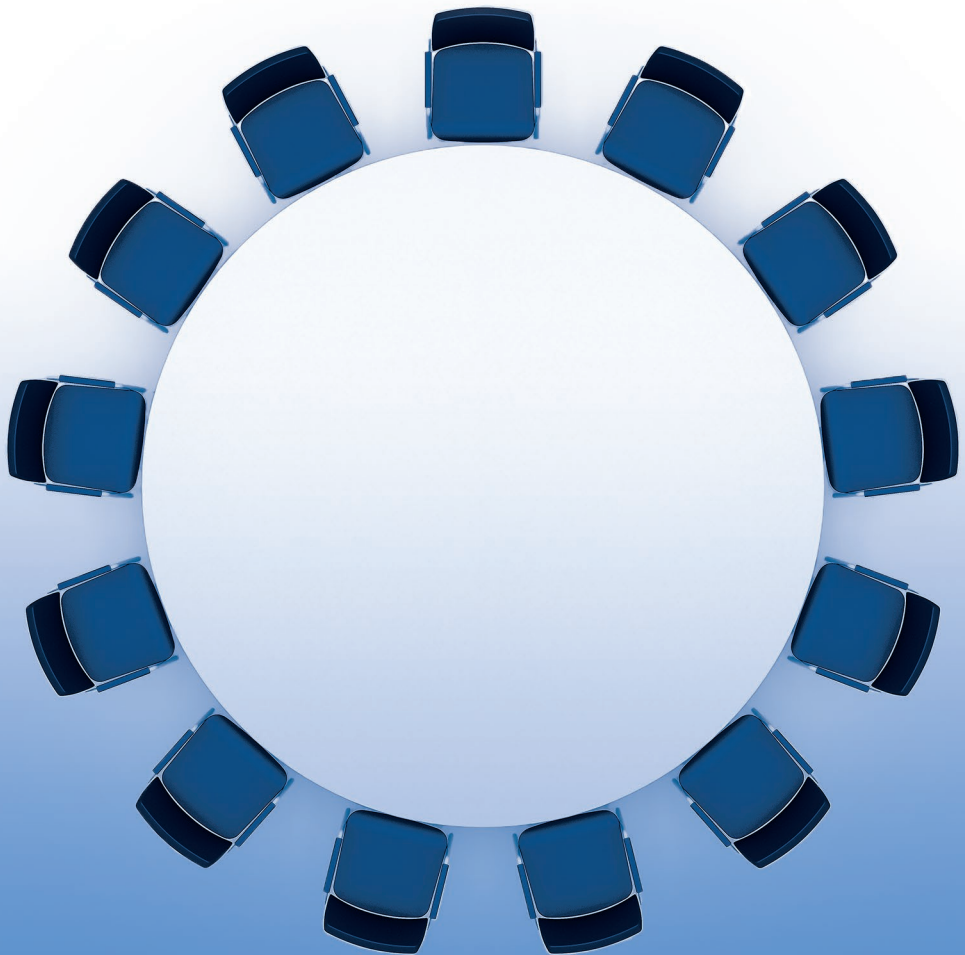


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# Long-term Boards in a Short-term World

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FCLTGlobal is dedicated to rebalancing investment and business decision-making towards the long-term objectives of funding economic growth and creating future savings.

FCLTGlobal is a not-for-profit organization that works to encourage a longer-term focus in business and investment decision-making by developing practical tools and approaches to support long-term behaviors across the investment value chain. We take an active approach to achieving our goals by:

- Conducting research and developing practical ideas based on solid evidence
- Engaging the world's top asset owners, asset managers, and corporations to problem-solve and test capital allocation approaches that create long-term value
- Developing educational resources and actionable approaches that are available and applicable globally
- Generating measurable change in capital markets behavior among savers, investors, corporations and other stakeholders

Focusing Capital on the Long Term began in 2013 as an initiative of the Canada Pension Plan Investment Board and McKinsey & Company, which together with BlackRock, The Dow Chemical Company, and Tata Sons founded FCLTGlobal in July 2016. In addition to our Founders, our Member organizations from across the investment value chain, including asset owners, asset managers and corporations, are committed to accomplish long-term tangible actions to lengthen the timeframe of capital allocation decisions.

**FOUNDERS**



**MEMBERS**



June 2018

# Long-term Boards in a Short-term World

Research from FCLTGlobal confirms that long-term companies outperform others on financial metrics, including revenues, profitability and stock price, as well as non-financial ones, such as job creation. It is also clear that resisting the short-term pressures of capital markets is an ongoing challenge. Some companies are able to follow their long-term strategies while others succumb to chasing short-term performance — often at the expense of future growth. The board has the opportunity to set the tone for long-term behavior.

What makes a company long term? Time and again, we see that successful companies, in addition to producing compelling financial returns, have long-term oriented cultures and governance processes that guide them through rough times, underscored by a framework of consistent principles and values.

Governance and culture can be “soft” topics, but discussions with FCLTGlobal’s Members and expert research (see *Further Reading*) make it clear that the tone from the top is critical - and the top is the corporate board of directors.

Often called a company’s biggest untapped strategic asset, a well-functioning board sets the tone for an organization and wields the power to meaningfully influence the purpose, culture, and long-term direction of a firm. Directors, as shareholders’ representatives and long-term leaders of the company, often with average tenures that exceed executive management, are uniquely positioned to keep an organization focused on the distant horizon. Corporate management teams, however, frequently cite corporate boards as one of the primary sources of short-term pressure. What can we learn from those boards that are true drivers of long-term value?

Much has been written on the elements of good corporate practices, and, in particular, on theories of best practice and shareholder rights. With this foundation, there is now an opportunity to dive deeper into understanding the elements that distinguish those boards that focus on long-term value creation.

What makes a board longer or shorter term? What practical actions can boards take to foster long-term value creation? How can boards be structured to maintain a long-term orientation while meeting their daily demands?

We posed these questions to our Members, including many seasoned executives and directors, and they all agree it is challenging to create a long-term board in today’s short-term world. Corporate leaders and long-term investors participating in Focusing Capital on the Long Term Summit’s working sessions discussed a broad range of ideas, including sharing their own experiences from behind closed doors, that could create an environment that enables boards to consistently focus on the long term.

This *Idea Exchange* distills conversations about building a long-term orientation in the boardroom into a toolkit of suggestions meant to spark constructive self-reflection and action at the board level. FCLTGlobal working group participants considered how boards could encourage long-term value creation and the roadblocks to doing so, rather than having a broader conversation about good corporate governance.

We began with a simple question: if you were constructing an ideal public company board, what would be the core elements crucial to having a long-term focus?

In considering this from a blank slate, a long-term board’s central focus is clear: to engage on corporate strategy, talent development, risk management, and

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the company's capital allocation decisions. Keeping board members' attention on the future of the business is critical for long-term success. A true high-functioning long-term board is an invaluable strategic asset and smart companies continuously leverage that asset.

What can boards do to better encourage long-term behavior within their organizations and set the right tone at the top? A few suggestions stand out from our discussions:

- Ensure the boards' composition is reflective of the future
- Align rewards for board service with long-term value creation
- Strengthen the board's understanding of long-term shareholders' objectives
- Reallocate time to activities that create long-term strategic value
- Consider the pros and cons of delegating long-term or short-term issues to subcommittees
- Focus on the long-term growth and development of board directors

The tools in this *Idea Exchange* are not meant to be applied universally or to be considered best practices. In fact, there is lively disagreement among our Members about many of the specific tools. This piece aims to provide ideas to help boards evaluate their own practices and consider which mechanisms could support their efforts to be more effective in the long term. These ideas are summarized as *Potential Tools for Long-term Boards in a Short-term World*.

SEE TOOLS ON PAGE 8-9

## ENSURE BOARD COMPOSITION REFLECTIVE OF THE FUTURE

How can a board be truly long term in its orientation? The most important factor is the composition of the board and whether its DNA is long-term. Building a long-term board starts with recruiting board members with long-term characteristics, often achieved by including "having a long-term orientation" as an explicit part of the search process. Some boards use psychometric characteristics to test for a long-term orientation; others simply review a candidate's track record.

Striking an appropriate balance between tenured board members with long-term perspectives on the company and the dynamism of new talent is another key theme in discussions of board composition. While there is often outside pressure to have annual terms, many long-term oriented organizations, such as not-for-profit organizations or family companies, tend to have multi-year or staggered terms. Boards can determine whether longer terms or tenured structures would facilitate a longer-term mindset.

Ensuring that the board has the relevant expertise to test and judge the long-term strategy is critical. Many companies have skill matrices to show their board's composition of skills and experiences. Future-oriented boards include expertise in relevant disruptive technologies or future growth areas in these matrices.

Board member diversity ranks among the highest priorities across the investment value chain. Board member diversity for the long-term board could include representation of its future customers, as well as an appropriate demographic mix along gender, age or geographic lines. Finally, boards and companies go through many stages; having board members who excel in times of crisis, as well as in times of calm, can enable boards to better weather full business cycles.

## **ALIGN REWARDS FOR BOARD SERVICE WITH LONG-TERM VALUE CREATION**

Executive compensation receives a great deal of focus, and board compensation is important. However, the principles that apply to executives may not apply to directors, for whom financial compensation for serving on a board may be only one component of their overall financial picture.

Having more “skin in the game,” as the boards of private or family-owned companies do, can be an effective mechanism to align board directors with long-term owners. Board compensation structures that link director rewards to the experience of the long-term owners they represent are appealing, including through compensating board members in stock and/or locking up directors’ stock awards beyond their term of service.

Having directors purchase stock with their own private wealth may be more effective than receiving equity solely through company grants. This behavioral nudge suggests that directors who purchase stock directly are more apt to feel that they are owners and will, therefore, take a longer-term approach than directors who are “playing with house money.”

Why do board members serve on boards? For many, financial compensation is not the primary reward. Among other reasons, we often hear that most directors serve because they want the opportunity to leverage their talents and experience or are motivated by prestige, career advancement, or mission. Board service that includes future-oriented creative thinking may be more fulfilling and drive longer-term engagement. Identifying a director’s rationale for serving can aid director selection and retention, as well as the design of appropriate reward structures.

Many corporate directors also serve as directors of not-for-profit organizations. Not-for-profit directors typically volunteer their time to act as stewards in the service of a long-term mission in which they believe. Periodically reminding directors of the company’s mission and vision may inspire a similar mission-driven culture on the boards of public companies. Providing new intellectual challenges and growth can encourage deep engagement over time.

## **STRENGTHEN BOARD’S UNDERSTANDING OF LONG-TERM SHAREHOLDERS’ OBJECTIVES**

Another major theme of our research is engagement between corporations and long-term shareholders. Noisy short-term shareholders often dominate the investor-corporate dialogue at the expense of quiet long-term shareholders. Boards are critical in supporting a strong dialogue between the company and its key long-term shareholders.

Boards that know their long-term shareholders and understand their objectives can build board-level relationships with these long-term shareholders. Developing these relationships over time, rather than during an activist situation or crisis, can be extremely valuable. The largest institutional investors increasingly request direct interaction with the board, and more boards are honing their approach to shareholder engagement.

The benefits flow both ways. By regularly meeting with long-term shareholders, board members can better analyze and understand their shareholder base and more effectively cultivate relationships with the very investors that they would like to have as long-term shareholders. Board members and company executives have also found significant value in visiting buy-side asset managers and encouraging them to present their views about the company, its strategy, and the quality of management. Understanding why long-term stockholders are investing in the company can provide invaluable insight and serves as a counterpoint to the often short-term views presented by the media, sell-side analyst reports, and transient or activist investors.

Long-term shareholders explain that direct board interactions facilitate discussions of long-term value creation and strategy, deepening their ties to, and understanding of, portfolio companies. While board members may not have the detail or content that management can provide, they often have the long-term context that is valuable to both the investor and the management team. Practical solutions to enable board-investor dialogue include appointing a lead independent

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director or directors as shareholder relationship manager(s) and encouraging them to attend events like investor days and the annual general meeting.

Finally, having the board spell out its belief of its duties to its long-term shareholders can both ground the dialogue in the long-term strategy and lay the foundation for the board to promote long-term value creation. Amazon, for example, publishes such a statement.

## Amazon's Responsibility of the Board:

The Board of Directors is responsible for the control and direction of the Company. It represents and is accountable only to shareowners. The Board's primary purpose is to build long-term shareowner value.

### REALLOCATE TIME TO ACTIVITIES THAT CREATE LONG-TERM STRATEGIC VALUE

Public company board members often complain that “there is no time for strategic discussion” or “we spend almost all of our time as a board on compliance.” By contrast, private company boards generally spend more time discussing longer-term opportunities and challenges. Making long-term planning an explicit part of every board meeting by starting each meeting with a review of the mission statement and long-term strategic roadmap can anchor the meeting to the long term.

How can the board focus the appropriate amount of time on long-term strategic goals and less time “checking boxes?” One suggestion is tight agenda management, with a defined and limited amount of time spent on short-term compliance or financial issues and more time allocated to discussing long-term business strategy, ensuring that the company has an appropriate and durable capital structure, developing the senior

leadership team and its talent strategy, and considering key issues related to enterprise risk management. Some boards also may allocate offsites or considerable time to discussing “softer” topics such as long-term values, culture, purpose, and employee engagement. It is too easy for these critical, but often not immediate, issues to be set aside in favor of short-term demands.

Another practical idea to help board members focus their time on important long-term issues is to ensure that directors have access to analysts to answer their questions and perform any required analysis. Private equity or activist board members often have teams of analysts prepping them for board meetings, while other board members may not have that support. We hear time and again that board members would like focused, concise materials that highlight the key issues and lay the foundation for a discussion, rather than hundreds of pages of data. A practical solution here is to provide concise “board books” of no more than 40–50 pages to reduce board time spent on minutiae and to free directors for bigger-picture planning and operational and strategic questions.

Finally, monitoring or publishing details on how the board spends its time, including the proportion of its business activities spent on strategy and long-term value creation, can help rebalance the time boards spend on various activities.

### CONSIDER PROS AND CONS OF DELEGATING TO SUBCOMMITTEES

Boards regularly delegate certain issues to board committees, and committees can help the board focus on long-term issues. Boards may wish to delegate these issues to a committee dedicated to long-term strategy, capital allocation, enterprise risk, or disruption. Boards may also consider establishing a dedicated shareholder relations committee to focus on long-term shareholders. These committees can do in-depth work on key topics and share their conclusions with the board as a whole.

Another suggestion is the reverse: free board time to focus on long-term strategy by delegating short-term issues, such as the quarterly cycle or routine compliance issues, to committees.

In each of these cases, the board decides what works best to achieve an appropriate balance between delegation, focus, and efficiency on the one hand, and full board attention and prioritization of long-term strategic issues on the other.

## **FOCUS ON THE LONG-TERM GROWTH AND DEVELOPMENT OF BOARD DIRECTORS**

Board training can help directors remain fresh and keep abreast of current industry trends, but too often focuses on legal responsibilities and compliance, rather than on long-term value creation. Ensuring that board development is future-oriented and builds director skills over time will pay dividends for the company and the market more broadly, as directors often serve on more than one board over time.

Another key theme is the importance of giving board members effective and true feedback on their performance and long-term impact, rather than simply measuring attendance. Setting clear long-term expectations for board members and giving them feedback can be difficult, particularly in a collegial environment where many board directors see their role as service. Setting expectations and evaluation criteria upfront helps establish the right tone with directors, while periodic peer and third-party review of director performance can ease potentially uncomfortable conversations. To enhance a long-term focus, evaluations weigh contributions to long-term strategy and value creation heavily, rather than taking a narrow focus on legal and compliance-related issues.

To keep directors fresh and focused on the future, some companies immerse the board in the most innovative parts of the business. Meetings held at those locations or covering those topics can help make the future-oriented innovations tangible to board members. This exposure to a company's leading-edge growth opportunities can often inspire better long-term strategic planning and better leverage directors' expertise.

## **SUMMARY**

In summary, boards can create an environment that engenders a long-term approach to value creation. By revisiting their processes, boards can set a long-term tone and lead by example. We encourage corporations to consider how these or other tools may provide mechanisms to focus on the long term, and we encourage long-term asset owners and asset managers to support those long-term boards.

We welcome your experiences, perspectives, and feedback at [research@fctglobal.org](mailto:research@fctglobal.org).



## Ensure board composition reflective of the future

- Identify key characteristics of long-term oriented board members
- Explicitly recruit long-term oriented board members
- Encourage tenure structure designed to balance tenure and new talent
- Consider staggered terms, rather than annual terms
- Cultivate expertise in relevant disruptive technology or business models related to long-term strategy
- Reflect the firm's long-term customers (e.g. millennials)
- Pursue appropriate demographic mix (gender, age, geography)
- Recognize need for board members suited for both times of crisis and calm



## Align rewards for board service with long-term value creation

- Compensate board members primarily in stock
- Lock-up board members' stock awards through or beyond their terms of service
- Encourage board members to purchase stock in addition to being granted shares
- Recognize role of intangible rewards for being a board member, including the fulfillment of driving long-term value creation and growth for the board members
- Periodically remind board members of the corporate mission to encourage them to see themselves as long-term trustees of that mission, just as not-for-profit directors do



## Strengthen board's understanding of long-term shareholder objectives

- Conduct board level discussions of targeted investor segments, current shareholder composition, and their investment objectives
- Facilitate direct board engagement with key shareholders to provide long-term context and solicit feedback
- Dedicate board members to engage with long-term shareholders
- Create and distribute formal statement of board duties to long-term shareholders





### Reallocate time to activities that create long-term strategic value

- Start meetings with a review of the mission statement and long-term strategic roadmap with KPIs
- Define and limit the amount of time allocated to short-term compliance and financial issues
- Allocate greater amount of time to discussing long-term business strategy, durable capital structure, talent development strategy and enterprise risk management
- Discuss long-term “soft topics,” such as values, culture, purpose and employee engagement
- Dedicate staff for board members to better leverage their time and expertise towards more strategic work
- Focus board materials on strategic issues and limit the length
- Analyze and/or report on allocation of board time to various topic areas



### Consider pros and cons of delegating to subcommittees

- Delegate critical long-term issues to dedicated long-term strategy, capital allocation, enterprise risk, or disruption committee
- Assign short-term issues, such as the quarterly cycle or regular compliance, to committees
- Establish dedicated shareholder relations committee to focus on long-term shareholders



### Focus on the long-term growth and development of board directors

- Implement an in-depth development process with focus on long-term strategy
- Consistently evaluate board member contribution and impact on long-term issues
- Set clear expectations of a long-term focus for board members
- Immerse in innovative or long-term areas of the business and/or locations

# Further Reading

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A new series from FCLTGlobal, the *Idea Exchange*, is a collection of tools and opinions designed to spur discussion on how investors and business leaders can drive greater long-term behaviors.

These *Idea Exchange* Reports complement our periodic whitepapers and aim to serve as conversation starters around long-term approaches across the global business community.

Our goal is for this series to produce a true exchange: we encourage you to share your perspectives and first-hand experiences to contribute to innovative, practical research. Reach us at [research@fcltglobal.org](mailto:research@fcltglobal.org).



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