Russell Reynolds Associates

For years, U.S. public companies have faced pressure from Wall Street to meet or beat quarterly earnings estimates. In response, they have discontinued quarterly guidance, forgone major investments, and sometimes prettied up results with accounting tricks. These defense mechanisms succeed to varying degrees but reveal a concerning truth: Executives often allow the market to define their time horizons, rather than prioritizing what is right for their companies over the long term.

Amazon has taken a different approach. When the company went public in 1997 at $1.50 per share, Amazon founder and CEO Jeff Bezos unapologetically promised to focus on long-term growth and discount short-term profits, and has doggedly stuck to it, as a recent *New York Times* article noted.[1] Even in years that ended in losses, Bezos made ambitious investments in projects with distant paydays, such as delivery logistics, cloud storage, and movie and television production. Yet over time, it seems Amazon's investors have come around to this way of thinking. Amazon's stock price has continued to grow through good years and bad, and now hovers around $1,500, thanks to recent profit records and years of positive ratings from the majority of its Wall Street analysts.

Amazon is in many ways a unique organization, but influential investors would increasingly approve of its approach. Some of the world's largest institutional investors including BlackRock, Vanguard, Fidelity, JPMorgan Chase, State Street, and others – investors who own the whole market to the extent they own index funds – are pleading with executives to focus on sustainable success to help dampen overall market volatility. BlackRock CEO Larry Fink has characterized his firm's index fund managers as "the ultimate long-term investors – providing patient capital for companies to grow and prosper."[2] Likewise, in an open letter to directors in 2017, Vanguard CEO F. William McNabb III reminded boards that "a long-term perspective informs every aspect of our investment approach, from the way we manage our funds to the advice we give our investors."[3]

Case studies and market forces can go a long way toward pushing companies to care more about the future. However, to create an environment which supports long-term thinking, it's also essential to get the right people into place within a company – both at the executive and board level. Drawing on our past research at Russell Reynolds Associates, we look at how boards can identify and develop CEOs who will put the appropriate emphasis on long term issues. We then drill down into how directors themselves can most effectively focus companies on enduring accomplishments rather than quick wins that lack lasting impact.

Boards need to pick the right CEO

All CEOs make trade-offs; it's an essential part of the job. Some, however, are better suited to balancing a long-term perspective with short-term considerations than others. From our database of 900 global CEOs, RRA recently identified 14 who stood out for their ability to make long-term contributions based on their firms' outsized financial performance and analyst reports over a three-year period. We then analyzed their psychometric profiles, as well as their routes to the top, compared to average CEOs.[4]

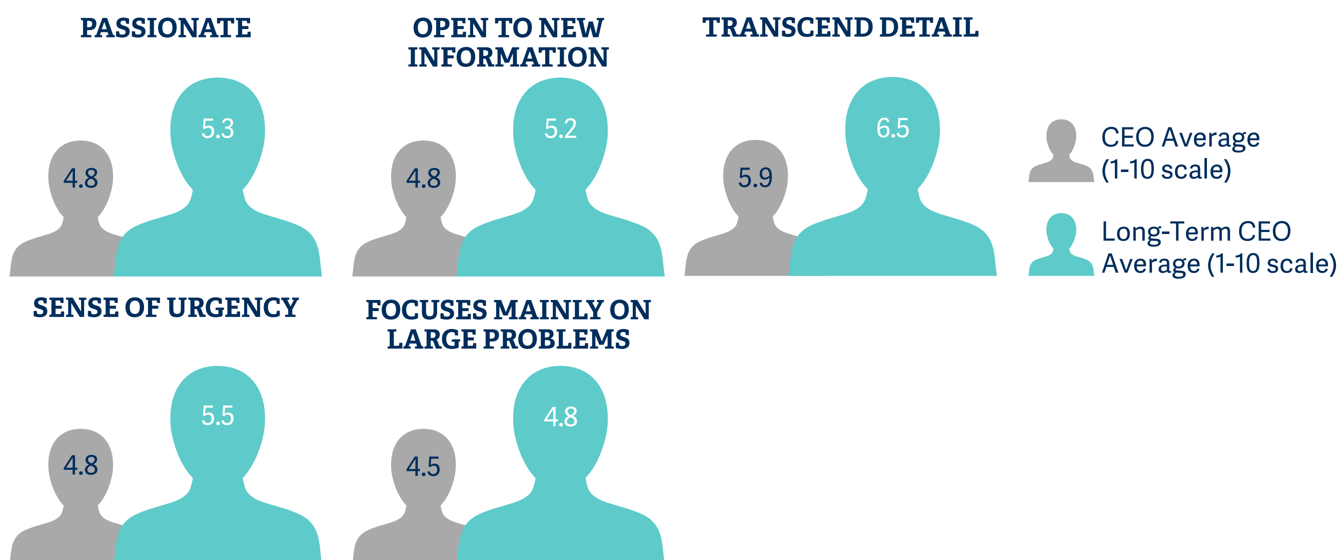
On the psychometric front, long-term CEOs demonstrate four key characteristics that set them apart from others. For one, they are more practical. When they commit to a vision or an idea, they become incredibly resourceful in making it a reality through tactical persistence and an ability to adapt. They act with laser focus, avoiding adjacent but ultimately unrelated ideas and distractions.

Second, they are more outgoing. They have a tendency to be talkative, expressive, and communicative, and will naturally keep stakeholders engaged, informed, and connected to the work of the company. Interestingly, they are also more caring than the average CEO.

Third, they are more inclusive. When building teams, they look far and wide for the right people to bring in to the effort. They recognize that investing in people is inherently a long-term investment, and tend to build cohesive and high-performing executive teams.

Lastly, and perhaps most importantly, they demonstrate a strong sense of optimism. They expect that things will go well. This tendency enables long-term CEOs because followers are far more likely to join the effort, and stay involved, if they (and their leader) are optimistic about the world they are creating, and their likelihood of success.

LONG-TERM CEOs DEMONSTRATED STRONGER PSYCHOMETRIC TRAITS IN SEVERAL AREAS COMPARED TO TYPICAL CEOs

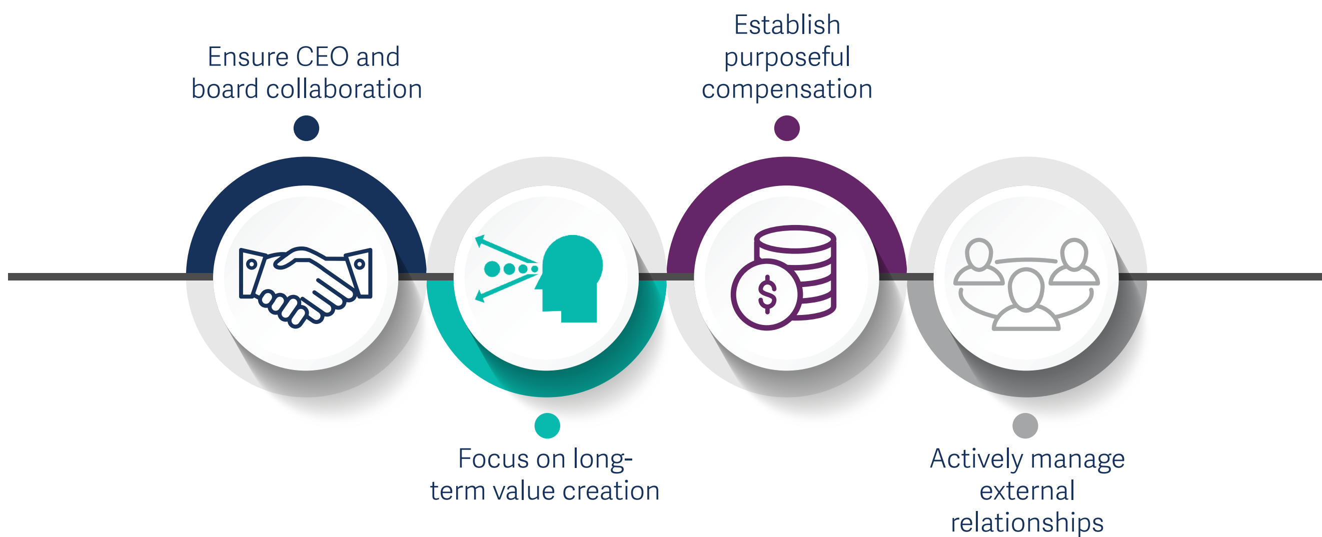


In terms of experiences, long-term CEOs have greater cross-functional and international experience behind them to expand their perspectives. Many were noted for successfully pulling off a transformational merger, or for refocusing their companies through savvy divestitures. Perhaps not surprisingly, the largest group (36 percent) were from the industrial and natural resources sector, which characteristically requires large upfront investments with the expectation of long future revenue streams. The technology and healthcare sectors – both fast-paced and quick-changing – were the least represented in the group.

As it turns out, the CEOs who excel at creating long-term value also have longer tenures (10.7 years) compared to average ones (7.1). While it is unclear if this long tenure is the cause or effect of their orientation, such long tenures may have helped them build credibility with the board and investors, allowing them to ride through short-term downfalls and understand firsthand the relationship between long-term investments and payoffs.

Board chairs need to purposefully strengthen the board-CEO relationship

How can board chairs best encourage a CEO to give more weight to long-term considerations? Our research suggests there are several key steps they can take to improve in this area, including ensuring CEO and board collaboration, keeping focus on long-term value creation, and establishing purposeful compensation. Directors should also be prepared to help CEOs articulate and defend their long-term plans to external constituents, namely investors, when necessary.



Ensure CEO and board collaboration: Directors who strive to deeply understand the CEO's vision and how it was formed will be better prepared to support the executive in bringing that strategy to life. Frequent interactions will also create a level of comfort that enable the board to constructively challenge the CEO, and give board members more credibility in defending the strategy to outside stakeholders. In fact, some investors may require it. In his annual letter, BlackRock CEO Fink asked CEOs to "explicitly affirm" that their directors have reviewed their strategy for long-term value creation.

Keep focus on long-term value creation: In a 2016 RRA survey, we asked more than 350 corporate directors around the world how often their boards used a 5-plus year time horizon to evaluate opportunities and make decisions. As a group, the directors on the most effective boards (as defined by respondents' self-ratings) averaged 3.7 on a one to five scale, while directors from lower-performing boards averaged 2.7. The upshot: the most effective boards are 38 percent more likely than others to frequently factor in long-term considerations.[5]

The variations in these results make it clear that board chairs play a major role in encouraging long-term perspectives for corporate decision-making. Board chairs have the authority to regularly raise the topic of sustainable value creation, and review progress and concerns. They also have some sway over which voices are heard in the boardroom, and the extent to which they hear out those who might slow down decision-making processes with a different perspective. In our experience, the best board chairs strive to hear all viewpoints before opening up a vote. Along with that, they create an open and inclusive culture in the boardroom; actively seeking diverse points of view to help protect against the tunnel vision that leads to short-sighted decisions.

To help foster a broader, longer-term perspective, many boards have undertaken succession planning for the board. By assessing current strengths and capabilities, and identifying areas for improvement, the board can systematically identify potential future directors who can bring new insight, expertise, and opinions to the board.

Establish purposeful compensation: For decades, companies have attempted to motivate long-term performance through deferred payouts such as stock options, restricted stock, and multi-year bonus plans. Yet several recent research efforts suggest these elaborately designed schemes fail to produce the desired results. A 2017 study by investment firm MSCI Inc. found that 61 percent of the 423 U.S. companies it studied had 10-year shareholder returns that were out of line with cumulative CEO payouts over the same period.[6] A previous MSCI study showed firms that awarded the smallest equity packages were more likely to have higher financial performance over time. Meanwhile, London School of Economics professor Alexander Pepper has interviewed nearly 800 senior executives to understand their perceptions of long-term incentive packages. He learned that most steeply discount future payouts and care more about how they are compensated relative to their peers than absolute numbers.[7] As one executive told him about long-term equity incentives, "Companies are paying people in a currency they don't value."

While directors will still want to consider the unique circumstances of their companies when setting executive pay structures and levels, it is important to realize that compensation is not a simple check-the-box activity. Standard long-term incentives may sound good in theory, but may or may not lead to expected behaviors.

Directors and the CEO need to actively manage external relationships: Institutional investors are increasingly looking to corporate directors for insight into how and why corporate decisions get made. Forty-two percent of the 886 directors surveyed by PricewaterhouseCoopers in 2017 said a representative of their board other than the CEO had met with shareholders in the previous year.[8] Such meetings are typically triggered by a specific concern about a board-level decision, such as executive compensation or board structure, rather than occurring on a regular basis. However, this trend means directors need to be ready to explain the firm's overall strategy as well as the issue at hand, as the two are often inherently linked.

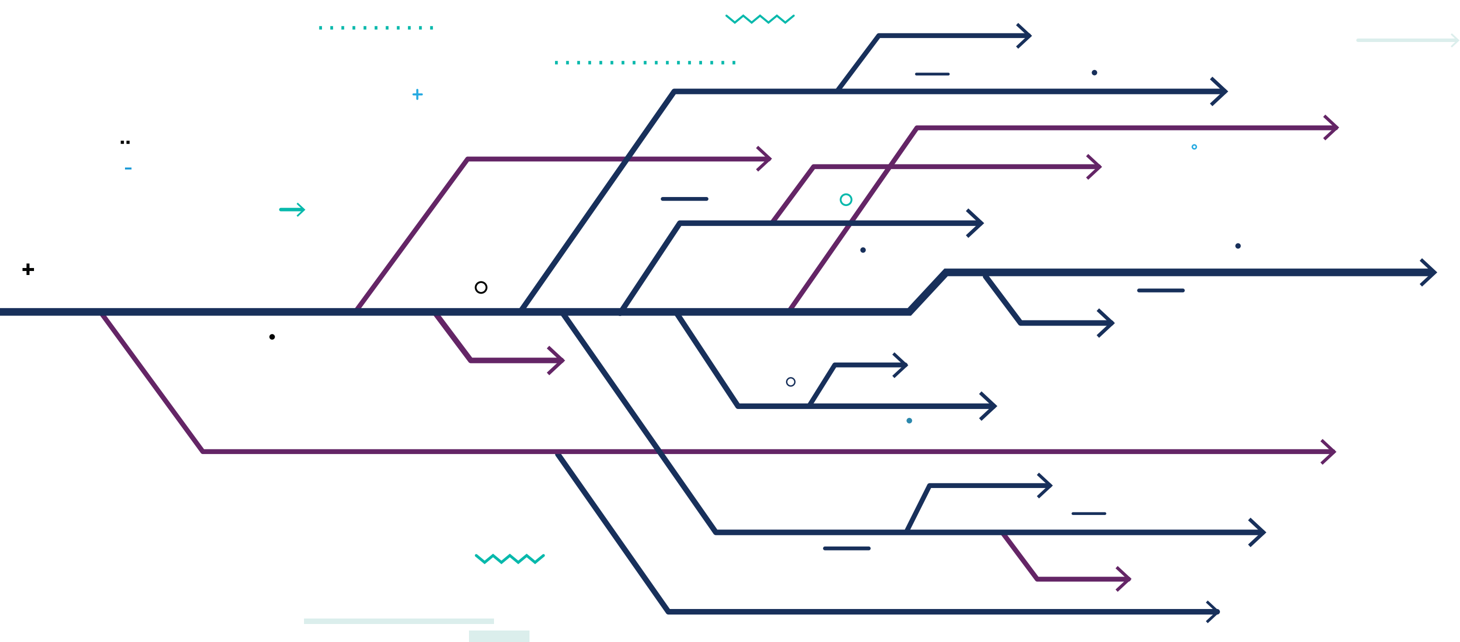
With some preparation and forethought, such meetings can help directors defend their company from investors seeking instant gratification. By articulating the differences between short-term demands and long-term corporate efforts, the board can lay out milestones to external stakeholders that may assuage them that they will get a return on their investment. Active engagement by the board also demonstrates that directors are taking their fiduciary responsibility seriously, and personally believe in the long-term effort championed by the CEO.

Where Do We Go From Here?

Many CEOs today are in the position of a homeowner with a leaky roof. If you are the homeowner, you can forestall the huge expense of replacing the roof for quite a while by using plugs and buckets. Eventually, however, when the roof collapses, you will wish you had made the investment to replace it far earlier, since it almost always costs more to repair a total disaster than it does to plan ahead. But exactly how much does short-sightedness cost? That's a million-dollar question.

One challenge facing proponents of long-termism is that many arguments for it are supported by purely anecdotal evidence, such as Amazon. Even with publicly-available data, it is difficult to draw a clear line between companies that successfully adopt a long-term philosophy and those that sacrifice long-term gains for short-term ones. At the same time, the very definition of long-termism may be up for debate, as technology forces more and more rapid changes.

Ultimately, we need to be able to answer the leaky roof question and measure the cost of short-sightedness in ways that are meaningful to the CEOs who command today's largest companies. And with that, we will be one step closer to a more balanced view of when and how to lead with the long term in mind.



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