Center for Higher Ambition Leadership White Paper:

Conquering Short-termism:

Building Your Business for the Long-term

One Quarter at a Time

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Trust in business is at a five-year high, according to the 2016 Edelman Trust Barometer.[1] People are looking to company leaders to solve a host of social ills; yet nearly 70 percent of survey respondents think that CEOs focus too much on short-term financial results. Nearly 60 percent believe that they don't focus enough on positive long-term impact. These findings mirror the growing chorus of voices[2] in business and academia that point to short-termism as a major business threat.

It is easy to fault CEOs for being too focused on the short term. However, we believe that most CEOs don't lack good intent. Rather, they are missing a practical road map to beat back short-termism and build enduring firms—ones that deliver superior economic returns, make positive contributions to society, and inspire public trust. We offer such a roadmap here, the outcome of a research project at the Center for Higher Ambition Leadership with 25 CEOs on their practices for mastering short-term pressures and creating long-term social and economic value, even in the toughest conditions.

Four Practices of Successful CEOs

1. Tell a story that is bigger than quarterly earnings

A purpose-driven mission, combined with a strong set of values that company leaders actively reinforce, are the starting point for mastering short-termism. Purpose is the "why," says Masonite CEO Fred Lynch, "Why do people get up and come to work in the morning?"

The distinguishing feature of purpose is its other-centered-ness. Purpose is about serving and enriching the lives of other people in a meaningful way. Purpose lifts people out of an internally focused mindset, and engages their hearts and minds in creating value for other people that goes beyond a transactional exchange. Companies whose employees are genuinely inspired by its purpose forge personal, human relationships with customers and other stakeholders to continually discover how to best meet their needs.

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[1] More than 80 percent of survey respondents agreed with the statement "A company can take specific actions that both increase profits and improve the economic and social conditions in the community where it operates." Among the top social issues mentioned were: education and training, the environment, healthcare access, human and civil rights, income inequality, infrastructure, and poverty.

[2] In 2011, Dominic Barton, the global managing director of McKinsey & Company exhorted business leaders "to reform the capitalist system by fighting the tyranny of short-termism." Adi Ignatius, the editor of Harvard Business Review, wrote in 2014, "The world would be a better place if businesses stopped thinking so much about short-term results and focused more on the long term. Yet it has proved nearly impossible to shift their behavior. The ideal is clear, but the incentive systems in place at many firms deter efforts to attain it." Most recently, in 2016, BlackRock CEO Laurence Fink sent a letter to chief executives at S&P 500 companies and large European corporations, "urging resistance to the powerful forces of short-termism afflicting corporate behavior." The letter noted that while there was strong support from CEOs to take a long-term view, "many companies continue to engage in practices that may undermine their ability to invest for the future."

The purpose of Masonite, a company that makes doors, is to "help people walk through walls." Masonite not only strives to create customer value with its door products, but also to break down barriers to development for employees and the larger community. Thrivent, a member owned financial service firm, defines its purpose as going beyond maximizing financial returns to "serving our members and society by guiding both to be wise with money and live generously."

A genuine other-serving purpose and supporting values help CEOs push back against short-termism by prioritizing the trust-based relationships that fuel long-term business value. Stan Bergman, the CEO of Henry Schein, Inc., a global provider of health care product and services to office-based physicians, dentists and veterinarians, describes the role of purpose and trust in his company: "Why are we successful? It is because of purpose and because of trust. Our purpose is to create value for our customers by delivering solutions that leverage the latest technology, and we drive that trust through a value system that builds alignment and engagement with all five of our constituents – our team, our customers, our supplier partners, our investors, and society. We view this shared commitment to society as the 'secret sauce' that makes the entire enterprise work. All of our constituents feel connected to something bigger, and ultimately, we all succeed in the long-term together. Trust is the way you build morale; trust is the way drive change."

Not only were the CEOs in our study skilled at shaping a larger firm purpose and long-term plan, they were also adept at *telling* their company's story. Great stories are credible, simple, consistent, and use both financial and nonfinancial metrics to link a long-term vision and firm values with a distinctive business strategy and focused operational priorities. Fred Lynch, CEO of Masonite, created a long-term value creation thesis that he called the Masonite "blueprint." The blueprint included the company's purpose, vision, values, and strategic goals, and fit on a single page. Doug Conant, former CEO of Campbell's Soup, did the same, with five core strategies that guided his long-term plan.

Our study CEOs repeated their companies' stories often and consistently to all their stakeholders—employees, boards, customers, business partners, communities, and the general public. As Conant put it, "I declared what we needed to do, and I was incredibly, obnoxiously consistent."

A purpose-driven story of value creation that is clearly and powerfully told is a CEO's first line of defense against short-term pressures. Once in place, it not only generates commitment of employees and customers, it puts the short-term and the quarter in context as the immediate building blocks to longer-term goals. The story can then be referenced to justify business decisions that build, rather than erode, the fundamental assets that underlie long term value creation: trust-based relationships and distinctive firm capabilities.

2. Don't overpromise: muster the courage to set realistic targets

The quickest way to spring the short-term trap is to set overly ambitious targets—the kind that make the CEO a hero with short-term investors, but threaten the long-term plan. Delivering on overly aggressive performance commitments can force leaders to optimize current results at the expense of needed investments for the future-- for instance by skimping on scheduled maintenance, cutting R&D investment, and shrinking travel and training budgets.

"The notion that 'we're long on short, and short on long' fully summarizes the current situation," noted Stan Bergman, CEO of Henry Schein, Inc. "We have always said that Wall Street is one of five constituents that we carefully balance. We promise our investors a steady, consistent return, and we have a very good track record of delivering on that commitment, while balancing the needs of our other constituents."

At the start of his tenure at Campbell's Soup CEO Doug Conant was faced with the task of reeling in the company's unrealistic targets. Campbell's was caught in a circle of doom: over-promising, under-delivering, cutting costs to get back to its targets, but then compromising everything from advertising to product quality, to the point where, "We were taking the chicken out of chicken noodle soup." Conant researched the food industry and halved Campbell's earnings growth targets from the mid-teens to between six and eight percent annual earnings growth. He made a compelling case for these targets with his Board, which backed him when he was pressured by investors to raise the targets. Realistic targets gave Conant the footing to engineer an impressive turnaround, and invest in the capabilities necessary to sustain long-term performance while delivering consistently on his short-term promises.

Likewise, Mark Bertolini, CEO of Aetna, began his tenure by lowering targets by nearly two-thirds in a single bold move. Bertolini observed that many of his peers had been promising fifteen percent earnings per share (EPS), even during the financial crisis of 2009. Bertolini knew that such unrealistic heights would create problems. "If you promise those kinds of returns, you're going to do stupid things to your company and to your fundamentals to make that fifteen percent work." Bertolini and his team concluded low double digit operating EPS growth over time was an appropriate target for the enterprise. That goal has given him breathing room to build his company for the future while delivering reasonable returns in line with economic and regulatory conditions. The strategy has paid off; Aetna's stock has risen threefold in the last five years, and the company posted record revenue and earnings in 2015.

CEOs have a great deal of control over the financial targets they set. However, once set, the company must live up to them in order to build and retain credibility with investors. Setting them high—too high to sustain for long—is a tempting way to drive performance.

But the pursuit of those performance goals may drive bad decisions and harm the company's long-term prospects. Setting realistic targets is only possible after thoughtful analysis, and requires agreement of the Board along with a good measure of personal CEO courage.

3. Teach your people to build the future, one quarter at a time

The CEOs in our study saw no contradiction between short-term performance and long-term value. They operated with a both/and mindset, seeking to deliver on immediate goals in a way that also built a sustainable future. Dick Gochnauer, the former CEO of United Stationers (Essendant), put it succinctly, "Most leaders come to realize that you can't over-focus on one or the other. If you focus too much on the short term, you jeopardize your ability to deliver long-term value, and you get stuck in the cycle of looking only a quarter or a year out. That doesn't work. And yet if you focus almost exclusively on the long-term and don't deliver in the short term, you may not be around to see the conclusion."

The challenge faced by all our study CEOs was how to instill a both/and performance mindset in strategy and investment decisions throughout their entire organizations. We highlight three examples here in which CEOs established cultural habits and practices to foster both/and decision-making.

Doug Conant got his senior team aligned around a both/and mindset using positive peer pressure. He developed a three-year plan for his turnaround vision, which was translated into annual and quarterly operating plans, and bi-quarterly responsibilities for his executive team. "And then," Conant described, "My team had to meet with me. They had to send me postings every Friday on how they were doing against quarterly expectations. We met physically as a group every Monday morning. The power of that process was I got their attention. And the beauty was that it became a self-governing system. After a little while, the guy in International was saying to the person running North America, 'Last month didn't you say that that project was going to be done by now? Has something changed?' And all of a sudden my whole team had an appreciation for our long-term plan and how we were going to get there."

Many CEOs in our interviews emphasized the importance of choosing the right metrics to support both/and decision-making. Brad Hewitt, CEO at Thrivent, has developed leading indicators for his long-term strategic intent that are organized in layers, from short term (1-3 years) to medium-term (3-5 years). Shorter-term metrics are integrated into the company's incentive plans. The key to getting this system to work is ongoing reflection and adjustment to ensure that the short-term and mid-term metrics are truly the right leading indicators for a long-term strategic intent, and aren't motivating unintended short-term behaviors.

Making the right long-term decisions is a challenge even in the best of business conditions. Mark Bertolini at Aetna uses a practice that blends the technical and cultural to optimize the quality of long-term decision-making. Through his own example, he encourages his senior team to talk openly about the assumptions behind the key drivers of long-term investment choices. When all those assumptions are arrayed, the team has a risk profile for the decision. Bertolini describes, “And then we stand back and we say, “Given this risk profile what do we need to believe in order to take this risk?’ Then we manage to what we believe to be.” Bertolini understands that long-term spreadsheet forecasts are not based on inviolable facts but rather are driven by human beliefs, opinions, and assumptions. He views his job as creating a team culture where members can talk openly about these deeper drivers, and engage in honest debate and dialogue in order to make the best-informed investment choices they can.

4. Build the bank account of trust: stay true to your values

The demands on CEOs to deliver short-term results can be brutal and unrelenting. The executives we interviewed showed how these demands can be met in a way that deliver superior long-term value. But this does require a tough skin and a strong moral center. Some of the CEOs in our study are charismatic leaders and gifted public speakers. Others are not. What they all do have is a large measure of personal courage, conviction, and authenticity.

The first three elements that are outlined here depend entirely on leaders who act consistently and courageously to uphold the company’s purpose and values. It is only this kind of leadership that will build the bank account of goodwill and stakeholder trust on which the long-term success of any business ultimately depends.

Consider the case of Fred Lynch, CEO of Masonite, an 80-year-old company that manufactures interior doors and entry door systems. Before Lynch’s arrival, the private equity firm KKR bought Masonite for more than $2.7 billion. Masonite began to struggle shortly after the deal was complete in 2005, and then declared bankruptcy in 2009.

Lynch, who came on board as CEO in 2007, steered the company through that bankruptcy, cutting costs dramatically and laying off nearly half the company’s workforce. No matter how difficult, with every move he made, Lynch aimed to act with integrity. In keeping with Masonite’s values of transparency and fairness, the entire senior team froze their own pay and took furloughs. They were completely candid with workers about the company’s situation and the need for layoffs. All employees were given at least two months’ notice prior to a layoff and a severance package.

This value-based leadership paid off. Rather than destroying morale, Masonite built stronger trust with workers through the downsizing—trust that laid the foundation for a return to profitability. As Lynch put it, “We might have had to burn some furniture to survive, but we couldn’t pull the studs out of the walls.” Preserving the company’s culture and the trust of its workers was what kept the walls up in the short-term, steadying them to support Lynch’s longer-term plan.

As Masonite regained financial health, the company’s hedge fund investors pushed for short-term approach, urging the Board to load the company up with debt and approve a dividend recapitalization. With his long-term vision in mind, Lynch found the courage to push back, putting his job on the line in the process. “As the leader of the company, I said no way are we going to put ourselves in that position again. If the board was going to do that, then they should find another CEO because that’s not what I wanted to do. Thankfully our board members were all on the same page.”

A systems view

These four practices operate together as a system. An other-oriented purpose serves to motivate and inspire a company’s people to work towards building long-term relationships based on trust and mutual commitment. Realistic targets that include the key indicators for successful execution on a distinctive strategy set the right tempo for delivering short-term performance results and long-term value creation. Internal practices are needed to help everyone at a company focus on building the future by delivering against short-term goals. These three elements can only work if people inside and outside a firm believe that its leaders will protect company values and uphold their trust in good times and in bad. These four practices together can help CEOs beat back the pressures of short-termism, and build financially strong and enduring firms that enrich the lives of the stakeholders they serve.