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Navigating COVID-19: Advice from long-term investors

Look after employees, customers, and suppliers; adopt a through-cycle mindset; and communicate transparently. Profits and dividends will come later if you make the right moves now.

by Sarah Keohane Williamson and Tim Koller

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The global COVID-19 pandemic has presented executives with the most challenging times in their careers. The social impact of their decisions is under the spotlight as they try to balance the needs of all key stakeholders—customers, partners, suppliers, and society in general.

The good news is that executives' most important investors, long-term shareholders, believe that doing the right thing for all stakeholders in the near term will benefit investors in the longer term.

To put executives' challenges into perspective and cut through the swarm of messages they are getting from bankers, sell-side analysts, short-term investors, and media pundits, FCLTGlobal and McKinsey conducted interviews with ten long-term investors in early to mid-April 2020 (see sidebar, "Our panel of investors"). We asked them a simple question: What advice would you give to executives during this difficult time?

The investors all acknowledged that executives are making decisions in an extremely uncertain environment. "Cash is king" in times of crisis, and every company is facing its own liquidity challenges. Some are fighting for survival and doing whatever they can to stay afloat for as long as possible. Some have more leeway in the actions and decisions they are taking because their cash flows have been less severely affected. Many companies likely fall somewhere in between the two extremes.

Several common-sense themes emerged in our conversations, however, including the advantages of using a through-cycle approach when making decisions about investments and operations and the need to communicate transparently during the crisis period. The investors' primary piece of advice? Look after employees first, followed by customers and suppliers. It will pay off in the long run, as each group will certainly remember how you treated them during this difficult time. The profits and dividends will come later if you make the right decisions and moves now.

Protect employees, customers, suppliers, and the community

Most of the investors we interviewed immediately focused on the importance of taking good care of current employees, assuming a company has enough liquidity to be a going concern. The emphasis should be on keeping employees working if possible, but only under the safest possible conditions. Protecting employees' health is not just the humane thing to do: it can also help a business ramp back up more quickly when the risks subside. It can also engender greater loyalty among employees—a benefit that can easily be underrated: one of the investors we spoke with cited a retailer that put employees at risk by keeping its stores open longer than was probably prudent. The investor viewed this negatively; the company's emphasis on quarterly sales will likely come with a cost in the future.

The investors we interviewed also note the importance of protecting customers and suppliers. Executives' reflexive reaction to the pandemic has been to try to conserve cash where they can—for instance, holding off on payments to suppliers and squeezing suppliers on price. These actions make sense for those companies that might not survive otherwise, investors acknowledge, but companies with some liquidity should consider using it to help smaller, weaker customers and suppliers. A quick recovery for customers means increased demand for goods and services. But if suppliers don't recover quickly (or at all), companies won't be able to ramp up production to meet this increased demand and may lose share to competitors.

Stakeholder and sustainability issues were already at the forefront of public discussions prior to the COVID-19 crisis. Some of the investors we spoke with say companies should remain cognizant of environmental issues, even now. One investor pointed to a company that made a quick decision to begin to diversify its supply chain geographically. It failed, however, to realize that, as a result of climate change, hurricane activity was likely to increase in

Our panel of investors

The following long-term investors were interviewed by FCLTGlobal and McKinsey:

— Thomas B. Bastian, retired managing director, Invesco

— Christine Chow, director of EOS, Federated Hermes

— Benjamin Colton, global cohead of asset stewardship, State Street Global Advisors

— Tracey Flaherty, global head of diversity and inclusion and public affairs, Natixis Investment Managers

— Steven M. Galbraith, managing member, Kindred Capital

— John P. Goetz, co–chief investment officer, Pzena Investment Management

— Michael J. Mauboussin, head of consilient research, Counterpoint Global

— Guy Moszkowski, retired cofounder and former director of research, Autonomous Research US

— Sally Pope Davis, managing director and co–lead portfolio manager, Goldman Sachs Small Cap Value Strategies

— Barnaby Wiener, equity portfolio manager and head of sustainability and stewardship, MFS Investment Management

its preferred location. The company would simply be swapping risks rather than reducing them. It remains a good time to think about how to remove waste from processes, which can reduce costs and benefit the environment.

Take a through-cycle approach to investments and operations

The investors we spoke with believe that strong companies with good liquidity should continue to pursue their most-promising business opportunities and use the crisis to strengthen their long-term competitive position. Joint research from FCLTGlobal and the McKinsey Global Institute supports that position: companies that invested through previous downturns emerged stronger and were able to generate higher returns than competitors once the crisis was over.[1]

Companies operating in a downturn as a result of the COVID-19 pandemic may similarly want to look for new opportunities—for instance, bringing ideas to market faster or acquiring intellectual property from unexpected sources. The investors in our panel note that it is particularly important to maintain momentum with R&D so that companies can retain top talent and scale up more quickly during recovery. Regarding talent, it may also be a good time to look for ways to bring in new faces. Several investors cite the opportunity to attract people from weaker companies or without competition from companies that have frozen their hiring—not just technical talent but sales, marketing, product-innovation, and general-management experts.

The same through-cycle mindset applies to capital expenditures. Stronger companies may be able to build capacity more cheaply or purchase assets at reasonable prices from weaker companies. During this period, well-capitalized companies can aggressively pursue M&A at attractive valuations. During the 2008–09 crisis, a strong bank gained significant share in certain critical markets by buying up some small, weaker companies with good talent and client relationships. It has retained its

[1] Dominic Barton, James Manyika, and Sarah Keohane Williamson, “Finally, evidence that managing for the long term pays off,” *Harvard Business Review*, February 9, 2017, hbr.org.

leadership position in several important product areas, while some of its competitors still haven't recovered more than a decade later.

The long-term investors we spoke with stress the importance of planning carefully for the eventual easing of the crisis. One investor pointed to a retailer with a strong balance sheet that is continuing to invest in its winter lineup now, potentially gaining an advantage over competitors next fall.

They also note that now is also a good time for executives to rethink aspects of their company's operating model. For instance, some companies are reconsidering their real-estate requirements in the wake of the pandemic. More employees may be working from home even after the peak of COVID-19, and companies now have a wealth of evidence about the effectiveness of videoconferencing.

Build for future shareholder value; deemphasize dividends and repurchases

The investors we spoke with acknowledge that many companies have cut their dividends and share repurchases as a matter of survival, especially those companies that are facing large layoffs. The decision about what to do with dividends becomes more difficult, however, for those companies that can still afford to pay them.

The investors support short-term dividend cuts in those instances where short-term uncertainty is high and cutting dividends is the prudent thing to do. But if a company has enough liquidity to pay its regular dividend under all stress scenarios, it should continue to pay the dividend. Doing so will send a positive signal to investors about the company's financial health and can provide much-needed cash to retail investors and income funds.

Investors' overarching advice to companies about share repurchases is to "proceed with caution." Stronger companies may be tempted to repurchase their stock at low prices, but the current political environment and the potential for continued economic disruption could lead them to regret that decision. One investor mentioned using a special dividend to distribute cash to shareholders and signal financial strength without incurring the political blowback associated with share repurchases. But most of the investors note that a strong balance sheet in a crisis is to be protected—and likely rewarded.

Communicate short-term execution of long-term plans—not short-term guidance

Every piece of communication from a company during a crisis will be heavily scrutinized by all stakeholders, each with their own agenda. Short-

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term investors may press the company for clues about trading opportunities. By contrast, long-term investors are looking for evidence of resilience: How will the company withstand the crisis, and how strong will it be in the long term, considering its competitive position, growth potential, and returns on capital?

The investors in our panel tell us they need a clear understanding of companies' liquidity and cash position. If companies are stressed, investors want to hear more frequently from them about how they are managing liquidity in the short term: a detailed view of these companies' sources and uses of cash (preferably on a month-by-month basis) would be helpful. For those companies that are clearly going concerns, investors want to understand how employees are doing and the steps companies are taking to ensure employees' safety and well-being. Some visibility into how these companies might adjust the size of their workforces under various scenarios can be helpful, as can an overview of the key economic drivers of their businesses.

Long-term investors say they are looking for honesty and transparency about the pandemic's effects on companies under various if–then scenarios. Such transparency is especially important when different parts of the business (regions and individual business units) are being affected unevenly. Investors understand that companies cannot predict the future. But they do expect that companies will share enough information about the pandemic's effect on their businesses that investors can make their own assessments of how the companies will fare through the crisis and beyond.

On quarterly calls and in other communications, companies should share the most current information, not just numbers from the previous quarter. Historical information is much less important in times like these.

And finally, the investors we spoke with recognize the folly of quarterly guidance in good times, let alone during a crisis. Most of them say they prefer companies to provide guidance based on long-term key performance indicators of value rather than short-term earnings per share. The COVID-19 crisis presents a good opportunity for companies to stop providing investors with short-term guidance—now and after the crisis passes.

Long-term shareholders and companies' interests are aligned. Both will succeed if companies navigate the COVID-19 crisis without liquidity issues and can build for long-term value, ultimately emerging from the crisis in a stronger position relative to competitors.

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