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Perspectives on the long term

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What will it take to shift markets and companies away from a short-term way of thinking?

The call to reform capitalism seems both less and more urgent the further we travel from the Great Recession of 2008. Less so because that event recedes in memory—and more so because, nearly seven years after the crisis, we've yet to make meaningful reforms, despite many calls to action.[1]

One issue is particularly essential: shifting markets and companies from "quarterly capitalism" to a true longer-term way of thinking, thereby renewing the fundamental ways we govern, manage, and lead today's corporations. Achieving that change, however, requires wide-ranging shifts in both mind-set and practice. How might these be accomplished? For insight, we invited leading executives and academics to contribute essays to *Perspectives on the Long Term* (FCLT, March 2015), a book in which broad cultural observations help frame more specific viewpoints from each part of the investment value chain.

While *Perspectives on the Long Term* takes a comprehensive approach, what follows in this article is necessarily more impressionistic—a sampler, if you will, of today's best thinkers on what it might take to instill long-termism into the capitalist system. Those writing here include Nitin Nohria, dean of Harvard Business School; Nicholas G. Carr, author of *The Glass Cage: Automation and Us* (W. W.

[1] We have tried to contribute to this debate as well. See "Where boards fall short," by Dominic Barton and Mark Wiseman, *Harvard Business Review*, January 2015; "Focusing capital on the long term," by Dominic Barton and Mark Wiseman, *Harvard Business Review*, January–February 2014; and "Capitalism for the long term," by Dominic Barton, *Harvard Business Review*, March 2011, on hbr.org.

Norton & Company, September 2014); Lim Chow Kiat, group chief investment officer at GIC; Ronald P. O'Hanley III, former president of asset management and corporate services for Fidelity Investments; and Charles Tilley, chief executive of the Chartered Institute of Management Accountants.

Our selection starts with two insightful looks at the psychological and technological obstacles to reform before moving on to more granular recommendations for board governance, corporate reporting, and the language we use when we talk about the performance of our investments.

Confronting psychology and technology

Nitin Nohria: All CEOs have aspirational long-term goals. They all want to make their companies better and stronger over the long term. Yet when it comes to priorities and plans of action, few have headlights that can shine further than two or three years. So while every CEO talks about managing for the long term, the reality is that the crush of immediate concerns and the uncertainty of the future lead them to focus on the short term. This tension between long-term intention and short-term action is one of the great challenges of modern management.

It's become almost customary for CEOs to accuse capital markets of creating undue pressure; it's the scourge of meeting quarterly earnings expectations, they argue, that prevents them from creating long-term economic and shareholder value. Or it's the structure of incentives for both CEOs and financial-market participants that makes short-term results more alluring than long-term gains.

I believe there is an equally important—and less explored—set of internal forces that contribute to this myopia. Three forces that I consider most important are the cognitive asymmetry between the uncertainty of long-term actions and the certainty of short-term actions (which is to say that leaders need certainty, and that can be easier to find in the short term); the need to maintain ongoing credibility to continue to enjoy the license to lead (which is to say that leaders need followers, who may have shorter time horizons);

and the desire to leave a legacy, with the knowledge that it is difficult to do so (which is to say that leaders need a legacy, even though they're more likely to be forgotten).

These internal, psychological forces that drive CEOs to favor the short term over the long term have at least one similarity with the external, capital-market forces that are usually described as the primary driver of short-termism: they are extremely difficult to counteract. But they are worth keeping in mind as we diagnose the causes of the growing managerial myopia. Managerial time horizons are certainly influenced by incentives and compensation, by the loud criticism of activists, and by the real pain (or anticipated pain) that occurs when a company misses earnings and its stock slides. But there are quieter, less celebrated, more psychological forces at work here, as well—and trying to understand them better can be a useful step in trying to design smart counterweights.

Nick Carr: In a speech delivered back in 1969, when the Net was in its infancy, the social scientist and future Nobel laureate Herbert Simon posited that a glut of information would produce a dearth of attention. Since then, psychologists and neuroscientists have learned a great deal about how our brains respond to distractions, interruptions, and incessant multitasking. What they've discovered proves how right Simon was—and underscores why we should be worried about the new digital environment we've created for ourselves. When it comes to thinking, we're trading depth for breadth. We're so focused on the immediate that we're losing the ability to think more deeply about the long-term implications of complex problems.

Why would we allow ourselves to become so reliant on a technology that ends up hampering our thinking and foreclosing our opportunities to excel? One reason appears to be biological. Experiments suggest that we have a deep, primitive inclination toward distraction. We want to know everything going on around us, a trait that probably helped keep us alive when we lived in the wilds. The very act of seeking out new information has been found to trigger the release of the pleasure-producing chemical dopamine in our brains. We're rewarded, in other words, for hunting and gathering data, even if the data are trivial, and so we become compulsive in checking the networked gadgets we carry around with us all day.

But it's not just biology. It's also society. Businesses and other organizations have been complicit in encouraging shallow and distracted thinking. Tacitly or explicitly, executives and managers send signals that they expect employees to be constantly connected, constantly monitoring streams of messages and other information. As a result, people come to fear that disconnecting, even briefly, may damage their careers, not to mention their social lives. Organizations gain the benefits of rapid communication and swift exchanges of data. But what they sacrifice is the deepest forms of analytical and critical thinking—the kinds of thinking that require a calm, attentive mind. The most important work can't be done, or at least can't be done well, in a state of distractedness, and yet that's the state companies today have come to promote.

What's more, we're at the dawn of a new era in automation. Thanks to advances in robotics, machine learning, and predictive analytics, computers are becoming adept at jobs requiring sophisticated psychomotor and cognitive skills—tasks that until recently we assumed would remain the exclusive preserve of human beings. Computers are flying planes and driving cars. They're making medical diagnoses, pricing and trading complex financial instruments, plotting legal strategies, and running marketing campaigns. All around us, computers are making judgments and decisions on our behalf.

There has been much discussion about the effects of rampant automation on the economy and on the labor market in particular. There has been much less attention paid to its effects on human talent and motivation. But what decades of human-factors research tell us is that when computers and other machines take challenging tasks away from us, we turn into observers rather than actors. Distanced from our work, we lose our focus and become even more susceptible to distraction. And that ends up dulling our existing skills and hampering our ability to learn new ones. If you've ever gotten lost while

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following the step-by-step directions of a GPS device, you've had a small lesson in the way that computer automation erodes awareness of our surroundings and dulls our perceptions and talents.

If computers were able to do everything that people can do, this might not be such a problem. But the speed and precision of computers mask their fundamental mindlessness. Software can do only what it's told. Human beings, blessed with imagination and foresight, can do the unexpected. We can think and act creatively, and we can conceive of a future that is different from and better than the present. But we can only fulfill our potential if we're engaged in the kind of difficult and subtle work that builds talents and generates insights. Unfortunately, that's exactly the kind of work that software programmers have been taking away from us to deliver short-term efficiency gains and indulge our sometimes self-defeating yearning for convenience.

Reframing mind-sets and language

Lim Chow Kiat: In Singapore, long-termism is our national ethos. A willingness to forgo short-term gratification and keep faith with the fundamentals has served us well. At the heart of GIC's investment philosophy is our value discipline. We look for the compounding of fundamental value and opportunities in price–value divergence. Both require a long-term orientation. We are also mindful that long-term investing does not oblige us to buy and hold for long periods. The holding period depends more on price and value than time. While we obviously prefer market prices to move up quickly to reflect our assessed valuations, we are prepared to wait longer for the convergence than most investors are.

Over the years, we have learned that it is actually not the time horizon that matters most but rather the mind-set and discipline to base investments on fundamentals consistently. In particular, it is important to have the ability to assess value and maintain price discipline in the face of market fluctuations and uncertainty. Having a long time horizon enhances this ability, especially in a world full of short-term investors.

It's also the case that nomenclature is destiny. The right word engenders the right attitude and the right behavior. From how a report is presented to how an investment loss is explained and how a concept is described, at GIC we are meticulous about word choice, as well as how we deliver the message. For example, we avoid displaying only short-term performance results, especially at important forums, to prevent the perception that we emphasize short-term results. We avoid using a phrase such as "consistent results," so that our teams do not wrongly focus on quick bets and quarterly gains. We prefer to say "sustainable results." We find that a nice saying such as "the long term is but a series of short terms" is extremely harmful. In our view, it is not true—at least not for investing. We would correct someone in our organization if he or she used that phrase or one like it. The drivers of short-term investment outcomes and the drivers of long-term investment outcomes are very different. In most cases, the former have to do with market emotions, the latter with fundamental developments, such as competitiveness. Think of Benjamin Graham's "voting" and "weighing" machines. The wrong words can corrode, if not corrupt, our process.

Upgrading governance and reporting

Ronald O'Hanley: Unless we can make long-term thinking the driving force behind the mission and governance activities of boards, no amount of change to management incentives or investor behavior or the like will be sufficient to ensure a focus on the long term.

It's not as though boards took a vote and decided to ignore the long term. We need to recognize that the role of the board and the job of director are more complex and demanding than ever. Moreover, some of those demands are in direct conflict. On the one hand, intense pressure exists to ensure attractive results every quarter. Yet stable, sustainable economic growth over the long term often requires companies to put long-term goals ahead of short-term gains.

Making that trade-off effectively and accommodating other growing demands require greater expertise and a substantially larger time commitment than is typical of many boards today. The executive–board relationship and, to some extent, the basic management–board governance model must evolve. The job of filling board seats

becomes even more critical, requiring a well-thought-out strategy to assemble the needed talent and expertise. Companies and their stakeholders must be prepared to increase the compensation of directors and support boards in a variety of other ways.

A primary lever is board recruitment, which becomes an even more critical function when viewed through the lens of a long-term focus. Most boards have appropriately focused on broadening their diversity. Diversity of thought is at least as important as other forms of diversity. Each vacancy should be considered an opportunity to add additional expertise and perspective to the board. That diversity can be deep experience within the industry, firsthand experience with a particular challenge the company faces, or even a deep understanding of a particular set of stakeholders, such as a customer segment, supplier group, or particular geography. Collectively, the directors should bring experience, expertise, diversity of perspectives, and wisdom to test strategy and become true partners to the CEO.

Charles Tilley: Over the past 30 years there has been a fundamental shift in macroeconomic value. More than 80 percent of the market value of companies now lies in intangible assets.[2] Yet many accounting practices and processes do not reflect this shift. This new set of circumstances urgently requires a change in behavior to focus more on long-term value creation.

Integrated reporting (IR) helps organizations address the specific concerns of long-term investors. It is essentially a narrative report, supported by traditional financial reports, that integrates all the factors material to an understanding of the value created by an organization and its future potential in a clear and concise manner.

The link between integrated reporting and long-term investment has been demonstrated by George Serafeim at Harvard Business School.[3] He studied more than 1,000 US firms to find the correlation between the use of IR and the time horizons of the investor bases

[2] See “Ocean Tomo announces 2010 results of annual study of intangible asset market value,” Vocus/PRWEB, April 4, 2011, prweb.com.

[3] See George Serafeim, “Integrated reporting and investor clientele,” Harvard Business School working paper, number 14-069, February 2014 (revised April 2014), hbs.edu.

they attracted over the period from 2002 to 2010. His research included not only those firms that prepared integrated reports but also those that reflected the principles of integrated reporting in their full range of published reports. Serafeim found that the greater the degree of integration included within firms' reporting, the more long term their investor bases were.

Novo Nordisk, the Denmark-based global healthcare company that has, for a number of years, published long-term targets, provides a good example. Its latest ones include the usual profit, sales, margin, and cash metrics but also targets that, although not directly financial, support long-term financial performance. These fall into two groups: social targets, which include employee motivation and senior-management diversity, and environmental targets, which include energy and water use, emissions, and waste.[4]

Research undertaken by the Chartered Institute of Management Accountants and Tomorrow's Company (a London-based international think tank) emphasizes the value of integrated reporting beyond its role as a reporting framework.[5] First, it can help an organization to better understand and connect the disparate sources and drivers of long-term value to improve the formulation of strategy and decision making. In addition, it provides a synthesis of how value is created, helping to win trust and secure a company's reputation by encouraging better relationships with investors, employees, and other stakeholders. A tool kit of questions published with the research aims to promote boardroom discussion on integrated reporting and in particular the importance of a thorough understanding of the organization's business model and how it creates value. ○

[4] See *Novo Nordisk Annual Report 2013*, Novo Nordisk, 2014, novonordisk.com.

[5] See *Tomorrow's Business Success: Using Integrated Reporting to help create value and effectively tell the full story*, Chartered Institute of Management Accountants and Tomorrow's Company, in association with the International Integrated Reporting Council, 2014, tomorrowscompany.com.

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