

The Push for Long-Termism

A vigorous debate has emerged among companies and investors about the importance of long-term corporate thinking

In the current era of the 24-hour news cycle, focusing on the long term can seem like a novelty. And yet many corporate executives and investors have begun emphasizing the benefits of looking beyond the upcoming quarterly or annual financials.

For some, so-called “long-termism” has more to do with setting priorities that go beyond increasing shareholder value. In this sense, many advocates of the approach group it together with a greater focus on environmental, social and governance (ESG) factors. Organizations such as B Lab, which

administers the B Corp certification, are encouraging companies to consider future generations in addition to their current set of investors.

Others view long-termism as a superior investment strategy as well, or as a guiding philosophy that makes it easier to do business. For instance, Apple announced last year that it would no longer report quarterly sales numbers for individual business units, as part of an effort to refocus investors on longer time horizons. A 2016 survey by FCLTGlobal and McKinsey found that 23% of CEOs would like their strategic-planning

timelines to be five years or greater, when in reality only 11% said they are able to look that far ahead.

All the same, not everyone agrees that longer-term thinking is a worthy priority, and some disagree about the length of time worth prioritizing. Private equity firms and activist hedge funds aim to boost profits over the course of just a few years before exiting.

What are the most important factors influencing long-termism in the current environment? We spoke with four leading experts in this area to find out.



The experts



Timothy Coffin

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Mergermarket

What effect, if any, do you think the push for ESG investing – and, to a lesser degree, a re-imagining of the corporation as a social enterprise – is having on a move toward long-termism? Do you think these efforts could have a meaningful effect?

Timothy Coffin, Breckinridge Capital Advisors

To put my answers in perspective, Breckinridge is an investment-grade fixed income manager – offering both sector-focused and multi-sector strategies. We currently manage about \$37 billion in assets, and we have integrated ESG across all our fixed income strategies. So much of the history of responsible investing – which has evolved into ESG investing in some cases – has been written in the equity markets in negative screening or shareholder activism. But because ESG issues may be powerful as risk-mitigation tools, it actually seems to be much more of a natural fit for the fixed income markets.

I think ESG is precisely about long-termism, or what I would consider a return to long-termism, and the rigorous type of investment research that really demands. And there are two

main reasons for that. First, here at Breckinridge we see a changing face of business. According to the Governance and Accountability Institute, the number of companies in the S&P 500 that publish corporate sustainability reports went up from a little over 20% in 2011 to over 80% in 2017. This demonstrates that from the board level down, many of the biggest, most recognizable companies understand that sustainability is a strategic imperative. As investors, if we're seeing these companies managing their business in this way, we need to be paying attention to that.

Second, there is also a changing face and pace of risk. The value of many of the world's largest companies is 70-80% intangible – it's driven by things like brand and reputation. So, by fully integrating ESG into our credit research, we believe that we're able to identify symptoms of idiosyncratic risks, such as a history of environmental infractions, or opaque governance, or not enough diversity on the board to encourage innovation. We believe this added rigor can help price risk better.

I would also say that I don't think the notion of the corporation as a social enterprise is really a fundamental change. You would be hard pressed to find a

**Charles Nathan,
Finsbury**

business who doesn't think they serve a social purpose. If business doesn't serve a public benefit, I don't see how any investor would look at it as a sustainable enterprise. Maybe some short-term investors or trading algorithms have lost sight of that, and in those cases, I think that ESG investing is having a meaningful effect, by helping to raise investors' sightlines on the horizon.

One challenge in answering this question is that ESG means a lot of different things to different people. There are people who talk about ESG and its relevance to investment strategy – they make very clear that it's an economic connection. They care about ESG insofar as it is tied to how corporations will function as economic units and produce value for shareholders. Then there are folks who refer to ESG in the context of the corporation having a purpose beyond shareholder value, which is a different way of thinking about a company.

So you've got this huge tent with all sorts of investors talking about ESG and really meaning very different things and having different viewpoints. And one person's solution is another person's pie-in-the-sky or value destroyer. None of this is simple. That's a problem with labeling – people tend to think in terms of convenient labels, but in fact, it's so much more complicated.

All that being said, I think ESG is a terrific idea on many levels. It makes a lot of sense. If you were going to invest in a coal company, I would say you need to understand how that company is adapting itself in the face of pressure over the use of fossil fuels. Do they have a long-term business model? Will their business model cease to be profitable?

"... many of the biggest, most recognizable companies understand that sustainability is a strategic imperative."

Timothy Coffin, Breckinridge Capital Advisors

Are they diversifying risks? I think that thinking in those terms makes perfectly good sense.

Andy Green,
Center for
American
Progress

ESG reporting can be a key tool for change. I am strongly in favor of having a transparent conversation about what's going on, of empowering policy makers to make decisions, and of empowering the investors that do have those longer-term

interests to throw their weight around in the ways they think are important, not just for their social purposes but for their own bottom line.

This is not to say that the markets have performed perfectly, as I would wish them to. There have been companies that have raised wages, and have been punished by the market for doing so, or markets will take a look at CEO pay ratios and say, "Well, why is yours this low? We want higher, not lower." Markets are not always the progressive vehicle for social change that I might want them to be.

But there is definitely a positive transition going on as more investors are integrating ESG factors, as millennials are demanding more responsible investing, as economic studies are coming back and saying that ESG is correlated with corporate performance, and as business leaders increasingly recognize that failing to take care of workers, the environment, and the public interest has very serious consequences for our country and society. The freedom that we enjoy in a democracy very much depends upon us moving away from a short-term extractive form of capitalism toward a long-term vision of shared positive outcomes.

Sarah
Williamson,
FCLTGlobal

In order to be a responsible investor, horizons need to be anchored in the long term. As investment horizons lengthen, investors are more likely to need to integrate ESG factors into their strategies. Investing for the future means considering shifting global demographics, climate change, and any number of factors that a company 20 years ago could delay action on. But that future is here and now. Being cognizant of these factors' impacts is a critical part



of investing for anyone with a long-term horizon. In that sense, ESG integration has become a necessity to an overall long-term approach to investment. Long-term investing has had a marked effect on the rise of the concept of a corporation as an instrument of social enterprise – truly long-term-oriented companies treat their employees, customers, and larger community well. This new dynamic puts more focus on stakeholders and an increased importance on widespread value creation and societal impact, which in the long run should drive shareholder value as well.

Mergermarket **Given the current market structure, do you think it is plausible to imagine a public company system in which investors are more strongly encouraged – or forced – to take a longer-term view? How can investors and regulators balance the need to provide current information with the desire to encourage long-term thinking?**

Sarah Williamson, FCLTGlobal

We already see many investors prioritizing the long-term future growth of a company over quarter-to-quarter results. For example, quarterly earnings per share guidance is a critical channel through which short-termism impacts companies, investors, and capital markets. But it's not desired by the majority of the investor community – our studies have found that fewer than 7% of investors want companies to offer guidance for periods of less than one year, and only 27% of companies offer it. It's a perfect example of a practice that emphasizes trading over ownership through a myopic focus on quarter-to-quarter profits.

By contrast, companies can reinforce their long-term narrative by presenting

investors with plans that include capital allocation priorities, key performance indicators, and 3-5-year objectives. Such plans, or what we've come to call "long-term roadmaps," can paint a clearer picture of a company's trajectory. Framing this vision with trackable metrics gives investors the assurances and corporate accountability they need to focus on the long term.

Neither of these practices is required by any regulatory body, and the SEC has recently brought the issue under review, exploring how a quarterly focus can damage value creation. Corporate communications are essential to maintaining transparency and long-term investors' confidence in a company's strategy. Regulators could support this ongoing behavioral shift by encouraging the use of long-term roadmaps in lieu of quarterly guidance in order to strike that perfect balance. This sort of prompt would put the investment community on the path toward a longer-term view.



"... disclosure on ESG issues can become a lot more meaningful when paired with smart, strong regulation."

Andy Green, Center for American Progress

Timothy Coffin,
Breckinridge
Capital Advisors

I don't think it's necessary for anyone to force long-termism – I think it's already happening because prudent investors are focused on the medium to long term. Those investors are trying to avoid dormant liabilities or latent risks that come from externalized costs, by paying closer attention to the factors that impact them. Certainly, companies are paying attention to these issues, and what I think is important is for investors to ask management to report on them, making the information transparent and available. Ultimately, as investors, we embrace as much transparency as we can get, but I don't think long-termism needs to be forced from a regulatory standpoint. The marketplace will reward those that do.

Andy Green,
Center for
American
Progress

I would say that corporate disclosure on ESG issues can become a lot more meaningful when paired with smart, strong regulation. For instance, worker training disclosure and human capital management disclosure packs a bigger punch when paired with public investments in workforce systems, increasing minimum wages, and full-employment policies that make it more incumbent upon companies to scrutinize how they're treating their workforce.

Mergermarket

Investor dollars are increasingly pouring into passive investment vehicles – despite the emergence of the 24-hour financial news cycle and the proliferation of stock-trading apps. Do you think this move toward passive investing makes it easier for companies to focus on the long-term?

Sarah
Williamson,
FCLTGlobal

Not necessarily – passive investments are certainly on the rise, but putting assets in an index fund or an ETF doesn't make that investment "long-term" by default, and we know that short-term trading in ETFs is rampant. Investors need to be an active and engaged part of a company's shareholder community whether their expected holding period is five years or five decades. The most vocal investors still tend to be those who concentrate on near-term returns – activists, hedge funds, and the sell-side.

Long-term investors are typically quiet publicly and may even share their perspectives with the company privately, creating an imbalance of pressure to focus on the short-term at the expense of long-term value creation. Our work has pointed us to a number of strategies that we believe asset owners and asset managers can employ to better connect with the companies they invest in. They may wish to prioritize their largest positions, the companies with upcoming issues, the highest- and lowest-performing companies, or simply those in a certain area. Some funds engage only on issues of specific importance to them; others engage deeply with a few companies on the major strategic issues relevant to each.

At the end of the day there's no one way to manage money, but all investors can engage appropriately with their portfolio

companies and ensure the long-term voice is heard. The analogy we like to use is a long road trip – even if there’s a long trip ahead you can’t take your hands off the steering wheel.

**Andy Green,
Center for
American
Progress**

I have not seen clear analytic answers to this question yet, so I think this is still a bit of a speculative landscape. It does seem to be intuitive that greater passive investing means a longer-term approach is more viable, because that cash is not going anywhere in the short term. Some major asset managers make the point that passive index investing requires them to engage with companies more to ensure that companies are performing well over the long term. I find that to be a convincing starting point for the discussion.

At the same time, I do think there is something potentially lost from overreliance on passive investing. Active trading and active capital deployment is the basic principle of capitalism – it’s what allows us to hold companies accountable. It’s one of the reasons we have disclosure, so that capital markets can make good decisions. I remain reasonably confident that there is enough capital out there in search of opportunities, so I’m less worried about the possibility of too much passive investing. I’m more worried about the concentration of companies across the economy, such that the active investors have no one to choose between. I’m also worried about the insufficiency of disclosure, such that the growing set of investors more concerned about ESG, for instance, don’t have enough information to make meaningful trades on.

**Timothy Coffin,
Breckinridge
Capital Advisors**

It’s an interesting question. I think that both passive and active strategies have a role in encouraging companies to focus on the long term. I think one example of



this is the increasing trend of investors, including passive asset managers, engaging with companies to be focused on sustainability. Some of the most influential passive managers are already actively engaged with the companies they own shares in. Engagement is a tool they

can use to provide added value for shareholders.

I would also say that on the active side, investors increasingly want to know what's in their portfolio – in some cases in order to determine whether their investments line up with their values. I think that's a constructive trend in the market, as it fosters a greater sense of stewardship.

Mergermarket **Many popular modern forms of investment – such as private equity, venture capital, and activist hedge funds – inherently focus on short-term gains at their investment targets. But few dispute the idea that these types of investors produce meaningful economic growth. Is it possible that defining long-termism strictly within the context of individual companies is not ideal for encouraging economically beneficial enterprise?**

**Charles Nathan,
Finsbury**

I would stress that “long-termism” and “short-termism” are relative terms, and they need to be put into context. For instance, activist investors will tell you they're in an investment for three to five years, and they will say that's “long term.” A lot of people will say, “Anybody who sees past five years is pretty good. Not many people see that far.” Five years is not a stupid timeframe for an investment, nor is it a stupid timeframe to own a stock.

**Timothy Coffin,
Breckinridge
Capital Advisors**

I think one of the things that is missed when using these labels is what I would argue is value creation, which is what I would call the real, essential, underlying issue. Value creation has a time function built into it. If you create a dollar in 12 months or \$2 in 10 years, which is better value creation? It's clearly the \$1 in 12 months because of the time value of money.

Long-term investing or long-term planning presumes an honest attempt to discount your predicted outcomes back to the current value. Unless you think in terms of net present value, it's very hard to measure what the real long-term or short-term value is. It's clearly true that long term isn't always good. So I don't think there's anything inherently good or bad about long term or short term. It should be about value creation on some scale and your ability to predict and plan.

This really depends on your definition of meaningful economic growth. If short term gains come at the expense of creating any shared value, it's hard to see how there's meaningful long-term economic benefit. The very notion of sustainability or sustainable investing is to protect future value. That's a very financially conservative principle. Looking through the lens of a bond investor, encouraging individual companies to focus and report on long-term sustainability factors is entirely

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Charles Nathan, Finsbury



consistent with rigorous research, and a prudent fiduciary principle.

**Andy Green,
Center for
American
Progress**

I think it's not correct to say that all hedge funds, or all private equity firms, are the same. There are some that create a lot of value, that really do build companies or bring good ideas to improving company performance, and do hold management accountable – and then there are some that do the opposite, and a lot in the middle.

Creative destruction is part of capitalism. We want to have creative destruction – we want to have accountability and checks on power. It's fundamental to why capitalism is about economic freedom and political freedom, quite frankly. And there are times when executives and management need to be held accountable to investors, to not see their money wasted on bad investments and bad ideas. But there are also times and places where executives need the

freedom not to be harassed by activist investors who just want to take money out for the short term.

**Sarah
Williamson,
FCLTGlobal**

Private equity, venture capital funds, and activist investors all have the advantage of being active owners. They engage, frequently and strategically, with the companies they invest in, which can create value and economic growth. The challenge is that some investors can invest with a long-term J-curve – tolerating the possibility of an initial loss for the sake of a longer-term gain. However, those with short-term time horizons cannot afford to wait, and so choose not to invest their assets in that way. This leads to companies feeling pressured to “bring earnings forward,” potentially leaving nothing for the future. Ideally an economy, or a portfolio, is comprised of companies with different time frames and less vintage risk – that's the advantage of a broadly diversified portfolio.

Mergermarket **Advocates of long-termism point to various regulations they believe could either help or hinder this mode of thinking. Are there particular changes you think would be effective at encouraging longer-term thinking at companies? Are there any proposals that you think would not be effective?**

**Charles Nathan,
Finsbury**

The problem with proposals is that they come and go. Bills go away at the end of a given Congress, and nobody knows if they will be reintroduced. They may be gone and forgotten. So it's very hard to know which proposals could have a meaningful impact that also have a realistic chance of taking effect. There certainly is a lot of lobbying in all different parts of the government about the right ways of fostering long-term investment. Often the impact a policy would have on the behavior of shareholders, companies and activist investors is quite unpredictable or controversial.

One example of such a policy would be the regulation of the proxy advisory firms. There were two bills in the last Congress taking different points of view. One was

relatively benign and would require the proxy advisors to register as investment advisors, although it's not clear what that would mean in real life. I think the other would have made more draconian changes in the proxy advisors' business model and perhaps make it impossible for them to do business, all under the guise of transparency and accuracy. The actual impact would have been devastating. Neither of those are on the table right now.

Now, it's true that the SEC also has this on their agenda. But they have not proposed any rules or regulations – nobody knows what they're going to propose. So it's very hard to talk about these things in the abstract. Ultimately I think you could argue that other aspects of industrial policy are far more important to encouraging long-termism. Tax law, for example, can encourage or discourage investments in property, plant and equipment or in R&D. If you were to change the patent laws to make patents harder to get, it could easily have an impact on R&D. I'm not even sure what the impact would be – there are all sorts of factors that go into decisions like that.

**Andy Green,
Center for
American
Progress**

There are some big high-level pressures in the economy, and people debate the degree to which they are pushing companies to focus more on the short term, and the degree to which they might think more about the long term if you dial them back.

Over the last 20-30 years, companies have taken on higher levels of debt; CEO pay has become highly aligned with stock market performance. At the same time, we've had a weakening of external levers of control, such as unions and antitrust.

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Sarah Williamson, FCLTGlobal

Those and a confluence of other factors have added up to a corporate sector that is under market pressure to maximize returns to investors, that is not sufficiently checked by workers who can bargain for higher wages and better training and benefits, that is increasingly concentrated such that there's less need to compete to make better products and provide better service.

That being said, not all investors are alike. There are some investors in companies that want to get their money out as quickly as possible, with little care for the results for the company, the community, the workers, etc. And then there are some investors who are in for the very long term. Hence the policy prescriptions that start to drive positive long-term change are to shift the incentives at companies toward that longer-term set of investors.

To me, that is at the heart of bringing ESG factors into corporate governance, corporate disclosure, and corporate accountability more broadly. Our corporate disclosure regime is entirely insufficient on this front. There's a cacophony of boilerplate disclosures, questionnaires, green-washed reports, and the like that are incomplete or not

effective, and that becomes a hassle for companies and also is not an effective framework for investors to use to deploy their capital efficiently. So I think a suite of policy prescriptions to expand, standardize, and increase the reliability of ESG disclosures by companies is critical. Other policy levers that need to be part of the discussion include the taxation and regulation of buybacks, the low level of corporate taxation more broadly, and the decline in upper income and wealth-related taxes, like the estate tax.

I also firmly believe that tougher antitrust is very important, not just horizontally but vertically. We don't have a world in which capital is being deployed efficiently because there's increasingly no real choice for that capital to make. If companies are not really competing amongst each other, what incentivizes them to invest for the long term? What incentivizes them to actually make those good decisions and be truly capitalist?

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