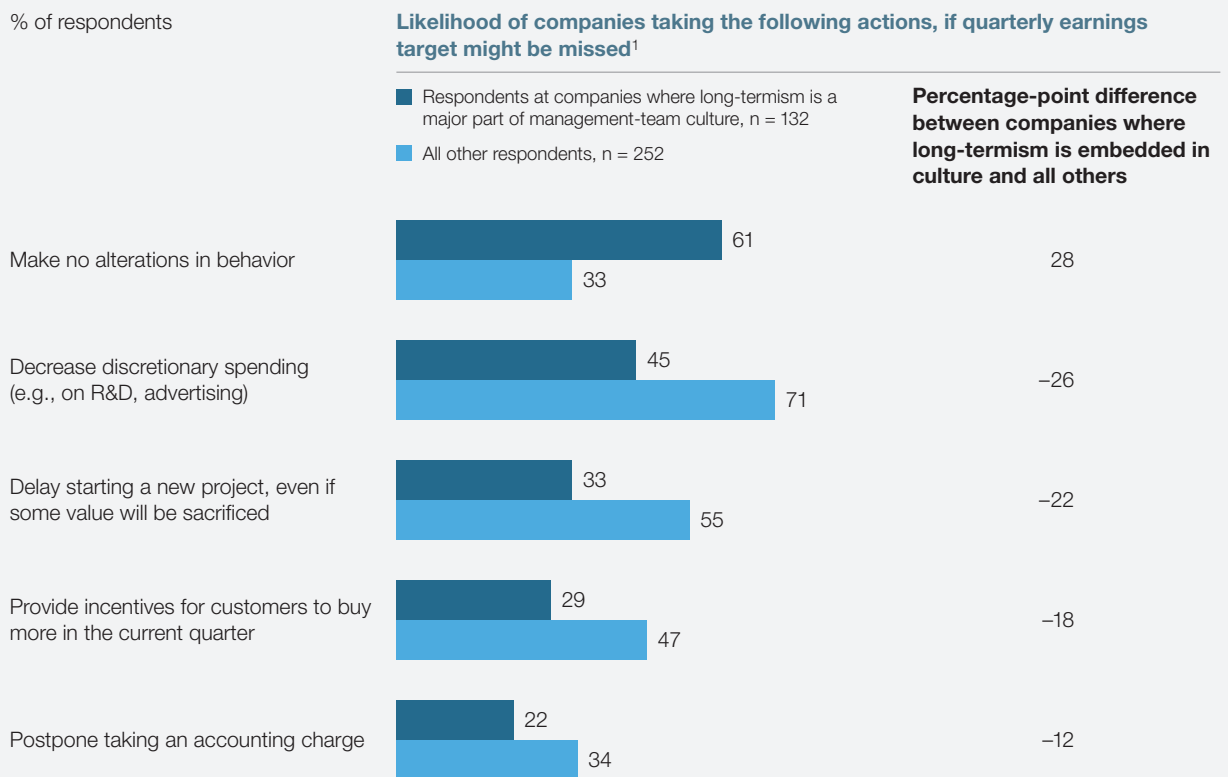
Respondents also report mixed results with codifying elements of their long-term strategies. The survey tested how far along respondents believed they were implementing ten key elements of a long-term strategy, from expressing a clear statement of purpose to providing medium- and long-term metrics with a detailed execution roadmap and link to long-term value creation. In fact, there was only one element—the company’s mission and vision—that a majority of respondents say is very formalized at their companies. At the same time, about one-quarter of executives say their companies haven’t formally articulated either their views on major market trends or their sources of competitive advantage. In order to maximize the value of such strategic planning exercises, companies must balance the length of the horizons over which they plan and the extent to which plans are formalized with the need for agility and flexibility in today’s business environment. Long horizons and codified strategies cannot be an excuse for intransigence. They should be rigorously reviewed on an ongoing basis to ensure they incorporate ongoing developments and remain relevant over the long term. Achieving this balance lies at the core of long-term, sustainable value creation.

**3. Long-term cultures are a boon to financial performance and directly affect the actions executives and their boards expect to take**

Amid these challenges, companies clearly struggle to keep long-termism at the top of their priorities. Not surprisingly, among the 37 percent of respondents who report that long-termism is a major part of their management teams’ cultures, a resounding 88 percent say the long-term view has had a positive effect on financial performance. For the rest of respondents, though, a lack of long-term thinking has a notable effect on company decisions.

We asked business leaders what their companies would do if it were near the end of the quarter and it seemed they would miss their earnings targets. Executives who reported that long-termism is a major part of their companies' cultures said their companies were 26% less likely than other companies to decrease discretionary spending in this scenario. Perhaps more strikingly, these executives reported that their companies were 22% less likely than others to delay a new project and sacrifice some value to hit quarterly earnings targets. In contrast, more than half of executives (55%) at companies where long-termism is not a major part of the culture said they would delay a new project, even with the stipulation that doing so would sacrifice some value (Exhibit 5).

**Exhibit 5 Companies with a strong long-term culture are more restrained in their reactions to quarterly earnings.**



<sup>1</sup> Out of ten actions that were tested in the question; the actions shown here represent the biggest percentage-point differences between the two groups of respondents, and respondents were asked to answer within the parameters of what standard accounting practices allow. Those who answered "neither likely or unlikely," "somewhat unlikely," "very unlikely," or "don't know/not applicable" are not shown.



Executives at long-term companies are also likelier than others to take no action at all: 61 percent of these respondents said their companies would likely make no changes in behavior in this situation, compared with just 33 percent of all other respondents.

**Exhibit 6**      **Only half of companies would make the unambiguously long-term decision when confronted with a major strategic decision.**

**Example:**

*In the second quarter of 2016, a weak economy hits revenue and profit from Company A's European activities—which means the company will likely not meet its consolidated profit target for the year. The only way Company A can meet its 2016 target is to slow its investments in building up activities in Asia (mostly marketing and sales related), which it believes have substantial long-term growth potential. But slowing its Asian investments might erode its competitive position there. In this situation, how would your own company react?*

<b>A.</b> Continue with planned investments in Asia and report 2016 profits below its target, then explain the source of its shortfall		50%	Unambiguously long-term
<b>B.</b> Make across-the-board spending cuts in Asia to meet its consolidated profit goal		11%	Unambiguously short-term
<b>C.</b> Scale back investments radically in the Asian markets with the least growth potential, thereby meeting the consolidated profit target while maintaining investments in the most attractive Asian markets		33%	Relatively short-term

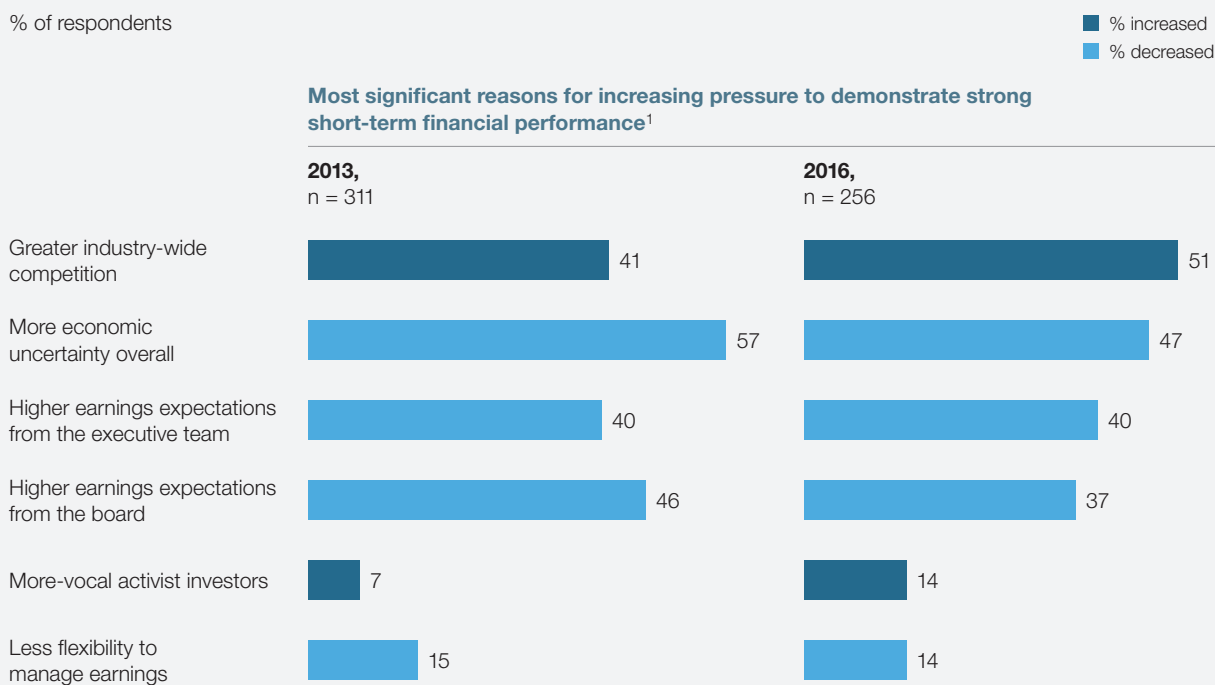
This mind-set affects a wide range of strategic decisions, which we tested in six hypothetical questions to explore how companies would react to changing economics, unexpected risk, and questions of transparency with investors. On average, across all questions, only about half of respondents report that their companies would make the decision that would unambiguously generate more long-term value. Moreover, nearly 40 percent on average would make the relatively or unambiguously short-term-oriented decision even though it would undermine long-term value—for example, implementing across-the-board spending cuts, scaling back strategic investments, or taking actions primarily intended to reduce the visibility of losses and volatility.

**4. The causes of increasing short-termism have evolved over time and come from both secular trends and forces within companies themselves**

Respondents say the sources of this pressure are evolving. They still say board members and C-level executives—in other words, they themselves—exert the most pressure to demonstrate short-term results. Boards also seem to play an outsized role in decisions to increase dividends or buy back shares:

49 percent of respondents say their boards played a large role in their companies' most recent decisions to distribute cash or buy back shares, compared with 30 percent who say the same for shareholders and one-quarter who say so of senior managers. But when asked why pressures are growing, the largest share (51 percent) of respondents cite greater industry-wide competition, up from 41 percent in 2013 (Exhibit 7). Respondents also blame the increased pressure on more-vocal activist investors twice as often as they did before, behind economic uncertainty and higher earnings expectations from company leaders.

**Exhibit 7 Sources of short-term pressure have evolved over time.**



<sup>1</sup> Out of 13 reasons that were presented as answer choices.

**Implications and recommendations**

At their core, these findings are unambiguous: excessive short-termism is perceived to be real and it is affecting the most fundamental decisions that boards and corporate executives make. That value is at stake, for both shareholders and the broader economies in which these decisions unfold, cannot be contested. This view is supported not just by the overwhelming majority of respondents when asked directly about their experiences and choices but by the consistency of these answers between the two surveys as well as their steady uptick over time.

For several years now, companies have been asking what they can do to combat excessive short-termism in the context of their organizations. Although there are no easy answers, possible responses have begun to take form. There is room for improvement on policies like executive compensation, where incentives can be aligned to long-term financial performance; on strategic planning, where companies can develop long-term (5+ year) plans to unlock value and align them with articulated views on their missions, competitive advantages, and other long-term elements of strategy; and on how companies engage their investor bases, focusing conversations on long-term value creation rather than this quarter's results. FCLT Global has codified these points as the ten key elements of a long-term strategy (see "10 elements of a long-term strategy" on page 13).

## Regional perspectives

While much of the debate on short-termism has focused on businesses and investment markets in the United States and United Kingdom, most countries and markets are struggling to maintain the right balance between short- and long-term performance. Indeed, we must be cognizant that in some markets excessive long-termism is the greater risk. When long-termism becomes an excuse for a lack of scrutiny or influence over the corporate decision making the result can be poor capital allocation, lower long-term investment returns and a drag on macro-economic growth.

To better understand how the balance of short- and long-termism is playing out across regions and markets, FCLT Global hosted a series of roundtables in Asia, Europe, and the Americas. At these roundtables we brought together local business leaders, regional investors and domestic asset owners as well as regulators and policy makers. We sought to better understand the structure of domestic capital markets, regulatory environments and industry dynamics as drivers of short- and long-termism.

The roundtables revealed some of the nuances and differences between markets. For example, at a roundtable in Brazil participants described the country's

institutional investors as a source of long-term capital combined with broad support by corporate leaders and stock exchanges for integrating sustainability factors into business decision making. While across the continent in Chile, participants described the dynamics of the domestic pension plan system as creating short-term pressure on asset managers and companies.

In the Netherlands, participants talked about the asset-liability matching rules that may constrain long-term investing by asset owners, but contrasted this with a long-standing commitment to corporate engagement by asset owners and asset managers. A roundtable in Switzerland focused on the role of family offices and private capital in sustaining a long-term perspective among that country's small and mid-sized businesses.

FCLT Global will continue to map the dynamics of short- and long-termism around the world, identifying the actions that have enabled some markets and countries to achieve an appropriate balance.

These solutions are only half the battle, though. As discussed above, the drivers of short-termism have at least as much to do with macro trends as they do with company policies. The most cited factors in rising short-termism, greater competition and economic uncertainty, are trends that do not inevitably result in excessive short-termism and that cannot be controlled. Rather, they are catalysts that affect nearly all companies and create an impetus for action. What that action is depends on how business leaders interpret these trends and choose to position themselves in response to them. That the response has been to focus on the short-term should give us pause, especially given that executives admit this response can sacrifice value.

The key to breaking the negative feedback loop driving corporate short-termism lies in empowering executives and directors to develop long-term strategies to manage these trends. Without that authority, uncertainty and competition can become amplifiers of short-term instincts rather than reasons to develop a long-term approach to address them. These survey results unambiguously demonstrate that executives know they should lengthen their time horizons – the next step is to give them the tools to reverse this cycle rather than feed it.

Stemming the rise in short-termism driven by such trends is difficult for companies to do on their own. If industry peers choose to respond to greater competition by pushing harder to consistently hit short-term earnings targets (and perhaps sacrificing valuable opportunities in the process), it is hard for any one company to deviate without facing the ire of the market.

Truly untangling these forces requires a long-term coalition to promote long-term choices and orientation at the industry and economy-wide levels, not just the company level. Policies commonly referenced as antidotes to short-termism are strengthened by numbers and broad awareness. In the context of such a coalition, a company's choice to set aside short-termism may be viewed as a visionary strategy rather than the whim of an outlier.

A long-term coalition, like FCLT Global, can build public awareness of short-termism's role in exacerbating many of the macroeconomic trends bemoaned by investors, from low investment and secular stagnation to slowing productivity growth. And it can give corporate leaders a platform on which to build broad-based support for their decisions and, ultimately, shift the sentiments of groups that may contribute to short-term pressure.

A crucial next step for FCLT Global and others concerned about excessive short-termism is to pursue a robust research agenda. This should include greater investment in both empirical research to truly understand the causal mechanisms driving short-termism and macroeconomic research to quantify the broader effects of excessive short-termism on economic growth, innovation, employment, and other key elements of macroeconomic success. This second point will be high on FCLT Global's agenda over the next year, and a place where we hope to break new ground in the debate on short-termism.

Excessive corporate short-termism is a difficult problem, but not an intractable one. Although it has no single silver bullet intervention, a collective approach that tackles its multi-faceted causes may be the next best thing. ■

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**Jonathan Bailey** is an Associate Partner at McKinsey & Company and the new Director of Research of FCLT Global.

**Josh Zoffer** is a consultant in McKinsey's New York office.

## 10 elements of a long-term strategy

1. Express a **clear statement of purpose, mission, and vision**.
2. Explain how the **company's business model creates long-term value** by identifying key value drivers at the reporting unit level.
3. State **management's view of the market**, major trends impacting the market, potential for growth, the company's relative positioning, and underlying assumptions (e.g., macroeconomic factors).
4. Highlight sources of **competitive advantage** such as talent, access to resources, or other assets that enable the company to execute its strategy and win in the marketplace, clearly substantiated by fact.
5. Disclose **strategic goals** ultimately tied to drivers of value creation (e.g., returns on invested capital, organic revenue growth) in the context of current and future market trends, and the company's competitive advantage.
6. Lay out a **detailed execution roadmap** that defines short-, medium-, and long-term actions linked to key milestones and strategic goals targeted at long-term value creation.
7. Provide **medium- and long-term metrics and targets** that indicate the company's ability to deliver on its strategy, such as customer satisfaction over time, brand strength, and product pipeline investment and returns. Explain how the selected metrics will be measured and tracked consistently.
8. Explain how **capital and non-capital investments**, including the mix of resource allocation, will yield sustained competitive advantage and the creation of long-term value.
9. Provide an **overview of risks** and their mitigation plans, including sustainability challenges (e.g., environmental, social, and governance issues).
10. Articulate how **executive and director compensation** tie to long-term value creation and strategic goals.

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FCLT Initiative, *Straight talk for the long term: How to improve the investor-corporate dialogue*, March 2015, [fcltglobal.org](http://fcltglobal.org).

## **Methodology**

The online survey was in the field from October 20 to October 30, 2015, and garnered responses from 1,035 C-level executives and board members representing the full range of regions, industries, and functional specialties. Of them, 384 respondents work at companies with revenues of \$100 million or more and answered the full survey. To adjust for differences in response rates, the data are weighted by the contribution of each respondent's nation to global GDP. Additional analysis was conducted in early 2016.

From April 30 to May 10, 2013, we surveyed 1,038 C-level executives and board members on the time horizons their companies use in decision making. Of them, 474 respondents worked at companies with revenues of \$100 million or more and answered the full survey. The respondents represented the full range of regions, industries, and functional specialties.



