

# Winning strategies for the long term

## **How to create value and enhance competitiveness in the age of disruption and short-termism**

*Transforming organizational capabilities series*

Companies need to rethink their financial, business and operating models to thrive in tomorrow's complex and dynamic business environment. Company strategies unilaterally focused on creating short-term shareholder value are increasingly under pressure. Emphasizing a long-term perspective in business and strategy is more important than ever. In this paper, KPMG professionals seek to show that companies who blend short- and long-term thinking in their business and corporate strategy can deliver superior and more stable financial performance than their peers, both in the short and longer term. A practical framework is presented which can support senior executives in unlocking this additional value in their organizations and improve corporate performance.

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# Blending short- and long-term thinking in strategy

Our research reveals that companies that prioritize long-term value creation in their strategy and decision-making processes can deliver better and more stable financial performance than their peers, both in the short and longer term.

Driven by technological disruption and societal shifts, the speed of change in virtually all industries has increased dramatically over the last few years. CEO tenures and company life spans have become shorter, while short-term pressures from activist investors keep growing. According to Activist Insight, a record 284 companies above US\$500m in market cap were targets of activists in 2018, up roughly 15 percent from 2017.<sup>1</sup>

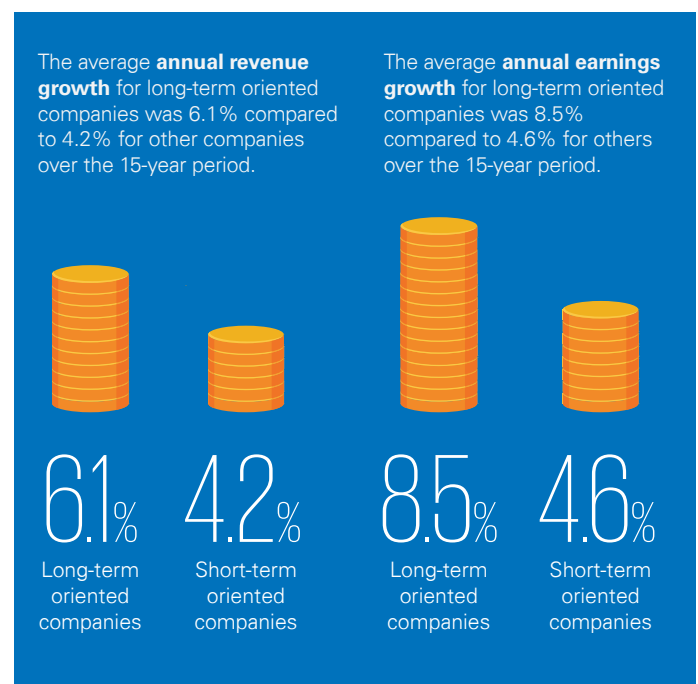
Such a volatile business environment creates uncertainty and erodes confidence. This could lead to short-term thinking and behavior by senior executives designed to shore up short-term shareholder value.

Indeed, there are signals that support this view. Research has shown that 87% of executives and directors feel pressured to demonstrate strong financial performance within 2 years or less.<sup>2</sup> According to HSBC, companies in the S&P 500 bought back US\$2.1tn of their own shares between 2010 and 2015,<sup>3</sup> instead of investing it in future growth options.

But to thrive in today's and tomorrow's complex and dynamic business environment, we believe senior executives need to resist the pressure to focus only on the short-term performance of their companies. Increasing speed of change, technological disruption and shorter life spans of companies, among other factors, all point to an era in which an ever-sharper focus on what's ahead becomes of paramount importance. Only by looking to the long-term horizon will businesses be able to understand how industry trends in three, five or more years will impact strategy and the competitive position of the company. To maximize the likelihood of winning in this

changing marketplace, we therefore argue that blending short- and long-term thinking in business strategy and performance management is critical.

New quantitative evidence from our study of more than 300 listed companies' financial performance shows that a focus on long-term value creation with a shorter-term results focus could indeed be a successful strategy. Our research shows that companies who focus on long-term value creation in their daily business can deliver superior and more stable financial performance than their peers, both in the short and longer term. Not only this, but business strategies that emphasize decisions taken for the long term are also more effective in an economic downturn.



Our analytic insights show that companies need to move away from the belief that a more long-term business horizon is irreconcilable with the ever-growing pressure to meet short-term targets. In fact, the opposite seems true. In today's and tomorrow's business environment, short-termism could diminish corporate financial performance and shareholder value, both in the short and long term. The insights reveal that companies could unlock value and improve financial performance by gaining a better understanding of how short- and long-term business decisions and investments interact with one another. Both too much short-termism or long-termism could distort corporate decision-making and diminish shareholder value. The winning companies in the future are likely to be those with the capacity to improve the long-term competitiveness and resilience of their business, without undermining their short-term performance.

#### About this paper

One of the main objectives of this paper was to provide quantitative evidence that winning companies in the future will be those with a long-term focus in their financial, business and operating models. For this purpose, we constructed a dataset consisting of 335 listed mid- and large-cap companies from Germany (DAX + MDAX), the Netherlands (AEX), the United Kingdom (FTSE 350) and the United States (S&P 500), with a minimum reported average annual revenue greater than US\$250m. Companies were selected based on random uniform selection across all sectors in the economy. Financial services companies were excluded because the indicators used to measure a company's ability to create long-term value do not readily apply to them.

The dataset spanned 15 years, from 2003 to 2017, to capture the long-term trends of each company's performance and included the 2007-2009 Global Financial Crisis. A number of companies were excluded on the basis of M&A activity, reverse-listings and other activities that caused significant outliers, five times the median absolute deviation (MAD).

The data was extracted from Capital IQ and further corrected and/or supplemented where possible from the official annual financial reports of the respective companies. Non-reported or missing values were not included in our data processing.



# The company of the future

In almost every industry, the sources of competitive advantage are under review. This new business reality requires companies to take a more holistic view of business strategy and corporate performance.

## **The business environment in which companies operate is changing...**

The financial, business and operating models that have led to success in the past do not guarantee success in the future. Some of the titans of the corporate world have already experienced this – such as investment fund 3G Capital that controls some of the largest consumer companies in the world, like Anheuser-Busch InBev. 3G Capital is well-known for its cost-cutting agenda, but this strategy is increasingly being called into question, including by co-founder Jorge Paulo Lemann.<sup>4</sup> Partly driven by changing consumer tastes and spending behavior, the financial performance of some of their consumer companies has dropped significantly, which shows how important it is for managers to have the right mix between short-term cost cutting and investing for long-term growth.<sup>5</sup> In the second half of 2018, meanwhile, Facebook's share price dropped nearly 40% from its peak in July because of its perceived slow response to Russian interference and the Cambridge Analytica data breach scandal.<sup>6</sup> Experts said the tech giant was struggling with its twin goals of achieving its mission to “make the world more connected” while maximizing its profitability.<sup>7</sup> We have also seen major oil & gas companies, such as Shell and ExxonMobil, listen to shareholders in recent years and incorporate climate change considerations into their business strategies.

## **Sources of competitive advantage are under review**

In virtually every industry, the sources of competitive advantage and market power that have underpinned business for the past several decades have been thrown into question. KPMG professionals have identified seven trends that have been driving these changes since the Global Financial Crisis and which will continue to shape the future business environment.



**1 Sources of value creation shifting to stakeholders:** Many companies are on the threshold of a shift where the source of value creation lies with customers, employees and broader society rather than with shareholders. We currently live in a world where simple financial capital is abundant. The combined global value of annual capital markets funding for companies is estimated to grow by US\$3.3tn within 10 years, representing a 58% increase on current global activity of US\$5.7tn a year.<sup>8</sup> What is becoming more challenging - and therefore more valuable - are stakeholder-related aspects of value such as human capital, customer lifetime value, sustainability, trust and data.

**2 Shorter company life spans:** The life spans of companies continue to shrink, requiring new strategies for navigating disruption. Research by Innosight shows that the 33-year average tenure of companies on the S&P 500 in 1964 had narrowed to 24 years by 2016 - and is forecast to shrink further to just 12 years by 2027.<sup>9</sup> Another study by Tuck School of Business at Dartmouth College shows that the five-year survival rate for newly listed firms has declined by 30% since the 1960s.<sup>10</sup>

**3 Distrust in companies:** Since the Global Financial Crisis, many companies have found themselves confronted by declining trust among key stakeholders such as customers and wider society, in a world where social media and other channels are increasing the visibility and exposure of reputational and ethical incidents. At the same time, this greater visibility is fueling higher stakeholder expectations of companies' standards of integrity.

**4 Changing risk and opportunity landscape:** Numerous companies are being impacted by new highly disruptive, unpredictable and complex risks and opportunities such as climate change, geopolitical risks, anti-globalization movements and increasing economic inequality in societies. In addition, general pressure on companies to do more for the good of society is increasing.

**5 Speed of change increasing dramatically:** Driven by technology, the pace of change in how businesses operate and interact with their customers and stakeholders is accelerating. Companies have to be more agile to identify and commercialize new opportunities through innovation in a constantly moving environment.

**6 Intangible assets becoming key:** A company's competitiveness and profitability lies in securing and enhancing intangible assets such as human capital, collaborations and partnerships, brands, algorithms, customer relationships, data, innovative business processes and more. Intangibles comprise 84% of corporate valuations, up from 32% in 1985.<sup>11</sup> Moreover, intangibles are associated with at least two drivers of rising market concentration in many sectors: market power and productivity gains.<sup>12</sup>

**7 Changing corporate governance and reporting requirements:** Partly as a response to the Global Financial Crisis, there has been a shift in the central themes in recently launched corporate governance codes and reporting frameworks in economies such as the Netherlands, the United Kingdom, Austria, Japan and Australia. The changes in these frameworks are meant to facilitate the transition from short-term thinking towards long-term value creation for all stakeholders.



### **What does this mean for companies?**

To anticipate these trends and remain competitive, we argue that senior executives need to start thinking differently about business strategy and the way they manage their companies.

### **Business strategies and behavior driven by short-term thinking may not be sustainable**

In the light of the seven trends we have just described, business strategies and management practices driven by short-term thinking and financial engineering are unlikely to be the right answers for future success. Short-term thinking, for example by focusing on the share price of the company, could lead to underinvestment in research and development (R&D) and innovation. This would be a critical mistake in a world approaching the end of its current economic cycle and in which company life spans are becoming shorter. Intangible assets are also difficult to build and strengthen with myopic thinking fixed on the short term.

### **Shareholder primacy as the company's sole objective is under pressure**

Another key consequence of the changing business environment is that shareholder primacy in company strategy and decision-making is increasingly under pressure. A single focus on shareholder value creation could harm an organization's future competitiveness and resilience. Driven by greater pressures from activist investors,<sup>13</sup> shareholder primacy in itself could pave the way for short-term company thinking and behavior. Moreover, at a time when the sources of value creation are shifting, it is actually in the best interests of shareholders if value creation is focused on all key stakeholders, not just one constituent.

## What could the winners of tomorrow look like?

We argue that companies need to focus more on long-term value creation in their strategies and daily business. This is not about 'corporate responsibility' – businesses need to be able to respond effectively to the changing sources of competitive advantage and market power for the sake of their own short- and long-term future success.

Calls for more long-term thinking in companies is not new<sup>14 15</sup> and indeed have become widespread. This includes some major institutional investors raising their voice. Larry Fink, founder, chairman and CEO of BlackRock, has been writing annually for some years to all listed companies that BlackRock invests in, asking CEOs to focus their business on long-term value creation and become more purpose-driven. Investors such as State Street Global Advisors and Vanguard are also following this type of activism.<sup>16</sup>

But despite all these efforts, long-term thinking and behavior has not yet become a daily reality in many boardrooms and executive domains. Executives and directors still feel pressured to demonstrate strong financial performance within two years or less and 2018 was an all-time record year for corporate share buybacks.<sup>17 18</sup>

There is a need to address the real problem, which is the lack of a holistic view of business strategy and corporate performance. Too many companies consider a focus on short-term financial performance and investing in the long-term health of the company as incompatible, or believe that a focus on value creation other than economic returns harms shareholder value creation. The result is that many companies miss the opportunity to unlock additional value and improve their performance.

We argue that in the current and future business environment, organizations need to move away from one-dimensional business strategies and management practices. Management practices such as decreasing R&D investment to boost earnings per share (EPS), investing in sustainability without a clear underlying business case, or driving zero based budgeting at the cost of future competitiveness will likely not create long-term value for the company and its stakeholders. We believe that many of the winners in today's and tomorrow's business environment will have more holistic business strategies and management practices. Senior executives need financial, business and operating models that enable them to allocate their company resources across today's requirements and tomorrow's opportunities. There needs to be a balance between investments in growth options across multiple time horizons and in assets that facilitate the most viable options for the long-term health of the company.

Consequently, we argue that the winning companies today and in the future will tend to be those with the capacity to focus on blending long-term value creation with a shorter-term results focus. This is not easy – it requires different management practices, leadership approaches, sets of skills and capabilities, performance metrics, incentive systems and more. In this paper, a practical framework is presented which could support senior executives in unlocking value by blending short- and long-term thinking in their strategy and decision-making processes.

# The financial impact of long-term thinking

Companies with a long-term business horizon have higher and more stable revenues, company earnings and market capitalization, both in the short and long term. These results suggest that a focus on blending long-term value creation with a shorter-term results focus is a successful strategy for companies.

Up until now, there has been limited quantitative evidence that businesses run for the long term are financially more successful than more short-term oriented companies. Taking into consideration the short-term performance pressures that many senior executives are under, this lack of evidence could be a barrier to them committing to a more long-term business approach.

Consequently, it was our aim to find the quantitative evidence that successful companies now and in the future will tend to be those with a more long-term focus. We wanted to find data in multiple geographies to strengthen the usefulness of our findings.

We then developed a method to systematically measure the level of long-term thinking at an enterprise level within our sample companies. This method consists of six indicators, that are all proxies for the extent to which a company blends short- or long-term thinking in its business decision-making. These indicators (see table 1) were chosen on the basis of academic studies, insights generated through client work by KPMG's Global Strategy Group, as well as KPMG member firm valuations and corporate finance practices. The set of indicators covers investment patterns in long-term growth opportunities, payouts to shareholders and investments to create value for relevant company stakeholders.

KPMG professionals' hypothesis was that these patterns would be different in long-term oriented companies. Compared to companies with a short-term focus, our assumption was that long-term oriented companies would invest more, and more consistently, both in terms of R&D and capital spending. We would expect to see long-term oriented companies prioritizing long-term health of the organization over short-term financial performance. Consequently, our expectation was that long-term oriented companies have lower payout levels to shareholders, both in terms of dividends and share buybacks. Short-term oriented companies, on the other hand, would be more inclined to focus on hitting EPS targets and meeting short-term shareholder demands in terms of expected annual dividends.

Finally, we hypothesized that long-term oriented companies invest more, and more consistently, in making their business models sustainable by delivering 'inclusive growth' – growth that is shared among relevant stakeholders, such as customers, employees and society. Short-term oriented companies, meanwhile, would be more inclined to reduce investments in human capital, branding, marketing and advertising if they fail or are at risk of failing to meet quarterly analyst forecasts.

We used the following indicators to measure the ability of companies to create long-term value, without undermining short-term performance:



| Indicator                                      | Definition  |
|--|---|
| 1 R&D spend                                    | Ratio of total R&D spend to total annual revenue (in %)   |
| 2 Total investments                            | Ratio of capital expenditure to total annual revenue (in %)   |
| 3 Payout ratio                                 | Ratio of total dividends paid to net income (in %)  |
| 4 Total share buybacks/repurchases             | Ratio of total share buybacks/ repurchases to total equity (in %)                                     |
| 5 Talent retention                             | Ratio of employees who stayed at the company in book year/ employees at start of the book year (in %) |
| 6 Marketing and customer experience (CX) spend | Ratio of total marketing and CX spend to total annual revenue (in %)                                  |

Table 1: Indicators used to measure the long-term orientation of companies, including definition

The financial performance of companies was determined by three indicators:

- 1 **Company revenue:** total income earned by a company for selling its goods and services at the end of the book year
- 2 **Company earnings:** net income a company has earned at the end of the book year
- 3 **Market capitalization:** aggregate valuation of the company based on its last close share price and the last close number of outstanding shares at the end of the book year

Our research should be considered as a descriptive analysis. By categorizing companies based on their ability to create long-term value, we aimed to examine the differences between them in historical financial performance. For more details about the research methodology, please see the 'About this paper' section at the beginning of this paper.



## What patterns did we identify?

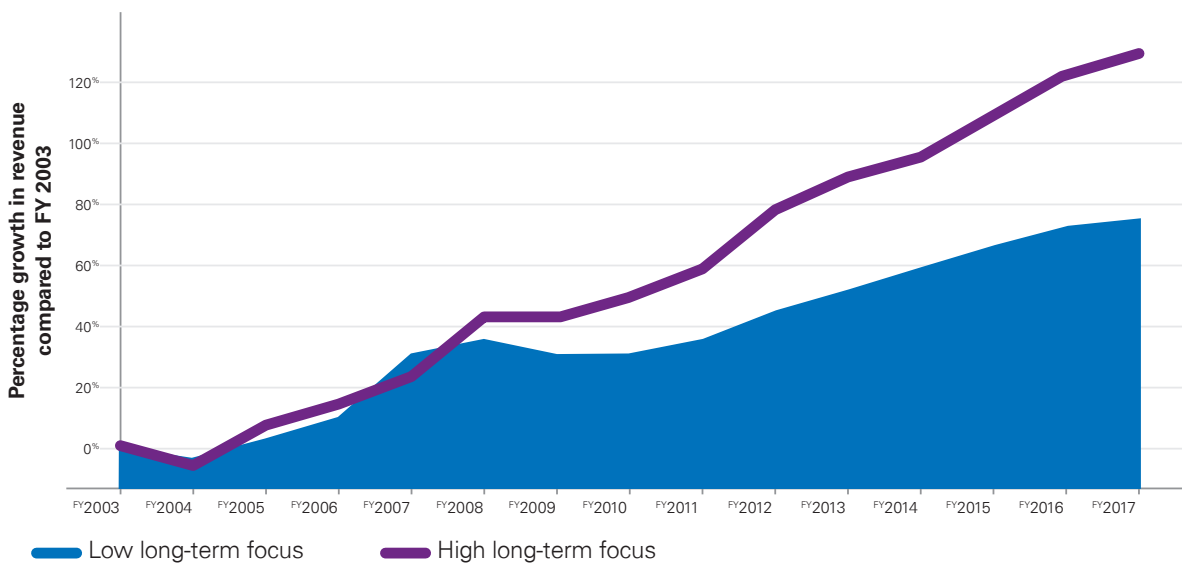
### Focus on long-term value creates superior and more stable financial performance

Long-term oriented companies on average experience higher revenue, earnings and market capitalization growth than businesses that are solely focused on the short term.

Looking at revenue, long-term oriented companies showed 130% growth in the period 2003-2017, whereas it was only 77% for short-term oriented companies (see figure 1). The average annual revenue growth for long-term oriented companies was 6.1% compared to 4.2% for other companies over the 15-year period. This higher growth pattern is also true when only analyzing 2008 onwards (i.e. from the Global Financial Crisis onwards), which confirms our view that long-term oriented companies are better equipped with the agility needed to be successful in changing and challenging business environments than short-term ones. In addition, over the 15 years, the revenues generated by long-term oriented companies were more stable compared to others.

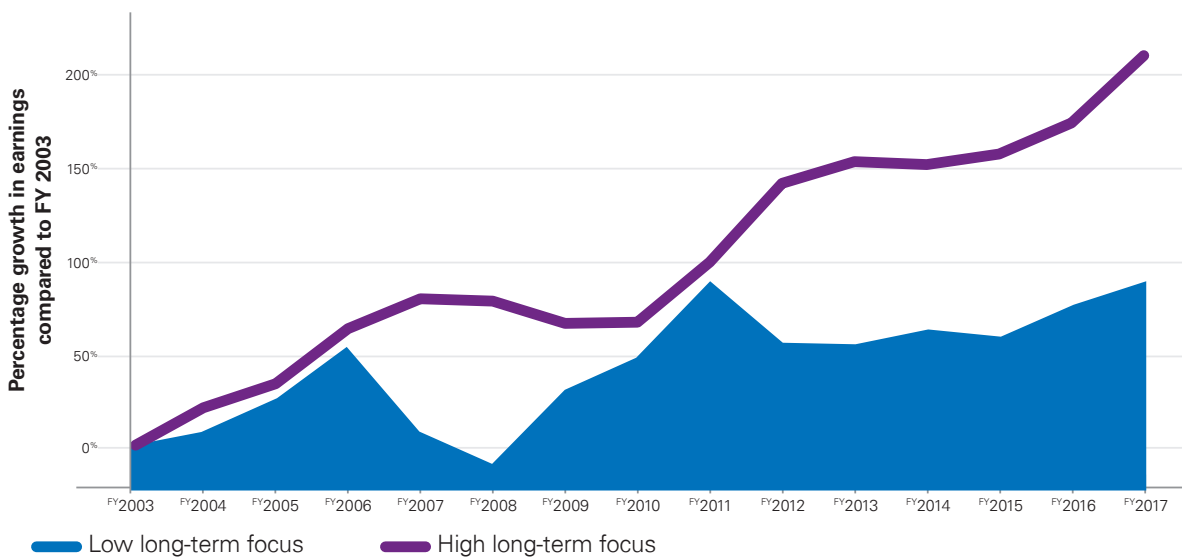
We see the same picture for company earnings. In the period between 2003 and 2017, we see growth of 212% for long-term oriented businesses, compared to only 92% for companies with a short-term focus (see figure 2). Moreover, in all in-between years, the growth in earnings per year was higher for long-term oriented companies than their short-term counterparts. Over the 15-year period, average annual earnings growth for long-term oriented companies was 8.5% compared to 4.6% for others. In addition, their earnings were more stable over the 15-year period.

**Figure 1: Comparison of company revenue of short-term and long-term focused companies**



Source: KPMG analysis (2018) based on data S&P Capital IQ

**Figure 2: Comparison of company earnings of short-term and long-term focused companies**

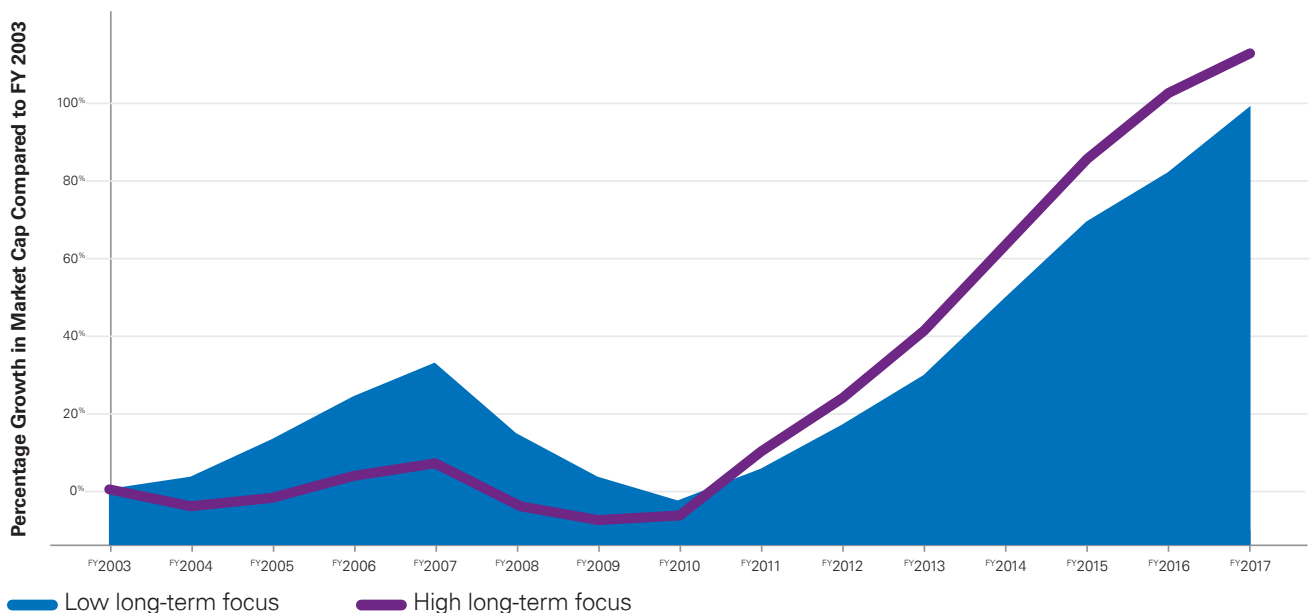


Source: KPMG analysis (2018) based on data S&P Capital IQ

For market capitalization, there was a smaller – but still significant – difference. In the period between 2003 and 2017, growth for long-term oriented companies was 112%, compared to 99% for others (see figure 3). Long-term oriented companies also showed growth in market capitalization since 2011, which could indicate that institutional investors are increasingly starting to reward companies for a long-term orientation, and this is becoming visible in a higher share price.

Furthermore, the findings also show that the differences in financial performance between long- and short-term oriented companies has grown since the Global Financial Crisis in 2007-2009. While the differences before the crisis were relatively small, they have now become much more significant. This underlines our view that the seven trends KPMG professionals identified earlier have changed the sources of competitive advantage since the Global Financial Crisis, making it increasingly important for companies to adopt business strategies and management practices that emphasize a long-term approach.

**Figure 3: Comparison of market capitalization of short-term and long-term focused companies**



Source: KPMG analysis (2018) based on data S&P Capital IQ

### Long-term oriented companies outperform their peers over the short term

Our research indicates that long-term oriented companies achieve better financial performance over the short term – not only over a longer timeframe. This finding underpins our belief that short- and long-term thinking can go hand in hand: a long-term focus can deliver both strong short- and long-term financial performance.

2%

higher revenue growth per year

4%

higher earnings growth per year

**Note:** Growth comparison in percentage point between long- and short-term oriented companies over a 15-year period, from 2003 to 2017.

### Long-term orientation is also an effective strategy in an economic downturn

After a period of economic growth in most major economies, the view of some economists is that the global economy is likely to experience a downturn in 2019. This will be driven by a combination of geopolitical risks, international trade tensions and a greater-than-envisaged slowdown in China.<sup>19</sup>

In general, a company's response to economic downturns tends to be defensive and short-term oriented, characterized by decreasing investment levels and a reduction in employee numbers to optimize short-term profitability. However, looking at the financial performance of companies during the economic downturn in 2007-2009, our research shows that these short-term responses are not effective.

Companies that kept focusing on long-term performance and competitiveness showed better financial performance during these years than others. Figure 1 shows that long-term oriented companies increased their revenues by 16% during the downturn, while more short-term oriented companies showed no growth. In addition, with only a 0.6% decrease in company earnings in the first year of the Global Financial Crisis, they were able to keep earnings reasonably stable, whereas short-term oriented companies suffered a 17% fall (see figure 2).

One of the issues that hampers companies with a short-term view is that they usually only respond to changing economic conditions when they are impacted. This reasoning is validated by our data. Although they suffered a 17% fall in profitability in the first year of the Global Financial Crisis, their profitability improved significantly the next year (2008-2009). One of the explanations for this could be that, by then, they had been able to catch up with the new reality and lower their investment levels and cost base to prop up short-term profitability.

Long-term oriented companies were penalized less by the stock markets during the downturn, experiencing smaller declines in market capitalization. The total market capitalization of long-term oriented companies showed a decline of 13% between 2007 to 2009, compared to a decline of 22% amongst other firms. The market capitalization of long-term oriented companies recovered more quickly after the crisis too, especially in 2010 and 2011.

# How companies can unlock value

There are ten key organizational capabilities that can enable senior executives to enhance the financial performance and competitiveness of their companies in both the short and long term.

## Business implications of analytic insights

In the previous section of this paper, new quantitative evidence was presented that shows that a focus on blending long-term value creation with a shorter-term results focus could be a successful strategy. Our research shows that companies with a long-term horizon in their daily business can deliver stronger and more stable financial performance than their peers, both in the short and long term. What does this mean for companies? Where should senior executives focus their efforts?

Our analytic insights show that many companies need to move away from the belief that a more long-term business horizon is irreconcilable with the ever-growing pressure to meet short-term targets. Too much short-termism could actually distort corporate decision-making and diminish shareholder value. Companies could unlock value and improve financial performance by becoming more long-term oriented and by gaining a better understanding on how short- and long-term market developments, investment decisions and business projects interact with one another. For example, how could long-term macro or societal trends impact the current or future profit or revenue pools of the company? What impact does the company's cost-cutting program have on the long-term competitiveness of the company? What are the short-term benefits of a more long-term investment or innovation program?

## How companies can blend short- and long-term thinking to unlock value

There is a need among senior executives for a practical framework to improve the long-term performance of their business, without undermining short-term performance. In this section, we present such a framework.

Some of the key challenges KPMG professionals often hear in conversations with senior executives are:

- How can I run my company for the long term, in a continuously changing industry where company lifecycles are decreasing?
- How can I reduce the short-term pressures from investors and within on my organization and management team?
- How can I allocate more resources to longer-term business opportunities when short-term resource pressures are already significant?
- How can we go about capitalizing on growth opportunities created by long-term trends in industry and society?
- How can we become a purpose-driven organization?

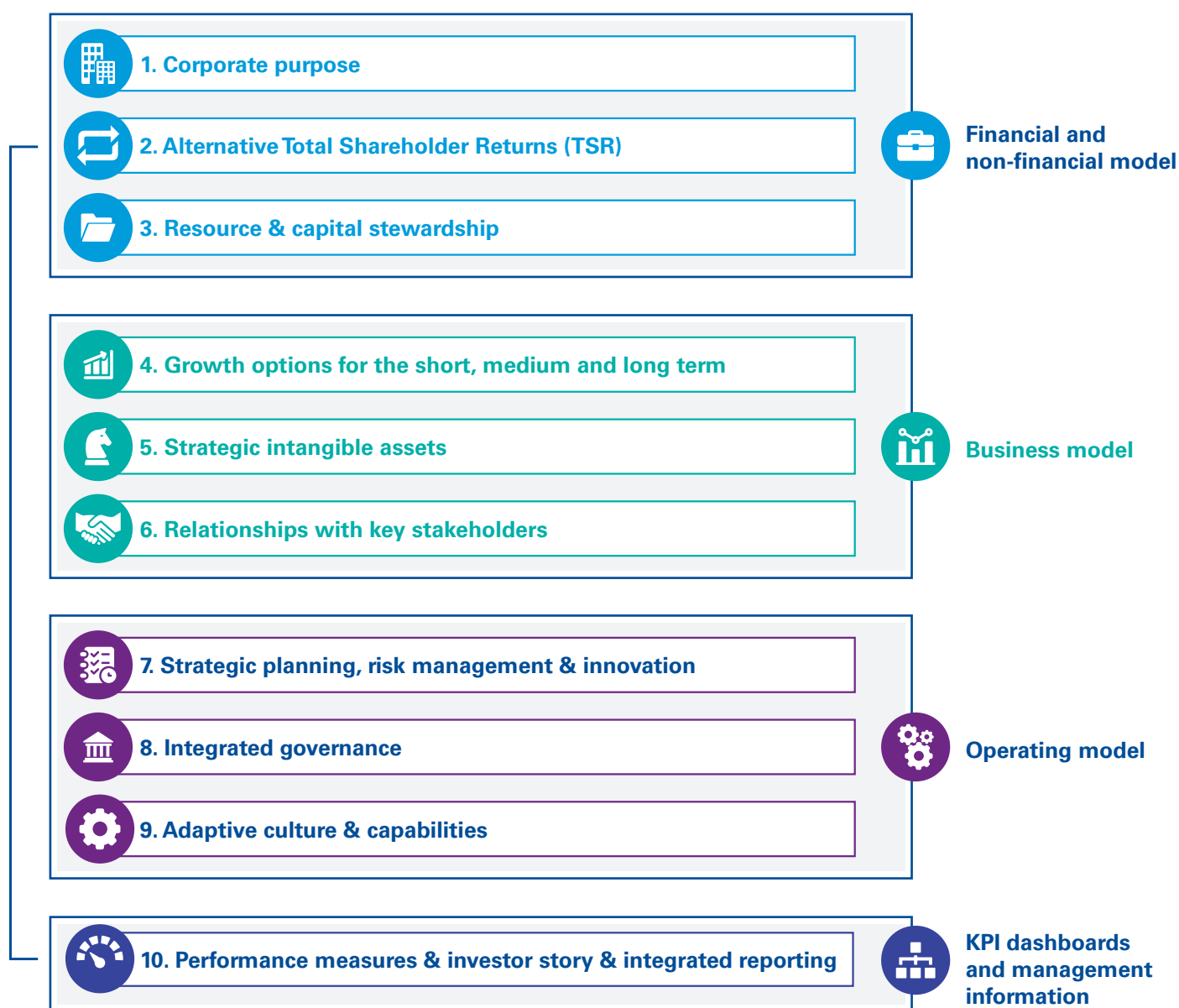
To support senior executives with solving these and other challenges, we have identified ten critical organizational capabilities that enhance the company's capacity to blend short- and long-term thinking in strategy and performance management.

There is no 'one-size-fits-all' approach to blending short- and long-term thinking. Some companies may focus on building their financial (and non-financial) model around corporate responsibility or sustainability, and aligning their business and operating model accordingly. Other companies may focus on long-term shareholder value creation. No matter which approach a company takes, it is critical that the long-term perspective is integrated into the entire organization and that all ten capabilities are fully aligned.

**KPMG’s Long Term Value Framework is a playbook designed to help create long term value with a shorter-term results focus.**

The ten organizational capabilities can be divided into four building blocks:

**Figure 4: KPMG Long Term Value Framework**





### Align senior management by creating financial and non-financial ambitions that blend short- and long-term value creation

To enhance the company's ability to create long-term value and, simultaneously, optimize short-term performance, it is key to clearly formulate financial and non-financial ambitions. Non-financial ambitions, such as the value that a company wants to create for stakeholders, are key to articulate, taking into consideration the redefinition of competitiveness as previously described. These non-financial ambitions need to be formulated such that they become a company's staging posts to creating value in the long term, as well as in the present.

The organization's financial and non-financial model should serve as the basis for its business and operating model, and management decisions related to them. There are three capabilities that are instrumental in creating a clear financial and non-financial model:



**Create a corporate purpose:** formulate a purpose that goes beyond the financials and shareholder value.

A strong purpose should clarify for whom the company aims to create value and act as a lens through which new growth options can be identified and short-term management decisions shaped.



**Determine an alternative Total Shareholder Returns (TSR):** move away from the traditional definition of

TSR to avoid short-term behavior and one-dimensional thinking. The underlying parameters of this traditional definition - the company's stock price and free cash flow - only reflect one part of business performance. A wider perspective is needed. To become long-term oriented, the company needs to create an alternative definition.



**Resources and capital stewardship:** focus on investments and divestments of both tangible and intangible assets over diverse time horizons. This requires more flexible resources and capital allocation frameworks. For example, the investment and financial thresholds for long-term bets should be different from the parameters for short-term investments (e.g. the next 1 to 2 years).





## Develop a dynamic business model that creates value across multiple time horizons

The business model should be composed in such a way that it creates value for the company and its stakeholders in the short, medium and long term. In addition, the business model needs to be strongly aligned with the financial and non-financial model of the company. This alignment is especially relevant because it can be the bridge between senior executives' vision and performance ambitions and the organization's day-to-day operation. Three capabilities are critical here:



**Create growth options for the short, medium and long term:** it is important to have a portfolio of growth options across different time horizons. One of the key competencies to develop is the ability to identify long-term societal and/or industry trends and link them to the markets and customer segments the business wants to play in.



**Secure and enhance strategic intangible assets:** today's and tomorrow's winning business models are increasingly driven by intangible assets - such as data, partnerships, technologies, R&D, brands, customer and stakeholder relationships. Intangible assets increasingly determine the value of any company. Investments in these assets are needed to blend long-term value creation with shorter-term results.



**Make stakeholder value creation an integral part of the business model:** stakeholder value creation should be at the core of a business model. Firstly, as we described earlier, the source of value creation is shifting from shareholders to stakeholders such as customers, society and employees. To create a business model that embraces long-term thinking, the products and services the company delivers need to be focused on building and enhancing relationships with such groups. Secondly, stakeholder value creation is a goal in itself due to changing expectations of the role that companies play in society.



## Create an agile organization that can deliver both short- and long-term performance ambitions

To deliver the desired financial and non-financial model and corresponding business model, the right operating model must be in place. The most important operating model aspects are:



**Integrate a long-term perspective into strategic planning, risk management and innovation:** in a continuously changing business environment, the organization's strategic planning, risk management and innovation processes should facilitate the continuous development of growth options across different timescales and manage the business risks accordingly. This includes the incorporation of ESG factors and key stakeholder interests into core business processes.



**Integrated governance:** governance structures and systems should be designed to enable the company to be run for the long term while also managing short-term demands. Critical elements include the incorporation of a long-term perspective into executive compensation schemes, the integration of stakeholder interests into decision-making processes, and increasing the focus of Supervisory and Management Board discussions on the longer-term perspective.



**Foster a dynamic culture:** the culture of the company should facilitate and stimulate long-term thinking. The right tone at the top, outside-in orientation, clarity on how to handle trade-offs among diverging stakeholder interests, openness to new ideas and experimentation – these are all fundamental aspects of an adaptive culture that embeds a long-term focus.



## Align KPI dashboards and management information to track and motivate progress towards goals

The performance metrics, targets and dashboards you formulate need to be fully aligned with the financial and non-financial ambitions and nature of the business model to effectively track progress and incentivize the right behaviors required to accomplish the ambitions:



**Performance measures, investor story and integrated reporting:** if a company is serious about becoming more long-term oriented, it needs to develop KPI dashboards and management information that go beyond the financial and backward-looking metrics that are traditionally used to measure business performance and align their investor story accordingly.

First, internal and external performance reporting should place more emphasis on the future performance and competitive position of the company. Alongside short-term financial and operational metrics, companies could disclose metrics that give an indication of the robustness of future performance and whether the organization is on track against the long-term strategy.

In addition, companies could spend more time measuring what needs to be measured - not just what is easy. To give investors and other stakeholders a more holistic picture of current and potential future performance, companies could provide more insight into the performance of their key intangible value drivers.

# Where to start?

## Five key actions for CEOs.

As we have seen, the competitive rules and drivers of virtually every industry are changing. Inevitably, this will create winners and losers. To get started on – or increase the pace of – the journey in your organization, we recommend considering the following steps:



### 1. Assess your current ability to blend long-term value creation with a shorter-term results focus

You need to know what your starting point is. Get a clear understanding of the position now:

- When, where and why is value being created by the company?
- Where in the product portfolio are the growth opportunities for the short, medium and long term (> 5 years)?
- How do you measure business success now?
- How much time does your team spend in Board meetings and discussions on matters that determine the long-term success of the company?
- Who are your long-term investors and how often do you engage with them compared to time spent with sell-side analysts?



### 2. Start to create a long-term oriented environment within your company

People in organizations are often swallowed up with meeting the requirements of their daily jobs. This short-term orientation is only reinforced if they are also assessed and incentivized mainly on their short-term performance. If you aim to blend short- and long-term thinking, it is key to start creating a business environment that rewards long-term thinking and that emphasizes decisions taken for the long term. Actions could include:

- Change the tone at the top by increasing communication around the long-term value creation story of your company.
- Spend more time in Management Board meetings discussing long-term business risks and opportunities and how they could impact your current strategy and long-term performance.
- Discuss your long-term strategy and competitive position with the Supervisory Board more frequently.



### 3. Measure the impact of your long-term oriented business programs and projects against the short- to medium-term performance of your company and vice versa

As discussed in this paper, understanding the interaction between short-term and long-term value creation is a key competitive factor in a continuously changing business environment. Start to consider questions such as:

- What business and customer value do your sustainability programs create? And over how much time?
- How effective is your innovation program? How many sales are created by your new products?
- What impact could your operational efficiency and share buyback programs have on the long-term competitiveness of the company?



#### 4. Bring stakeholder management to the core of your business

In most companies, stakeholder management is currently executed by Corporate Social Responsibility (CSR) or sustainability departments. Because the source of value creation is shifting to stakeholders, such as customers and employees, the quality of stakeholder management becomes a competitive factor for companies in many industries. This has consequences for the way the stakeholder impacts and expectations are managed in your organization. To blend long-term value creation with shorter-term business results, stakeholder management should become an integral part of the decision-making processes within your company. Actions could include:

- Integration of stakeholder management into your strategic planning, risk management and innovation programs.
- Integration of stakeholder impact and expectations in your company's strategic decision-making process.



#### 5. Put more emphasis on long-term value creation in all investor communications and reporting

The way you report and communicate to capital markets about your performance could be a key driver in blending short- and long-term thinking in your company. Actions you could consider include:

- Proactively involve your key shareholders in your long-term strategy discussions.
- Focus your investor relations activities on long-term shareholders.
- Besides your short-term financial and operational metrics, disclose performance metrics that say something about the long-term competitiveness of your company and the robustness of your company earnings. For example, KPIs related to your R&D activities, sustainability performance, long-term investment programs.
- Start to measure and disclose your relevant intangible assets, such as human capital, stakeholder relations and brand equity.

As we have seen throughout this report, achieving a long-term focus is not straightforward. The pressure to deliver short-term results is constant, while maintaining a position in a changing world can be challenge enough in itself. But those companies that are able to successfully blend long-term value creation with a shorter-term results focus will see a pay-off – not just at some distant time in the future, but in the short and medium term too. They are more likely to deliver strong returns to shareholders and build long-term competitiveness in the age of disruption and short-termism.

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